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Introduction

1.1 General

This book is concerned with the 'insolvent entity problem'. This problem can arise in two ways. In the first case, a subsidiary company within a corporate group becomes insolvent and is unable to pay its creditors in full. In the second case, a company participating in a business network becomes insolvent and cannot pay its creditors in full. In both cases, the insolvent entity problem involves the question whether liability can be extended beyond the insolvent company to another company, whether in the group or in the network.

Much of the law in this area is concerned with corporate groups rather than networks. In this way, this book focusses predominantly on the insolvent entity problem in the group context. However, reasons will be given for which the problem of corporate groups is linked inextricably to the problem of networks. In brief, many companies cooperate with each other on projects through purely contractual relations. Any increase in the liability of corporate groups will encourage reorganisation in the network form. Such reorganisation has the potential to push the insolvent entity problem from groups to networks, which indicates the need for a principle of extended liability applicable in the latter case as well as the former.

The insolvent entity problem tends to arise (as we will see) in medium-size and smaller businesses, and less so in larger businesses. The reason for this has to do with the importance to larger businesses of their commercial reputations, as well as their greater dependence upon key suppliers, who are likely to deal only with solvent companies. However, the insolvent entity problem has arisen in certain larger corporate groups dealing in hazardous substances (such as asbestos and toxic chemicals), to which corporate reputation does not seem to matter a great deal.

This book will argue for new principles of extended liability applicable in cases of unsatisfied personal injury claims. Personal injury claims are deserving of special treatment because they involve the most important interests protected by law – interests in the human mind and body. One of the fundamental premises of this book is that the law regarding the insolvent entity problem must give priority to interests in mind and body over commercial and financial interests. The law should strive to protect the integrity of mind and body effectively and, if necessary, subordinate commercial interests to this end. While this book argues for an exception to limited liability in favour of personal injury claims, it accepts that no strong argument can be made for any exception applicable to purely financial claims arising in insolvency. In cases involving purely financial claims, the law of limited liability generally should prevail.

The argument in this book is made against a background of legislative and judicial failure in dealing with the insolvent entity problem. The legislation which addresses the insolvent entity problem does so in an unsystematic way, for example facilitating extensions of liability with respect to certain dangerous activities and certain transactions which impede companies' ability to pay their debts. This book argues for a comprehensive statutory exception to limited liability in cases of unsatisfied personal injury claims.

Failure in the common law is seen most explicitly in the doctrine of veil-piercing. Veil-piercing has failed because it does not sufficiently respect the fact that each company in a corporate group is a separate legal entity, and because courts have not properly determined the reasons for which this doctrine should be available independent of other common law actions. Indeed, there appears to be little justification for a principle of extended liability directed solely at controlling shareholders. By contrast, the 'equivalence principle' adhered to in this book states that common law doctrines applicable to individuals should be applicable to corporate entities on similar terms, unless there is a good reason for exemption. This book argues that the common law can facilitate extended liability through development of the tort of unlawful means conspiracy. A modified tort of conspiracy would facilitate extensions of liability horizontally to co-subsidiaries, or to other network participants.

Of course, there are policy choices to be made in determining an appropriate liability regime for dealing with the insolvent entity problem. A policy issue which looms large concerns the way in which the legal system in a modern economy ought to balance the interests of big business, on the one hand, and the victims of big business, on the other. In the typical case, the insolvent entity problem impacts disproportionately on the poor and the weak. The failure of legislatures and courts, when addressing this problem, to make proper provision for personal injury victims represents their *choice in favour* of businesses that injure the poor and the weak. As Guido Calabresi stated long ago: 'even leaving accident burdens where they happen to fall is an implicit decision of what an accident costs and which act or activity ought to bear the costs.'[1] The inability of personal injury victims to obtain redress from parent companies, or from other network participants, represents a gap in the law that needs to be justified[2] or eliminated – and this gap is a large one when one considers (as this book does) the strong senses in which those engaging in collective commercial endeavours have a real responsibility for injuries that they cause.

