Liability Deficit Problem of Multinational Corporate Groups: A Proposal for Legislative and Judicial Reform

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Abstract

Multinational corporate groups are now the world's dominant economic institution. In the common law jurisdictions analyzed in this thesis, (the U.K., the U.S. and Canada) legal regulation has not kept pace with regulating the intragroup liability of corporate groups. This thesis focuses on the circumstances under which a subsidiary's tortious liability should be attributed to the parent company. Through a comparative examination of the case law in the three-subject jurisdiction, this thesis investigates the common law's attempt to set aside the principles of limited liability and separate corporate personality in order to hold a parent company responsible for its subsidiary's liability.

My multi-jurisdictional comparative analysis of the judicial approaches to allocating tortious liability vertically in corporate groups concludes that while veil piercing remedy is inconsistent in many ways with the economic realities of how parent and subsidiary companies are related, strong policy considerations nonetheless still support its use. Yet, this approach still does not fully address the liability deficit problem characteristic of corporate groups which the common law has been attempting to address through incremental adjustment.

This, thesis, therefore calls for legislative correction of the liability deficit problem by making the following recommendations for reform: Parent companies should be required by law to assume the tortious liability of their wholly-owned or controlled subsidiaries, and that corporate groups should maintain intragroup liability insurance coverage where proceeds are payable to tort victims who suffer harm.

The legislative proposal is not a bright-line rule in that where the subsidiary company is not wholly-owned but controlled, the courts will be responsible for making a decision as whether or not to set aside the two fundamental principles of corporate law in order to hold a parent company liable. Since the courts will still be responsible for deciding whether to pierce the parent's veil, there is always the potential risk of judicial discretion to be exercised by the courts. In exercising that discretion, this thesis suggests that the courts should abandon the normal presumption of non-liability in favour of parent companies and adopt the economic reality test when faced with veil piercing inquiry involving partly-owned/controlled subsidiaries.

Lay Summary

This thesis argues that limited liability is the main cause of the liability deficit problem. It also contends that *Salomon* is a false foundation for limited liability in tort cases because *Salomon* deals specifically with contractual liability, not tortious liability. To address the deficit problem, this thesis recommends that parent companies should be required by law to assume the tortious liability of their wholly-owned or controlled subsidiaries, and that corporate groups should maintain intragroup liability insurance coverage where proceeds are payable to tort victims. Further, instead of the courts focusing exclusive attention on the legal characterization of the parent company and its subsidiary when faced with veil piercing inquiry, they should abandon the presumption of non-liability in favour of the parent and adopt the economic reality test. The economic reality test will mitigate the overall rigidity of limited liability and the strict application of the *Salomon* principle in tort cases.

Preface

This thesis is an original, unpublished, intellectual product of the author, Paul Tepre.

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Dedication

This is for my beloved dad, Vitus Jonas Tepre who suddenly passed away while I was writing this thesis. You will forever be missed! Rest in peace Papa!!!

Chapter 1: Introduction

1.1 Phenomenon of Multinational Corporate Groups

Over the past decades, the business world of the most advanced commercial jurisdictions has seen a significant transformation in the way business is carried out. This transformation is not by any means trivial or esoteric. It began with the sole proprietorship form of business, then progressed to the partnership system of commerce, to joint stock companies to limited liability companies, and now, to multinational corporate groups – 'the big elegant in the room.' The current wave of globalization has certainly contributed to the rising phenomenon of multinational corporate groups: a group of companies, usually consisting of a parent company and its subsidiary operating either in the same or different jurisdiction.

Multinational corporations choose to carry on business through a network of affiliated or associated companies for a number of reasons. First, it is the most attractive form of global business. Second, unlike the orthodox forms of business associations mentioned earlier, using corporate groups enables corporations to go beyond borders and to expand their global operations. Other economic reasons include leveraging capabilities, portfolio diversification, risk management, tax planning, and regulatory requirements and efficiency considerations.

Although this modern phenomenon of conducting business through interrelated corporations was virtually unknown some years ago, today, the corporation in general, and multinational corporate groups, have "risen from relative obscurity to become the world's dominant economic institution."[1] It is estimated that multinational corporate groups "have a turnover larger than many nation states."[2] They have so much power and influence that they pose a challenge not only to the legislature and regulators but also to society at large.

1.2 Liability Deficit Problem of Corporate Groups

Multinational corporate groups can contribute positively to the development of the global economy, they can also be responsible for many far-reaching consequences; notably, the externalization of risks of enterprise liability. By their very nature, multinational corporate groups carry out risky business activities that may cause harm, injury, loss or damage to others.[3] As Bakan argues, the corporation is "an externalizing machine" because "nothing in its legal makeup limits what it can do to others in pursuit of its selfish ends, and it is compelled to cause harm when the benefits of doing so outweigh the costs."[4] The high-profile corporate failures of the last decades and the recent global financial crisis which cost millions of people their homes, savings, and jobs remind us of the far-reaching consequences of reckless corporate behaviour.

Despite the rising phenomenon of multinational corporations, there is currently no legislation or regulation in the U.K., the U.S. or Canada that specifically governs how tortious liability arising

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[1]Joel Bakan, *The Corporation: The Pathological Pursuit of Profit and Power* (Toronto: Penguin Canada, 2004) at 5.
[2] Peter T Muchlinski, *Multinational Enterprises and the Law* (Oxford: Oxford University Press, 2007) at 3 [Muchlinski, "Multinational Enterprises"].
[3] José Engrácia Antunes, *Liability of Corporate Groups: Autonomy and Control in Parent-Subsidiary Relationships in US, German and EU Law: An international and Comparative Perspective* (Boston: Kluwer Law and Taxation Publishers, 1994) at 1.
[4] Bakan, *supra* note 1 at 60.

within corporate groups should be allocated vertically within a parent-subsidiary relationship. This lack of regulatory control (i.e., the failure to regulate intragroup liability) gives rise to the liability deficit problem. The liability deficit is a growing problem because it shields shareholders from liability by creating double immunity for corporate groups: one between the parent and its wholly-owned or controlled subsidiary, and another between the parent company and its shareholders.

Two primary factors contribute to the liability deficit problem. The first is the principle of limited liability, which brings with it a number of economic benefits (see Chapter 3 below) but also potential drawbacks. Primarily, limited liability allows corporations to take excessive risks without shouldering the burden of liability when things go wrong. The second is separate corporate personality. This, together with limited liability create a veil of incorporation between the parent company and its wholly-owned or controlled subsidiary. As a result, holding a parent company liable for wrongs committed by its wholly-owned or controlled subsidiary and, in this way, addressing the deficit problem that might otherwise arise without this allocation of responsibility, runs counter to the two fundamental principles of corporate law.

1.3 How is the Liability Deficit Problem Addressed?

Given the lack of sufficient legal regulation in relation to how tortious liability is allocated vertically within a parent-subsidiary relationship, how is the liability deficit problem addressed? This issue is governed by common law principle - veil piercing remedy. However, since veil piercing remedy is an equitable remedy, it is within the discretion of the courts to grant or deny such a remedy. Furthermore, although the courts have attempted to address the liability deficit problem, the case law has made it clear that there are significant variations in the way the courts apply veil piercing remedy, leading to ambiguities, inconsistencies and unfair results.

Since veil piercing lacks any consistent or coherent articulation, it is fundamentally inconsistent with the economic realities of how parent and subsidiary companies are related. Further, since veil piercing remedy is the exception, not the rule, the liability deficit problem which the common law has been attempting to address through case-specific and incremental adjustment still remains. The challenge then is to determine how the current veil piercing regime can be reformed to address the liability deficit issue and adequately protect victims who suffer harm caused by the activities of parent-subsidiary companies.

1.4 Recommendations for Legislative and Judicial Reform

This thesis asserts that the best way to address the liability deficit problem is to tackle the root cause of the problem - i.e. limited liability. Since limited liability was created by an Act of Parliament or Congress, only the legislature can plug the loopholes and the imbalance created by limited liability, thereby remedying the liability deficit problem. Given that limited liability was created by statutory or charter provisions, it requires an even clearer Act of Parliament or Congress to reform or amend the doctrine in areas where its use and application has caused more harm than good. In other words, the principle of limited liability cannot be abrogated, abolished or interfered with by the courts except by the clearest legislation unequivocally expressed.

Against this backdrop, this thesis calls for legislative correction of the liability deficit problem by making the following recommendations for reform: Parent companies should be required by law to assume the tortious liability of their wholly-owned or controlled subsidiaries. I call this approach statutory assumption of liability. To ensure that parent companies have the financial ability to satisfy the assumed liability, this thesis recommends further that multinational corporate groups should maintain intragroup liability insurance coverage where proceeds are payable to tort victims who suffer harm because of corporate activities.

The reason why parent companies should maintain intragroup liability insurance coverage is that most of the subsidiary companies are shell companies – they have little or no assets. Since parent companies have the assets, they are in a better position to "insure" against any potential risks of liability than the subsidiary. It therefore makes logical sense that the asset-owning parent company should be responsible for insuring against the risks of intragroup liability and equally assume the corresponding liability arising out of the tortious acts of its wholly-owned or controlled subsidiaries. While the proposed intragroup liability insurance coverage cannot resolve the liability deficit problem, it will, at the very least, compensate tort victims for harms or losses suffered.

The legislative proposal is not a bright-line rule; it has its limitations and challenges. Where the subsidiary company is not wholly-owned but controlled, the courts will be responsible for deciding as whether to set aside the two fundamental principles of corporate law in order to hold a parent company liable for its subsidiary's liability. Since the courts will still be responsible for making a decision as whether or not to pierce the parent's veil, there is always the potential risk of judicial discretion to be exercised by the courts.

In exercising that discretion, however, this thesis suggests that the courts should abandon the normal presumption of non-liability in favour of parent companies and adopt the economic reality test when faced with veil piercing inquiry involving partly-owned/controlled subsidiaries. Thus, instead of the courts focusing exclusive attention on the legal characterization of the parent company and its subsidiary when faced with veil piercing inquiry in cases where the subsidiary is not wholly-owned but controlled, they should adopt a more lenient approach i.e. abandon the non-liability presumption and adopt the economic reality test. This approach is called judicial leniency.

The justification for the judicial leniency approach is two-fold: First, *Salomon v Salomon* (1897)[5], which is often cited as the leading authority for the normal presumption of non-liability in veil piercing inquiry, deals specifically with contractual liability, not tortious liability. As such, it is a false foundation for limited liability in tort cases, and therefore needs rethinking. Second, the current veil piercing remedy has been applied in a most harsh and unforgiving manner, leading at times to unfair results, especially in tort cases. In light of this unfairness, abandoning the normal presumption of non-liability as well as adopting the economic reality test will go a long way to mitigate the overall rigidity of limited liability and the strict application of the *Salomon* principle in tort cases.

It is necessary to emphasize that the legislative proposal and the judicial leniency approach are not mutually exclusive; they work together. The starting point is that where the subsidiary is wholly-owned or controlled, the parent company should be, or is presumed liable under the proposed

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[5] *Salomon v Salomon & Co. Ltd*, [1897] AC 22 (HL) [*Salomon*].

legislative change. Accordingly, there is no problem with the application of the proposed legislative change if the subsidiary is wholly-owned. Where the subsidiary company is not wholly-owned but controlled by the parent, the courts will have to determine the issue of control having regard to the underlying economic interrelationship between the parent and its subsidiary company. The intervention of the courts in determining what constitutes sufficient degree of control in partly-owned/controlled cases should trigger the judicial leniency approach.

When applying the economic reality test, this thesis recommends that the courts should employ the common enterprise principle instead of a single entity principle. Under the common enterprise principle, the courts should ask whether the subsidiary has "common bonds" of economic interests or association with the parent company. While the methods by which a subsidiary and its parent could be regarded as having common bonds depends on the circumstances of each case, in most cases, the answer is yes.

How does the proposed recommendation differ from the existing common law, veil piercing remedy? First, the current veil piercing remedy is fundamentally inconsistent with the economic realities of how parent and subsidiary companies are related because the usual treatment of a parent company and its subsidiary as a separate legal entity, notwithstanding the strong interrelationship between the two companies obscures their underlying economic reality. In other words, the current veil piercing remedy creates a false dynamics between the parent and its wholly-owned or controlled subsidiary as though the parent and its subsidiary are operating as independent legal entities, when in reality, they are not.

Adopting the economic reality test will enable the courts to focus veil piercing inquiry on substance, not on form, and thereby address the false dynamics issue. Similarly, abandoning the normal presumption of non-liability in favour of parent companies will force the courts to act with a degree of fairness towards tort victims. This may result in the parent's veil being pierced more frequently if circumstances warrant it.

Second, and most importantly, whereas the current veil piercing is largely *ex-post* remedy and is at the discretion of courts, the proposed legislative reform will leave little room for discretion and varying interpretations especially in cases involving wholly-owned subsidiaries. Finally, as part of the recent move toward better corporate governance, it is hoped that the legislative reform will go a long way towards ensuring that corporations are governed more conscientiously. This will minimize the risk of reckless corporate behaviour, restore integrity to the corporate form and strengthen good corporate governance.

1.5 Scope and Limitations of Research

This thesis deals specifically with tortious liability arising in the context of a parent-subsidiary relationship. Without limiting the generality of the concept of tort, the concept as applied in this thesis, covers the widest possible range of civil wrongs committed by corporate groups. In this thesis, references to "tort victims" means victims who suffer harm due to corporate activities. Similarly, references to "subsidiary" includes a wholly-owned, partly-owned or controlled subsidiary.

1.6 Structure of the Thesis

This thesis proceeds in six chapters including the introductory Chapter. Chapter 2 examines the underlying legal and jurisdictional problems associated with the activities of corporate groups, focusing particularly on legal causes of the liability deficit problem. The goal here is to highlight some of the difficulties plaintiffs face in bringing an action against parent companies for the act or omission of their subsidiaries.

In highlighting the liability deficit gap and the challenges tort victims face when suing multinational corporate groups for harms suffered, I will explore how those challenges are exacerbated when a parent company has a number of subsidiaries operating in foreign jurisdictions. The question of parent company liability for the act of its wholly-owned or controlled subsidiary will be illustrated through references to the case law and notable disasters involving multinational corporate groups.

The legal causes of the liability deficit problem and the jurisdictional problems identified in Chapter 2 will provide me with the necessary analytical tools to proceed to Chapter 3. Starting with the universal adoption of limited liability, I examine the legislative root of the doctrine, its rationales, its extension to corporate groups and its potential consequences. Having done this, I then focus attention on how the courts apply the doctrine in the landmark case of *Salomon*.

My jurisprudential analysis of limited liability from a historical perspective is relevant because any examination of parent company liability for the obligations and debts of its subsidiary requires an understanding of the original rationales of limited liability and its place in corporate law.

Chapter 4 investigates veil piercing remedy in comparative perspective. In this Chapter, I focus on the common law’s direct and indirect attempts to codify when the two fundamental principles of corporate law will be set aside so as to hold a parent company liable for the acts or omissions of its subsidiary. In the first part of this Chapter, I consider how the courts of the three-subject jurisdiction have structured their tests for piercing the corporate veil - in particular, I compare and contrast the reasoning inherent in the traditional entity law principle and the single unit approach.

In evaluating the development of veil piercing jurisprudence in the three-subject jurisdiction, I will focus on four legal issues: (a) the judicial power to pierce the corporate veil at common law; (b) the rationales for piercing the corporate veil; (c) the test for piercing the corporate veil; and (d) the limitations of veil piercing remedy. The second part of this Chapter investigates the alternative liability regime that the courts sometimes use to address the liability deficit problem. Here, I focus exclusively on direct parent liability. I conclude at the end of this Chapter that despite the emerging trend of direct parent liability, the traditional veil piercing remedy continues to prevail, and shows no sign of being superseded. Yet this approach still fails to address the liability deficit problem which the common law has been attempting to address for decades.

To address the liability deficit problem, Chapter 5 examines the merits of the legislative proposal and the judicial leniency approach. Finally, this thesis concludes with a summary of research findings, limitations and practicality of the proposed legislative reform.

Chapter 2: Corporate Groups and Legal Causes of the Liability Deficit Problem

This Chapter examines the legal causes of the liability deficit problem and the potential challenges tort victims face when suing multinational corporate groups. In this Chapter, I focus my analysis primarily on separate corporate personality and the doctrine of *forum non conveniens* (FNC). Before examining these doctrines in greater detail, it is necessary to understand the structure of corporate groups and how they operate.

2.1 Structure of Corporate Groups

Multinational corporate groups ("MNCGs") or multinational enterprises ("MNEs")[6] usually operate through a network of interrelated or affiliated corporations. The principal form of business

[6] While there is no unified definition of "MNCGs" or "MNEs", the following definitions have been widely used to describe the concept: (1) David Lilienthal, quoted in David K Fieldhouse, "The Multinational: A Critique of a Concept" in Alice Teichova et al., eds, *Multinational Enterprise in Historical Perspective* (Cambridge: Cambridge University Press: 1986) at 10, defines multinational enterprises as "corporations … which have their home in one country but which operate and live under the laws and customs of other countries as well."; (2) Neil Hood & Steven Young, *The Economics of the Multinational Enterprise* (London: Longmans, 1979) at 3, define multinational enterprise as any enterprise which "owns (in whole or in part), controls and manages income generating assets in more than one country." See also Richard Caves, *Multinational Enterprise and Economic Analysis*, 2nd ed (Cambridge: Cambridge University Press, 1996) at 1; (3) John H Dunning, *Multinational Enterprise and the Global Economy* (Wokingham: Addison-Wesley Publishing, 1993) at 3, defines MNE as "an enterprise that engages in foreign direct investment (FDI) and owns or controls value-adding activities in more than one country."; (4) OECD, OECD Publishing, (2011), OECD Guidelines for Multinational Enterprises (2011), at 17, online: <http://dx.doi.org/10.1787/9789264115415-en>, defines MNE as an enterprise which "usually comprise companies or other entities established in more than one country and so linked that they may coordinate their operations in various ways. While one or more of these entities may be able to exercise a significant influence over the activities of others, their degree of autonomy within the enterprise may vary widely from one multinational enterprise to another. Ownership may be private, State or mixed."; (5) UN, *The Impact of Multinational Corporations on Development and on International Relations*, UN Pub E74 IIA 5 (1974) at 25, defines MMEs an "enterprise which own[s] or control production or service facilities outside the country in which they are based."

structure commonly associated with multinational corporate groups includes contractual and equity-based relationships. A key feature of the latter, which is the focus of this thesis, involves share ownership and a relationship of control and interlocking directorship.[7] Other examples of multinational business integration include joint ventures, informal alliances and supranational forms of international business.[8]

There are two types of equity-based structures, namely, horizontal and vertical. Although the focus of this thesis is on the vertical corporate group, suffice to mention that horizontal corporate group involves "a complex network of small cross-shareholdings."[9] This type of business arrangement is predominantly contractual and consists of a number of independent contracting companies. The most famous example of a horizontal corporate group is the traditional Japanese '*Keiretsu*.'[10] A vertical corporate group, on the other hand, is often made up of parent and subsidiary companies operating within a group of company, with the parent company seated at the apex of the group structure with powers of control or management, often directing and controlling the affairs of the subsidiary.

The key difference between vertical and horizontal corporate groups is independence. While individual companies operating within a vertical group are interdependent on each other and

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[7] Janet Dine, *The Governance of Corporate Groups* (Cambridge: Cambridge University Press, 2000) at 39.
[8] For detail analysis of the business and legal forms of multinational enterprise, see Muchlinski, "Multinational Enterprises," *supra* note 2 at 45 -79.
[9] Dine, *supra* note 7 at 39-40.
[10] For a general analysis of the Japanese Keiretsu, see Ronald Gilson & Mark Roe, "Understanding the Japanese Keiretsu. Overlaps Between Corporate Governance and Industrial Organization" in Sally Wheeler, ed, *The Law of the Business Enterprise* (Oxford: Oxford University Press, 1994); See also Muchlinski, "Multinational Enterprises," *supra* note 2.

usually submit to a common direction, in a horizontal group, the component companies may submit to a common direction but without necessarily being dependent on each other.[11] To the extent permitted by the corporate charter, the structure of a vertical group is often characterized by intercorporate shareholding. This essentially allows one corporation not only to acquire or hold shares of another company but also to control that corporation.

It is worth emphasizing that the concept of intercorporate shareholding, a relatively modern phenomenon was previously prohibited in the nineteenth century.[12] Since that restriction was lifted, intercorporate shareholding has become such a key feature of parent-subsidiary business structure that corporate law must account for it. Today, modern corporations are not only permitted to hold stock in another company, but also have the right to control and direct the affairs of that same company of which they are shareholders.

While the concept of intercorporate shareholding brings with it a number of economic benefits, this ability of corporations to acquire or hold stock of another company has led to what Antunes describes as "the emergence of the new paradigm of corporate reality."[13] This new paradigm of corporate groups presents some challenging legal issues, particularly in relation to how tortious liability arising in the context of a parent-subsidiary relationship is allocated within the group

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[11] Antunes, *supra* note 3 at 235.
[12] See generally Adolf Berle, "The Theory of Enterprise Entity" (1947) 47 Columbia Law Review 343 [Berle, "Theory of Enterprise"]. See also *De La Vergne Refrigerating Machine Co. v German Savings Institution*, 175 U.S. 40 (1899) at 54-55, where the U.S. Supreme Court stated as follows: "But as the powers of corporations, created by legislative act, are limited to such as the act expressly confers, and the enumeration of these implies the exclusion of all others, it follows that, unless express permission is given to do so, it is not within the general powers of a corporation to purchase the stock of other corporations for the purpose of controlling their management."
[13] Antunes, *supra* note 3 at 29.

vertically. Before examining this issue, it is necessary to review how intercorporate shareholding has brought with it the emergence of a new separate corporate personality for corporate groups.

2.2 New Corporate Personality

It is a deeply entrenched principle of corporate law that once a company is incorporated, it is recognized as an independent legal entity.[14] As a result, the company has its own rights, duties, and obligations, separate and distinct from its shareholders, officers and directors. The corporation, although an artificial entity, is permitted by law to perform functions reserved for the natural person in its own rights, including but not limited to, the right to sue and be sued, the right to contract as well as the right to hold and dispose of property. This is a metaphor, but one that is deeply rooted in the common law jurisdictions analyzed in this thesis. Recently in *Prest v Petrodel Resources Limited and others* (2013), Lord Sumption stated that "[the separate corporate personality] and property of a company is sometimes described as a fiction … [but] the fiction is the whole foundation of [U.K.] company and insolvency law."[15]

Although the principle of separate corporate personality could be traced back to the period of free incorporation around 1844,[16] it was not until 1897 that the doctrine was judicially reaffirmed by the House of Lords (now the Supreme Court of U.K.) in the seminal decision of *Salomon*. In

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[14] Paul L Davies, *Gower and Davies' Principles of Modern Company Law*, 8th ed (London: Sweet & Maxwell, 2008) at 33 [Davies, "8th ed"].
[15] *Prest v Petrodel Resources Limited and others,* [2013] UKSC (U.K. Supreme Court) 34 at para 8 [*Prest*].
[16] Paddy Ireland, "Limited liability, Shareholders Rights and the Problem of Corporate Irresponsibility" (2010) 34 Cambridge Journal of Economics 837.

Salomon, the Lords made it clear that once a company has been duly incorporated, it must be treated as an independent legal entity irrespective of whether the shares in the company are held by one person. Since *Salomon*, the doctrine of separate corporate personality has become one of the fundamental principles of corporate law not only in the common law jurisdictions but also civil law jurisdictions.

Limited liability and separate corporate personality are the two fundamental pillars of corporate law. Although these fundamental principles emerged separately, and at different times, they have become so inseparable that it is not possible to discuss one doctrine without the other. Limited liability is dealt with in detail later in Chapter 2, but it is worth pointing out that this principle is a necessary corollary of the separate corporate personality rule. One of its greatest incentives is to protect shareholders from liability of the company that exceeds their committed investment. That is, the shareholders' liability "for the company's debts is limited to the amount they have paid or have agreed to pay to the company for its shares."[17]

Limited liability has clearly developed both as a device to partition assets and to shield the shareholders from liability. This immunity from liability operates as an "asset partitioning"[18] device which shields the shareholders from personal liability in the event of business failure. The best way to illustrate this is by example. Assume X is worth $150 million. X then decides to invest part of his or her money, say $5 million, in ABC Inc., a mining exploration firm in Vancouver.

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[17] Davies, "8th ed", *supra* note 14 at 37.
[18] Henry Hansmann & Reinier Kraakman, "The Essential Role of Organizational Law" (2000) 110:3 The Yale Law Journal 387 [Hansmann & Kraakman, "Essential Role"].

Assume further that ABC Inc. runs into some financial difficulty and was liquidated within a year, owing about $250 million to various creditors including Canada Revenue Authority (CRA). At the time of liquidation, the company's assets were valued at $150 million, leaving a shortfall of $100 million – the difference between assets and liabilities. Given the shortfall, could the creditors go after X to satisfy the remaining debt of the company? Generally, the answer is no. Why?

Due to the privilege of limited liability, X's indebtedness to ABC Inc. as a shareholder is limited to only $5 million. That means the rest of X's personal worth - $145 million and other assets including homes and pension funds - remain unaffected because they are insulated from any potential liability claims by the creditors of ABC Inc. This is the privilege of limited liability - if the company becomes insolvent, the shareholders lose everything they have invested in the corporation but will be free from any personal liability.

It should be clearer by now that the artificial reification of the corporation separates the business entity from its shareholders, and thus, creates a veil of incorporation which is generally difficult to pierce. Historically, the principles of separate corporate personality and limited liability were designed to protect the individual shareholders, and by so doing, create only a single layer of corporate personality - between the corporation and its individual shareholders.

However, the advent of corporate groups coupled with the subsequent extension of the two fundamental principles of corporate law to parent-subsidiary companies, creates double immunity for corporate groups: one between the parent and its wholly-owned or controlled subsidiary, and another between the parent company and its shareholders. This new form of corporate personality recognizes the parent and its subsidiary as a separate legal entity, even if both companies are economically interrelated and under a common direction, which they often are.

The economic activities of the parent and its wholly-owned or controlled subsidiary company are conceptually treated as separate and distinct despite being intermingled in reality. This legal characterization of each individual corporation within a group of companies notwithstanding that they are always linked and interrelated is clearly inconsistent with the economic realities of corporate groups.