In setting the stage for the discussion which follows in this book, some preliminary observations should be made about what corporate groups and networks are, about the growth of corporate groups and the problems to which they give rise, and about regulation, compensation, and the development of appropriate liability rules.

1.2 Definition of Corporate Group

Our discussion begins with definitions of the terms 'corporate group' and 'network'. In its core conception, a 'corporate group' comprises separate legal entities related hierarchically through shareholdings. Shareholding is 'hierarchical' in the intended sense when company A is the *controlling shareholder* in companies B and C.[3] This does not necessarily entail that A Co has majority voting rights in B Co and C Co. Control can arise through indirect[4] and minority shareholdings.[5] However, the premise is that A Co has the capacity to control its subsidiaries B Co and C Co on an *ongoing basis*, whether or not control actually is exercised.[6] The conception of the corporate group can be extended to other structures where the exercise of a

1 G. Calabresi, *The Costs of Accidents* (1970), p. 133.
2 See J. C. P. Goldberg and B. C. Zipursky, 'The Easy Case for Products Liability Law: A Response to Professors Polinsky and Shavell' (2010) 123 *Harvard Law Review* 1919, 1938; P. Spender, 'Blue Asbestos and Golden Eggs: Evaluating Bankruptcy and Class Actions as Just Responses to Mass Tort Liability' (2003) 25 *Sydney Law Review* 223, 254.
3 See L. Sealy and S. Worthington, *Sealy and Worthington's Cases and Materials in Company Law* (10th edn., 2013), p. 69; UNCITRAL, 'Legislative Guide on Insolvency, Part Three: Treatment of Enterprise Groups in Insolvency' (2012), pp. 2 and 7.
4 See S. Haddy, 'A Comparative Analysis of Directors' Duties in a Range of Corporate Group Structures' (2002) 20 *Company & Securities Law Journal* 138, 140.
5 See, e.g., Companies Act 2006, s 1159(1).
6 *Walker* v. *Wimborne* (1976) 137 CLR 1, 6. See also A. Muscat, *The Liability of the Holding Company for the Debts of its Insolvent Subsidiaries* (1996), p. 441; M. A. Eisenberg, 'Corporate Groups', in M. Gillooly (ed.), *The Law Relating to Corporate Groups* (1993), p. 3.

different kind of common control is possible, such as where a family owns several companies which are not hierarchically structured.[7] In such a group, each company, D Co, E Co, and F Co, is related to the others as 'sibling', but no parent exercises control over those companies.[8]

There are wider conceptions of the corporate group which are not based upon hierarchical shareholdings. Thus, corporate groups might be said to exist in cases of significant but non-controlling shareholdings, combined with common management,[9] such as where there are 'cross-holdings' or 'circular holdings' of shares. An example of a cross-holding arrangement arises when three companies each have a 26 per cent shareholding in the others, and there is overlapping management. This arrangement 'enables the companies to be operated as a group so long as there is an agreement between the directors of the three companies'.[10] Under the circular shareholding arrangement, A Co holds 40 per cent of the voting shares in B Co, which holds 40 per cent of the voting shares in C Co, which in turn holds 40 per cent of the voting shares in A Co. 'The effect of this is that, although there is not de jure control of the various companies, when the directors of each company act in unison, they can control effectively the various companies in which the circular holdings are held.'[11]

The wider conceptions of the corporate group just explained should be kept in mind, but cannot always be relied upon for the purposes of determining an appropriate extended liability regime. In contentious areas of law, such as that under discussion, courts revert to narrow and legalistic criteria of liability. They prefer to limit the conception of the corporate group 'to entities linked by direct equity interests and control'. This is because 'this narrow approach gives due regard to the formal legal structure of the group' and distinguishes the corporate group 'more clearly from general agency relationships'.[12]

[7] I. Mevorach, *Insolvency within Multinational Enterprise Groups* (2009), p. 16 (example of Parmalat); D. D. Prentice, 'Some Aspects of the Law Relating to Corporate Groups in the United Kingdom' (1999) 13 *Connecticut Journal of International Law* 305, 314.
[8] See, e.g., *Charterbridge Corporation Ltd* v. *Lloyds Bank Ltd* [1970] Ch. 62, 66.
[9] *Re Enterprise Gold Mines NL* (1991) 3 ACSR 531, 540; V. Harper Ho, 'Theories of Corporate Groups: Corporate Identity Reconceived' (2012) 42 *Seton Hall Law Review* 879, 944; S. Elson, 'Legal Liability of Holding Companies for Acts of Subsidiary Companies' [1930] *Commercial Law Journal* 680, 682. Some would say that common management is more important than equity ownership in defining a corporate group: e.g., P. Nygh, 'The Liability of Multi-national Corporations for the Torts of Their Subsidiaries' (2002) 3 *European Business Organization Law Review* 51, 53.
[10] Prentice, 'Some Aspects', 313. [11] Prentice, 'Some Aspects', 314.
[12] Harper Ho, 'Theories of Corporate Groups', 932.

1.3 Definition of Network

The core conception of the corporate group can be distinguished from the 'corporate network', in which the relationship between constituent companies does not include the potential for equity-based control.[13] Network participants are related, instead, by detailed cooperation agreements, and/or repeated transactions.[14] For the most part, we focus upon the former case, cooperative agreements facilitating stable relationships between two or more companies over the medium term. For a number of reasons related, for example, to the increased importance of technology and know-how in the manufacture and distribution of products, the availability of instantaneous communications, and the need for quick adaptability to changing market conditions, corporate networks of this nature have become common in the modern, commercial world.

Whether we speak of corporate groups or networks (and the distinction between them is not always sharp),[15] the insolvent entity problem is capable of resolution only when there is a solvent company to which liability can be extended. In the corporate group context, this means extension either to the parent company or to a co-subsidiary. In the network context, it means extension of liability to another network participant. Given that businesses can choose between corporate group and network forms, and given the potential this presents for the evasion of liability rules directed at corporate groups alone, any extended liability regime must take this fact into account. The regime must, to the extent possible, be neutral as between business forms (hereafter, the 'business form neutrality principle') so as not to distort commercial operations. This gives rise to the need for rules by which liability can be extended among network participants. One of the challenges is to construct an appropriate way of doing this, based on the ability to bind together companies that coordinate with each other in ways that cause harm.[16]

[13] See fuller discussion in Chapter 2.
[14] G. Jones, *Merchants to Multinationals: British Trading Companies in the Nineteenth and Twentieth Centuries* (2000), p. 181.
[15] R. Whittington and M. Mayer, *The European Corporation: Strategy, Structure, and Social Science* (2000), p. 179.
[16] See, e.g., A. Nolan, 'The Position of Unsecured Creditors of Corporate Groups: Towards a Group Responsibility Solution which Gives Fairness and Equity a Role' (1993) 11 *Company & Securities Law Journal* 461, 468.

1.4 Growth of Groups

Corporate groups are extremely important economic, social, and political actors. Large, listed companies are characterised by control over multiple subsidiary companies. In order to understand the subject matter of this book properly, it will be necessary to examine the economic, tax, and regulatory reasons which stimulate the formation of corporate groups. Briefly, many large businesses prefer the group form for reasons that include: the convenience of organising business activity into separate units with their own products, services, and brands; the implementation of management control over and accountability for unit activities; ease of purchase and sale of assets held at the subsidiary level; the desire to adopt different financing models for different group activities; the ability of the parent company to limit its own liability for subsidiary debts; and so on. These matters are discussed at length in Chapters 2 and 3.