The two fundamental principles of corporate law have some economic advantages including but not limited to passive investment and management under a board structure, portfolio diversification, organized securities markets, and reduction in monitoring costs (see section 3.4 below for further detail) but also have potential drawbacks in certain areas. For example, the extension of these principles to parent-subsidiary companies without modification can give rise to abuses of the corporate form; a parent company can easily interpose the corporate form by setting up a subsidiary to avoid liability or reduce exposure to liability. This capacity to externalize risks of liability to others is one area in which limited liability promotes irresponsibility and recklessness within the corporate form.

One only has to examine the case law - regarding how tortious liability arising in corporate groups is dealt with - by the courts to appreciate the substantial risks and the far-reaching consequences of limited liability and separate corporate personality on victims who suffer harm due to corporate activities. Whether the extension of limited liability and separate corporate personality to corporate groups is desirable or not, it is worth noting that when these principles were first developed during the industrial revolution corporate groups were virtually non-existent.

Whatever justification may be put forward to defend the legitimacy of limited liability or separate corporate personality for corporate groups, it is equally necessary to be mindful of the moral hazard and the unfair results that such an extension creates, particularly in light of inadequate compensation to tort victims who suffer harm caused by the acts or omissions of parent-subsidiary companies.

Regardless of whether the parent is a dominant and controlling shareholder in its subsidiary, corporate law stills protects parent companies from corresponding liability arising from the activities of their wholly-owned or controlled subsidiaries. This immunity from liability is the underlying cause of the liability deficit problem which the common law has been attempting to rectify, though unsuccessfully. How then does corporate law protect a parent company from its subsidiary's liability?

2.3 Parent Company Immunity from Liability

The main protection accorded to corporate shareholders (parent companies) as well as individual shareholders is the normal presumption of non-liability. While this presumption is rebuttable, corporate law does not recognize parent and subsidiary companies within a group of companies as a single economic entity or treat parent-subsidiary companies as a unified legal entity for the purposes of liability. Instead, it recognizes each individual company within a group of companies as separate and distinct from others even if the whole group or enterprise was formed to pursue a common or an integrated business activity.[19]

This point was emphasized by the Court of Appeal (U.K.) in *Adams v Cape Industries Plc.*, (1990). In *Adams*, the Court of Appeal stated: "There is no general principle that all companies in a group of companies are to be regarded as one. On the contrary, the fundamental principle is that "each company in a group of companies (a relatively modern concept) is a separate legal entity possessed of separate legal rights and liabilities.""[20]

Insofar as veil piercing remedy is concerned, the consequence of this presumption of non-liability is that parent companies are often not liable for the obligations and debts of their subsidiaries. Clearly, the existence of limited liability and separate corporate personality bars the courts from holding a parent company liable for wrongs committed by its subsidiary except in limited circumstances, which circumstances are rare. Moreover, any interference with or restriction of the privilege of limited liability, except in cases of flagrant or egregious abuses of the corporate form, will be regarded as going to the root of corporate law, and thus against the will of the legislature.

[19] Phillip I Blumberg, *The Multinational Challenge to Corporation Law*: *The Search for a New Corporate Personality* (Oxford: Oxford University Press, 1993) at viii [Blumberg, "Multinational Challenge"]. Blumberg points out that "each component corporation of the group – whether parent, subsidiary, or affiliate – for legal purposes was still separate and distinct from every other corporation in the group, and its and its rights and responsibilities were separate from those of the other constituent companies of the group and were unaffected by them."
[20] *Adams v Cape Industries Plc.*, [1990] Ch. 433 (CA) at 532 [*Adams*]. See also *Albacruz (Cargo Owners) v Albazero (Owners),* [1976] 3 WLR 419 (UKHL) at 809 [*The Albazero*].

Ironically, however, although the corporate law allows a parent company to conduct business through its subsidiary, it does not attribute the corresponding liability arising from the operations of that same subsidiary to the parent. This was the view taken in *Re Southard*. In that case, Templeman LJ stated as follows:

> [U.K.] company law possesses some curious features that generate some curious results. A parent company may spawn a number of subsidiary companies, all controlled directly or indirectly by shareholders of the parent company. If one of the subsidiary companies, to change the metaphor, turns out to be the runt of the litter and declines into insolvency to the dismay of its creditors, the parent company and other subsidiary companies may prosper to the joy of the shareholders without any liability for the debts of the insolvent subsidiary.[21]

Thus far, I have highlighted some of the far-reaching consequences of limited liability and separate corporate personality. But the main area in which these principles remain a major concern is in relation to compensation and recovery of damages for harms, injuries, and losses suffered as a result of corporate activities. Insofar as the allocation of liability within corporate groups is concerned, these principles serve to either bar recovery for damages or fail to provide adequate or sufficient compensation for tort victims who suffered harm caused by the act or omission of wholly-owned or controlled subsidiaries operating within a group.

Since corporate law partitions the assets of the individual units within a group of companies, any potential claims against a parent company for the act or omission of its subsidiary "will be limited to the asset of the [subsidiary] and cannot be asserted against the [assets of the parent company as

[21] *In re Southard & Co Ltd*, [1979] 1 WLR 1198 (CA) at 1208 [*Re Southard*].

a shareholder]."[22] Where the subsidiary has no assets, as is often the case, those who suffer harm caused by corporate activities receive no monetary compensation. This is the height of the moral hazard problem and the unfair results produced by these doctrines. The following disasters involving the activities of subsidiary companies operating within a group of companies illustrate the reality of the moral hazard and the unfair result dilemma: the *Pennsylvania Railroad v Jones* (1894)[23] and *Walkovszky v Carlton* (1966).[24]

The *Pennsylvania Railroad* was one of the earliest cases involving the liability of corporate groups. In this case, the plaintiffs were hit by a train operated by a subsidiary of Pennsylvania Railroad Co. ("PRC"). The plaintiffs then brought an action against the parent company and its subsidiaries for damages. The issue, in this case, was whether the controlling parent company – (PRC) should be liable for the acts of its subsidiaries. The court declined to pierce the veil of the controlling parent liability. The court justified its decision by holding that the individual units operating within the group were separate legal entities, therefore, it could not impose liability on the parent company.

Similarly, in *Walkovszky*, the plaintiff who was hit by a cab operated by one of the subsidiary companies sued all ten companies within the group including the controlling individual shareholder, Mr. Carlton. The issue was whether the veil should be pierced in order to hold Mr. Carlton personally liable for the injuries suffered by the plaintiff. The plaintiff argued that Mr.

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[22] Davies, "8th ed," *supra* note 14 at 193.
[23] *Pennsylvania Railroad v Jones*, 155 U.S. 333 (1894) [*Pennsylvania Railroad*].
[24] *Walkovszky v Carlton*, 18 N.Y. (2d) 414 (N.Y. App Ct 1966); 223 N.E. (2d) [*Walkovszky*].

Carlton conducted one single business, *albeit*, through the incorporation of ten different corporations, and therefore should be personally liable because he was the controlling shareholder of all ten corporations.

The *Walkovszky* Court rejected this argument and dismissed the claim against the defendant without providing an adequate remedy for the plaintiff. The *Walkovszky* Court held that piercing the corporate veil or imposing personal liability on the defendant "would destroy completely the efficacy" of limited liability. The court went on to emphasized that "the law permits the incorporation of a business for the very purpose of enabling its proprietors to escape personal liability."[25]

The intermingling of the economic activities between the parents and their subsidiaries coupled with the fact that, in *Walkovszky*, Mr. Carlton had effective control over all ten corporations, should give rise to liability in each case. Instead, the courts relied on a legal technicality - the existence of separate corporate personality and limited liability to deny the plaintiffs compensation for harms suffered. In my view, where strict adherence to limited liability and separate corporate personality would give rise to unconscionable results, the courts should not sacrifice adequate protection for tort victims on the altar of such doctrines.

In addition to the imbalance created by the corporate veil issue, the liability deficit problem is also heightened by a jurisdictional problem. The jurisdictional problem arises when a subsidiary

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[25] *Ibid.*

company has a *situs* in a foreign jurisdiction other than that of its parent. Like the corporate veil, the "jurisdictional veil"[26] enables a non-resident foreign parent company to limit its exposure to liability for the act or omission of its subsidiary on the basis that it was not present within the jurisdiction of the subsidiary where the harm occurred. Below, I examine the jurisdictional problem of corporate groups by highlighting some of the difficulties tort victims face when suing multinational corporate groups for wrongs committed in another jurisdiction. My analysis will focus mainly on forum shopping and the doctrine of *forum non conveniens* (FNC).

2.4 Suing Multinational Corporate Groups

Multinational corporate groups usually operate on a global basis through parent-subsidiary relationship. Often, the parent company operates in one jurisdiction, the subsidiary in another. Given this, if a tort victim wants to bring an action against a non-resident foreign parent company for wrongs committed by its subsidiary in another jurisdiction, or enforce a judgment debt against the parent company, how does one commence such a proceeding? Is the plaintiff permitted to choose a forum of his or her choice? Is the plaintiff allowed to bring an action in the jurisdiction where the subsidiary carries on business (the host country), or where the parent resides (the home country), or both or some other jurisdiction with "real and substantial connection" to the case? These questions raise the issue of exclusive or extraterritorial jurisdiction. (i.e., "the power of the court to hear a dispute").[27]

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[26] Peter T Muchlinski, "Limited liability and multinational enterprises: A case for Reform?" (2010) 34 Cambridge Journal of Economics 915 at 920 [Muchlinski, "Limited Liability"].
[27] Stephen G A Pitel & Nicholas S Rafferty, *Conflict of Laws*, 2nd ed (Toronto: Irwin Law Inc., 2016) at 53.

2.4.1 The Problem of Jurisdiction

To bring an action against a non-resident foreign parent company for the acts or omissions of its overseas subsidiary, it is necessary to show that the foreign parent company is "present" or amenable to that jurisdiction despite its absence from the forum jurisdiction. In other words, it must be shown that the parent company has a "real and substantial connection"[28] with the jurisdiction of the subsidiary where the harm occurred. However, given the corporate separation rule, the foreign parent company will be deemed not "present" within the jurisdiction of its subsidiary. Consequently, the parent cannot be held to have submitted to the legal forum of the subsidiary for the purposes of determining intragroup liability.[29]

Although a parent company may not be physically present within the jurisdiction of its subsidiary, it is suggested that there are a number of ways to show that the parent was "present" within the jurisdiction of its subsidiary where the harm occurred. First, that "the parent has acted as a joint tortfeasor with its subsidiary, or that the subsidiary has acted as the agent or *alter ego* of the parent when committing the alleged tort."[30]

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[28] The "real and substantial connection" test is mostly used in Canada. Recently, the Supreme Court of Canada has clarified the "real and substantial connection" test for assuming jurisdiction in *Club Resorts Ltd. v Van Breda*, 2012 SCC 17 [*Club Resorts*].
[29] Muchlinski, "Limited Liability," *supra* note 26 at 920.
[30] Peter T Muchlinski, "Holding Multinationals to Account: Recent Developments in English Litigation and the Company Law Review" (2003) 23:6 Company Lawyer 168 [Muchlinski, "Holding Multinational"].

Second, that the parent company "has acted directly on its own behalf within the jurisdiction [of the subsidiary]."[31] I will examine the second suggestion in detail later in this thesis, – under direct parent liability. In brief, while it may be possible to hold a parent company directly liable, it is difficult to prove direct liability of a parent especially when the corporate governance structure of the whole group and its decision-making is decentralized.

The difficulty with the first suggestion – the agency or *alter ago* approach - is that the courts rarely find that a subsidiary company, which is recognized in law as separate and distinct from its parent could at the same time become the agent or *alter ego* of the parent (see, for example, *Adams* below). Although the jurisprudence on this particular issue is still not clear, in the absence of clear evidence to the contrary, it is unlikely to hold that a subsidiary company is at the same time the agent or *alter ego* of its parent.

The situation becomes even more problematic where the parent company has acted indirectly outside the host jurisdiction through its subsidiary. In such a case, any assertion of extraterritorial jurisdiction over the parent company by the host country court will have to be based on whether the parent company was present in that jurisdiction at the time. It is not possible to offer an exhaustive list of factors that will be appropriate or adequate in all cases. Instead, the court may consider a wide variety of factors which are peculiar to the circumstances of each case. Such factors may include a relationship of ownership and control or the presence of officers, agents, or

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[31] *Ibid* at 140-41.

representatives of the parent company or products made by the parent company within the jurisdiction of the subsidiary.[32]

In *Littauer Glove Corp. v FW Millington (1920) Ltd* (1928), the court held that the company was present in a particular jurisdiction when it engaged in "some carrying on of business at a definite, and, to some reasonable extent, permanent"[33] in that jurisdiction. Also in *Adams*,[34] the Court of Appeal outlined the circumstances in which a company could be regarded as doing business in a particular jurisdiction through its agent or representative.

However, the question of whether a company is carrying on business in a particular jurisdiction is not always easy to determine.[35] More recently, in *Club Resorts Ltd. v Van Breda* (2012), the Supreme Court of Canada held that carrying on business "requires some form of actual, not only

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[32] *Ibid* at 148-49. See also Campbell McLachlan & Peter Nygh, eds, *Transnational Tort Litigation: Jurisdictional Principles* (Oxford: Oxford University Press, 1996).
[33] *Littauer Glove Corp. v FW Millington (1920) Ltd*, (1928) 44 TLR 746 (KB) at 747.
[34] See *Adams*, *supra* note 20 at 530-31 where Slade LJ stated that the answers to the following questions are relevant in determining whether the agent or representative had been carrying on the business of the corporation: "(a) whether or not the fixed place of business from which the representative operates was originally acquired for the purpose of enabling him to act on behalf of the overseas corporation; (b) whether the overseas corporation has directly reimbursed him for (i) the cost of his accommodation at the fixed place of business; (ii) the cost of his staff; (c) what other contributions, if any, the overseas corporation makes to the financing of the business carried on by the representative; (d) whether the representative is reimbursed by reference to transactions, e.g. by commission, or by fixed regular payments or in some other way; (e) what degree of control the overseas corporation exercises over the running of the business conducted by the representative; (f) whether the representative reserves (i) part of his accommodation, (ii) part of his staff for conducting business related to the overseas corporation; (g) whether the representative displays the overseas corporation's name at his premises or on his stationery, and if so, whether he does so in such a way as to indicate that he is a representative of the overseas corporation; (h) what business, if any, the representative transacts as principal exclusively on his own behalf; (i) whether the representative makes contracts with customers or other third parties in the name of the overseas corporation; (j) if so, whether the representative requires specific authority in advance before binding the overseas corporation to contractual obligations."
[35] Albert Venn Dicey & JHC Morris, *Dicey and Morris on the Conflict of Laws*, 9th ed (London: Stevens & Sons, 1973) at 164.

virtual, presence in the jurisdiction, such as maintaining an office there or regularly visiting the territory of the particular jurisdiction."[36]

In summary, without sufficient evidence of ownership and control as well as interlocking directorship and maintaining a unified office, it is difficult to establish that the parent was present in the jurisdiction of the subsidiary. However, as the Supreme Court of Canada pointed out in *Club Resorts*, "the mere ownership of shares in the subsidiary is not a sufficient connecting factor between the parent and the jurisdiction."[37] Except in rare circumstances of flagrant abuses of the corporate form, the courts prefer to preserve the legal separation of a parent company and its subsidiary. This means that the courts will not regard a subsidiary as the agent, *alter ego* or representative of its parent. To do otherwise, would undermine *Salomon* and create a lacuna in the deeply entrenched principles of limited liability and separate corporate personality.

Even if the non-resident foreign parent company is amenable to the jurisdiction of its subsidiary, the exercise of that jurisdiction is discretionary – the courts may or may not grant it. For example, "the court may conclude, under the doctrine of *forum non conveniens*, that the exercise of jurisdiction is inappropriate, in view of the inconvenience that the proposed litigation would cause to the parties and the proper administration of justice."[38] The next section examines the effect of FNC and its application in litigations involving parent-subsidiary companies.

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[36] See *Club Resorts, supra* note 28 at 87.
[37] *Ibid* at 143. See also *Walker v Newgent*, 583 F (2d) 163 (5th Cir 1978), where the court held that: "*Although GM does own 100% Of Opel's stock, this fact alone is not sufficient to fuse the subsidiary into the parent corporation for the purpose of establishing an agency relationship*."
[38] Muchlinski, "Multinational Enterprises," *supra* note 2 at 153.

2.4.2 *Forum Non Conveniens* (FNC)

FNC is a procedural defence normally advanced by parent companies to prevent an action being brought against them for wrongs committed by their subsidiary operating in a different jurisdiction. This doctrine was originally designed to prevent 'forum shopping.' Forum shopping is a practice in which potential litigants simply choose to bring a suit in a particular jurisdiction that is most likely to produce a favourable judgment. For example, a plaintiff who suffers harm as a result of the act or omission of a subsidiary company in another jurisdiction may decide to sue both the parent and the subsidiary in the following jurisdictions: (a) the jurisdiction of the subsidiary, (b) the jurisdiction of the parent company or (c) in some other jurisdiction with real and substantial connection to the claim.

The three jurisdictions analyzed in this thesis discourage forum shopping especially if an adequate alternative forum exists, even though it may be less favourable to the plaintiff. One way to prevent forum shopping is to stay the proceedings on the basis of FNC. While FNC does not completely bar the plaintiff from bringing an action against the parent/subsidiary, it forces the plaintiff to sue the defendant(s) in the most appropriate forum.

I will now examine the effect of FNC and its application in litigations involving parent-subsidiary companies. In doing so, I am mindful that both the U.S. and Canada have developed their own rules and principles regarding FNC and the circumstances in which the courts in these locations will assume jurisdiction. As common-law countries, however, they adhere generally to the inherited U.K. approach to jurisdiction. For this reason, I will focus my analysis on the doctrine of FNC with references predominantly to U.K. case law.

2.4.3 Origin of FNC

The doctrine of FNC is widely associated with English law, but in all fairness, its origin is rooted in the Scottish case of *Sim v Robinow* (1892).[39] The doctrine was first recognized in English law in the case of *MacShannon v Rockware Glass* (1978)[40] and later applied in *The Abidin Daver* (1984).[41] In *MacShannon*, Lord Diplock stated as follows:

> In order to justify a stay two conditions must be satisfied, one positive and the other negative; (a) the defendant must satisfy the court that there is another forum to whose jurisdiction he is amenable in which justice can be done between the parties at substantially less inconvenience or expense, and (b) the stay must not deprive the plaintiff of a legitimate personal or juridical advantage which would be available to him if he invoked the jurisdiction of the English court …[42]

The doctrine was finally accepted in the landmark case of *Spiliada Maritime Corporation v Cansulex Ltd* (1987)[43] as part of the common law tradition. In *Spiliada*, Lord Goff of Chieveley chronicled the development of the doctrine and its acceptance in English law and most of the common law jurisdictions.

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[39]*Sim v Robinow*, (1892) 19 R 665; On application by the defendant to stay the proceedings on the basis of *forum non conveniens*, Lord Kinnear stated that "the plea can never be sustained unless the court is satisfied that there is some other tribunal having competent jurisdiction, in which the case may be tried more suitably for the interests of all the parties an for the ends of justice."
[40] *MacShannon v Rockware Glass*, [1978] AC 795 (HL).
[41] *The Abidin Daver*, [1984] AC 398 (HL) at 411 [*The Abidin Daver*].
[42] *Ibid* at 812.
[43]*Spiliada Maritime Corporation v Cansulex Ltd*, [1987] AC 460 (HL) [Spiliada].

While reformulating the test of FNC, Lord Goff stated that:

> The basic principle is that a stay will only be granted on the ground of *forum non conveniens* where the court is satisfied that there is some other available forum having competent jurisdiction which is the appropriate forum for the trial of the action, i.e. in which the case may be tried more suitably for the interests of all the parties and the ends of justice.[44]

When the defence of FNC is advanced in any litigation, the applicable test is: First, the defendant must show that there is another *prima facie* forum, which is clearly more appropriate for the action to be tried. In most cases, this is usually the jurisdiction or forum in which the harm occurred, and in which the evidence, witnesses and victims are located. Second, and once the defendant satisfies the first stage, the onus then shifts onto the plaintiff, to prove that notwithstanding that another forum is more appropriate, substantial injustice would occur if the case is not tried in the prevailing jurisdiction.

The defence of FNC is not absolute in that the judge before whom the motion is brought retains absolute discretion as whether to grant a stay of proceedings depending on the evidence presented by the parties. Like the principles of limited liability and separate corporate personality, however, the rigidity of FNC in cases involving harm caused by activities of parent-subsidiary companies gives rise to unfair results. The harshness of the doctrine FNC on tort victims is illustrated by examining how it was applied in the *Bhopal* (1986)[45] and *Adams* cases. A legal doctrine which was initially designed to prevent frivolous forum shopping has been ruthlessly applied in these

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[44] *Ibid* at 476.
[45] In *re Union Carbide Corporation Gas Plant Disaster at Bhopal*, 634 F Supp 842 (S.D.N.Y. 1986), affirmed and modified 809 F (2d) 195 (2d Cir 1987) [*Bhopal*].

cases in the most unforgiving manner to the extent that it made it difficult for tort victims to bring an action against parent companies for wrongs committed by their subsidiaries in another jurisdiction.

In *Bhopal* litigation, the plaintiffs together with the Government of India brought a joint claim in the U.S. against the subsidiary company (Union Carbide of India (UCIL)) and its U.S. parent company (Union Carbide Corporation of U.S. (UCC)). The plaintiffs argued that the parent corporation was responsible for the acts of its subsidiary because it "controlled the design, construction, and operation of the Bhopal plant through its global network of corporate planning, direction and control."[46]

The plaintiffs claimed, among other things, that the U.S. was the proper forum for the litigation because the legal system in India was not sufficiently robust to handle a claim of that magnitude.[47] The parent company counter-argued that the U.S. was not the appropriate forum because the accident happened in India and the evidence, victims, and witnesses were in India. The trial judge declined to assume jurisdiction and dismissed the action against the parent company on the basis of FNC, holding that India was the proper forum. The trial judge's decision was later upheld by the U.S. Court of Appeal for the Second Circuit.[48]

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[46] See *Bhopal*, *supra* note 45. See particularly the Plaintiff's Executive Committee Memorandum in Opposition to UCCs' Motion to Dismiss the Claim on Grounds of *Forum Non Conveniens* dated December 6, 1985 at 3.
[47] See Marc Galanter, "Legal Torpor: Why So Little Has Happened in India After the Bhopal Tragedy" (1985) 20:2 Texas International Law Journal 273.
[48] *Bhopal, supra* note 45.

In *Bhopal* litigation, we see how FNC was rigidly applied to deny adequate compensation to the victims of the gas leak disaster which killed about 2,100 people, and in which over 200,000 people suffered various injuries. Although the case was subsequently tried in India, it was settled for $470 million, representing less than 15 percent of the total damages.[49] While no amount of monetary compensation could make up for a loss of life or compensate for life changing injuries, the courts should have ensured that the victims of the *Bhopal* disaster receive adequate compensation instead of allowing the controlling parent company to escape liability on the basis of FNC.

The *Bhopal* litigation highlights the defects of the current veil piercing remedy and its inherent injustice. It also highlights the far-reaching consequences of limited liability and separate corporate personality. Limited liability *per se* may not be an unjust law but it clearly gives rise to unfair results, and a legal doctrine that produces inequitable or unconscionable results can hardly be justified.

Like *Bhopal*, a similar result was reached by the Court of Appeal in *Adams* to deny foreign claimants the right to enforce a default judgment issued against Cape Industries and its subsidiary company in the U.S. A key question, in this case, was whether, for the purposes of establishing jurisdiction, the parent company could be said to have had a presence in the U.S. at the relevant time. The parent company argued that it had no presence in the U.S., and as such, it was not amenable to the jurisdiction of the Texas court. Accordingly, the parent argued that the default judgment issued against it was void.

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[49] Antunes, *supra* note 3.

To establish the presence of the parent in the U.S., the plaintiffs argued that the U.S. sales subsidiary and parent company were a single economic unit. The Court of Appeal rejected this argument, holding that it was not entitled to pierce the parent's veil simply because the corporate forum had been used to avoid liability. The Court of Appeal noted as follows:

> It is not suggested that the arrangements involved any actual or potential illegality or were intended to deprive anyone of their existing rights. Whether or not such a course deserves moral approval, there was nothing illegal as such in Cape's arrangement of its affairs (whether by use of subsidiaries or otherwise) so as to attract the minimum publicity to its involvement in the sale of Cape asbestos in the United States.[50]

Although the *Adams* Court declined to treat the parent and its subsidiary as a single economic unit for the purposes of determining intragroup liability, that decision did not lay down a general principle that corporate separation is a complete bar to the enforceability of a foreign judgment.[51] What is worth pointing out about *Adams* is that the parent company had no asset in the U.S. and took no part in the proceedings. This could possibly be another reason why the Court of Appeal declined to pierce the parent's veil because to do otherwise would be contrary to the fundamental principle of natural justice.

In some cases, however, the U.K. courts have recognized that it may be in the interest of justice to allow foreign claimants to bring a claim in the U.K. These cases consist of a series of asbestos-related litigations which arose out of the activities of the subsidiaries of U.K. based parent

[50] *Adams*, *supra* note 20 at 544.
[51] Peter T Muchlinski, "Corporations in International Litigation: Problems of Jurisdiction and the United Kingdom Asbestos Case" (2001) 50:1 The International and Comparative Law Quarterly 1 [Muchlinski, "International Litigations"].

companies operating in South Africa.[52] While these cases highlight the willingness of the U.K. courts to apply the second stage of the *Spiliada* test to assume jurisdiction if justice so requires, the cases only deal with a procedural issue of jurisdiction, and not a substantive issue of liability. In most cases, once the question of jurisdiction has been dealt with, the substantive issue of liability rarely goes to trial since the majority of cases are settled before a final decision was rendered. This happened in *Cape*, *Bhopal* and Thor Chemicals litigations. Accordingly, there is a lack of juridical pronouncement regarding the issue of jurisdiction and the circumstances under which a subsidiary's liability should be attributed to the parent company.