1.5 Problems of Corporate Groups and Networks

While corporate groups and networks contribute much to economic activity, employment, wealth creation, and political stability, they are the source of the insolvent entity problem as well. This book provides three case studies as illustrations. These involve mass asbestos-related injuries, mass pharmaceutical-related injuries, and what is described as 'the next catastrophe'. Asbestos-related injuries have given rise to significant social and legal problems in a number of jurisdictions. These arose, in part, because asbestos producers sought to divorce themselves from legal liability for the causation of personal injuries through their activities and their products. Mass pharmaceutical-related injuries began to appear in the 1950s and 1960s, notably with the Thalidomide poisoning cases. Given the ever-increasing importance of pharmaceuticals in modern medicine, outpatient treatment, and everyday life, there is the potential for many more mass-tort claims against producers in the future. 'Big pharma' has anticipated such problems, and this manifests itself in the ways in which they are, today, organising their developmental, testing, manufacturing, and distribution activities. Their methods of organisation encompass both the corporate group and the network. While we do not necessarily know what harms will be done when 'the next catastrophe' occurs, we can predict some of the circumstances that will make it possible. These include large-scale industrial processes, which are tightly coupled or interconnected, where disaster might begin anywhere in the chain.[17] The Bhopal chemical plant explosion of 1984 and the *Deepwater Horizon* oil spill of 2010 are illustrations of this type of event, which will be discussed in Chapter 4.

It is likely that the insolvent entity problem will become more critical over time. This is because we inhabit a world of 'synthetic living', dependent upon mass producers for food and drink, 'cures and complexions, apparel and gadgets'.[18] 'Synthetic living' involves the use of artificial products, the deployment of new technologies, and scientific discoveries the medium- to long-term risks of which might not become apparent until many years after testing is over and consumption has begun.[19] Moreover, the mass production, storage, and distribution of goods means that catastrophes become large-scale events which have a substantial impact upon persons, property, and the environment.[20] In the circumstances, one cannot characterise corporate insolvency 'at the hands of involuntary tort creditors as a fat-tail risk, a risk of a high-impact event that has a low probability of occurring. These kinds of risks are real and present for firms of all kinds'.[21] Indeed, both large and small companies face potential 'financial ruin as a result of having placed defective products in the stream of commerce', or having engaged in risky activities with the ability to injure on a wide scale. This is not simply because of the 'increasing sophistication of technology, marketing, and systems of distribution' which 'likely make the problem a recurring one for large corporations'.[22] The problem arises also because businesses engage in conscious decisions to structure their relationships so as to protect assets and to reduce potential exposure to liability. This is evident, for example, when the parent company operates as no more than a holding company, with no substantial operations of its own, and/or

[17] C. Perrow, *The Next Catastrophe* (2007); A. C. Hutchinson, 'Out of the Black Hole: Toward a Fresh Approach to Tort Causation' (2016) 39 *Dalhousie Law Journal* 651; J. B. Ruhl, 'Managing Systemic Risk in Legal Systems' (2014) 89 *Indiana Law Journal* 559, 563 and 588.

[18] *Dalehite* v. *United States* 346 US 15, 51–2 (1953).

[19] W. K. Viscusi and R. J. Zeckhauser, 'Deterring and Compensating Oil-Spill Catastrophes: The Need for Strict Two-Tier Liability' (2011) 64 *Vanderbilt Law Review* 1717, 1726. See also *MC Mehta* v. *Union of India* 1987 AIR 965; P. Bartrip, 'Changing Attitudes to Risk? Managing Myxomatosis in Twentieth-Century Britain', in B. Hutter (ed.), *Anticipating Risks and Organising Risk Regulation* (2010), p. 68.

[20] Viscusi and Zeckhauser, 'Deterring and Compensating', 1727.

[21] P. Conti-Brown, 'Elective Shareholder Liability' (2012) 64 *Stanford Law Review* 409, 462.