2.5 Chapter Summary

This Chapter examines the major causes of the liability deficit problem, limited liability and separate corporate personality, by showing how these fundamental principles of corporate law protect parent companies from liability through the normal presumption of non-liability. The Chapter then highlights the challenges potential plaintiffs face when bringing an action against a non-resident foreign parent company for wrongs committed by its subsidiaries in another jurisdiction. The general immunity from liability coupled with the doctrine of *forum non conveniens* gives rise to unfair results in cases involving harm caused by corporate activities. For

[52] See generally *Lubbe et al., v Cape plc*, [1998] CLC 1559 (CA); *Group Action Afrika et al., v Cape plc*, [2000] 1 Lloyd's Rep 139 (QBD); *Rachel Lubbe et al., v Cape plc*, [2000] 1 Lloyd's Rep 139 (CA), reversed on appeal before the House of Lords *Shalk Willem Burger Lubbe et al., v Cape plc*, (2000) 2 Lloyd's Rep 383; *Lubbe and Others v Cape Plc. and Related Appeals*, [2000] UKHL 41 [*Lubbe*]. See also *Ngcobo v Thor Chemicals Holdings Ltd* (July 31, 1998, unreported) (CA) [*Thor litigation*]. See also *Connelly v RTZ Corporation*, [1998] AC 854 (HL). See generally Muchlinski, "International Litigations," *supra* note 51; Richard Meeran, "Liability of Multinational Corporations: A Critical Stage in the U.K." in Menno T Kamminga & Saman Zia-Zarifi, eds, *Liability of Multinational Corporations Under International Law* (The Hague: Kluwer Law International, 2000) at 251.

this reason, it is suggested that Parliament or Congress should lay down explicit justification or test for interfering with all the common law doctrines discussed in this Chapter.

Chapter 3: Revisiting the Legislative Origin of Limited Liability and its Affirmation in *Salomon*

The corporation, as Bakan argues, is "a legal institution, one whose existence and capacity to operate depend upon the law."[53] Among the two fundamental principles of corporate law, limited liability is by far the greatest incentive and a necessary consequence of incorporation. Since the universal adoption of limited liability in the nineteenth century, "the form of the business enterprise has changed remarkably."[54] Without limited liability, it is argued, commercial certainty and business efficacy would be severely compromised.[55]

Addressing the legislative origin and rationale of limited liability, to its current extension to corporate groups, this Chapter seeks to highlight the potential shortcomings of limited liability by offering a critique of the doctrine in relation to parent-subsidiary relationships vis-à-vis tortious liability. The key arguments presented in this Chapter are two-fold: First, that limited liability is the major cause of the liability deficit problem characteristic of corporate groups. Second, that the landmark case of *Salomon* is a false foundation for limited liability in tort cases. This essentially calls for rethinking of the application of limited liability and the *Salomon* principle in tort cases.

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[53] Bakan, *supra* note 1 at 1.
[54] *Ibid* at 19-20.
[55] Robert J Rhee, "Bonding Limited Liability" (2010) 51:4 William and Mary Law Review 1417.

3.1 Origin of Limited Liability

Limited liability is an established principle of case law, and as such, there is a general (false) perception that the principle was developed by the courts. Examining the historical root and trajectory of limited liability will: (1) Help clarify this misconception; and (2) Provide a foundational understanding from which to examine parent company liability for wrongs committed by its wholly-owned or controlled subsidiary.

Contrary to the perception that limited liability evolved through case law (i.e. was created by the courts), the jurisprudence has made it clear that limited liability was created by an Act of Parliament or Congress. In the U.K., for example, there is a substantial body of literature to support the view that the general adoption of limited liability was through an Act of Parliament – through the *Limited Liability Act*, 1855.[56] This may provide some insight into why the courts have struggled and continue to struggle with how to interfere with or restrict the privilege of limited liability in cases where it has been abused.

Although the *Limited Liability Act* was subsequently repealed and replaced with the *Joint Stock Companies ("JSC") Act*, 1856,[57] the JSC *Act* also provided limited liability for shareholders. The JSC *Act* made free incorporation in the U.K. even more straight forward by removing some of the stringent requirements for granting limited liability under the previous *Act*.[58] Under the JSC *Act*,

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[56] *Limited Liability Act*, 1855.
[57] *Joint Stock Companies Act*, 1856.
[58] Muchlinski, "Limited Liability," *supra* note 26. The stringent conditions for the granting of limited liability as stated by Muchlinski include the "requirements as to the number of members - at least 25 - the extent of paid-up capital, the

the only requirement for granting limited liability was a memorandum of association signed by seven or more persons.[59] Once that requirement was duly complied with, a new legal person – a corporate personality with limited liability - is deemed to have been created by law. This was essentially the key issue which the House of Lords had to settle in the landmark case of *Salomon*.

Similarly, the U.S. also has a rich tradition of limited liability. However, unlike the U.K., limited liability was initially granted in the U.S. to public service/utility companies through special Acts of incorporation.[60] Although statutory recognition of the doctrine of limited liability in the U.S. varies from state to state, commentators agree that most state legislatures consistently adopted a policy of limited liability around the 1840s.[61]

It is also worth pointing out that in addition to the U.K. and the U.S., limited liability has recently found statutory expression in other common law jurisdictions, thereby stamping the statutory authority of the doctrine in those jurisdictions as well.[62] In general, the statutory expression of

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use of the word 'limited' in the corporate title and the personal liability of directors if they paid a dividend knowing the company to be insolvent or if they made loans to the members."

[59] Paul L Davies, *Gower's Principles of Modern Company Law*, 6th ed (London: Sweet & Maxwell, 1997) at 45 [Davies, "6th ed"].

[60] Blumberg, "Multinational Challenge," *supra* note 19 at 10. See also Blumberg, "Corporate Entity," *infra* note 65.

[61] *Ibid* at 10-7

[62] See generally the following provisions in Canada: Section 45(1) of the *Canada Business Corporations* Act ("CBCA"), 1985 states that: "The shareholders of a corporation are not, as shareholders, liable for any liability, act or default of the corporation except under subsection 38(4), 118(4) or (5), 146(5) or 226(4) or (5)." In Ontario, section 92(1) of the *Ontario Business Corporations* Act ("OBCA") 1990 states that: "The shareholders of a corporation are not, as shareholders, liable for any act, default, obligation or liability of the corporation except under subsections 34 (5), 108 (5), 130 (5) and section 243." In British Columbia ("B.C"), section 87(1) of the *B.C Business Corporations* Act ("BCBCA") 2002 states that: "No shareholder of a company is personally liable for the debts, obligations, defaults or acts of the company except as provided in Part 2.1." Similarly, in the U.S., § 6.22(b) of the *Model Business Corporations Act* ("MBCA") 2006 provides that: "Unless otherwise provided in the articles of incorporation, a shareholder of a corporation is not personally liable for the acts or debts of the corporation except that he may become personally liable by reason of his own acts or conduct."

limited liability makes it extremely difficult for the courts to disregard or interfere with the doctrine as doing so - not only undermines its statutory authority but is also inconsistent with the common law principle laid down in *Salomon*.

3.2 Rationales for Limited Liability

In order to appreciate the importance of limited liability and its place in business, it is necessary to understand its original rationales. Therefore, a review of the economic climate in which limited liability emerged provides contextual understanding of why it came about. Prior to the adoption of limited liability during the mid-nineteenth century, commerce was predominantly conducted by means of sole proprietorships and ordinary partnerships largely because the capital required for such businesses was relatively small. The main feature of the partnership system of commerce - the precursor to limited liability corporation - is unlimited liability. In partnership, the partners are generally regarded as the agents of the partnership, and as such, their liability for the obligations and debts of the firm is joint and several.

The potential exposure to unlimited personal liability was, and still is, a major concern to individual investors, especially those who wanted to invest in businesses without being actively involved in management (i.e. passive investors). Within such a context, proponents of limited liability argued that the exposure to unlimited personal liability would discourage people from investing their surplus funds.[63] To address this concern, as well as promote and encourage investments, the legislature enacted the first *Limited Liability Act* in 1855.

As one commentator asserts, the adoption of limited liability "is a statutory development that represents the triumph of the rising political power of business interests."[64] In other words, the general adoption of limited liability was: (1) "induced by economic exigencies,"[65] and (2) "a political construct developed to further the interests of particular groups."[66] These schools of thought altogether affirm the dual aspects of limited liability - to encourage entrepreneurial activity (investments) and to protect investors from personal liability.

It is worth noting that the economic and social climate in which limited liability emerged coincided with the industrial revolution, which meant the capital required to carry out major infrastructure projects in sectors (i.e. canals, public utilities, railways, etc.) was substantially high. Accordingly, such projects could only be carried out through a joint investment platform of a group of investors – soliciting for equity or debt financing from different investors. The financing of such large-scale projects through a joint investment platform ultimately paved the way for the formation of several joint stock companies (JSC).

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[63] Paul Halpern, Michael J Trebilcock & Stuart M Turnbull, "An Economic Analysis of Limited Liability" (1980) 30 University of Toronto Law Journal 117.
[64] See Phillip I Blumberg, "The Corporate Entity in an era of Multinational Corporations" (1990)15:2 Delaware Journal of Corporation Law 283 [Blumberg, "Corporate Entity"].
[65] Reinier Kraakman et al., *Anatomy of Corporate Law: A Comparative and Functional Approach* (Oxford: Oxford University Press, 2004) at 1.
[66] Ireland, "Limited liability," *supra* note 16 at 837.

The conferment of limited liability, was, and still is today, a necessary economic tool for raising capital and promoting entrepreneurial activity. Limited liability has become a fundamental principle of corporate law, and, arguably, the greatest incentive for incorporating a company. The business case for limited liability is so strong that all other things must necessarily be sacrificed so as to preserve the efficacy of the doctrine. However, in light of the potential abuses and far-reaching consequences of limited liability, one wonders why the legislature has failed to address the imbalance created by this risk-shifting device.

Whether limited liability as a risk shifting device is politic or impolitic, morally repugnant or economically savvy, it was argued that the privilege of limited liability was the only way to encourage investors to invest "their surplus funds in the many large capital projects which companies were being set up to carry out at that time."[67] But is it still desirable to confer limited liability on modern corporate groups (i.e. parent-subsidiary companies) even where there is no separation of ownership and control? It seems instead that limited liability needs rethinking, particularly in light of the liability deficit problem addressed in this thesis.

Although limited liability was created by the legislature, the courts are now the supreme custodians of the doctrine, and though the application of limited liability gives rise to some unfair judicial decisions in certain cases, the courts continue to preserve the primacy of this ancient doctrine with alacrity regardless. Since the first judicial affirmation of limited liability in the landmark case of *Salomon*, there is a substantial body of case law which bears witness to the subsequent courts'

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[67] Davies, "6th ed," *supra* note 59.

unwavering commitment to the principle of limited liability. The excerpts below from *Salomon* provide a brief overview of how this fundamental feature of corporate law was reaffirmed by the House of Lords.

3.3 Salomon v Salomon & Co. Ltd.

The facts were as follows. Mr. Aron Salomon was a successful leather merchant who decided to convert his sole proprietorship business into a limited company. He subsequently formed and registered "Aron Salomon & Company Limited" pursuant to the requirements of the *Companies Act*, 1862.[68] In consideration for the sale of his old business, Mr. Salomon was issued 20,000 fully paid shares, each share having a par value of £1 (representing £20,000). He was also issued £10,000 debentures secured against the assets of the company. The remaining balance was satisfied in cash. His wife and five children held one share each.

The new company ran into some difficulties and went into liquidation within a year. The key issue was whether a shareholder of a one-man company should personally be liable to indemnify the company against the claims of the unsecured creditors. The liquidator argued that the company was a mere sham; an alias, agent, trustee or nominee for Mr. Salomon. As such, the liquidator said Mr. Salomon should be personally liable to indemnify the company against the claims made by the unsecured creditors. The trial judge ruled in favour of the liquidator and found Mr. Salomon personally liable to indemnify the company's unsecured creditors.

[68] *Companies Act*, 1862.

The Court of Appeal affirmed the decision of the trial judge on appeal. Lindley LJ who spoke on behalf of the Court stated that "one-man companies" were contrary to the spirit and intent of the *Companies Act*, 1862. Lindley LJ went on to emphasize that:

> [Mr. Salomon's] liability does not arise simply from the fact that he holds nearly all the share in the company …[It] rests on the purpose of which he formed the company, on the way he formed it, and on the use which he made of it. There are many small companies which will be quite unaffected by this decision. But there may possibly be some which, like this, are mere devices to enable a man to carry on trade with limited liability, to incur debts in the name of a registered company, and to sweep off the company's assets by means of [secured] debentures which he has caused to be issued to himself in order to defeat the claims of those who have been incautious enough to trade with the company without perceiving the trap which he has laid for them.[69]

Mr. Salomon appealed the decision of the Court of Appeal which the House of Lords unanimously reversed. In addressing the issue of Mr. Salomon's personal liability – whether he should be liable for the debts of the company - the Lords unanimously ruled that once a company has been duly incorporated, it must be treated as an independent legal entity, regardless of whether the shares in the company are held by one person. According to Lord Macnaghten:

> The company is at law a different person altogether from the subscribers to the memorandum; and, though it may be that after incorporation the business is precisely the same as it was before, the same persons as managers, and the same hands receive the profits, the company is not in law the agent of the subscribers or trustee for them. Nor are the subscribers as members liable, in any shape or form, except to the extent and in the manner provided by the Act.[70]

Lord Halsbury LC also stated that "either the limited company was a legal entity or it was not. If it was, the business belonged to it and not to Mr. Salomon; if it was not, there was no person and

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[69] *Broderip v Salomon*, [1895] 2 Ch 323 [CA] (Court of Appeal) at 338-39 [*Broderip*].
[70] *Salomon*, *supra* note 5 at 51.

nothing to be an agent at all; and it is impossible to say at the same time that there is a company and there is not."[71]

In addressing the agency ground upon which both the first instance court and the Court of Appeal had found that Mr. Salomon was an "alias" or agent or trustee of the company, Lord Herschell stated as follows: "A company may in every case be said to carry on business for and on behalf of its shareholders, but this certainly does not in point of law constitute the relation of principal and agents between them or render the shareholders liable to indemnify the company against the debts which it incurs."[72]

In determining whether the company (Aron Salomon & Company Limited) was duly incorporated, the House of Lords adopted a formalistic approach – a contextual and purposive interpretation. In doing so, the House of Lords concluded that: (1) the company complied with the requirements of the *Companies Act*, 1862, (2) the purpose of which the company was incorporated was lawful, and (3) there was no fraud committed against the unsecured creditors.[73] The decision in *Salomon* was essentially a triumph of form over substance.

Whether it was prudent for the House of Lords to focus solely on the requirements of the *Companies Act* and to adopt a contextual and purposive interpretation regardless of the imbalance remains debatable. However, by focusing exclusively on the legislative intent or purpose of the

[71] *Ibid* at 31.
[72] *Ibid* at 43.
[73] *Ibid* at 34 & 48.

Companies Act, the *Salomon* Court made it clear that it was not permitted to insert limitations into statutory provisions.[74] This is an important consideration, and is further elucidated here: Under the doctrine of separation of powers, the judiciary is expected to apply and interpret legislative provisions. Given that law-making powers remain the prerogative of the legislature, the courts must, as a matter of principle or conversion, defer to Parliament or Congress when it comes to 'reading' or inserting limitations into statutory provisions.

Relying on this political doctrine of separation of powers, the House of Lords rightly declined to insert any limitations into the *Companies Act*, 1862, which could have precluded Mr. Salomon and his company from enjoying limited liability. In essence, the *Salomon* Court is saying that unless a statutory provision expressly grants the judiciary power to dislodge limited liability, the courts have no right to do so.

In *Salomon*, the House of Lords (unlike the first instance court and the Court of Appeal) declined to interfere with or restrict the privilege of limited liability. In doing so, they laid down the following principles. First, "provided the formalities of the Act are complied with, a company will be validly incorporated, even if it is only a 'one person' company."[75] Second, limited liability is available to all companies regardless of the size of the company, the number and the relationship of the shareholders to each other. Third, shareholders are not agents or trustees of a company in which they own shares, and as such, are not personally liable for the debts of the company.

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[74] *Ibid*.
[75] Davies, "8th ed," *supra* note 14 at 35.

Generally, the courts regard contract making as a means of risks allocation, and as such, do not like interfering with contractual rights of parties for the purpose of allocating risks between the parties, save in exceptional circumstances. The House of Lords' decision in *Salomon* elucidates that the Court recognized the need to allow contractual parties to define for themselves how to protect their interests from the risks of liability.

Since contract-making is about the allocation of risks of liability between the parties, the courts rarely interfere with contractual relationships for the purpose of allocating such a risk.[76] To do otherwise - would undermine the cardinal principle of freedom of contract and commercial certainty. While this justification is true for contractual liability cases, not all cases involving intragroup liability arise in that context. For this reason, the subsequent courts, in applying the *Salomon* principle should make an exception in non-contractual liability cases.

The outcome of *Salomon* remains debated today, as it was when the judgment was first pronounced in 1896. The decision has been much criticized by certain commentators. For example, after describing *Salomon* as "calamitous decision," Kahn-Freund went on to argue that since that decision, "the company has often become a means of evading liabilities and of concealing the real interest behind the business." [77]

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[76] This point was made clear in *Sinaltrainal v Coca-Cola Co.,* 528 F (3d) 1252 (11th Cir 2009) [*Sinaltrainal*]. In this case, the court rejected the plaintiffs' claim to establish the responsibility of Coca-Cola and its Columbia subsidiary for the acts of a local bottling company which was under a contract with both the parent and subsidiary. The court held that the contract between the Coca-Cola companies and the local bottler was a typical franchise agreement which imposed no duty upon the Coca-Cola companies to monitor, enforce, or control operational practices at the bottling company. This summary is taken from Muchlinski, "Multinational Enterprises," *supra* note 2 at 317.

[77] Otto Kahn-Freund, "Some Reflections of Company Law Reform" (1944) 7 Modern Law Review 54 at 55.

Kahn-Freund also argued that the extension of limited liability and corporate separation to "a single trader … even where no particular business risk is involved [meant] the courts have given a measure of protection to the shareholders over and above that provided by Parliament."[78] Higgins, on the other hand, accused the House of Lords of rejecting the clear intention of the legislature in favour of a formalistic interpretation of *Act*, noting that:

> Seldom has the entire House of Lords sunk to such a level of jurisprudential ineptitude as to reject the clear intention of the legislature in favour of the application of the so-called literal rule of interpretation. The decision in that case [*Salomon*] has probably done more to undermine commercial integrity in sixty years than did the Statute of Frauds in nearly three hundred.[79]

Despite such criticisms, *Salomon* has become deeply entrenched in the legal system of both common and civil law jurisdictions[80] to the extent that even those who advocate for its reversal know it is an impossible task. For example, the view that limited liability is an integral part of corporate legal identity has contributed to the result reached by the House of Lords in *MacLaine Watson & Co. Ltd v International Tin Council* (1989).[81] In this case, Lord Oliver of Aylmerton stated that "the decision of this House in *Salomon* … is much the law today as it was in 1896."[82]

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[78] *Ibid*.
[79] P F P Higgins, *The Law of Partnership in Australia and New Zealand* (Sydney: Law Book Co. of Australasia, 1963) at 16.
[80] Sung-Bae Kim, "A Comparison of the Doctrine of Piercing the Corporate Veil in the United States and in South Korea" (1995) 3 Tulsa Journal of Comparative & International Law 73. See also Phillip I. Blumberg, "Limited Liability and Corporate Groups" (1986) 11 Journal of Corporation Law 573 [Blumberg, "Limited Liability"].
[81] *MacLaine Watson & Co. v International Tin Council*, [1990] 2 AC 418 (HL) [*MacLaine Watson*].
[82] *Ibid* at 506.

While this thesis argues that *Salomon* is a false foundation for limited liability in tort cases, I do not mean to suggest that *Salomon* was wrongly decided. My concern relates to the distorted and rigid application of the *Salomon* principle by subsequent courts, particularly in cases involving harm caused by corporate activities. I say distorted because *Salomon* itself deals primarily with contractual liability, not tort liability.

That said, until such time as the judiciary or the legislature thinks fit and proper to address the controversy surrounding *Salomon*, that decision remains a leading authority. As such, the courts are required, as a matter of judicial precedent, to preserve the efficacy of this "sacred" decision. Again, my only concern is how far the courts will go in preserving the primacy of *Salomon* and limited liability even in the face of gross injustice to victims who suffer harm due to corporate activities. Before examining why *Salomon* is a false foundation for limited liability in tort cases, it is necessary to review some of the perceived economic benefits of limited liability.

3.4 Perceived Economic Benefits of Limited Liability

It is argued that limited liability "is the reason why the corporation succeeded where the partnership failed."[83] Despite its potential for abuse and far reaching consequences, limited liability has a number of economic and commercial advantages, particularly when compared with a regime of unlimited liability. First, limited liability encourages entrepreneurship and reduces

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[83] Grant Hayden & Matthew Bodie, "The Uncorporation and the Unraveling of "Nexus of Contracts" Theory" (2011) 109:6 Michigan Law Review 1127 at 1138.

monitoring costs for investors and creditors.[84] Generally, limited liability facilitates business enterprise in two ways: (1) by making it possible to raise capital from multiple investors, and (2) by shielding investors from personal liability as well as the risks associated with conducting business. In other words, the privilege of limited liability reduces the investors' risk of liability only to the amount invested. [85]

Second, limited liability facilitates the efficient operation of an organized securities markets.[86] Due to limited liability, it is argued, "there exists a thriving securities market in which the outstanding securities of corporations are traded."[87] The existence of an organized securities markets enables the shareholders and brokers to sell their securities freely without prospective buyers having to incur extra costs investigating the financial background of the shareholders.

Third, limited liability reduces the agency cost associated with the separation of ownership and control (i.e. passive investment and management under a board structure).[88] For example, without limited liability the shareholders (the agents) would have to spend additional costs in monitoring the actions of the principals (managers) to ensure they act responsibly. Under a regime of limited liability, however, the shareholders have less incentive to monitor the behaviour of corporate managers, and thereby reducing the agency cost.

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[84] Frank H Easterbrook and Daniel R Fischel, "Limited Liability and the Corporation" (1985) 52:1 The University of Chicago Law Review 89 at 94-97; See also Richard A Posner, "The Rights of Creditors of Affiliated Corporations" (1976) 43 University of Chicago Law Review 499 at 502 [Posner, "Rights of Creditors"].
[85] Ellis Ferran, *Principles of Corporate Finance Law* (Oxford University Press: Oxford, 2008) at 19-20.
[86] Halpern, Trebilcock & Turnbull, *supra* note 63 at 117.
[87] *Ibid* at 129-131.
[88] Michael C Jensen & William H Meckling, "The Theory of the Firm: Managerial Behavior, Agency Cost, and Ownership Structure" (1976) 3 Journal of Financial Economics 305.

Fourth, limited liability allows more efficient portfolio diversification and ensures the promotion of the market for corporate control.[89] Portfolio diversification is a practice in which investors seek to reduce the risks associated with high-risk investments by balancing them with less risky ventures. Cheffins argues that without limited liability, "diversification would become an unwise strategy" because the more diversified an investor's portfolio, the greater the possibility of that investor being exposed to personal liability in the event of business failure.[90]

It seems that most justifications for limited liability are borne out of a cost-benefit or utility-focused analysis. That is, those defending limited liability from an economic efficiency viewpoint often argue that the economic advantages of the doctrine outweigh the societal costs. Given, the rising phenomenon of corporate groups, it is hardly convincing if some of the above economic justifications for limited liability are still relevant in the context of a parent-subsidiary relationship. Take, for example, the claim that limited liability reduces the agency cost associated with the separation of ownership and control. In most, if not all, parent-subsidiary relationships, the parent is not only a dominant shareholder in its subsidiary but also a controlling one. Consequently, there is hardly any form of separation of ownership and control between the parent and its subsidiary to warrant the parent's claim to limited liability on such basis.

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[89] Henry G Manne, "Our Two Corporation Systems: Law and Economics" (1967) 53 Virginia Law Review 259 at 262.

[90] Brian R Cheffins, *Theory, Structure and Operation* (Oxford University Press: Oxford, 2008) at 499-504; See also Joseph A Grundfest, "The Limited Future of Unlimited Liability: A Capital Markets Perspective" (1992) 102 Yale Law Journal 387 at 399-405.

In commenting on the desirability of limited liability for corporate groups, Blumberg points out that out of the four major advantages flowing from limited liability, only one is relevant to corporate groups – “encouraging risk-taking and diversification.”[91] Blumberg continues to say that “the … [other advantages of limited liability], which pertain to public shareholders, simply become inapplicable when a parent corporation is substituted as [the] shareholder in the place of tens of thousands of public investors.”[92] While this may be correct, perhaps risk-taking does not need to be encouraged since this ultimately leads to parent corporations interposing the corporate form by setting up subsidiaries to embark on risky adventures without shouldering the burden of liability when things go wrong.

Although limited liability has been extended to one-man companies as well as closely-held and multinational corporations, in addressing the economic benefits of limited liability, it is assumed that the ultimate shareholders are natural persons. This assumption is not always true; as a result of intercorporate shareholding, the ultimate shareholders in corporate groups may include both corporations and natural persons. In the context of a parent-subsidiary relationship, it is almost certain that the corporate shareholder – the parent company - is not a natural person.

Ironically, when limited liability was first introduced, it was meant to protect passive investors from personal liability. As previously mentioned in this thesis, to impose unlimited liability on

[91] See, Blumberg, “Limited Liability,” *supra* note 80 at 125. The four main advantages include: “(a) encouraging investment without participation in control (or absentee ownership), thereby promoting large-scale investment and corporate activity; (b) promoting the efficiency of the capital markets; (c) avoiding the allegedly intolerable inefficiencies of a liability system; and (d) stimulating entrepreneurial risk-taking and risk diversification.”
[92] *Ibid*.

passive investors for wrongs committed by professional managers would be counter-productive, as this would discourage those investors from investing their surplus funds. This ethical consideration (which justifies the granting of limited liability to the ultimate shareholders) no longer applies to corporate groups and intercorporate shareholders.

Though limited liability does provide some economic benefits, such benefits should be balanced with the underlying risks, particularly in the context of the activities of multinational corporate groups. Otherwise, limited liability will continue to encourage corporate groups to engage in potentially risky endeavours.

3.5 *Salomon*: A False Foundation in Tort Cases

Though the statutory/charter provisions which first encouraged the development of limited liability for shareholders in the nineteenth century are now defunct, the judicial application of the principle continues unabated mainly because of the seminal case of *Salomon*. Much of the case law regarding veil piercing jurisprudence is based on this landmark decision. In this section, I argue that *Salomon* is a false foundation for limited liability in tort cases. Insofar as tortious liability is concerned, the rigid application of *Salomon* is unhelpful. Accordingly, given *Salomon* deals specifically with contractual liability, not tort liability, its rigid application in tort cases needs rethinking.

Generally speaking, veil piercing jurisprudence is case-specific – the remedy is determined on a case-by-case basis. For this reason, I am not entirely sure if it is prudent to always rely on the

Salomon principle any time the courts are faced with a veil piercing challenge. It is therefore important to understand the context in which the House of Lords delivered its judgment in the landmark case of *Salomon*. In *Salomon*, the unsecured contractual creditors brought an action against the company and Mr. Salomon in order to enforce their security against the assets of the company following the company's liquidation. While critics may argue that this contextualization of *Salomon* is a trivial issue, it is worth noting that whether trivial or not, the entire judgment of the House of Lords was premised on this issue.

Would the House of Lords have reached a different decision if the underlying liability issue was tortious liability instead of contractual liability, and the plaintiffs were non-contractual tort victims as opposed to contractual victims? There are two possible answers: "yes" or "no." The "yes" camp may argue that the House of Lords would have reached the same conclusion regardless of whether the Lords were dealing with a contractual liability or a tortious liability issue. The "no" camp, on the other hand, may argue that the House of Lords could have reached a different conclusion.

Whichever camp you may belong to, the rigid application of the *Salomon* principle without a basic appreciation of contract-tort liability dichotomy may have contributed to the courts not asking the right question whenever they are faced with a veil piercing remedy in tort cases. Unless you ask the right question, you will inevitably receive the wrong answer, and draw a conclusion based on that wrong answer. The fact that a conclusion is reached does not necessarily mean it is the right one, if that conclusion is procured by and/or is based on a faulty premise.

In *Salomon*, the House of Lords was faced with a choice: (1) upholding the privilege of limited liability or (2) restricting this privilege in order to protect contractual creditors. Stated differently, the *Salomon* Court was faced with whether to protect the financial interests of the contractual creditors or grant immunity to Mr. Salomon and shield him from personal liability. The Lords obviously favoured the latter over the former, but they did so, in my opinion by asking the right question. What was the question that the House of Lords asked in *Salomon*? Could the contractual creditors have protected themselves from risks of liability? If so, then what?

In answering this question, the House of Lords made it clear that "the unsecured creditors of 'Aron Salomon and Company Limited,' may be entitled to sympathy, but they have only themselves to blame for their misfortunes."[93] Why would the House of Lords make such a statement? The House of Lords gave the following reasons: first, that the contractual creditors had full notice that they were dealing with a limited liability company; and second, that the creditors should have protected their interests.[94]

In *Salomon*, there was almost complete agreement by the Lords on this crucial issue: The Lords were of the view that if the creditors can protect themselves then the Court should not protect them. In other words, the *Salomon* Court did not think the courthouse is the best place for contractual creditors to seek protection from risks of business liability.

[93] *Salomon*, *supra* note 5 at 53.
[94] *Ibid* at 45 & 53.

Generally speaking, the contractual creditors of any corporation can limit their liability exposure in a number of ways; notably, through security for debts arrangements. These may include, but are not limited to, insuring against the potential risk of liability, requiring personal undertakings from the majority shareholders, insisting on personal or parent company guarantees or demanding indemnification from controlling shareholders. Depending on the bargaining power of the particular contractual creditor, these mechanisms can be used as a condition precedent for entering into any debt financing agreement with corporations.

In *Salomon*, the House of Lords made it clear that because the contractual creditors could have protected their interests from risks of business failure but failed to do so, they should blame themselves for their misfortune. This statement holds the clue as to why tortious liability should be treated differently from contractual liability. Unlike contractual creditors, non-contractual creditors, (including tort victims) are, unable to protect or insure against any potential risks of liability. The fact that tort victims cannot protect themselves from exposure to risks of liability is a good reason for the legislature or judiciary to protect them. Rather, the courts have often rigidly applied *Salomon* in tort cases to deny those who suffer harm adequate compensation.

Another reason why I believe *Salomon* is a false foundation for limited liability in tort cases is that the underlying motives of contractual liability and tortious liability are different from each another. Contractual liability and tortious liability represent the two main elements of liability of any business; however, the nature and circumstances of tortious liability pose a different issue, and thus, deserve to be treated differently.

In contractual liability cases, the injured party chooses to deal with the company knowing that it is a limited liability company. By doing so, the contractual creditor, as the House of Lords rightly emphasized, is deemed to have had notice of the limitation of the company's and its shareholders' liability. By dealing freely with corporations, the contractual creditors could be deemed to have acquiesced to the possibility of being exposed to the risks of liability in the event of business failure. In tort liability cases, on the other hand, the alleged harm, injury, loss or damage is always inflicted against the will of the injured party who is often not in a position to protect himself or herself from any potential risks of liability.

Furthermore, contractual liability and tortious liability have a completely different regime of assessing and awarding damages to the injured party. Most remedies arising in contractual cases are governed by contract law, which assesses contractual damages on the principle of expectation/reliance loss. Contractual remedies are designed to compensate or put the injured party in the position he or she would have been in had the contract been honoured. Tort damages, on the other hand, are calculated on the basis of putting the injured party in the position he or she was prior to the act or omission that caused the injury.

In drawing these distinctions between contractual and tortious remedy, I am not insinuating that the courts are not mindful of the differing policy reasons underpinning each regime. I am trying to emphasize that the restorative or curative nature of the award of damages arising in tort cases should play a key role in the courts' determination of liability and assessment of appropriate remedy in those cases. Instead, the courts often decline to pierce the corporate veil in tort cases, citing *Salomon* as justification for not disregarding the corporate autonomy rule. This rigid application of *Salomon* has given rise to unfair results in tort cases.

My final argument is that when *Salomon* was decided some decades ago, corporate groups were virtually non-existent. Therefore, the relevancy and justifications of *Salomon*, when determining the question of parent company liability for the act or omission of its wholly-owned or controlled subsidiary, is negligible. In other words, limited liability and the *Salomon* principle do not accord well with the economic realities of multinational corporate groups.

It has been crudely pointed out in *Radaszewski v Telecom Corp*., (1992) that "the doctrine of limited liability is intended precisely to protect a parent corporation whose subsidiary goes broke."[95] However, my historical analysis of the doctrine shows that it was developed primarily to protect individual investors from business liabilities. After all, when limited liability was adopted, intercorporate shareholding was generally prohibited.[96]

It should be clearer by now that limited liability for corporate groups often leads to tort victims bearing the cost of enterprise activities.[97] Against this backdrop, relying on *Salomon* (a case that

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[95] *Radaszewski v Telecom Corp*., 981 F (2d) 305 (8th Cir 1992) at 311.
[96] See Blumberg, "Multinational Challenge," *supra* note 19 at 19-20. Blumberg argues that "limited liability triumphed when corporations were simple, when one corporation could not acquire and own shares of another." See also, Jonathan M Landers, "A Unified Approach to Parent, Subsidiary, and Affiliate Questions in Bankruptcy" (1975) 42:4 University of Chicago Law Review 589 at 619. Landers, too, points out that "limited liability was never intended to protect a parent corporation against liability for the debts of its subsidiary…"
[97] Stephen M Bainbridge & Todd Henderson, *Limited Liability: A Legal and Economic Analysis* (Cheltenham: Edward Elgar Publishing, 2016) at 294 [Bainbridge & Henderson, "Limited Liability"]. These commentators argue that: "Due to limited liability and the formalistic separation of the two entities, tort creditors are left without a remedy. The operating entity, which has the tort liability, has no assets, while limited liability bars tort plaintiffs from reaching the owning entity's assets. In effect, the enterprise is judgment proof."

addresses the issue of business liability in the specific context of a one-man company), to resolve complex intragroup liability matters vis-à-vis tort victims, certainly needs rethinking. In highlighting the potential implications of limited liability on tort victims, I do not write from a clean slate. Hansmann and Kraakman argue that "strong empirical evidence indicates that increasing exposure to tort liability has led to the widespread reorganization of business firms to exploit limited liability to evade damage claims."[98] Whether the extension of limited liability to corporate groups is justifiable in light of this remains to be seen. Like Landers, I am also of the view that "if limited liability were being considered for the first time, a strong argument could be made that it should not be extended to the corporate parent vis-à-vis its subsidiary."[99]

3.6 Chapter Summary

This Chapter raises a number of challenging issues in relation to limited liability and the application of the *Salomon* principle in corporate groups. Limited liability for corporate groups creates a serious liability deficit problem because it allows corporate groups to take excessive risks while also externalizing the risks of liability to others. I also argue that *Salomon* is a false foundation for limited liability in tort cases because it deals specifically with contractual liability, not tort liability. Given that limited liability is subject to abuse, we must now determine how to guard against the widespread abuses of limited liability, and to protect tort victims from exposure to liability.

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[98] Henry Hansmann & Reinier Kraakman, "Toward Unlimited Shareholder Liability for Corporate Torts" (1991) 100 Yale Law Journal 1879 at 1881 [Hansmann & Kraakman, "Unlimited Liability"].
[99] *Ibid*.

The courts have been trying to address this problem by piercing the corporate veil, largely unsuccessfully. Limited liability was created by statute and much of the judiciary's failure to address the liability deficit problem stems from the courts' inability to override a statutory provision. The courts cannot simply circumvent this doctrine, even in the face of abuse, except in limited circumstances. As one learned jurist forcefully puts it, the courts "have no right to add to the requirements of the statute, nor to take from the requirements thus enacted."[100] To do otherwise - would be tantamount to the judiciary usurping the role of the legislature. It follows from this that only Parliament or Congress can interfere with or restrict the privilege of limited liability in order to address some of the undesirable consequences of the doctrine discussed in this thesis.

[100] *Salomon*, *supra* note 5 at 29.

Chapter 4: The Limits of Piercing the Corporate Veil

The courts of the three-subject jurisdiction have developed a set of judge-made rules - by way of veil piercing - to set aside the principles of limited liability and corporate separate personality in an attempt to address the liability deficit problem discussed in this thesis. Focusing on veil piercing remedy, this Chapter examines how the courts have structured their tests. I compare and contrast the reasoning of the traditional entity law approach and the single unit approach. I also examine the alternative of courts holding a parent company directly liable for its subsidiary's liability under the principle of joint tortfeasor. This Chapter proceeds in two parts: Part one examines the common law's indirect approach, part two focuses on direct parent liability.

4.1 What is Veil Piercing?

Veil piercing is a colourful corporate law metaphor or figure of speech that is generally associated with the process by which the courts will disregard the principles of limited liability and separate corporate personality in order to hold a shareholder responsible for the liabilities of a corporation.[101] Although the U.K., the U.S., and Canada have developed their own rules and principles regarding the circumstances in which the courts will set aside these principles, they all

[101] Robert B Thompson, "Piercing the Corporate Veil: An Empirical Study" (1991) 76 Cornell Law Review 1036 [Thompson, "Empirical Study"]. See also Stephen B Presser, *Piercing the Corporate Veil* (New York: Clark Boardman Company, 1991) at 1-3. Presser explains that "the "veil" of the "corporate fiction," or the "artificial personality" of the corporation, is "pierced," and the individual or corporate shareholder exposed to personal or corporate liability, as the case may be, when a court determines that the debt in question is not really a debt of the corporation, but ought, in fairness, to be viewed as a debt of the individual or corporate shareholder or shareholders."

have one thing in common: limited liability and separate corporate personality remain the default rule. This means that veil piercing is the exception, not the rule. As a result, the courts will only pierce the corporate veil in exceptional circumstances. The rarity of veil piercing remedy and its contradictory decisions meant that the liability deficit problem still remains unsolved.

While the courts cannot completely dislodge the privilege of limited liability and separate corporate personality, they often claim that they have inherent power to set aside these principles, if circumstances warrant it. Before examining those circumstances, it is necessary to review the case law to determine how the courts are empowered to pierce the veil. In the U.K., Lord Denning's famous statement in *Littlewoods Mail Order Stores v IRC* (1969)[102] is often cited for the proposition that the courts in that jurisdiction have the discretionary power to pierce the corporate veil, particularly where it would be too flagrantly opposed to justice to apply the principle laid down in *Salomon*. In *Littlewoods,* Lord Denning stated as follows:

> The doctrine laid down in *Salomon v. Salomon & Co*. … has to be watched very carefully. It has often been supposed to cast a veil over the personality of a limited company through which the courts cannot see. But that is not true. The courts can and often do draw aside the veil. They can, and often do, pull off the mask. They look to see what really lies behind. The legislature has shown the way with group accounts and the rest. And the courts should follow suit.[103]

In Canada, most judges cite the Supreme Court of Canada decision in *Kosmopoulos v Constitution Insurance Co*. (1987)[104] as authority for piercing the corporate veil in that jurisdiction. In *Kosmopoulos*, Wilson J stated that "I have no doubt that theoretically the veil could be lifted

[102] *Littlewoods Mail Order Stores v IRC*, [1969] 1 WLR 1241 (CA) [*Littlewoods*].
[103] *Ibid* at 1254.
[104] *Kosmopoulos v Constitution Insurance Co*., [1987] 1 SCR 2 [*Kosmopoulos*].

… to do justice."[105] However, unlike the U.K., the judicial power to pierce the corporate veil in Canada seems to be inconsistent with certain statutory provisions such as *Canada Business Corporation Act*, *Ontario Business Corporation Act*, and *British Columbia Business Corporation Act*.[106]

In the U.S., *United States v Milwaukee Refrigerator Transit Co*., (1905) is widely quoted as authority for disregarding the corporate entity rule. In this case, Judge Sanborn stated that as a general rule, a corporation will be regarded as a separate legal entity "until sufficient reason to the contrary appears."[107] Judge Sanborn went on to emphasize that the court will pierce the corporate veil "when the notion of legal entity is used to defeat the public convenience, justify wrong, protect fraud, or defend crime."[108] Also, in *Whittle v Vanderbilt Mining & Milling Co*., (1897) the court stated that "The doctrine [of corporate entity] is technical, and a court of equity will disregard it, and treat the corporation, not as an entity, but an association of persons, whenever justice between the parties so requires."[109]

It should be clear from the foregoing that the judicial power to pierce the corporate veil relates primarily to the prevention of fraud or some wrongdoing. This point has recently been emphasized by the Supreme Court of U.K. in *Prest*: "[T]he principle that the court may be justified in piercing the corporate veil if a company's separate legal personality is being abused for the purpose of some

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105 *Ibid*.
106 See, for example, section 45 of the CBCA 1985, section 92(1) of the OBCA 1990 and section 87(1) of the BCBCA 2002, *supra* note 62.
107 *United States v Milwaukee Refrigerator Transit Co*., 142 F 247 (Cir Ct E.D. Wis. 1905) at 255.
108 *Ibid.*
109 *Whittle v Vanderbilt Mining & Milling Co*., 83 F 48 (Cir Ct SD Cal 1897).

relevant wrongdoing is well established in the authorities… [T]he recognition of a limited power to pierce the corporate veil in carefully defined circumstances is necessary if the law is not to be disarmed in the face of abuse."[110] Further, in *Walkovszky*, Judge Fuld stated that: "Broadly speaking … [the] courts will pierce the corporate veil, whenever necessary to prevent fraud or to achieve equity."[111]

4.2 Veil Piercing in Comparative Perspective

In this section, I examine veil piercing jurisprudence from a multi-jurisdictional comparative perspective, focusing particularly on the main grounds for piercing the corporate veil in the three-subject jurisdiction. My comparative analysis concludes that veil piercing is fundamentally inconsistent in many ways with the economic realities of how parent companies and subsidiaries are related.

4.2.1 Grounds for Piercing the Corporate Veil in the U.K.

Veil piercing in the U.K. generally follows the rigid entity law approach. This traditional approach starts all veil piercing inquiry with the normal presumption of non-liability: the presumption that a corporation is an independent legal entity, separate and distinct from its shareholders, officers, and directors, and that the liability of the corporation cannot be

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[110] *Prest*, *supra* note 15 at para 27.
[111] *Walkovszky*, *supra* note 23 at 30.

attributed to the shareholders. In relation to corporate groups – parent-subsidiary companies, the entity law treats all companies within the group of companies as independent legal entities. As such, the liability of a subsidiary company will not be attributed to the parent company, even if the two corporations are economically linked and interrelated, as they often are.

Although there is a substantial body of case law regarding veil piercing remedy in the U.K., case law has yet to develop a single test for setting aside the principles of limited liability and separate corporate personality. Consequently, there is no universal principle for piercing the corporate veil in the U.K. The next section examines some of the grounds for piercing the corporate veil in the U.K.

4.2.1.1 Fraud, Façade or Sham

The first major attempt to pierce the veil in the U.K. under the fraud, façade or sham exception can be traced back to the landmark of *Salomon*. In this case, the liquidator argued that Mr. Salomon should personally be liable to indemnify the company against the claims of the contractual creditors. Underpinning the liquidator's claim is the allegation that Mr. Salomon interposed the corporate form so as to commit fraud on unsecured creditors, who, according to Lindley LJ, "have been incautious enough to trade with the company without perceiving the trap which he has laid for them."[112]

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[112] *Broderip, supra* note 69 at 339.

The House of Lords unanimously rejected the fraud base argument in *Salomon*, overturned the decision of the Court of Appeal, and effectively declined to pierce the corporate veil in order to hold Mr. Salomon personally liable for the debts of the corporation. Despite this, the so-called illegality ground (i.e., fraud, façade or sham) has since become one of the most recognized exceptions in U.K. veil piercing jurisprudence.

The difficulty with the fraud exception is that the courts have yet to identify the relevant circumstances in which they may pierce the veil. Also worth noting is that the majority of the cases where the fraud exception has been successfully relied upon to pierce the corporate veil relate primarily to individual shareholders who have had effective control of a corporation. For example, in piercing the corporate veil in *Re Darby, ex parte Brougham*[113] on the basis of fraud and misrepresentation, Phillimore J stated that "the fraud here is that what they [the promoters] did through the corporation they did themselves and represented it to have been done by a corporation of some standing and position …[114]

Similarly, in *Gilford Motor Company v Horne* (1933),[115] the court pierced the corporate veil because of fraud. In this case, Lord Hanworth MR stated that: "I am quite satisfied that this company was formed as a device, a stratagem, in order to mask the effective carrying on of a

[113] In *re Darby, exparte Brougham*, [1911] 1 KB 95 (KBD) at 103 [*Re Darby*].
[114] *Ibid* at 101.
[115] *Gilford Motor Co. v Horne*, [1933] Ch 935 AC (CA) [*Gilford*].

business of Mr E B Horne. The purpose of it was to try to enable him, under what is a cloak or sham …"[116]

Despite the fact that the fraud exception has been widely invoked in cases involving individual shareholders vis-à-vis one-person or closely-held corporations, the courts have applied this exception to address liability issues arising in corporate groups. However, it is much easier to establish fraud or fraudulent intent in individual cases than in corporate groups, because it is relatively straight-forward to show that an individual shareholder interposes the corporate form for wrongful purposes. Save to avoid liability, the interposition of the corporate form for fraudulent purposes is completely irrelevant when an individual shareholder is substituted for a corporate shareholder.

In relation to corporate groups, even if the alleged conduct (i.e. interposing the corporate form to avoid liability) is comparatively similar to those of individual shareholders, the fraud exception ultimately makes it hard to pierce the parent's veil, particularly in tort cases. Take, for example, the case of *Adams*. In this case, although one of the subsidiary companies of the parent company (Cape Industries plc) was found to be a façade, the Court of Appeal nonetheless concluded that since that particular subsidiary did not conduct any business in the U.S., it could not be used to establish the presence of the parent company in the U.S. under the fraud exception. Accordingly,

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[116] *Ibid* at 956. See also *Jones v Lipman*, [1962] 1 WLR 832 (ChD) where the court relied on the fraud ground to pierce the corporate veil.

the Court of Appeal held that there was nothing wrong with using the corporate structure to limit or avoid liability. The Court of Appeal noted as follows:

> We do not accept [that the corporate veil should be pierced] merely because the corporate structure has been used to ensure that the legal liability (if any) in respect of particular future activities of the group (and correspondingly the risk of enforcement of that liability) will fall on another member of the group rather than the defendant company. Whether or not this is desirable, the right to use a corporate structure in this manner is inherent in our corporate law.[117]

The court pierced the corporate veil in *Gilford* referred to above, relying on the fraud exception, where an individual shareholder or promoter interposed the corporate form in order to avoid liability. In *Adams*, however, the Court of Appeal found nothing wrong with the parent company interposing the corporate form in order to limit or avoid liability, nothing that “the right to use a corporate structure in this manner [to avoid liability] is inherent in our corporate law.”[118]

The jurisprudence has made it clear that the courts do not generally regard intercorporate structures (parent-subsidiary arrangments), which are specifically designed to avoid or limit liability, as constituting fraud. Since, as Slade LJ noted, corporate law sanctions this type of business arrangement; there is hardly any evidence of wrongdoing to warrant piercing the parent’s veil in those cases. It is hard to reconcile *Gilford* with *Adams*. In both cases, the corporate form has been interposed, in some way or the other, to avoid or limit liability but the judicial response in individual shareholder case (*Gilford*) is completely at odds with that of a corporate shareholder (*Adams*).

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[117] *Adams, supra* note 20 at 538.
[118] *Ibid*.

This differing treatment highlights one of the gross imperfections of veil piercing remedy: it is contradictory and the decisions are irreconcilable. It seems that in deciding whether to pierce the corporate veil in the context of a parent-subsidiary relationship, the courts seem to signal a rising recognition of the advantages of allowing parent companies to set up subsidiaries in order to limit or avoid liability. It remains to be seen how interposing the corporate form in order to avoid liability in the context of a parent-subsidiary structure so compelling that the controlling parent is often shielded from the subsidiary's liability, but not so in the case of an individual shareholder having effective control of a corporation.

In summary, the courts often profess that they will disregard the principles of limited liability and separate corporate personality and will pierce the veil if the corporate form is abused for fraudulent purposes. In practice, however, the case law is not clear about which conducts will satisfy the fraud threshold in parent-subsidiary relationships. This gives rise to inconsistent judicial decisions, even in cases with similar facts. This, of course, is a dangerous precedent, and one that has created an acute problem in veil piercing jurisprudence. It is therefore not a question of whether piercing the corporate veil under the fraud exception has become moot when it comes to corporate shareholders, but a question of how to address the unprincipled nature of this vague exception and make it more suitable for corporate groups.

4.2.1.2 Agency or *Alter Ego*

The agency or *alter ego* ground was first developed in the seminal case of *Smith, Stone and Knight v Birmingham Corporation* (1939).[119] This case is unique in many ways, not least because it was the first attempt by a U.K. court to develop an "analytical framework for English veil piercing cases."[120] The uniqueness relates to the fact that a parent company tried to pierce its own veil for an opportunistic purpose.[121] This is often referred to as "reverse veil piercing."

The facts of *Smith, Stone and Knight* were as follows: Birmingham Corporation compulsorily acquired lands owned by the subsidiary of the parent company. The parent company owned all the shares of the subsidiary so it brought a claim for compensation for disturbance to the subsidiary's business. To succeed, however, the parent company had to show that the subsidiary was not a separate legal entity. The question for the *Smith, Stone and Knight* Court was "whether the subsidiary was carrying on the business as the [parent] company's business or as its own."[122] To answer this question, Atkinson J formulated a series of six relevant criteria:

> (a) Were the profits of the subsidiary treated as profits of the parent?
> (b) Were the persons conducting the business of the subsidiary appointed by the parent?
> (c) Was the parent the 'head and brain' of the subsidiary?
> (d) Did the parent govern the subsidiary?
> (e) Were the profits of the subsidiary made as a result of the skill and direction of the parent?
> (f) Was the parent in effectual and constant control of the subsidiary?[123]

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[119] *Smith, Stone and Knight v Birmingham*, [1939] 4 All ER 116 (KBD) [*Smith, Stone and Knight*].
[120] Bainbridge & Henderson, "Limited Liability," *supra* note 97 at 239 -250.
[121] *Ibid* at 238.
[122] *Ibid* at 121.
[123] *Smith, Stone & Knight*, *supra* note 119.

Having answered these questions in the affirmative, the court concluded that the parent corporation and its wholly-owned subsidiary were one entity. Accordingly, the court held that the parent was entitled to claim compensation for disturbance to its subsidiary business, which it would not have been able to collect in its own capacity under the pre-existing law. The *Smith, Stone and Knight* Court arrived at this conclusion by an analogy to the common law principle of agency, noting that: "An analogous position would be where servants occupy cottages or rooms for the purposes of their business, and it is well settled that if they have to occupy those premises for the purposes of the business, their occupation is the occupation of their principal."[124]

The *Smith, Stone and Knight* decision contradicts the principle laid by the House of Lords in *Salomon*. In *Salomon*, the Court made it clear that once a company is duly formed, it must be recognized as an independent legal entity. By treating the parent and its wholly-owned subsidiary as one entity, the *Smith, Stone and Knight* Court blurred this distinction and disregarded the corporate autonomy rule. Again, in *Salomon*, the House of Lords made it clear that a corporation is not, at law, an agent or alias or trustees of its shareholders. Nonetheless, the *Smith, Stone and Knight* Court treated the subsidiary as the agent of its parent company.

Like the fraud exception discussed above, the agency analogy adopted in the *Smith, Stone and Knight* decision is completely at odds with the *Salomon* principle. Another difficulty with the *Smith, Stone and Knight* decision is that when the test is applied in a parent-subsidiary relationship, the majority, if not all, of the questions posed in that case could be answered in the affirmative.

[124] *Ibid.*

Yet the separate corporate personality of the wholly-owned or controlled subsidiary is not disregarded, nor is the liability of the subsidiary attributed to the parent company.[125] The reason for this is that corporate law does not treat a parent and its subsidiary as a single economic unit for the purposes of liability.