[22] M. Lyle, 'Mass Tort Claims and the Corporate Tortfeasor: Bankruptcy Reorganization and Legislative Compensation versus the Common-Law Tort System' (1983) 61 *Texas Law Review* 1297, 1299–300.

when operating companies in the group are separated from asset-holding companies. An alternative strategy involves disaggregating the corporate group, so as to reorganise as a network of companies joined through contractual agreements to cooperate in the design, production, storage, marketing, and distribution of goods.

1.6 Regulation

The aim of this book is to determine the ways in which parent companies and other companies within corporate groups and networks should be held to account through means of statute and/or tort law. It situates the development of rules aimed at resolving the insolvent entity problem, as well as their enforcement, in a framework of business regulation. In so doing, this book adopts a wide view of what passes for 'regulation'. This is in accordance with modern regulatory theory,[23] which sees the most effective regulatory strategy as a mixed one that combines traditional top-down command-and-control with more devolved approaches.[24]

Command-and-control regulation is epitomised by legislation setting out standards of conduct and penalties for non-compliance, as well as enforcement actions by regulatory bodies which undertake inspections, prosecutions, and civil suits. This type of regulation is important in creating proper standards of conduct in industries that have the potential to injure on a mass scale. However, command-and-control regulation is not effective when the subject matter of regulation changes quickly, for example in the technology and financial sectors. Part of the problem is that legislators and regulators cannot hope to understand advances in technology and finance in the way that those who work within these sectors do.[25] This makes it inevitable that regulatory rules do not cater for all potential problems, and that gaps in the rules can be exploited. Even if the rules are well-tailored to the subject matter, there might be difficulties of enforcement on account of limited budgets, limited numbers of personnel with proper training and expertise, the time and cost of

[23] R. Baldwin, M. Cave, and M. Lodge, *Understanding Regulation: Theory, Strategy, and Practice* (2nd edn., 2012), p. 2: 'think of the word regulation [as] all state actions that are designed to influence business or social behaviour.' This view is increasingly influential among tort lawyers: see, e.g., Goldberg and Zipursky, 'The Easy Case', 1930–1; T. M. Schwartz, 'The Impact of the New Products Liability Restatement on Prescription Products' (1995) 50 *Food & Drug Law Journal* 399, 410–11.

[24] Baldwin, Cave, and Lodge, *Understanding Regulation*, pp. 3, 63, 80, and 132.

[25] Baldwin, Cave, and Lodge, *Understanding Regulation*, p. 110; B. Fisse and J. Braithwaite, *Corporations, Crime and Accountability* (1993), p. 196.

enforcement actions, and so on.[26] Deficiencies such as these played their part in disasters such as the *Deepwater Horizon* oil spill and the global financial crisis.[27]

Today, experts accept that command-and-control regulation is not sufficient, in itself, to achieve all regulatory goals. Regulation is seen as a multifaceted activity which can take – and should take – a number of forms, so that the system has in-built redundancy, and so that each regulatory prong reinforces the others.[28] Mixed regulation takes advantage of the 'corporatisation' of work and other forms of business activity, which provides ready-made organisational structures for pursuing regulatory objectives.[29] The ultimate goal of regulation involves proper understanding of the risks of activity,[30] proper planning of those activities, and the formulation of general standards of conduct for business activities and interactions.[31] These standards derive from a number of sources. Courts have a role to play when deciding legal cases because they not only look back at what has happened in the past, but also set standards for future conduct. But regulation goes beyond the 'official' level of statutes, courts, and regulatory agencies, and includes various levels of delegated or self-regulation, which have advantages that include greater expertise about the issues and lower costs for the state.[32] Delegated regulation occurs, for example, when trade and industry associations establish guidelines for action, when companies adopt codes of conduct, and when they devise internal policies and procedures.[33] Companies and other organisations are typified by features which assist in the dissemination and implementation of policies and procedures that control action, including their specialisation of function, hierarchy of authority, commitment by members to organisational objectives, and reproachability amongst members when

[26] See, generally, Perrow, *The Next Catastrophe*. See also K. Greenfield, 'The Disaster at Bhopal: Lessons for Corporate Law?' (2008) 42 *New England Law Review* 755, 759.