The third difficulty with the agency exception is that, under the traditional common law principle, the principal-agency relationship is based on mutual or consensual relationship, whereas, in a parent-subsidiary relationship, the agency analogy is based on control and economic interrelationships of the companies operating within the group. Heintzman and Kain observe that the agency ground for imposing liability on a controlling shareholder is different from piercing the corporate veil in that the "former assumes that the corporation and controlling mind are distinct; whereas the latter ignores the legal persona of the corporation."[126]

Insofar as the corporate law is concerned, there is no presumption of an agency relationship between a parent company and its wholly-owned or controlled subsidiary. Even if the courts were to find that such a relationship exists, it is simply by analogy or metaphor. However, in determining whether to pierce the corporate veil while relying on metaphors, one is reminded of the warning of Judge Cardozo in *Berkley*: "Metaphors in law are to be narrowly watched, for starting as devices to liberate thought they end often by enslaving it."[127]

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[125] Robert Yalden et al., *Business Organizations: Principles, Policies and Practice* (Toronto: Emond Montgomery Publications Limited, 2008) at 194.
[126] Thomas G Heintzman & Brandon Kain, "Through the Looking Glass: Recent Developments in Piercing the Corporate Veil" (2013) 28:3 Banking & Finance Law Review 525 at footnote 76.
[127] *Berkley v Third Avenue Railway Co.*, 155 N.E. 58 (N.Y. Ct App 1926) at 94-95 [*Berkley*].

In view of the Court of Appeal's decision in *Adams*, in the absence of any specific arrangements, it is difficult to establish an agency relationship between a parent and its subsidiary. In other words, the courts rarely find that an agency relationship exists between a parent company and its subsidiary. It is little surprising that the attempt by the *Smith*, *Stone and Knight* Court to develop a universal veil piercing framework under the agency principle was short-lived, as the guidelines articulated in that case were largely overlooked in subsequent cases in lieu of the rigid entity law principle.[128] While the *Smith*, *Stone and Knight* decision continues to be cited for the proposition that the courts will pierce the corporate veil where there is a finding of an agency relationship between the corporation and its shareholders, in practice, however, the courts are very reluctant to treat a corporation as the agent of its shareholders and *vice-versa*.

4.2.1.3 Single Economic Unit

Following the failure of the *Smith*, *Stone and Knight* Court to develop a universal veil piecing guideline along the agency or *alter ego* exception, the U.K. courts continued to experiment with various grounds, *albeit* on an ad hoc basis. The breakthrough finally came in 1976 where another audacious attempt was made to articulate a universal veil piercing framework in the famous case of *DHN Food Distributors Ltd. v Tower Hamlets London Borough Council* (1976).[129] In *DHN*, Lord Denning MR adopted the "single economic unit" theory to pierce the corporate veil in a case that is similar to *Smith*, *Stone and Knight* discussed above.

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[128] Thomas K Cheng, "The Corporate Veil Doctrine Revisited: A Comparative Study of the English and the U.S. Corporate Veil Doctrines" (2011) 34:2 British Columbia International & Comparative Law Review 329 at 337.
[129] *DHN Food Distributors Ltd. v Tower Hamlets London Borough Council*, [1976] 1 WLR 852 (AC) at 857 [*DHN*].

The facts of *DHN* were as follows: In this case, the parent corporation, *DHN* owned all the shares in the two subsidiary companies operating within the group of companies. One subsidiary owned the vehicles, the other subsidiary owned the land. The vehicles and the land were used by *DHN* to carry on its own business. When the land was later acquired under a compulsory purchase scheme, *DHN* brought a claim for compensation for disturbance to its business. Lord Denning gave judgment in favour of the parent company and ruled that it was entitled to claim. Lord Denning stated as follows:

> The case might be called the "Three in one" Three companies in one. Alternatively, the "One in three." One group of three companies…. We all know that in many respects a group of companies are treated together for the purpose of general accounts, balance sheet and profit and loss accounts. They are treated as one concern. Professor Gower in his book on company law says: "there is evidence of a general tendency to ignore the separate legal entities of various companies within a group, and to look instead at the economic entity of the whole group." This is especially the case when a parent company owns all the shares of the subsidiaries, so much so that it can control every movement of the subsidiaries. These subsidiaries are bound hand and foot to the parent company and must do just what the parent company says… This group is virtually the same as a partnership in which all the three companies are partners. They should not be treated separately so as to be defeated on a technical point.[130]

Like the *Smith, Stone and Knight* decision, notwithstanding that the subsidiary company legally owned the land, the court treated the parent company as the beneficial owner of the land on the basis that it owned all the shares in the subsidiary. Accordingly, the court held that *DHN* was entitled to compensation. In articulating the single economic unit theory, Lord Denning relied on what Professor Gower said in his book – "to look instead at the economic entity of the whole group." Lord Denning also took 'judicial notice' of other areas where a group of companies had

[130] *Ibid* at 860.

been treated as a single economic unit for the purposes of general accounts, balance sheet and profit and loss accounts.

The "single economic unit" theory advanced in *DHN* is often regarded as the birthplace of "enterprise liability." But this analytical framework, too, has failed to live up to expectation just like the agency principle articulated in *Smith, Stone and Knight*. In *Woolfson v Strathclyde Reginal Council* (1978)[131] the House of Lords refused to follow *DHN* and pierce the corporate veil. Although the facts of *Woolfsen* were substantially similar to *DHN*, Lord Keith noted that "it is appropriate to pierce the corporate veil only where special circumstances exist indicating that it is a mere façade concealing the true facts."[132] There is, therefore, an emerging trend in the cases thus reviewed that the fraud exception is perhaps the only legitimate ground that could justify piercing corporate veil. However, establishing fraud in the context of parent-subsidiary relationships is like "looking for a needle in a haystack."

Although the single economic unit theory was short-lived even before the judiciary had any real opportunity to experiment with this ground,[133] Lord Denning made certain points that are worth a bit more attention. First, Lord Denning indicated that all individual companies within a group of companies should be regarded as a partnership and that the law should not treat them separately for the purposes of liability. The partnership notion will have a chilling effect on corporate groups in that it runs the risk of treating individual companies operating within a group of companies as

[131] *Woolfson v Strathclyde Reginal Council*, [1978] SC 90 (HL) [*Woolfson*].
[132] *Ibid*.
[133] See F G Rixon, "Lifting the Veil Between Holding and Subsidiary Companies" (1986) 102 Law Quarterly Review 415.

"partners" and therefore, jointly and severally liable. This is essentially a return to a regime of unlimited liability which I personally do not think is sustainable.

Second, in determining the benefits and corresponding liabilities of corporate groups, Lord Denning noted that it is necessary to have regard to their economic realities. The economic reality argument is discussed in Chapter 6. Notwithstanding what the corporate law says about the legal characterization (independent legal entity) of each company within a group of companies, in reality, the majority of parent-subsidiary relationships often share a community of economic interests. Until the courts pay particular attention to the underlying economic benefits of corporate groups, any attempt to attribute tortious liability vertically within the group will be an exercise in futility - devoid of reality.

The final point that Lord Denning made is that although the parent company was not the legal owner of the land, since it owned all the shares in its subsidiary, it should be treated as the *de facto* beneficial owner. Lord Denning clearly moved the focus of his analysis away from the rigidity of form (legal – *de jure* ownership) and focused instead on substance (*de facto* – ownership).

Usually, the true beneficial owner in any parent-subsidiary relationship is the parent company, but the courts often rigidly start veil piercing analysis from the normal presumption that the parent company is not liable for the liabilities of its subsidiary. If the courts had greater regard for the underlying economic interests between the parent and its subsidiary, the courts would pierce the corporate veil more frequently in those circumstances. Instead, the courts have been critical of the single economic unit theory describing it as one based on economics and not on law. Lord Goff emphasized this point in *Bank of Tokyo Ltd v Karoon* (1987)[134] while responding to an argument that it would be too technical to separate the parent from its subsidiary. Lord Goff stated as follows:

> Mr. Hoffman suggested beguilingly that it would be technical for us to distinguish between parent and subsidiary company in this context; economically, he said, they were one. But we are concerned not with economics but with law. The distinction between the two is, in law, fundamental and cannot here be bridged. For this reason, I should, in any event, dismissed this argument.[135]

Since *Adams* the courts have refused to recognize the concept of a single economic unit for corporate groups: "There is no general principle that all companies in a group of companies are to be regarded as one."[136] This reluctance to accept the single economic unit theory impacted the decision reached by the courts in *Re Polly Peck International Plc* (1996)[137] and *Ord v Belhaven Pubs Ltd* (1998).[138] In these cases, the courts concluded that recognition of a group of companies operating within corporate groups, as a single economic unit, would create a new exception to the *Salomon* principle and would also be contrary to the Court of Appeal's decision in *Adams*. The only way to pierce the corporate veil under the single economic unit exception is under specific statutes, which are rare.

Thus far, I have tried to highlight some of the inconsistencies surrounding veil piercing jurisprudence in the U.K. The contradictory decisions are sharp and irreconcilable even in similar cases like *DHN* and *Woolfsen*. It remains to be seen why the court pierced the veil in the former

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[134] *Bank of Tokyo Ltd v Karoon*, [1987] AC 45 (HL).
[135] *Ibid* at 64.
[136] Davies, "8th ed," *supra* note 14 at 203.
[137] *Re Polly Peck International Plc*, [1996] 2 All ER 433.
[138] *Ord v. Belhaven Pubs Ltd*, [1998] 2 BCLC 447.

but declined to so in the latter? Also in *Gilford,* the court pierced the corporate veil on the ground that setting up a limited liability company to avoid liability amounted to fraud, façade or sham. In *Adams,* however, the Court of Appeal found nothing wrong with the parent company interposing the corporate form to avoid liability, or to limit its exposure to risk.

These contradictory decisions highlight the case-specific nature of the entire veil piercing jurisprudence. The House of Lords made this observation in *Woolfsen* when the Lords distinguished *DHN* as piercing based on a statutory provision. This is an important observation in that, under the compulsory purchase order of land, the enabling statute usually provides a mechanism for redress and compensation to the affected parties. This type of remedy is determined on a case-by-case basis and cannot be used to justify veil piercing in other cases that are completely different. This explains why the single economic unit exception has since been rejected by the Court of Appeal in *Adams*.

To sum up this section, veil piercing is now a rarity under U.K. law, especially in tort cases, because of the rigid application of the entity law principles and the courts' strict adherence to *Salomon*.[139] Although the U.K. courts have made some attempts to formulate a universal principle for piercing the corporate veil, the jurisprudence has made it clear that there is no single test for doing so. Moreover, the entire jurisprudence surrounding veil piercing remedy is subject to discretion and varying interpretations. Since veil piercing remedy continues to be plagued with

[139] Cheng, *supra* note 128 at 412. See generally Dan D Prentice, "Veil Piercing and Successor Liability in the United Kingdom" (1996) 10 Florida Journal of International Law 469. See also Charles Mitchell, "Lifting the Corporate Veil in the English Courts: An Empirical Study" (1999) 3 Company Financial & Insolvency Law Review 15.

colourful metaphors,[140] it is also difficult to predict with any degree of accuracy when the U.K. courts will disregard the corporate separateness and limited liability. That means the search for a credible solution to address the liability deficit problem continues. The next section examines veil piercing jurisprudence in the U.S.

4.2.2 Grounds for Piercing the Corporate Veil in the U.S.

The main grounds for piercing the veil in the U.S. include the "instrumentality" and the "*alter ego*" grounds.[141] Others include "identity,"[142] "*alter ego* plus fraud or injustice" test,[143] and quasi-agency.[144] For the purposes of this thesis, I will focus my analysis on the *alter ego* and the instrumentality grounds and treat these under a single heading.

4.2.2.1 *Alter Ego* and Instrumentality

In *Automotriz v Resnick* (1957), the court held that the veil will be pierced under the *alter ego* ground, provided the following requirements are satisfied: "(1) When there is such unity of interest and ownership that the separate personalities of the corporation and of the shareholders no longer

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[140] Metaphors such as "sham", "façade", "alter ego", "puppet", "shell", "tool", "mask," "buffer", "agent", "alias", "mere instrumentality," "pawn," "cloak", etc.
[141] See generally, Cheng, *supra* note 128.
[142] See Blumberg, "Multinational Challenge," *supra* note 19 at 84.
[143] See also Bainbridge & Henderson, "Limited Liability," *supra* note 97 at 86.
[144] Thompson, "Empirical Study", *supra* note 101 at 1063. See also Robert H Thompson, "Piercing the Veil within Corporate Groups: Corporate Shareholders as Mere Investors" (1999) 13 Connecticut Journal of International Law 379 at 387 [Thompson, "Corporate Groups"]; Robert H Thompson, "Agency Law and Asset Partitioning" (2002) 71 University of Cincinnati Law Review 1321 at 1329 [Thompson, "Agency Law"]. For a useful review of the history of this ground see, C Krendl & J Krendl, "Piercing the Corporate Veil: Focusing the Inquiry" (1978) 55 Denver Law Journal 1.

exists; and (2) If an inequitable result would follow if the acts were treated as those of the corporation alone."[145] Since the *Automotriz* decision, the *alter ego* doctrine has been widely used in a number of cases in the U.S.[146]

The instrumentality test, on the other hand, was first formulated in legal science by Powell in 1931.[147] The test was subsequently applied in the landmark case of *Lowendal v Baltimore & Ohio Railroad* (1936).[148] In *Lowendahl*, the court held that three elements must be present in order to pierce the corporate veil under the instrumentality variant. These include:

> 1. Control, not mere majority or complete stock control, but complete domination, not only of finances but of policy and business practice in respect to the transaction attacked so that the corporate entity as to this transaction had at the time no separate mind, will or existence of its own;
>
> 2. Such control must have been used by the defendant to commit fraud or wrong, to perpetrate the violation of a statutory or other positive legal duty, or a dishonest and unjust act in contravention of plaintiff's legal rights; and
>
> 3. The aforesaid control and breach of duty must proximately cause the injury or unjust loss complained of.[149]

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[145] *Automotriz del Golfo de la California v Resnick* 47 Cal (2d) 792 (Cal Sup Ct 1957) [*Automotriz*].
[146] Most recent cases in which the *alter ego* doctrine has been invoked include the following: *FMC Fin Corp. v Murphree*, 632 F (2d) 422 (5th Cir 1980); *Gallagher v Reconco Bldrs. Inc.*, 91 III App (3d) 999 (III App Ct 1980); *Institute Veterinary Pathology Inc. v California Health Laboratories Inc.*, 116 Cal App (3d) 111 (Cal Ct App 1981) at 74; *Baker v Caravan Moving Corp.*, 561 F Supp 337 (N.D.III 1983) at 340; *Sabine Towing & Transport Co. v Merit Ventures In.*, 575 F Supp 1442 (E.D. Tex 1983) at 1446; *RRX Indus. Inc. v Lab-Con Inc.*, 772 F (2d) 543 (9th Cir 1985) at 545; *Flynt Distributor Co. Harvey*, 734 F (2d) 1389 (9th Cir 1984) at 1393; *Oriental Commercial & Shipping Co. v Rossel,* N.V., 609 F Supp 75 (S.D.N.Y. 1985) at 78; *Wegerer v First Commodity Corp.*, 744 F (2d) 719 (10th Cir 1984); and *Van Dorn Co. v Future Chem. & Oil Corp.*, 753 F (2d) 565 (7th Cir 1985).
[147] Frederick Powell, *Parent and Subsidiary Corporations: Liability of a Parent Corporations for the Obligations of its Subsidiary* (Callagham: Chicago, 1931).
[148] *Lowendahl v Baltimore and Ohio Railroad,* 272 N.Y 360 (N.Y Ct App 1936), aff'd, (6 N.E (2d) 56; 247 A.D 157 (N.Y Sup Ct 1936); 287 N.Y.S.
[149] *Ibid* at 76.

Like the *alter ego* doctrine, the instrumentality test has been widely used as an analytical framework for piercing the corporate veil in the U.S., predominantly in cases involving contractual liability, tortious liability and bankruptcy liability.[150] Before examining how the U.S. courts apply these doctrines in veil piercing cases, I must pause to emphasize that the *alter ego* and the instrumentality grounds are not mutually exclusive, as both doctrines have been utilized concurrently by the courts. For example, in order to pierce the corporate veil under any of these grounds, it is necessary to show the following: (1) excessive exercise of control,[151] (2) wrongful or inequitable conduct,[152] and (3) causal link to the claimant's loss.[153] If there is any difference at all, it is "primarily one of form rather than substance: as the courts themselves recognize, they are 'slightly different roads to the same destination.'"[154]

Veil piercing in the U.S. is in many ways similar to the U.K. approach discussed above except the following: (1) the duality of veil piercing in that jurisdiction, and (2) the mechanical application of a checklist or multi-factor tests. The duality of U.S. veil piercing is that it varies from state to state and uses both the common law and federal/state laws. The application of a multi-factor list usually relates to a veil piercing decision in the context of a parent and its subsidiary company. In *Hamilton v Water Whole International Corp*. (2008),[155] the court identified up to nine elements which would render a subsidiary as the *alter ego* of the parent. These include:

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[150] For further details on the "instrumentality" doctrine, see Antunes, *supra* note 3 at 242.
[151] See, for example, *KLM Indus., Inc. v Tylutki*, 815 A (2d) 688 (Conn App 2003) at 691.
[152] See, for example, *Glenn v Wagner*, 329 S.E (2d) 326 (N.C. 1985) at 330.
[153] See, for example, *Krivo Indus. Supply Co. v Nat'l Distillers & Chem. Corp*., 483 F (2d) 1098 (5th Cir. 1973) at 1103.
[154] Antunes, *supra* note 3 at 245.
[155] *Hamilton v Water Whole International Corp*., 302 Fed Appx 789 (U.S. CA 10th Cir 2008).

> (1) whether the dominant corporation owns or subscribes to all the subservient corporation's stock; (2) whether the dominant and subservient corporations have common directors and officers; (3) whether the dominant corporation provides financing to the subservient corporation; (4) whether the subservient corporation is grossly undercapiltalized; (5) whether the dominant corporation pays the salaries, expenses or losses of the subservient corporation; (6) whether most of the subservient corporation's business is with the dominant corporation; (7) whether the dominant corporation refers to the subservient corporation as a division or department; (8) whether the subservient corporation's officers or directors follow the dominant corporation's directions, and (9) whether the corporations observe legal formalities for keeping the entities separate.[156]

Similarly, in *Birbara v Locke*, (1996), the U.S. Court of Appeals considered up to nine factors to determine whether to pierce the veil. The factors include:

> (1) insufficient capitalization; (2) non-observance of corporate formalities; (3) failure to pay dividends; (4) insolvency at the time of the litigated transaction; (5) siphoning off corporate funds; (6) absence of functioning officers besides the dominant shareholders; (7) absence of corporate records; (8) use of the corporation to advance the interests of the dominant shareholders; and (9) use of the corporation in promoting fraud.[157]

Also, in *Associated Vendors, Inc. v Oakland Meat Co* (1962), the California appellate court considered up to 20 factors (the so-called "California laundry lists") to determine whether to pierce the corporate veil.[158]

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[156] *Ibid* at 793.
[157] *Birbara v Locke*, 99 F (3d) 1233 (U.S. CA 1st Cir 1996) at 1240.
[158] *Associated Vendors, Inc. v Oakland Meat Co*., 26 Cal Rptr 806 (Cal App 1962): "A review of the cases which have discussed the problem discloses the consideration of a variety of factors which were pertinent to the trial court's determination under the particular circumstances of each case. Among these are the following: (1) Commingling of funds and other assets, failure to segregate funds of the separate entities, and the unauthorized diversion of corporate funds or assets to other than corporate uses; (2) the treatment by an individual of the assets of the corporation as his own; (3) the failure to obtain authority to issue stock or to subscribe to or issue the same; (4) the holding out by an individual that he is personally liable for the debts of the corporation; (5) the failure to maintain minutes or adequate corporate records, and the confusion of the records of the separate entities; (6) the identical equitable ownership in the two entities; (7) the identification of the equitable owners thereof with the domination and control of the two entities; (8) identification of the directors and officers of the two entities in the responsible supervision and management; (9) sole ownership of all of the stock in a corporation by one individual or the members of a family; (10) the use of the same office or business location; (11) the employment of the same employees and/or attorney; (12) the failure to adequately capitalize a corporation; (13) the total absence of corporate assets and undercapitalization; (14) the use of a corporation as a mere shell, instrumentality or conduit for a single

One of the main difficulties with the *alter ego* doctrine is its over-reliance on a checklist approach. The mechanical application of this approach often skews the outcome of veil piercing inquiry in favour of the parent company because the inquiry usually requires detailed investigations. Furthermore, in most veil piercing cases involving parent-subsidiary companies, the courts typically set a high threshold for establishing when the parent's veil should be pierced, compared to individual shareholders. The complexity and the extensive nature of veil piercing inquiry, particularly in a parent-subsidiary relationship meant that the parent company is often not held accountable.

The second challenge is that both the *alter ego* and the instrumentality tests require some elements of fraud or wrongdoing or unjust act in addition to control and domination. This point was emphasized by the New York Court of Appeal in *Morris v NY State Dept. of Taxation and Finance*.[159] The Court of Appeal held that under New York law, "piercing the corporate veil requires a showing that: (1) the owners exercised complete domination of the corporation with respect to the transaction attacked; and (2) that such domination was used to commit a fraud or wrong against the plaintiff which resulted in plaintiff's injury."[160]

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venture or the business of an individual or another corporation; (15) the concealment and misrepresentation of the identity of the responsible ownership, management and financial interest, or concealment of personal business activities; (16) the disregard of legal formalities and the failure to maintain arm's length relationships among related entities; (17) the use of the corporate entity to procure labor, services or merchandise for another person or entity; (18) the diversion of assets from a corporation by or to a stockholder or other person or entity, to the detriment of creditors, or the manipulation of assets and liabilities between entities so as to concentrate the assets in one and the liabilities in another; (19) the contracting with another with intent to avoid performance by use of a corporate entity as a shield against personal liability, or the use of a corporation as a subterfuge of illegal transactions; (20) and the formation and use of a corporation to transfer to it the existing liability of another person or entity.[158]

[159] *Morris v N.Y. State Dept. of Taxation and Finance*, 82 N.Y. (2d) 135 (N.Y.S.2d 1993).

[160] *Ibid* at 141.

As previously mentioned, establishing fraud or wrongdoing solely on the basis that a parent company interposes the corporate form (i.e. by setting up a wholly-owned or controlled subsidiary to avoid liability) is extremely unlikely. It is unlikely because corporate law sanctions this type of corporate arrangement. In addition, while evidence of ownership and control is a necessary ingredient of the *alter ego* doctrine, excessive control or domination alone is not enough to justify piercing the corporate veil under this ground. The Supreme Court of Ohio made this point clear in *Dombroski v Well Point, Inc*.,(2008):[161]

> Were we to allow piercing every time a corporation under the complete control of a shareholder committed an unjust or inequitable act, virtually every close corporation could be pierced when sued, as nearly every lawsuit sets forth a form of unjust or inequitable action and close corporations are by definition controlled by an individual or small group of shareholders. Controlling shareholders in publicly traded corporations could also be subject to frequent piercing, regardless of the corporation's liability and its ability to pay for the plaintiff's injuries. Such expansive liability would run contrary to the concept of limited shareholder liability.[162]

Generally, veil piercing is determined on a case-by-case basis; however, the US approach has added another dimension to this in that the formulation of veil piercing test vary from state to state. Given these variations, it is not easy to determine the circumstances under which the courts in that jurisdiction will pierce the corporate veil. In other words, it is not possible to identify the precise circumstances in which the courts will pierce the corporate veil because of the dual aspects of US veil piercing. In the State of Ohio, for example, piercing the corporate veil under the *alter ego* doctrine requires that the controlling shareholder "used his influence to defraud or injure" the

[161] *Dombroski v WellPoint, Inc.*, 895 N.E.(2d) 538 (Ohio Sup Ct 2008) at 544-5.
[162] *Ibid*.

claimant.[163] Under Delaware law, the presumption of corporate separateness between the parent and its subsidiary can only be defeated by showing that: "(1) the parent exercises exclusive control over the subsidiary to the point that the subsidiary has no independent significance; and (2) that the corporate structure causes fraud or similar injustice.[164]

The formulation of veil piercing tests in the U.S. depends not only on the circumstances of each case but also varies from state to state.[165] This has led one commentator to conclude that the majority of veil piercing decisions in the U.S. "are irreconcilable and not entirely comprehensible."[166] Notwithstanding, there is a general perception that the U.S. tends to pierce the corporate veil more than the U.K. Before determining whether or not the U.S. tends to pierce the corporate veil more than the U.K., it is first, necessary to examine the difference between the entity law approach and the single unit doctrine. For the purposes of this thesis, the single unit doctrine, enterprise, or group liability have the same meaning.

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[163] *Belvedere Condo. Unit Owners' Assn. v R.E. Roark Cos., Inc.,* 617 N.E (2d) 1075 (Ohio Sup Ct 1993) at 1086. See also *Janos v Murduck*, 672 N.E.(2d) 1021 (Ohio App 1996) at 1023-4, where the Ohio Court of Appeals held that: "A court can permit a plaintiff to hold a shareholder personally liable for the debts of a corporation only if the shareholder is indistinguishable from the corporate entity. In order for the plaintiff to pierce the veil of the corporate form and hold the shareholder personally accountable, the plaintiff must demonstrate: (1) that the control over the corporation by those to be held liable was so complete that the corporation did not have a separate mind, will, or existence of its own; (2) that the control over the corporation by those to be held liable was exercised in such a manner as to commit fraud or an illegal act against the person seeking to disregard the corporate entity; and (3) that the plaintiff suffered the injury or unjust loss as a result of such control and wrong."
[164] *Glover v Standard Fed. Bank*, 2001 WL 1640097 (D Minn 2001).
[165] See following cases from the States of California, Illinois, Virginia and Minnesota with variations in the formulation of veil piercing test:*Van Dorn Co. v Future Chemical and Oil Corp.*, 753 F (2d) 565 (7th Cir 1985) at 570; *Minifie v Rowley*, 187 Cal 481(Cal Sup Ct 1921); 202 P. 673 at 676 ; *In re Hoffmann*, 475 B.R. 692, 699 (Bankr. D. Minn. 2012); *Cheatle v Rudd's Swimming Pool Supply* Co., 360 S.E.(2d) 828 (Va. 1987) at 831; *Perpetual Real Estate Services, Inc. v Michaelson Properties, Inc.*, 974 F (2d) 545 (4th Cir 1992) at 548; and *Sung Chang Interfashion Co. v Stone Mountain Accessories, Inc.*, 2013 WL 5366373 (S.D.N.Y. 2013), *cited* in Bainbridge & Henderson, "Limited Liability," *supra* note 97 at 96-9.
[166] Blumberg, "Multinational Challenge," *supra* note 19 at 86-7.

4.2.2.2 Single Unit Doctrine

The main difference between the entity law and the single unit doctrine is that under the entity law approach, each individual company within a group of companies is recognized as an independent legal entity with limited liability. As such, the liability of one company cannot be attributed to another company within the group. The single unit doctrine, on the other hand, seeks to impose liability on "sister companies" or "affiliated companies" for the actions or omissions of an individual unit within the group regardless of the separateness of individual units. The California Appellate Court emphasized this point in *Las Palmas Associates v Las Palmas Ctr. Associates* (1991). The Court noted that "… under the single-enterprise rule, liability can be found between sister companies."[167]

4.2.2.3 Application of the Single Unit Doctrine

Pan Pacific Sash & Door Co. (1958)[168] is one of the early cases in which the US courts applied the single unit doctrine. In this case, the California appellate court invoked this doctrine to impose group liability on a real estate business which was split into two corporations: one corporation owned the land, the other provided construction services. In imposing a group liability, the court held that:

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[167] *Las Palmas Associates v Las Palmas Ctr. Associates*, 235 Cal App (3d) 1220 (1991) at 1249.
[168] *Pan Pacific Sash & Door Co. v Greendale Park, Inc*, 166 Cal App (2d) 652; 333 P (2d) 802 (Cal App 1958) [*Pan Pacific*].

> There was such unity of interest and ownership that the separateness of the two corporations had in effect ceased and an adherence to the fiction of a separate existence of the two corporations would, under the circumstances here present, promote injustice and make it inequitable for [the sister corporation] to escape liability for an obligation incurred as much for its benefit as for [the debtor corporation].[169]

Similarly, in *Gartner v Snyder* (1979),[170] the court disregarded the corporate separateness of three real estate companies and treated them as one single enterprise on the basis that all the three corporations acted as one integrated business entity. The *Gartner* Court relied on the following to justify the imposition of liability under the single unit doctrine: "All documents were kept in a single file; all financial records were kept in a single account book; letters purportedly being sent on behalf of one entity were typed on another's letterhead; offices were shared; no separate corporate formalities were observed."

It seems that the *Pan Pacific Sash* case referred to above could also be decided under the *alter ego* principle or the instrumentality doctrine. This is because the two-pronged test articulated in *Pan Pacific Sash*: (1) a high degree of unity between the two entities and (2) unjust result, are the same requirements for the *alter ego* and the instrumentality doctrines. Both the *Pan Pacific Sash* and *Gartner* cases highlight the fact that the traditional entity law principle is not absolute. Thus, the entity law principle can be disregarded if there is evidence of a contrary intention.

As shown in both *Pan Pacific Sash* and *Gartner* cases, the application of the single unit doctrine to impose liability on corporate groups violates the principles of separate corporate personality and

[169] *Ibid.*
[170] *Gartner v Snyder* 607 F (2d) 582 (2d Cir 1979) [*Gartner*].

limited liability. In both cases, although each corporation operating within the corporate group was recognized in law as a separate legal entity, in practice, there was evidence to the contrary. This evidence was so compelling and substantial that the court had to simply disregard the separateness of each individual corporation and treat them as a single unit.

That said, it is hard to reconcile *Pan Pacific Sash* and *Gartner* with *Walkovszky* and *Pennsylvania Railroad*. In the latter cases, the U.S. courts refused to impose group liability, noting that the imposition of such a liability on the ground that one corporation is part of a larger enterprise, is inconsistent with the *Salomon* principle. [171] The next section examines the application of the single unit liability in a group of cases known collectively as the unitary tax cases.

4.2.2.4 Unitary Tax Cases

According to Blumberg, the U.S. "courts are turning to enterprise principles in solving the legal problems involving constituent companies of corporate groups."[172] Blumberg and other commentators who claim the U.S. tends to pierce the corporate veil more than the U.K. rely on the cases in which the U.S. Supreme Court considered the suitability of the single unit liability. These cases are known collectively as the unitary tax cases. The principal cases include *Mobil Oil Corp.*

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[171] *Walkovszky*, *supra* note 23.

[172] Blumberg, "Multinational Challenge," *supra* note 19 at 92 & 226. Blumberg noted that "The law of [enterprise liability] rests on two unifying factors that lead, in appropriate cases, to the application of enterprise principles to impose intragroup liability or other legal consequences in place of traditional entity law. These primary unifying factors are "control," typically arising from ownership or control of voting stock, and economic interrelationship. These factors are the hallmark of a unitary enterprise that has been fragmented among the affiliated corporations as a matter of legal form, with the companies continuing in the collective conduct of the business under a central, coordinated control."

v Commissioner of Taxes (1980); *Exxon Corp. v Wisconsin Department of Revenue* (1980); *ASARCO, Inc. v. Idaho State Tax Commission* (1982); *F.W. Woolworth Co. v Taxation & Revenue Department* (1982); and *Container Corp. of Am. v Franchise Tax Bd*. (1983).[173]

In determining whether to impose a single unit liability in *Exxon Corp*, the Supreme Court of the U.S. noted that it is necessary to consider the underlying economic goal of the enterprise as a whole, not the form of business activity being carried out. The Supreme Court went on to emphasize that "one must look principally at the underlying activity, not the form of investment… [because] the form of business organization may have nothing to do with the underlying unity or diversity of business enterprise.[174]

Having considered the economic objective of *Exxon Corp*., as well as the highly integrated nature of its business operation, the Supreme Court concluded that it was appropriate to impose a single unit liability on *Exxon Corp*. The Court noted that it was "irrelevant that Exxon organized functionally into marketing, exploration, and production and conducted only marketing activities within the state, where the marketing was an integral part of a "highly integrated business…""[175]

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[173] *Mobil Oil Corp. v Commissioner of Taxes*, 445 U.S. 425 (1980) [*Mobil Oil*]; *Exxon Corp. v Wisconsin Department of Revenue*, 447 U.S. 207 (1980) [*Exxon Corp*]; *ASARCO, Inc. v Idaho State Tax Commission*, 458 US 307 (1982) [*ASARCO*]; *FW Woolworth Co. v Taxation & Revenue Department*, 458 U.S. 354 (1982) [*F W Woolworth*]; and *Container Corp. of Am. v Franchise Tax Bd*., 463 U.S. 159 [*Container Corp*].
[174] *Ibid*.
[175] *Exxon Corp., supra* note 173 at 219-20, 224-25. See also *Mobil Oil, supra* note 173 at 440-41.

A similar decision was reached in *Copperweld Corp. v Independence Tube Co.*, (1984).[176] In this case, the Supreme Court held that the "coordinated activity of a parent and its wholly owned subsidiary must be viewed as that of a single enterprise."[177] The Supreme Court's decision to impose a single unit liability in *Copperweld Corp*. was based on a finding that the parent and its subsidiary "always have a unity of purpose or common design."[178]

Recently, the single unit doctrine of *alter ego* liability was invoked by the California Court of Appeal to disregard the corporate form in *Toho-Towa Co. v Morgan Creek Prods., Inc.*, (2013).[179] The issue in this case was whether Morgan Creek Productions, Inc., ("MCP"), a Delaware corporation, with its principal place of business in Los Angeles and its two subsidiaries or affiliates - Morgan Creek International B.V ("MCI"), Netherlands, and Morgan Creek International Ltd., ("MCIL"), Bermuda - constituted a single business enterprise. The answer to this question would determine whether to impose a single unit liability on MCP for the debts of MCI and MCIL or not. The trial judge answered the question in the affirmative and awarded $ 5.7 million to Toho-Towa Co., Ltd., a Japanese company. The defendant appealed the judgment order arguing that the trial judge erred in ruling that the three companies constituted a single business enterprise. The Court of Appeal dismissed the appeal and affirmed the trial judge's ruling.

While there is some evidence to suggest that the US courts are gradually applying the single unit doctrine to impose group liability especially in tax cases, not all the unitary tax cases referred to

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[176] *Copperweld Corp. v Independence Tube Co*., 467 U.S. 752 (1984) [*Copperweld*].
[177] *Ibid*.
[178] *Ibid* at 771-74.
[179] *Toho-Towa Co. v Morgan Creek Prods., Inc.*, 159 Cal Rptr (3d) 469 (2013) at 480 [*Toho-Towa*].

above successfully invoked the single unit liability. For example, in *FW Woolworth*, the Supreme Court refused to find that a group of companies constituted a single economic unit. The Court reached that decision on the basis that the overseas subsidiaries of the parent were responsible for the selection of their own merchandize and store site, as well as responsible for their own accounting without any “centralized purchasing, manufacturing, or warehousing” or “central personnel training.”[180]

Although the circumstances under which the courts may invoke the single unit liability is easy to articulate in theory, it is difficult to apply in practice. Like the rigid U.K. approach discussed elsewhere in this thesis, there is no universal test for invoking the single unit doctrine. Again, like the traditional entity law approach, the determination of the single unit liability is case-specific. Given that the application of the single unit doctrine suffers similar imperfections as the rigid U.K. approach, it seems rather too premature to celebrate the influence (if any) that the single unit doctrine is having on U.S. veil piercing jurisprudence. If there is any influence, it relates mostly to tax cases.

The question then is why the courts often pierce the corporate veil in tax cases but not in tort cases. Given that the majority of the income tax liability cases in which the courts pierced the corporate veil happened under a specific statute, the infringement of limited liability and separate corporate personality in income tax liability cases has been justified on the basis that it furthers legislative

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[180] *FW Woolworth, supra* note 173 at 466-70.

objectives. This underscores the reason why the courts are generally opposed to corporations abusing the corporate form in order to defeat income tax legislations or regulations.

Furthermore, since all governments depend on taxation for a number of reasons, the ability to collect taxes in order to fund major infrastructure projects would be severely jeopardized if businesses are permitted to use separate corporate personality to evade, avoid or reduce their tax liabilities. For this reason, the courts tend to focus their inquiry on whether interposing the corporate form would defeat a legislative purpose. If so, the court is likely to pierce the corporate veil and impose liability.

In addition, imposing income tax liability on a group of companies as a whole as opposed to doing so on an individual unit basis certainly increases the size of the income for corporation tax purposes. It seems, however, that insofar as income tax liability is concerned, the courts treat the principles of limited liability and separate corporate personality entity less seriously by piercing the corporate veil, if circumstances warrant it. It is intriguing that this justification for piercing the corporate veil is so compelling in tax cases and for the purpose of revenue collection, but not in tort cases.

Notwithstanding the unjust results highlighted throughout this thesis, the courts remain committed to applying the entity law principles rigidly in tort liability cases, and by doing so, continue to preserve limited liability and the separateness of each company within corporate groups. It seems that in tort cases, the focus of veil piercing inquiry is not to set aside limited liability and separate corporate personality because the circumstances that may warrant such an action are always rare.

This is why the courts pierce the veil less frequently in tort cases as compared to income tax or contract cases, a result confirmed by Thompson and Matheson.[181]

Although it is beyond the scope of this thesis to examine the influence of the Alien Tort Statute (ATS) or Alien Tort Claims Act (ATCA) on U.S. veil piercing, it is worth pointing out that some of the tort related litigations against multinational corporations have been brought under ATCA. Notable cases include *Doe v Unocal* (1996);[182] *Wiwa v Royal Dutch Shell Petroleum* (2002);[183] *Larry Bowoto v Chevron Texaco Corp*. (2004);[184] *Romero v Drummond Coal, Inc*. (2008); *Sinaltrainal v Coca-Cola Co.* (2009); and *Bauman v Daimler Chrysler Corp*. (2009).[185]

In conclusion, while there is some evidence to suggest that veil piercing in the U.S. is more 'liberalized' as compared to the more rigid U.K. approach, veil piercing jurisprudence in the U.S. suffers from almost the same or similar imperfections as its U.K. counterpart. In relation to the single unit doctrine, the majority of the cases in which the U.S. courts invoke this doctrine deal exclusively with income tax liability as opposed to tort liability. But even if the U.S. courts seem

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[181] Thompson, "Empirical Study," *supra* note 101. See also John H Matheson, "Why Courts Pierce: An Empirical Study of Piercing the Corporate Veil" (2010) 7 Berkeley Business Law Journal 1 at 4; Robert H Thompson, "Piercing the Veil within Corporate Groups: Corporate Shareholders as Mere Investors" (1999) 13 Connecticut Journal of International Law 379 at 387 [Thompson, "Corporate Groups"].
[182] *Doe v Unocal* 936 F Supp 880 (U.S. Dist Ct, CD Cal 1997), (U.S. Dist Ct, CD Cal August 31, 2000) 2000 U.S. LEXIS 13327, vacated by U.S. CA 9th Cir: *John Doe v Unocal* 403 F (3d) 708 (2005), (U.S. CA 9th Cir, April 27, 2001) 248 F (3d) 915 [*Unocal*].
[183] *Wiwa v Royal Dutch Shell Petroleum*, No 96 Civ 8386, 2002 U.S. Dist LEXIS 3293 (S.D.N.Y 2002).
[184] *Larry Bowoto v Chevron Texaco Corp*. 2004 U.S. Dist LEXIS 4603 (U.S. Dist Ct ND Cal 2004).
[185] *Wiwa v Royal Dutch Shell Petroleum*, 226 F.3rd 22 (2d Cir. 2000); *Romero v. Drummond Coal, Inc.*, 552 F (3d) 1303 (11th Cir 2008); *Sinaltrainal, supra* note 76; and *Bauman v. Daimler Chrysler Corp.*, 579 F (3d) 1088 (9th Cir 2009).

more willing to pierce the corporate veil and impose tax liability on corporate groups, the courts do not always do so in every tax case.

Given that veil piercing jurisprudence in the U.S. suffers from similar deficiencies as its U.K. counterpart, in the sense that it is unprincipled and contradictory, it seems misleading to describe the U.S. approach as embracing elements of a single unit or enterprise liability as opposed to entity liability.[186] Moreover, contrary to the perception that the U.S. courts tend to pierce the corporate veil more often in tort cases than in contract, one thing is clear - the single unit doctrine has made virtually no impact in tort cases.[187] A study conducted by Thompson shows that the imposition of single unit liability on corporate groups is least likely in tort cases.[188] Accordingly, the utility of the single unit doctrine vis-à-vis tortious liability of corporate groups may be open to doubt. Furthermore, the duality of U.S. veil piercing coupled with the inconsistent case law does not offer much guidance as to the circumstances in which the courts will pierce the corporate veil in tort cases and hold a parent company liable for the acts or omissions of its subsidiary.

4.2.3 Grounds for Piercing the Corporate Veil in Canada

The Canadian legal system is modelled on the common law system, and thus, veil piercing jurisprudence in Canada is in many ways similar to the U.K. approach. However, the Canadian

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[186] Blumberg, "Multinational Challenge," *supra* note 19 at 92. Blumberg argues that the U.S. "courts are turning to enterprise principles in solving the legal problems involving constituent companies of corporate groups."
[187] Muchlinski, "Limited Liability," *supra* note 26 at 920.
[188] Thompson, "Empirical Study," *supra* note 101 at 1058. See also Thompson, "Corporate Groups," *supra* note 144 at 632.

approach is more of a hybrid, blending elements of both the U.K. and the U.S. approaches discussed above. The main grounds under which Canadian courts will pierce the corporate veil include: "agency principle,"[189] "alter ego," "controlling mind," "mere façade," and "evasion principle,"[190] as well as statutory piercing.[191] In this section, I will focus my analysis on the agency, *alter ego* and the "controlling mind" principle and treat them as one, but only for the purposes of this thesis.

4.2.3.1 Agency, *Alter Ego* or Controlling Mind

In *Transamerica Life Insurance Co. of Canada v Canada Life Assurance Co.* (1996)[192] Sharpe J (as he then was) established a two-prong test for piercing the corporate veil under the agency ground. In formulating this test Sharpe J stated as follows:

> … the courts will disregard the separate legal personality of a corporate entity where it is completely dominated and controlled and being used as a shield for fraudulent or improper conduct. The first element, "complete control", requires more than ownership. It must be shown that there is complete domination and that the subsidiary company does not, in fact, function independently… The second element relates to the nature of the conduct: is there "conduct akin to fraud that would otherwise unjustly deprive claimants of their rights?[193]

[189] See *Dumbrell v Regional Group of Companies Inc*., (2007) 85 OR (3d). 616 (CA) at 80. See also *Globex Foreign Exchange v Launt*, [2011] 335 DLR (4th) 257 (NSCA) at 21-2.
[190] See generally the following cases where the evasion principle has been applied, albeit on limited occasions: *MD Donald Ltd. v Brown*, [1933] SCR 41 1 at 422; *General Security Co. of Canada v Howard Sand & Gravel Co.,* [1954] SCR 785 at 790 & 794; *Esso Standard (Inter-America) v IW Enterprises*, [1963] SCR 144 at 150-151; *Miller v Ameri-Cana Motel Ltd.*, [1983] 1 SCR 229 at 238-239; *Marzetti v Marzetti*, [1994] 2 SCR 765 at 803-804.
[191] Statutory veil piercing often arises in the context of tax and revenue law: see the discussion in *Buanderie cemrale de Montreal Inc. v Montreal (City)*, [1994] 3 SCR 29.
[192] *Transamerica Life Insurance Co. of Canada v Canada Life Assurance Co.*, (1996) 28 OR (3d) 423 (Ont. Gen. Div.), aff'd 1997 CarswellOnt 3496 (Ont. CA) [*Transamerica*].
[193] *Ibid* at 433-434.

Under the *Transamerica* two-prong test, it is necessary to show: (1) evidence of control or domination by the controlling shareholder; and (2) proof that the controlling shareholder used "that domination to conceal egregious wrongdoing."[194] As with all other grounds discussed thus far in this thesis, it is not enough to show evidence of ownership and control, some elements of fraud or wrongdoing are required.

Case law has developed around the issue of what constitutes domination or control. Prior to the *Transamerica* decision, the Supreme Court of Canada held that control or domination of a company by another corporation or individual is sufficient to justify piercing the corporate veil. In that case - *Conseil de la Santé (Montréal) v City of Montréal* (1994), the Supreme Court described the circumstances in which a company may be regarded as the agent or *alter ego* of another corporation, noting control as the crucial factor. The Court stated as follows:

> [a] corporation may be regarded as the alter ego of another corporation when there is such a close relationship between them that what apparently concerns one actually pertains to the activities of the other. Undoubtedly a large number of factors can be identified to determine the existence of such a relationship: in my opinion, however, the one that is most explicit and most likely to cover all aspects of the concept is control.[195]

The agency or the *alter ego* concept as applied in Canada and its over-reliance on control and domination has a number of drawbacks, especially when it comes to determining tortious liability arising within corporate groups. The jurisprudence has made it clear that "unless the subsidiary is

[194] Heintzman & Kain, *supra* note 126 at 539-40.
[195] *Conseil de la Santé (Montréal) v City of Montréal*, [1994] 3 SCR 29 at 44 [*Conseil de la Santé (Montréal)*].

under the complete control of the parent and is nothing more than a conduit used by the parent to avoid liability,"[196] it cannot be regarded as the agent or *alter ego* of the parent.

Unlike individual shareholders, proving the liability of a parent company for wrongs committed by its wholly-owned or controlled subsidiary is a complex process. It requires an extensive analysis of complex documents and detailed investigations. It is an onerous exercise which requires a special commercial awareness which some of the courts are less equipped to handle. The liability determinant factors of an individual shareholder, from a veil piercing perspective, are quite different from those of a corporate shareholder (parent company). It is therefore less challenging to establish that an individual shareholder in one person or a closely-held corporation has effective control or domination of the corporation than in a parent-subsidiary structure.

Furthermore, it is unclear under what circumstances a subsidiary will be relegated to the status of an agent or *alter ego* of its parent, given the normal presumption in favour of separate corporate personality. In *Harrington v Dow Corning Corp*. (1998), the court held that the subsidiary must be "under the complete control of the parent to the extent it has no independent functions of its own" or "exercises no discretion independently of the parent."[197] Again, the problem with this independent mind test is that it is an analogy which has no bearing or relevance to the way parent-subsidiaries are related in reality.

[196] *Gregorio v Intrans-Corp.*, (1984) 18 OR (3d) 527 (CA).
[197] *Harrington v Dow Corning Corp*., (1998) 55 BCLR (3d) 316.

Although the cases referred to above seem to suggest that ownership and control are key requirements of the agency or *alter ego* doctrine, the case law has made it clear that the mere existence of parent-subsidiary relationship evidenced by ownership of shares alone is not sufficient to pierce the corporate veil.[198] Accordingly, any attempt to predict when Canadian courts will pierce the corporate veil under the agency or *alter ego* principle can be an exercise in frustration. The cases that follow serve to highlight this point.

In *Yaiguaje v Chevron Corp.* (2017),[199] the court refused to pierce the corporate veil in transnational litigation involving a U.S. parent company and its Canadian subsidiary. The facts of this case were as follows: The plaintiffs were residents of Ecuador who obtained a judgment against Chevron Corporation ("Chevron") for environmental pollution caused by oil spillage. The value of the judgment debt was $9.5 billion U.S. dollars. Chevron failed to pay the judgment debt, and since it had no asset in the jurisdiction, the plaintiffs commenced an action in Ontario, Canada, for the recognition and enforcement of the Ecuadorian judgment against Chevron and its Canadian subsidiary, Chevron Canada.

Chevron Canada was originally incorporated in 1966 and is presently a seventh-tier, indirect subsidiary of Chevron. It has no connection to the legal proceedings in Ecuador that led to the award of the judgment debt, and as such, Chevron and Chevron Canada challenged the jurisdiction

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[198] See *Cunningham v Hamilton*, (1995) 169 AR 132 (CA) at 3-4; *Actton Petroleum Sales Ltd. v British Columbia (Minister of Transportation and Highways)*, (1998) 161 DLR (4th) 481 (BCCA) at 14-19; *Meditrust Healthcare Inc. v Shoppers Drug Mart, a Division of Imasco Retail Inc.*, (2002) 61 OR (3d) 786 (CA) at 29-31.
[199] *Yaiguaje v Chevron Corp.*, (2017) 2017 ONSC 135, 2017 CarswellOnt 868 (Ont. S.C.J) [*Yaiguaje*].

of the Ontario court to hear the dispute. The trial judge dismissed this challenge and held that Ontario has jurisdiction over the matter. Chevron and Chevron Canada jointly appealed the trial judge's decision. The appeal on the issue of jurisdiction was also dismissed by the Court of Appeal for Ontario and later upheld by the Supreme Court of Canada.[200]

The issue of substantive liability was subsequently referred to the first instance court for trial where the trial judge declined to pierce the corporate veil of Chevron Canada. In refusing to pierce the corporate veil, Hainey J held that: "The evidence does not establish that Chevron Canada is Chevron's "'puppet'". Rather, I find that Chevron and Chevron Canada have a typical parent/subsidiary relationship. Chevron does not exercise complete dominance or control over the affairs of Chevron Canada."[201]

The *Yaiguaje* Court relied on the following findings of fact to support its ruling: (a) Chevron Canada was subject to its own board of directors; (b) Chevron Canada was fully capitalized and did not take financial contributions from Chevron; (c) Chevron Canada employed, trained and directed the activities of its own professional; and (d) Chevron Canada filed its own tax returns and corporate statements.[202] The *Yaiguaje* decision shows that the mere existence of a parent-subsidiary relationship or the ownership of shares by one company in another corporation alone is not sufficient to hold that one company is the agent or *alter ego* of another corporation.[203]

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[200] See *Chevron Corp. v Yaiguaje*, 2015 SCC 42 (S.C.C) and *Yaiguaje v Chevron Corp.*, 2013 ONCA 758 (Ont. CA)
[201] *Yaiguaje*, *supra* note 199 at 73.
[202] *Ibid* at 29.
[203] *Canada Life Assurance Co. v Canadian Imperial Bank of Commerce and First National City Bank of New York, Third Party*, 1974 CarswellOnt 887 [*Canada Life Assurance*].

By contrast, the Supreme Court of Canada relied on the agency principle to pierce the corporate veil in *City of Toronto v Famous Players' Canadian Corp. Ltd*. (1936).[204] The Supreme Court's decision was based on the following findings: (a) the subsidiaries were completely controlled by the parent, (b) there was no independent subsidiary book-keeping, (c) there were interlocking boards of directors, and (d) the wholly-owned subsidiaries had virtually no control of policy.

The *City of Toronto* principle was later applied in *Aluminum Company of Canada v Toronto (City)* (1944),[205] where Rand J stated that the corporate veil may be pierced where, "it can be said that the [subsidiary] company is, in fact, the puppet of the [parent]; when the directing mind and will of the [parent] reaches into and through the corporate façade of the [subsidiary] and becomes, itself, the manifesting agency."[206]

Although the use of the agency principle to pierce the corporate veil is still in flux, like the U.K., the application of this principle in Canada is not based on the traditional concept of principal-agent relationship. Instead, it is based on some form of business relationship between the parent and the subsidiary and involves the intervention of the parent in the affairs of the subsidiary.[207] The *Aluminum Company of Canada*[208] decision supports this point. However, despite the finding of control and a high degree of interlocking directorship in that case, the court found that no agency

[204] *City of Toronto v Famous Players' Canadian Corp. Ltd*. [1936] SCR 141 [City of Toronto]; affirming *Toronto (City) v Famous Players' Canadian Corp*., 1935 CanLII 15 (ON CA).
[205] *Aluminum Company of Canada v Toronto (City)*, [1944] 3 DLR 609 [*Aluminum Company of Canada*].
[206] *Ibid* at 15.
[207] Anil Hargovan & Jason Harris, "Piercing the Corporate Veil in Canada: a Comparative Analysis" (2007) 28:2 Company Lawyer 58.
[208] *Ibid* at 16.

or *alter ego* relationship exists between the parent and its subsidiary. This was based on the fact that the subsidiary carried out its own business, directed its own affairs, and as such, could not be regarded as a puppet of the parent.

As mentioned earlier, the second limb of the *Transamerica* two-prong test requires proof of some wrongdoing or improper conduct on the part of the controlling shareholder. While the U.K. or the U.S. approach definitely require some elements of fraud, some Canadian cases have held that the corporate veil may be pierced even where there is "no allegation that the controlling mind used the company to conceal its involvement in fraudulent or improper conduct."[209] In *Globex Foreign Exchange v Launt* (2011), the court held that "a party's conduct does not have to rise to the level of fraud or criminal wrongdoing before the court will pierce the corporate veil."[210] This is yet further evidence that shows that veil piercing remedy in the three jurisdictions is discretionary and subject to differing interpretations.