[27] See, e.g., J. Ray, 'Offshore Safety and Environmental Regimes: A Post-Macondo Comparative Analysis of the United States and the United Kingdom' (2014) 33 *Mississippi College Law Review* 11; H. M. Osofsky, 'Multidimensional Governance and the BP *Deepwater Horizon* Oil Spill' (2011) 63 *Florida Law Review* 1077, 1102; Viscusi and Zeckhauser, 'Deterring and Compensating', 1753–4.

[28] Baldwin, Cave, and Lodge, *Understanding Regulation*, p. 80; J. Braithwaite, *Regulatory Capitalism* (2008), p. 29.

[29] Braithwaite, *Regulatory Capitalism*, p. 4. See also ibid. pp. 29 and 157.

[30] Baldwin, Cave, and Lodge, *Understanding Regulation*, p. 83.

[31] See C. Macrae, 'Regulating Resilience? Regulatory Work in High-Risk Arenas', in B. Hutter (ed.), *Anticipating Risks and Organising Risk Regulation* (2010), pp. 141–3 and 153.

[32] Baldwin, Cave, and Lodge, *Understanding Regulation*, pp. 139, 148, and 289.

[33] Baldwin, Cave, and Lodge, *Understanding Regulation*, pp. 65 and 266.

things go wrong.[34] These features create conditions conducive to the deterrence of wrongful and injurious conduct by organisations and their employees.[35] Both statute law and tort law have a role to play at the industry and corporate level in encouraging this type of proactive regulation of activity.[36]

Different levels of regulation of corporate groups exist in different jurisdictions, ranging from the more intrusive regimes of Germany and several other civil law countries[37] to the less intrusive regimes in the common law countries examined in this book. In countries like the United Kingdom and Australia, the current main objectives of the regulation of corporate groups include promoting transparency of ownership and availability of information about group operations, facilitating management of groups, preferment of employee entitlements to other debts, and protection of general creditors.[38] The latter objective is achieved largely through prohibitions on certain kinds of transaction which deplete the assets of indebted companies, and through the imposition of directors' duties which might be capable of extension to the parent company.[39]

However, some potentially helpful statutory means of extending liability exist, although they have had limited impact on the insolvent entity problem to this point. First, these jurisdictions feature protections of consumers and bystanders injured by defective products.[40] Liability is strict or 'stricter', so as to either negate or reduce the importance of fault in liability determinations. However, in their present incarnation, product liability rules are limited by a wide development risks defence and by restrictive long-stop time limits. Second, various common law jurisdictions give courts powers to consolidate group debts in cases of abuse,[41]

[34] These matters are discussed in Chapter 5. See also Fisse and Braithwaite, *Corporations, Crime and Accountability*, pp. 29, 53, 79, and 97; B. L. Garrett, 'The Corporate Criminal as Scapegoat' (2015) 101 *Virginia Law Review* 1789.

[35] This is a crucial point: see W. K. Viscusi, 'Pricing Lives for Corporate Risk Decisions' (2015) 68 *Vanderbilt Law Review* 1117, 1122.

[36] This lesson was reinforced by the *Deepwater Horizon* oil spill (discussed, e.g., in Chapter 4): see M. Greenstone, 'Liability and Financial Responsibility for Oil Spills under the Oil Pollution Act of 1990 and Related States' (Testimony before US House of Representatives Committee on Transportation and Infrastructure)(9 June 2010), available at: www.brookings.edu/research/testimony/2010/06/09-oil-spill-greenstone.

[37] K. J. Hopt, 'Groups of Companies: A Comparative Study on the Economics, Law and Regulation of Corporate Groups' (ECGI Law Working Paper 286/2015), 9.

[38] See also Hopt, 'Groups of Companies', 2–3.

[39] Such as Insolvency Act 1986, s. 214. See Chapter 6.

[40] See Chapter 8.

[41] See Chapter 7.