Like the U.K. and the U.S. approaches discussed earlier in this Chapter, Canadian veil piercing jurisprudence also lacks a universal analytical framework. Wilson J emphasized this point in *Kosmopoulos* where he stated that:

> As a general rule, a corporation is a legal entity distinct from its shareholders: *Salomon v. Salomon & Co.*, [1897] A.C. 22 (H.L.) The law on when a court may disregard this principle by "lifting the corporate veil" and regarding the company as a mere "agent" or

[209] Heintzman & Kain, *supra* note 126. For general discussions on those cases see, *Nedco Ltd. v Clark* (1973), 43 DLR (3d) 714, [1973] SJ No 409 (CA) at 19-27 (QL); *Northeast Marine Services Ltd. v Atlantic Pilotage Authority*, [1995] 2 FC 132, [1995] FCJ No 99 (CA) at 82 and 86 (QL); leave to appeal to Supreme Court of Canada refused [1995] SCCA No. 129; and *White v EBF Manufacturing Ltd.* (2005), 12 BLR (4th) 1 (NSCA) at 49-58.
[210] *Globex Foreign Exchange v Launt*, (2011) 335 DLR (4th) 257 (NSCA) at 24.

> "puppet" of its controlling shareholder or parent corporation follows no consistent principle… "[211]

Wilson J went on to suggest that the corporate veil may be pierced where to do otherwise "could yield a result 'too flagrantly opposed to justice, convenience or the interests of the Revenue."[212] However, it remains to be seen if Canadian courts will pierce the corporate veil merely on the basis of interests of justice as this ground is nothing more than an umbrella ground which has been widely rejected because of its vagueness.[213]

Insofar as veil piercing remedy is concerned, Canada's approach, though unique in its own way, still blends some elements of both the U.K. and the U.S. approaches. Canada's geographical proximity to the U.S. provides a good reason for Canadian courts to take judicial notice of some of the veil piercing cases in that jurisdiction and *vice-versa*. Although there is no evidence to show that Canadian courts are seemingly invoking the single unit doctrine to impose group liability, in one of the leading tax cases, a Canadian court invoked this doctrine to impose liability. That case is *De Salaberry Realties Ltd. v Minister of National Revenue* (1976).[214]

In *De Salaberry Realties Ltd*., the Federal Court of Appeal disregarded the separate corporate personality doctrine and treated a group of companies as a single economic unit for tax purposes.

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[211] *Kosmopoulos, supra* note 104 at 62.
[212] *Ibid*.
[213] See *BG Preco1 (Pacific Coast) Ltd. v Bon Street Holdings Ltd.*, (1989) 60 DLR (4th) 30, 1989 Carswell BC 104 (CA) at 37-39 (WLeC); *Boyd v. Wright Environmental Management Inc.*, (2008) 303 DLR (4th) 747 (Ont. CA) at 44 -46; and *Yaiguaje v Chevron Corporation*, 2013 ONSC 2527 at 97-98. See also *Transamerica, supra* note 192 aff'd [1997] OJ No. 3754.
[214] *De Salaberry Realties Ltd v Minister of National Revenue*, (1974), 46 DLR (3d) 100 (Fed. TD), aff'd. (1976), 70 DLR (3d) 706 (Fed. CA) [*De Salaberry Realties Ltd*].

Notwithstanding this result, and given that Canadian courts generally abide by the *Salomon* principle, it is unlikely the courts will move away from this sacred doctrine in lieu of enterprise liability, except perhaps in tax cases. That said, in *Emtwo Properties Inc. v Cineplex (Western Canada) Inc.*, (2011), the British Columbia Supreme Court warned against the use of tax cases to justify veil piercing in corporate groups. The *Emtwo* court noted as follows:

> The decisions in the Supreme Court of Canada relied on by the plaintiffs both concern the application of the alter ego concept in tax cases and the question of whether the activities of one entity justify treating two entities as one for tax purposes, not whether the legal obligations of a subsidiary may be attached to a parent corporation. Those authorities do not deal with an attempt to make the subsidiary's liability under a contract the liability of the parent. As the Court noted in *Aluminum Co. of Canada* at 271, where the business of the subsidiary is, in fact, the business of the parent, "[this] does not mean, however, that for other purposes the subsidiary may not be the legal entity to be dealt with."[215]

There is, therefore, good reason to believe that outside tax cases, Canadian courts will not adopt the single unit doctrine to resolve tortious liability issues arising in corporate groups. The question now is, "where does Canadian veil piercing jurisprudence fit in the broader corporate law context?"[216] In answering this question, it is necessary to note that the widely used agency or *alter ego* ground in Canada relies to some extent, on the *Smith, Stone and Knight* principle. While the *Smith, Stone and Knight* principle is rarely used in the U.K. following the landmark decision of *Adams*, Canadian courts have built upon that principle to develop their own unique veil piercing jurisprudence.[217]

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[215] *Emtwo Properties Inc. v Cineplex (Western Canada) Inc.*, [2011] BCSC 1072 at 106 [*Emtwo*].
[216] Hargovan & Harris, *supra* note 207.
[217] For recent applications of *Smith, Stone and Knight* principles, see *Sarcee Gravel Products Inc v Alberta (Workers' Compensation Board)* 2006 ABQ. 56 (CanLII), where the Honourable Madam Justice Marguerite J Trusser of the Court of Queen's Bench of Alberta held at [29]: "For purposes of this review I will assume that the *Smith, Stone and Knight* case sets out the appropriate test as all counsel have taken this position." *Scavuzzo v The Queen*, 2005 TCC

In Canada, there are instances where the courts may pierce the corporate veil and hold shareholders personally liable under certain statutory provisions.[218] However, given that the legal system of Canada closely resembles the inherited U.K. approach, it is possible that veil piercing decisions in the U.K. may have an effect on Canadian veil piercing jurisprudence just like *Smith, Stone & Knight*. This next section examines the alternative doctrine that the courts sometimes use to address the liability deficit problem.

4.3 Part Two: Direct Parent Liability

Although I discuss the direct parent liability under Chapter 4 - i.e. as part of the limits of piercing the corporate, it is necessary to emphasize that direct parent liability is not a veil piercing remedy. It is generally regarded as an alternative to veil piercing remedy and mostly relied on by litigants as a back-up claim in the likely event that veil piercing remedy is unsuccessful.

As previously mentioned, the corporate veil and the jurisdictional veil pose a challenge particularly to claimants seeking to bring an action against a non-resident foreign parent company for wrongs committed by its wholly-owned or controlled subsidiary in a different jurisdiction. One way to address this issue is to bring a direct action against the parent corporation under ordinary tort

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772 (CanLII); *Nova Scotia Power Inc v The Queen*, 2002 CanLII 906 (TCC); *BMF Trading v Abraxis Holdings Ltd*, 2002 BCSC 590 (CanLII); (2002) 219 DLR (4th) 533; *International Trademarks, Inc v Clearly Canadian Beverage Corp*, 1999 CanLII 5824 (BC SC).

[218] See generally CBCA, *supra* note 62, sections 38(4) (violation of capital reduction statutes), section 118(4) or (5) (shares in exchange for kick-backs), section 146(5) (unanimous shareholder agreements limiting directors), and section 226(4) or (5) (shareholders forced to return property if it otherwise would have been available to creditors at time of dissolution).

principle of joint tortfeasor. Thus, to establish direct liability of a parent company, it must be shown that, "by its actions or omissions, it was a joint tortfeasor with its subsidiary."[219] This is entirely based on tort law, not corporate law.

Before examining the case law in connection with the application of direct parent liability, it is important to bear in mind that this alternative way of addressing the liability deficit problem has not been fully adopted by the courts. In fact, the cases in which the courts invoked the direct liability principle could also be decided under some of the grounds already discussed in this chapter. For this reason, it is not necessary to offer a detailed analysis of the case law regarding the direct liability principle.

One of the leading cases in which the court imposed direct parent liability on a multinational corporate group is *Amoco Cadiz* (1984).[220] The facts were as follows: In 1978, the *Amoco Cadiz* tanker grounded off the coast of Northern France, resulting in the spillage of a substantial quantity of crude oil. The oil spillage caused widespread environmental and ecological damage. As a result, the French government, French individuals, businesses, and associations brought an action against the Amoco Transport Company ("Amoco Transport"), Amoco International Oil and Company ("AIOC"), and their parent, Standard Oil Company (now Amoco Corporation) for negligence.

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[219] Muchlinski, "Multinational Enterprises," *supra* note 2 at 309.

[220] *The Amoco Cadiz* [1984] 2 Lloyd's Rep 304 [*The Amoco Cadiz*]. See also 659 F (2d)780 (7th Cir 1981); 699 F (2d) 909 (7th Cir 1983).

The court found the parent company directly responsible for the tortious acts of its wholly-owned subsidiaries on the ground that the parent:

> … exercised such control over its subsidiaries … that those entities would be considered to be mere instrumentalities of [the parent]. Furthermore, [the parent] itself was initially involved in and controlled the design, construction, operation and management of Amoco Cadiz and treated that vessel as if it were its own. [The parent] therefore is liable for its own negligence and the negligence of [its subsidiaries] with respect to the design, operation, maintenance, repair and crew training of Amoco Cadiz.[221]

In my view, if the *Amoco Cadiz* Court had decided this case under the *alter ego* doctrine or the instrumentality ground discussed above, the court could have reached a similar conclusion. Also worth noting is that the trial judge cited no authority to support the imposition of direct liability on the parent company. The finding of direct liability against the parent company in *Amoco Cadiz* based on (a) the active involvement of the parent in the alleged tort, and (b) on its close control over the conducts of the subsidiaries, is hard to reconcile with *United States v Bestfoods*, (1998).[222] In *Bestfoods*, the court emphasized that the active participation in and control over the operations of a subsidiary was insufficient to render a parent liable for the acts of its subsidiary.[223]

Although the direct parent liability is not unique to only the U.S. or Canada, there is an emerging trend of case law in Canada where plaintiffs attempt to hold a parent company directly liable for

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[221] *The Amoco Cadiz*, *supra* note 217 at 338.
[222] Muchlinski, "Multinational Enterprises," *supra* note 2 at 311, citing numerous U.S. cases such as *Moffat v Goodyear Tyre & Rubber Co* 652 SW (2d) 609 (Texas CA 1983); *Liberty Financial Management Corp v Beneficial Data Processing Corp* 670 SW (2d) 40 (Miss CA 1984); *Grywczynski v Shasta Beverages Inc* 606 F Supp 61 (ND Cal 1984) where "the existence of the parent/subsidiary relationship, and the integrated nature of the corporate group, is insufficient to ground parent company liability for the tortious acts of its subsidiary."
[223] *United States v Bestfoods*, 524 U.S. 51 (1998) [*Bestfoods*]. See also *Greene King plc v Harlow*, [2004] 2 All ER 102 (QBD).

wrongs committed by its overseas subsidiary. Recent attempts by Canadian courts to pierce the parent's veil or assign tortious liability directly to the parent for the actions or omissions of its subsidiary illustrate this point. Note, however, that the cases referred to below only deal with procedural issues such as jurisdiction and stay of proceedings on the basis of FNC. Since some of the cases are still awaiting trial, the issue of substantive liability has yet to be decided.

In *United Canadian Malt Ltd. v Outboard Marine Corp. of Canada* (2000),[224] the Ontario Superior Court of Justice allowed a tort claim against a U.S. parent company to proceed to trial. In this case, the plaintiff brought an action against a Canadian subsidiary of a U.S. parent company, its individual directors, and officers as well as the parent company. The plaintiff claimed that its property had been contaminated by leachate originating from the operation of the subsidiary company. The defendants brought a motion to strike out the case on the basis of lack of reasonable cause of action. The court rejected the motion to strike out the case and held that the plaintiff had an arguable case that the parent "managed, directed and controlled" the operations of the subsidiary.[225]

Similarly, in *Choc v Hudbay Minerals Inc.* (2013),[226] the Ontario Superior Court of Justice allowed a claim against Hudbay Minerals Inc. ("Hudbay"), HMI Nickel Inc. ("HMI") and Compania Guatemalteca De Niguel ("CGN") to proceed to trial. The plaintiffs, in this case, were indigenous Mayans from Guatemala who sought damages against the parent company, Hudbay, and its

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[224] *United Canadian Malt Ltd. v Outboard Marine Corp. of Canada*, (2000) 34 CELR (NS) 116.
[225] *Ibid* at para 22.
[226] *Choc v Hudbay Minerals Inc*., 2013 ONSC 1414 [*Choc*].

subsidiaries for alleged human rights abuses by security personnel at the Guatemalan mine site. The plaintiffs argued that the parent company was negligent in its management of the security personnel at the mine site and therefore should be directly liable.[227] The parent company brought a motion to dismiss the case on the ground that it disclosed no cause of action. The court rejected this and allowed the case to proceed to trial.

The openness of the Ontario court to recognize the possibility of direct parent liability inspired two similar actions in British Columbia. The first is *Garcia v Tahoe Resources Inc*., (2017); [228] the second is *Araya v Nevsun Resources Ltd*. (2016).[229] In the latter case, the British Columbia Supreme Court allowed the plaintiffs' claim against a Canadian parent and its subsidiary for a tort allegedly committed in Eritrea to proceed to trial. Given that all the three cases mentioned above are yet to be decided, there is a possibility they may end up being settled out of court.

What is unique about the direct parent liability approach is that the legal theory advanced in invoking such a liability is novel in that rather than piercing the veil of the parent, the plaintiffs seek instead to hold the parent directly liable as a joint tortfeassor based on tort law principle. This essentially requires the plaintiff to establish a duty of care, breach, causation, remoteness and damages.[230]

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[227] *Ibid* at paras 24-6.
[228] *Garcia v Tahoe Resources Inc*., 2017 BCCA 39, reversing *Garcia v Tahoe Resources Inc.* 2015 BCSC 2045 [*Garcia*].
[229] *Araya v Nevsun Resources Ltd*., 2016 BCSC 1856 [*Nevsun*].
[230] To establish a novel duty of care, the plaintiff must follow the test laid down by the House in *Anns v Merton London Borough Council,* [1978] AC 728 (HL). This test was adopted by the Supreme Court of Canada in *Kamloops (City of) v Nielson*, [1984] 2 SCR 2 and later affirmed by the same Court in *Odhavji Estate v Woodhouse*, 2003 SCC 69.

Furthermore, the direct parent liability cases reviewed thus far focused mainly on the affirmative actions of a parent corporation in relation to the operating of its subsidiary. While this may offer an alternative route for avoiding the ambiguities surrounding traditional veil piercing under the entity law principles, a review of the cases illustrates that it is not easy to hold a parent corporation directly liable for the action or omission of its subsidiary on a traditional tort principle.[231]

Like the indirect veil piercing remedy discussed above, the direct parent liability also has its limitations. Primarily, since it operates in a legal system that is generally welded in the concept of entity law principles,[232] it is incapable of displacing the traditional veil piercing approach.[233] The strong presumption of non-liability also makes it difficult to hold a parent company directly liable as a joint tortfeasor or assign the tortious liability of the subsidiary directly to the parent.

Secondly, the essential factors required to establish direct parent liability depend on control or active/direct involvement of the parent in the operation of the subsidiary.[234] As such, and in the absence of clear evidence of direct control or specific involvement, it is difficult to prove such a liability especially when the corporate governance structure of the whole group and its decision-making is decentralized. Even where those essential factors are established, "the prevailing principle remains that of preserving the legal separation of parent and subsidiary."[235]

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[231] See, for example, *Aguinda v Texaco*, 142 F Supp (2d) 534 (S.D.N.Y 2001).
[232] Blumberg, "Multinational Challenge," *supra* note 19 at 96.
[233] *Ibid*.
[234] Muchlinski, "Multinational Enterprises," *supra* note 2 at 309.
[235] OECD, *supra* note 6 at paras 65-70.

Finally, since the direct parent liability requires the plaintiff to prove the parent's specific involvement in the alleged tort, it is more difficult to prove, compared to establishing the parent's equity ownership of its subsidiary. The direct parent liability poses a fundamental threat to the principles of separate corporate personality and limited liability because it may result in "unlimited liability of parent companies."[236]

4.4 Chapter Summary

This Chapter has sought to discuss the limitations of veil piercing doctrine in comparative perspective. While there is a substantial body of case law regarding the circumstances in which the courts will pierce the corporate veil in the U.K., the U.S. and Canada, veil piercing "seems to happen freakishly. Like lightning, it is rare, severe and unprincipled."[237] Veil piercing is fundamentally inconsistent with the economic realities of how parent and subsidiary companies are related, and as such, it fails to address the liability deficit problem highlighted in this thesis. Despite this, strong policy considerations nonetheless still support its use. We must now determine what protection to put in place to guard against the abuses of limited liability and separate corporate personality, and to protect tort victims from exposure to liability. In the next Chapter, I explore some of the ways to remedy the liability deficit problem of corporate groups.

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[236] Antunes, *supra* note 3 at 298.
[237] Easterbrook & Fischel, *supra* note 84.

Though the liability deficit problem discussed in this thesis exists in all areas of business activities (i.e., from contractual liability, to product liability, to environmental liability, to human rights related liability), this thesis focuses exclusively on tort liability. My decision to focus on tort liability is due to the vulnerability of tort victims and the unjust results that the current veil piercing remedy produces in this particular area. While there is no one-size-fits-all approach, I believe the best way to address the liability deficit problem is to tackle the root cause of the problem.

Given that limited liability was created by an Act of Parliament or Congress, only the legislature can plug the loopholes and the imbalance created by this doctrine, and thereby remedy the liability deficit problem. In calling for legislative correction of the liability deficit problem in tort cases, I am mindful that some commentators believe the resulting consequences of limited liability could be remedied in some other ways.[238]

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[238] See generally the following: (1) George W Dent, "Limited Liability in Environmental Law" (1991) 26 Wake Forest Law Review 151 at 178, proposes a "reasonable prudence" test for imposing limited liability on controlling shareholders; (2) Halpern et al., *supra* note 63 at 148-49, call for unlimited liability for small, closely-held corporations in both tort and contract, and suggest that directors of large, publicly-traded corporations be held personally liable to involuntary creditors; (3) Blumberg, "Multinational Challenge," *supra* note 19 at 136, suggests that limited liability should be abolished among individual units within corporate groups; (4) Alan Schwartz, "Products Liability. Corporate Structure, and Bankruptcy: Toxic Substances and the Remote Risk Relationship" (1985) 14 Journal of Legal Studies 689 at 716-17, calls for the abolition of limited liability for "knowable tort risks," without specifying whether shareholders or only directors should be made personally liable in an alternative regime; (5) Bob Tricker, "Re-inventing the Limited Liability Company" (2011) 19:4 Corporate Governance: An International Review 384, Tricker calls for the "re-invention of the corporate concept relevant to contemporary circumstances"; (5) Ireland, *supra* note 16, suggests "decoupling the privilege of limited liability from rights of control"; (6) Hansmann & Kraakman, "Unlimited Liability," *supra* note 98, call for the return of unlimited liability in non-contractual corporate liabilities; (7) David Campbell & Stephen Griffin, "Enron and the End of Corporate Governance? In Sorcha MacLeod, ed, *Global Governance and the Quest for Justice: Volume II Corporate Governance* (Oxford: Oxford University Press, 2006), call for the abandonment of limited in general.

However, I believe the need to protect non-contractual tort victims who suffer harm due to the act or omission of parent-subsidiary companies is best accomplished by imposing statutory liability on parent companies for civil wrongs committed by their wholly-owned or controlled subsidiaries. This Chapter first explores the merits of the legislative approach (i.e. the statutory assumption of liability) and then examines the judicial leniency approach.

5.1 Statutory Assumption of Liability

Under the traditional fault-based concept of tort, a party is only liable for his/her/its, act or omission that caused harm to the injured party. For this reason, imposing statutory liability on a parent company for wrongs committed by its subsidiary may raise a few concerns. Also worth mentioning is that the legislative proposal runs counter to the principles of limited liability and separate corporate personality, in particular, the normal presumption that a parent company is not liable for the debts or obligations of its subsidiary. As such, the proposal runs the risk of being opposed or rejected on the ground that imposing such a liability on corporations "would take away flexibility in the way businesses [organize] themselves and would strike at the limited liability basis for company law."[239] This is essentially the business case argument for limited liability.

In light of these concerns, in particular, the business case argument for limited liability, it is critical to examine the basis for the imposition of statutory liability on parent companies for wrongs

[239] The Company Law Review Steering Group, *Modern Company Law for a Competitive Economy: Completing the Structure* (London: DTI, 2000) at para 10.20 [CLRSG].

committed by their subsidiaries. Before doing so, it is important to clarify that this thesis proceeds with the assumption that the subsidiary company is wholly-owned or controlled by the parent. This leaves the resolution of the liability deficit problem of partly-owned/controlled subsidiaries as well as the determination of the issue of what constitutes sufficient degree of control subject to courts' interpretation. This issue is later addressed in this Chapter.

In calling for legislative change, however, it is necessary to point out that commentators including Muchlinski and Blumberg have already made a similar recommendation. Muchlinski, for example, calls for the "introduction of a statutory principle of enterprise liability for torts" along the lines suggested by Blumberg.[240] In examining the circumstances under which a subsidiary's liability arising from tort should be allocated to the parent company, this thesis relies on the following: (1) ownership and control, (2) benefit and burden principle, (3) good corporate governance and why statutory intervention is necessary?

Starting with ownership and control ground, this thesis asserts that since the subsidiary is wholly-owned or controlled by the parent company, the latter ought to be responsible for any corresponding liability arising from the act or omission of the former. In other words, to the extent the subservient subsidiary has little or no say in the way its business affairs are being governed or controlled, the dominant parent company should assume the corresponding liability arising from that business relationship.

[240] Muchlinski, "Limited Liability," *supra* note 26.

Take, for example, a tort concept of assumption of responsibility or liability. This obligation is normally imposed in relationships where one party has power, control, or influence over another party. In almost every parent-subsidiary relationship, the parent company is the dominant and controlling shareholder of its subsidiary. Given the imbalance of power usually existing between the parent and its subsidiary, it makes a logical sense that the law imposes obligation on the dominant parent corporation to assume the corresponding liability of the subservient subsidiary.

As previously mentioned, one of the main rationales for granting limited liability to individual shareholders in the nineteenth century was to protect passive investors (i.e. those who wanted to invest in corporations without being actively involved in management) from personal liability. In the absence of powers of control and management (i.e. separation of ownership and control), it made sense that the legislature granted those passive investors complete immunity from personal liability.

However, unlike individual (passive) investors, there is rarely any separation of ownership and control in a parent-subsidiary relationship. When individual shareholders are substituted for corporate shareholders (parent companies) in a modern parent-subsidiary relationship, who is the passive investor that limited liability must still protect from personal liability? Certainly not the parent company because it is the owner and often the controlling shareholder in its subsidiary. Therefore, if there is no separation of ownership and control, the rationale for shielding the parent company from liability has become moot. In other words, "the limitation of the liability of the controlling [parent] shareholder can no longer be justified on the basis of the lack of management power: in contrast to the individual shareholder…"[241]

With regards to the benefit and burden principle,[242] this thesis asserts that the legal separation between the parent and its wholly-owned or controlled subsidiary creates a false dynamics between the two corporations as though the parent and its subsidiary are operating as independent legal entities, when in reality, they are not. Since the parent company is essentially entitled to the whole profit of its wholly-owned or controlled subsidiary if it prospers, it should also be responsible for the tortious act or omission of that same company.

The benefit and burden principle attempts to address the false dynamics issue in parent-subsidiary relationships by ensuring that whoever takes the benefit bears the burden of liability. Thus, since the parent company enjoys the benefits, it must shoulder the burden of liability. The benefit-burden proposition is in line with the decision reached decades ago in *Aladdin Oil Corp. v Perluss* (1964).[243] In this case, the court held that: "Parties who determine to avail themselves of the right to do business by means of the establishment of a corporate entity must assume the burdens thereof as well as the privileges."[244]

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[241] Antunes, *supra* note 3 at 132.
[242] The benefit and burden principle which is well-known in common law tradition especially in property law. The benefit and burden principle was first used in *Halsall v Brizell* [1957] Ch 169 Ch.D, and recently applied in *Elwood v Goodman* [2013] EWCA Civ 1103.
[243] *Aladdin Oil Corp. v Perluss*, 41 Cal Rptr 239 (Cal App 1964).
[244] *Ibid* at 246.

A similar point, although on a slightly different equitable principle of unconscionability has been echoed by Lady Hale (with whom Lord Wilson agreed) in *Prest*.[245] In *Prest* and *VTB Capital Inc. v Nutritek International Corp*., (2013),[246] both Lords Neuberger and Sumption respectively suggest that some element of "wrongdoing" - either by way of "concealment" or "evasion" - must be present before the courts will pierce the corporate veil.

In questioning whether it is appropriate to classify the cases in which the courts will pierce the veil into cases of either concealment or evasion,[247] Lady Hale stated that: "[t]hey may simply be examples of the principle that the individuals who operate limited companies should not be allowed to take unconscionable advantage of the people [and society] with whom they do business."[248]

Allowing parent companies to profit from the activities of their wholly-owned or controlled subsidiaries while at the same time avoiding liability for wrongs committed by that same entity is wholly unconscionable. For this reason, this thesis suggests that the benefit and burden principle

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[245] *Prest*, *supra* note 15 at para 35. Lord Sumption proposed the following test for when the corporate veil could be pierced: "I conclude that there is a limited principle of English law which applies when a person is under an existing legal obligation or liability or subject to an existing legal restriction which he deliberately evades or whose enforcement he deliberately frustrates by interposing a company under his control. The court may then pierce the corporate veil for the purpose, and only for the purpose, of depriving the company or its controller of the advantage that they would otherwise have obtained by the company's separate legal personality. The principle is properly described as a limited one because in almost every case where the test is satisfied, the facts will in practice disclose a legal relationship between the company and its controller which will make it unnecessary to pierce the corporate veil. … I consider that if it is not necessary to pierce the corporate veil, it is not appropriate to do so because on that footing there is no public policy imperative which justifies that course."
[246] See, *VTB Capital Inc. v Nutritek International Corp*., [2013] UKSC 5 [*VTB*] at para 142, where Lord Neuberger stated as follows: "In my view, if the corporate veil is to be pierced, "the true facts" must mean that, in reality, it is the person behind the company, rather than the company, which is the relevant actor or recipient (as the case may be)."
[247] *Prest*, *supra* note 15 at para 92.
[248] *Ibid*.

should become part of the ultimate test for the imposition of statutory liability on parent companies for wrongs committed by their wholly-owned or controlled subsidiaries. The next section examines the merits of the legislative proposal from an *ex-ante* point of view.

5.1.1 Why Statutory Intervention?

The form of business enterprise has changed dramatically over the last decades. In order to respond to some of the changes brought about by the rising phenomenon of corporate groups, the attitude of the legislature and the judiciary, particularly regarding how tortious liability is allocated within corporate groups, should change. In the words of Blumberg, the nineteenth century "legal concepts fashioned to serve the needs of the largely agrarian society … have become archaic in a world where business is conducted worldwide by giant corporate groups…"[249]

While no remedy is entirely *ex-ante* or *ex-post*, the difference between the legislative proposal and the current veil piercing remedy is that, the former is an *ex-ante* remedy while the latter is an *ex-post* remedy. There are a number of reasons why an *ex-ante* remedy is more sanguine, compared to the current *ex-post* remedy. First, in light of the limitations surrounding the current veil piercing remedy (see Chapter 4 above for more details), it remains to be seen how continuous reliance on this remedy to address the liability deficit problem is still desirable.

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[249] Blumberg, "Multinational Challenge," *supra* note 19 at vii.

The court is often being called upon to wear two hats: that of the legislature and that of the judiciary. This is an untenable position because the judiciary's mandate is to apply and interpret laws, not to make laws. Without being pessimistic, this thesis asserts that the liability deficit problem has reached a crisis level that it requires a statutory intervention. After all, limited liability was created by an Act of Parliament or Congress. As such, it is only the legislature that has the constitutional mandate to limit or restrict the privilege of this doctrine in areas where it has been abused to the extent that its utility is now questionable.

The corporate form as presently constituted is characterized by irresponsibility; this has set corporations and corporate managers free without appropriate restrictions. The recent financial crisis and corporate failures of the past decades affirm this view. As part of the recent move toward better corporate governance, imposing statutory liability on corporate groups will drive corporate managers to act in accordance with reasonable commercial standards or behave more conscientiously. This will strengthen good corporate governance and restore confidence and integrity to the corporate form.

Generally, when the law imposes responsibility and liability, it makes us behave more responsibly. Take, for example, road traffic offences. If there were no such laws regulating how we drive on the road, the consequences would be disastrous. But because the law imposes such a liability on road users, it forces drivers to drive carefully and with due attention. Of course, the imposition of road traffic liability on road users does not completely eliminate the risks of accident or dangerous driving, but at the very least, it minimizes the risk of harm to road users.

Statutory intervention is not only necessary given the failure of the judiciary to address the liability deficit problem, it is also far better than the current veil piercing remedy because it is proactive instead of reactive. Thus, it warns those who seek to interpose the corporate form (i.e. by setting up shell subsidiary companies) of the potential liability if things go wrong. Though businesses are extremely adept at finding loopholes in the law in order to circumvent regulatory control,[250] if the law imposes statutory liability on corporate groups, it will force corporations to conduct their affairs conscientiously, and in a manner that is more socially responsible.

The current veil piercing remedy, as a common law principle, is largely contradictory and unprincipled. The same can be said about certain common law duties, for example, the duty to act *bona fide*. To address the contradictions surrounding the interpretation and application of the duty to act *bona fide*, and whether company directors should consider the interests of other stakeholders than shareholders, the U.K. Parliament passed the *Companies Act* in November 2006.[251] Section 172 of the *Act* adopted the enlightened shareholder value model as opposed to the traditional shareholder-oriented model.

While it is beyond the scope of this thesis to examine whether section 172 of the *Act* has changed the fundamental objective of corporations in the U.K., section 172 now sets the objective of companies for the first time in the history of U.K. company law. Section 172, among other things,

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[250] Doreen McBarnet, "Corporate Social Responsibility Beyond Law, Through Law, for Law: The New Corporate Accountability" in Doreen McBarnet, Aurora Voiculescu, & Tom Campbell, eds, *The New Corporate Accountability: Corporate Social Responsibility and the Law* (Cambridge: Cambridge University Press, 2007) at 13.
[251] Company Law Review Steering Group *Modern Company Law for a Competitive Economy: The Strategic Framework* (London: DTI, 1999) at para 5.1.1 [*The Strategic Framework*].

imposes statutory duty on directors to act in the way they consider, in good faith, would be most likely to promote the success of the company. In doing so, directors are to ‘have regard’ to the wider interests of multiple stakeholders including shareholders, employees, suppliers, customers, the community, and the environment as well as the likely consequences of any long-term decisions.[252] Section172 embodies the concept of inclusive corporate governance because it requires directors to ‘have regard’ to the wider interests of multiple stakeholders. The long-term focus of this legislative provision is likely to promote more socially responsible corporate behaviour and corporate social responsibility consciousness in the U.K.

It is worth noting that prior to the codification, the application of the common law duty to act *bona fide* was subject to various interpretations, leading to inconsistent results.[253] It is believed that the codification will go a long way towards minimizing judicial discretion and varying interpretations. In the same vein, a legislative correction of the liability deficit problem will leave little room for discretion and differing interpretations.

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[252]*Companies Act*, RSC 2006, c 46. Section 172 (1) states: “A director of a company must act in a way that he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole and in doing so have regard (amongst other matters) to –

(a) the likely consequences of any decision in the long term,
(b) the interests of the company's employees,
(c) the need to foster the company's business relationships with suppliers, customers and others,
(d) the impact of the company's operations on the community and the environment,
(e) the desirability of the company maintaining a reputation for high standards of business conduct, and
(f) the need to act fairly between the members of the company.”

[253] *Hutton v West Cork Railway Co* (1883) 23 Ch.D 654. See generally, *Peoples Department Stores Inc. (Trustee of) v Wise*, [2004] 3 SCR 461 (SCC), *Martin v Gibson*, [1907] O.J. No. 85, [1907] 15 O.L.R. 623 at 632 (Ont. H.C.J); *Parke v Daily News Ltd* [1962] 1 Ch. 927 (Ch.D). But see also *Percival v Wright*, [1902] 2 Ch 421, confirmed in *Peskin v Anderson*, [2000] 1 BCLC 1, affirmed by the Court of Appeal [2000] All ER (D) 2278; *Foss v Harbottle*, (1843) 2 Hare 461.

5.2 Judicial Leniency Approach

Thus far, I have focused my analysis on wholly-owned subsidiaries. However, not all subsidiary companies are wholly-owned. Where the subsidiary company is not wholly-owned but controlled, the courts will be responsible for making a decision as whether or not to set aside the two fundamental principles of corporate law in order to hold a parent company liable for its subsidiary's liability.

Since the courts will still be responsible for deciding whether to pierce the parent's veil, there is always the potential risk of judicial discretion to be exercised by the courts. In exercising that discretion, however, this thesis suggests that the courts should abandon the normal presumption of non-liability in favour of parent companies and adopt the economic reality test when faced with veil piercing inquiry involving partly-owned/controlled subsidiaries. The next section examines why the courts should abandon the normal presumption of non-liability in favour of parent companies in tort cases.

5.2.1 Abandon the Non-Liability Presumption

Since veil piercing remedy is the exception, not the rule, the courts usually begin the inquiry with a rebuttable presumption of non-liability in favour of shareholders: the shareholders are not generally liable for the debts or obligations of corporations of which they are shareholders. This presumption of non-liability imposes a double burden of proof on plaintiffs, particularly when it comes to veil piercing cases involving parent-subsidiary companies. First, it requires the plaintiffs to disprove the presumption by showing that the parent company should be liable for the wrongs committed by its subsidiary notwithstanding the legal separation of the two corporations. Second, the plaintiff must also prove the requisite elements of the wrongful acts or omissions that caused the harm to the satisfaction of the court.

The totality of these burdens coupled with the overall rigidity of *Salomon* meant that the current veil piercing remedy has often been applied in a most harsh and unforgiving manner, leading at times to unfair results, especially in tort cases. For this reason, this thesis suggests that the normal presumption of non-liability should be abandoned in tort cases vis-à-vis partly-owned/controlled subsidiaries. Some other justifications for abandoning the normal presumption of non-liability in tort cases include: First, limited liability was specifically designed to protect individual shareholders, not corporate shareholders, therefore shielding parent companies from liability arising from the wrongful acts or omissions of their subsidiaries is undesirable.

Second, the seminal case of *Salomon* which is often cited as the authority for the strong presumption of non-liability deals specifically with contractual liability, not tort liability. As such, *Salomon* itself is a false foundation for limited liability in tort cases (see Chapter 2 for further analysis).

Third, Judge Cardozo once remarked that veil piercing is a doctrine "enveloped in the mists of metaphor."[254] Blumberg, too, has echoed this point, noting that veil piercing is a "jurisprudence

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[254] *Berkley, supra* note 127 at 61.

by metaphor or epithet."[255] Some of the metaphors that the courts have consistently applied in veil piercing inquiry include: "agency," "alter ego," "instrumentality," "sham," "façade," "controlling mind," "head and brain," "fraud," "conduit," "department," "puppet," "cloak," or "tool."[256]

However, the over-reliance on metaphors in veil piercing inquiry coupled with the normal presumption of non-liability in favour of parent companies meant that the parent company often escapes liability for wrongs committed by its subsidiary. [257] The application of metaphors or checklists to determine when to pierce the parent's veil is unhelpful because those metaphors fail to account for the underlying economic interrelationship of parent-subsidiary arrangements.[258] Further, the complex structure of corporate groups makes it more challenging for the courts to find that a parent company is the controlling mind of its subsidiary, or has effective domination or control of the subsidiary to the extent that the subsidiary has become a puppet, conduit, agent or *alter ego* of the parent company.

Fourth, the underlying problem with the current veil piercing remedy is that the courts are not adjudicating veil piercing claims in tort cases fairly. In *Salomon*, the House of Lords made it clear that since the contractual creditors were in a position to protect their interests, but failed to do so, they were not entitled to any protection from the court. Unlike contractual creditors, non-contractual tort victims cannot protect themselves, and thus, the courts should protect them.

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[255] Blumberg, "Multinational Challenge," *supra* note 19 at 86.
[256] *Ibid*.
[257] See Thompson, "Empirical Study," *supra* note 101 and Thompson, "Corporate Groups," *supra* note 144.
[258] See Matheson, *supra* note 181.

In this regard, instead of starting veil piercing inquiry with the normal presumption of non-liability in favour of parent companies, it may be helpful if the courts focus on whether the plaintiffs have a good cause of action against the parent company notwithstanding the legal separation of the parent and its subsidiary. By focusing on the effects of harm on the victims and the harsh results that strict adherence to the *Salomon* principle would otherwise produce, it will force the courts to act with a degree of fairness and open mindedness towards those victims.

None of the foregoing should lead to the conclusion that abandoning the presumption of non-liability will result in an automatic parent liability under the proposal. As previously mentioned, where the subsidiary is not wholly-owned but controlled, the courts will still be responsible for making a decision as whether or not to pierce the parent's veil but without presuming that a parent company is not generally liable for the debts of its subsidiary, as they often do. In other words, instead of victims leading evidence to rebut the normal presumption, a parent company that seeks to deny responsibility for the acts or omissions of its partly-owned/controlled subsidiary should have the onus to prove so without relying on the corporate autonomy rule.

Given that the current veil piercing remedy is fundamentally inconsistent with the economic realities of how parent and subsidiary companies are related, how should the courts address this issue, particularly in cases involving partly-owned/controlled subsidiaries? Instead of focusing exclusive attention on the legal characterization of the parent company and its subsidiary, this thesis recommends that the courts should adopt the economic reality test. The next section examines the economic reality test and how the courts should adopt this test in practice.

5.2.2 Economic Reality Test

The traditional entity law principle of ascribing tortious liability within a group of companies does not accord well with the economic realities of the group. This stems from the fact that in veil piercing remedy the courts often focus their inquiry primarily on form over substance. It is for this reason that substance should now prevail over form. That is, the courts should adopt an economic reality-focused approach when deciding whether to impose liability on parent companies for wrongs committed by their partly-owned/controlled subsidiaries.

When dealing with the liability issues of partly-owned/controlled subsidiaries, the key issue is whether there is sufficient degree of economic relationship and control between the parent and the subsidiary. While a variety of factors such as organizational structure, intercorporate shareholding, and interlocking directorship may determine what constitutes sufficient degree of relationship, control is a crucial factor. Where the level of the intercorporate shareholding structure between the parent and its subsidiary falls below a certain threshold, (i.e. below that of a controlling shareholder), the courts may have to focus on a *de facto* control rather than a *de jure* control.

In *McGillivray Restaurant Ltd. v Canada* (2016),[259] the Federal Court of Appeal applied the *de facto* control test to deny multiple access to small business deduction (SBD - $500,000) to interrelated family businesses. In this case, Mr. Howard and Mrs. Ruth Howard operated Keg

[259] *McGillivray Restaurant Ltd. v Canada*, 2016 FCA 99 [*McGillivray*].

restaurant franchises. For the purposes of claiming multiple SBDs, the couple attempted to avoid associating the corporations by having the wife own 76% of the shares of the corporation while the husband owns the remaining 24%. The corporate structure was done in such a way that the husband's share ownership of the corporation was below the 25% cross-ownership threshold that would otherwise associate the corporations and require them to share one SBD.

In affirming the decision of the Tax Court of Canada, the Federal Court found that though the wife held 76% of the shares (making her the controlling or *de jure* owner), the husband, who was the only director and officer of the taxpayer corporation effectively managed the business, thereby having *de facto* control. Accordingly, the Court concluded that all the corporations were associated and had to share the small business deduction. *McGillivray* demonstrates an excellent way of addressing the issue of control vis-à-vis partly-owned corporations. In this case, instead of focusing on legal ownership (*de jure*) which the courts often do, the Federal Court adopted the *de facto* ownership test and reached what I believe was an appropriate decision.

When applying the economic reality test, this thesis recommends that the courts should employ the common enterprise principle instead of a single entity principle. Under the common enterprise principle, the courts should ask whether the subsidiary has "common bonds" of economic interests or association with the parent company. While the methods by which a subsidiary and its parent could be regarded as having common bonds depends on the circumstances of each case, in most cases, the answer is yes.

In determining whether a parent and its subsidiary have common bonds, the courts should look to the degree of economic integration to find out whether (a) the parent and its subsidiary share a community of economic interests, and (b) whether the business relationship between the two corporations constitutes a common enterprise. In determining (a) and (b) above, the courts should look to the connecting factors which are potentially relevant to parent-subsidiary relationships. Factors that may satisfy the common bonds test include, but are not limited to: intercorporate shareholdings, relationships of control, links of economic integrations, pursuing joint investments activities and interlocking directorships.[260]

The application of the economic reality test is illustrated by examining how it was applied in *Pacific Coast Coin Exchange of Canada Ltd. et al. v Ontario Securities Comm*ission (1978).[261] The Supreme Court of Canada adopted this test to decide whether an investment scheme constituted an "investment contract" within the meaning of sections 1(1)(22) of the Ontario *Securities Act*, 1970.[262] In this case, a promoter entered into several agreements to sell bags of silver coins on margin to investors who may or may not take actual delivery of the silver coins. The silver coins could also be resold to the promoter after the investors had paid for it.

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[260] See generally, Blumberg, "Multinational Challenge," *supra* note 19 at 226. According to Blumberg, some of the factors that define the economic contours and the decision-making structure of corporate groups include: "(a) a common public persona featuring a common trade name, logo, and marketing plan;(b) financial interdependence in which the parent or the group participates in financing of the subsidiaries, who do not raise their own capital independently; (c) administrative interdependence in which the subsidiary operates without its own legal, auditing, tax, public relations, safety, engineering, or research and development departments and relies on its parent personnel for such purposes; and (d) group identification of employees with group-wide, rather than company-by-company stock option, retirement, medical insurance, and related benefit plans, and group personnel assignments as executives move through various companies of the group during their careers."

[261] *Pacific Coast Coin Exchange of Canada Ltd. et al. v Ontario Securities Comm*ission, [1978] 2 SCR 112 [*Pacific Coast*].

[262] *Securities Act*, RSO 1970, c. 426 ss. 1(1) (22).

The issue was whether the investment activity constituted the offer and sale of securities to the public. The Supreme Court held that the commodity account agreement between the parties was an "investment contract" within the meaning of the *Act*, and therefore was a "security." The Supreme Court emphasized that the underlying policy of the *Act* is to protect the public, therefore the securities legislation must be construed broadly and in the context of economic realities. The Court noted that: "such remedial legislation must be construed broadly, and it must be read in the context of the economic realities to which it is addressed. Substance, not form, is the governing factor."[263]

Thus far, I have focused my analysis on the issue of control in relation to the liability of corporate shareholders (i.e. parent companies). However, if the controlling shareholder is an individual shareholder in a small or closely-held company, should the law impose the same statutory liability? In practice, the majority of individual controlling shareholders are personally liable in contract and in tort, therefore, the proposed statutory liability will rarely make any difference. For example, for the purpose of securing the payment of a debt or the performance of an obligation, most banks and financial institutions will only lend money to small corporations, subject to the individual controlling shareholder's personal undertakings, guarantees, or covenants.

This obviously imposes personal or unlimited liability on individual shareholders because their personal assets, including homes could be secured by a charge. As Hansmann and Kraakman point out, the controlling shareholders of closely-held corporations "must frequently assume personal

[263] *Ibid* at 43.

liability for the corporation's contractual debts in order to facilitate the firm's access to credit, and for this reason do not have an incentive to minimize personal assets that are accessible to creditors."[264]

It is important to note that imposing statutory liability on parent companies will not necessarily mean that those corporations will be in a position to satisfy any tortious liability or judgment debt that may arise. To ensure that parent companies have the financial ability to satisfy the assumed liability, this thesis suggests that parent-subsidiary companies should maintain intragroup liability insurance coverage for the benefit of non-contractual tort victims. The next section examines this issue.

5.3 Intragroup Liability Insurance Coverage

When it comes to the allocation of commercial risks, insurance is a key financial provision. The availability of insurance proceeds can provide financial compensation to victims who suffer loss, injury, or damage caused by corporate activities. Given the substantial uninsurable risks involving the activities of corporate groups vis-à-vis tortious liability, maintaining intragroup liability insurance coverage is one of the ways to address this imbalance. Against this backdrop, this thesis proposes that parent companies should be required by law to maintain intragroup liability insurance where proceeds are payable to tort victims.

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[264] Hansmann and Kraakman, "Unlimited Liability," *supra* note 98 at 1910.

The reason why parent companies should maintain intragroup liability insurance is that the majority of the subsidiary companies are shell companies – they have little or no assets. Since parent companies have the assets, they are in a better position to "insure" against any potential risks of liability than the subsidiary company. It therefore makes logical sense that the asset-owning parent company should be responsible for insuring against the risks of intragroup liability, and thus assume the corresponding liability arising out of the acts or omissions of its wholly-owned or controlled subsidiary.

While the intragroup liability insurance proposal cannot resolve the liability deficit problem, it will, at the very least, compensate tort victims for harms or losses suffered. There have been cases where corporations were found liable and judgment debt was entered in favour of the plaintiffs, but those corporations had little or no financial means to satisfy the judgment debts. This situation arises mainly in cases where the overseas subsidiary is either undercapitalized or has no assets at the time the judgment debt was entered.

When the plaintiffs in those cases later brought an action against the solvent parent company to enforce the judgment debt, the courts refused their claims, citing separate corporate personality and limited liability as a bar to the enforceability of such a judgment debt. This happened in a number of cases including, for example, *Adams* and *Yaiguaje* discussed above. Assuming mandatory intragroup liability insurance coverage was in place, the plaintiffs in these cases could have received some financial compensation instead of being left with nothing.

In addition to compensating tort victims, it is also in the interest of parent companies to maintain intragroup liability insurance coverage as this will limit or reduce their own liability exposure for wrongs committed by their wholly-owned or controlled subsidiaries. The protection of parent companies from exposure to liability is illustrated by reference to directors' errors and omissions (E&O) insurance coverage which is available under certain statutes.

Under the Canadian *Income Tax Act*, 1985,[265] if a corporation fails to comply with the requirements of the *Act* (i.e., by defaulting on income taxes, or failing to withhold or remit certain amounts on account of income taxes, or evading income taxes), the directors are also jointly and severally liable with the corporation for those offences. One way of reducing the directors' potential personal income tax liability is for the corporation to purchase E&O insurance on behalf of the directors.[266]

Compliance with the proposed liability insurance coverage would not be burdensome on corporate groups because corporations are generally required by law to carry various types of liability insurance coverage.[267] The only difference is that, under the proposed recommendation, the liability insurance proceeds are payable to tort victims who suffer harm and can establish provable claims against the parent-subsidiary company. One way of showing that the insurance is actually in place is by way of insurance certificate showing proceeds as payable to tort victims.

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[265] See, *Income Tax Act*, R.S.C., 1985, c. 1

[266] See, *Canada Business Corporation Act*, R.S.C., 1985, c C-44, s 124(4).

[267] Timo Rapakko, *Unlimited Shareholder Liability in Multinationals* (Kluwer Law International: Boston,1997) at 175.

Before concluding this chapter, it is important to reiterate that the legislative proposal runs counter to the principles of limited liability and separate corporate personality, and as such, it runs the risk of being opposed or rejected. In considering this possibility, this thesis suggests that in the event the legislative proposal does not work because of a lack of political will, the courts should adopt the judicial leniency approach in all tort-related veil piercing cases regardless of whether the subsidiary is wholly-owned, partly-owned or controlled

In summary, I would like to ask whether it would be just and equitable in light of the liability deficit problem addressed in this thesis, for a solvent parent company to bear the burden of tortious liability instead of the party of limited means – tort victims? In answering this question, it is worth noting that throughout the centuries, the Courts of Equity have been called upon to fashion a remedy that is just and equitable in the circumstance.

While it is not always easy to reach a fair conclusion due to competing needs which ought to be balanced, in veil piercing inquiry, however, the courts should decide whether it is equitable or inequitable to shield a group of companies whose wrongful conduct caused injury, harm, loss, or damage to tort victims from liability. No doubt, corporations are more likely to take risks if they do not bear the burden of liability. This is why a new legislative channel must be cut through the principles of limited liability and separate corporate personality to allow those who interpose the corporate form to carry on business to also bear the corresponding burden of liability if things go wrong.

Chapter 6: Conclusion

Multinational corporate groups are now the "world's dominant economic institution."[268] But there is currently no legislation or regulation in the U.K., the U.S. or Canada that sufficiently governs how intragroup liability arising within corporate groups should be allocated. This thesis focuses on the circumstances under which a subsidiary's tortious liability should be attributed to the parent company. Holding a parent company liable for wrongs committed by its subsidiary and, in this way, addressing a liability 'deficit' that might otherwise arise without this allocation of responsibility is contrary to the principles of limited liability and separate corporate personality.

The liability deficit problem characteristic of corporate groups is a growing problem because it creates double immunity for corporate groups: one between the parent and its wholly-owned or controlled subsidiary, another between the parent company and its shareholders. While the courts have attempted to address the liability deficit problem through the common law doctrine of veil piercing, this remedy is the exception, not the rule. The jurisprudence surrounding veil piercing has made it clear that it is highly discretionary and case-specific. As such, there is a significant variation in the way the courts apply this remedy, leading to ambiguities and inconsistent results.

Since veil piercing remedy is fundamentally inconsistent with the economic realities of how parent and subsidiary companies are related, the liability deficit problem which the courts have been attempting to address through incremental adjustment still remains. This, thesis, therefore argues

[268] Bakan, *supra* note 1 at 5.

that the best way to address the liability deficit problem is to tackle the root cause of the problem: limited liability.

Since limited liability was created by an Act of Parliament or Congress, this thesis asserts that only the legislature can plug the loopholes and the imbalance created by limited liability, thereby remedying the liability deficit problem. Against this backdrop, this thesis calls for legislative correction of the liability deficit problem in tort cases. In making this recommendation for legislative reform, this thesis suggests that parent companies should be required by law to assume the tortious liability of their wholly-owned or controlled subsidiaries, and that corporate groups should maintain intragroup liability insurance coverage where proceeds are payable to tort victims.

In calling for legislative intervention, I believe the need to protect non-contractual tort victims who suffer harm caused by wrongful act or omission of parent-subsidiary companies is best accomplished by imposing statutory liability on parent companies. That said, the legislative proposal is not a bright-line rule; it has its limitations and challenges. Where the subsidiary company is not wholly-owned but controlled, the courts will be responsible for making a decision as whether or not to set aside the two fundamental principles of corporate law in order to hold a parent company liable for its subsidiary’s liability.

Since the courts will still be responsible for making a decision as whether or not to pierce the parent’s veil, there is always the potential risk of judicial discretion to be exercised by the courts. In exercising that discretion, however, this thesis suggests that the courts should abandon the normal presumption of non-liability in favour of parent companies and adopt the economic reality test when faced with veil piercing inquiry involving partly-owned/controlled subsidiaries.

The main challenge of the legislative proposal is that there is a recognized possibility that it may not be pursued due to its chilling effect on the fundamental principles of corporate law (i.e. limited liability and separate corporate personality). Limited liability and separate corporate personality are generally regarded as an economically convenient way of conducting business. As the twin concepts of the entity law principle, they continue to prevail and show no signs of being superseded. Notwithstanding that the entity law principle is inconsistent in many ways with the economic realities of how parent companies and subsidiaries are related, strong policy considerations nonetheless still support its use.

Given that the entity law principle still provides the legal framework that governs the relationships between individual corporations operating within corporate groups, it will require a monumental effort to dislodge or replace it with any other concept that strikes against it. As the U.K. Company Law Review Steering (Steering Group) recently pointed out, there is currently no "jurisdiction providing for parent companies to be automatically liable for the torts or delicts of their subsidiaries."[269]

[269] CLRSG, *supra* note 239 at para 10.59.

Since the legislative proposal runs counter to the twin concepts of the entity law principle, it runs the risk of being opposed or rejected. It seems therefore that the implementation of the proposed legislative reform may prove difficult in practice. In considering this possibility, this thesis suggests that in the event the legislative proposal does not work due to a lack of political will, the courts should adopt the judicial leniency approach in all tort-related veil piercing cases regardless of whether the subsidiary is wholly-owned, partly-owned or controlled.

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