

THE LEGAL MEASURES AGAINST THE ABUSE OF SEPARATE CORPORATE PERSONALITY AND LIMITED LIABILITY BY CORPORATE GROUPS: THE SCOPE OF *CHANDLER v CAPE PLC* AND *THOMPSON v RENWICK GROUP PLC*

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Abstract: While the scope of ‘veil lifting’ has been severely restricted in UK case law, two recent notable judgments, *Chandler v Cape Plc* and *Thompson v Renwick Group Plc*, have held that a parent company could owe tortious liability for the health and safety of its subsidiary’s employees. This article contends that the legal principle recognised in *Chandler* and *Thompson* could successfully prevent corporate group abuses of separate corporate personality and limited liability, when combined with ‘veil lifting’ and protection against misrepresentation in UK law. With reference to the theoretical justification of limited liability, there are three circumstances in which limited liability should not apply: *ex ante* opportunism, *ex post* opportunism and in relation to involuntary creditors. Most cases in the former two categories can be dealt with by applying existing UK legislation and case law concerning misrepresentation and ‘veil piercing’. The final category can be dealt with by *Chandler*’s direct tortious liability regime if it is appropriately refined. This paper proposes an integrated understanding of *Caparo*’s three requirements for establishing a duty of care, namely foreseeability, proximity and fairness, and four-group categorisation, namely reliance on superior knowledge, confusing representation, business integration and fairness for other reasons, in which the parent’s direct tortious liability should be recognised.

A. INTRODUCTION

As corporate groups have gained power in the global economy, concern has grown regarding their abuse of separate corporate personality and limited liability in order to avoid liabilities such as tax, tortious claims of personal injury, environmental damage and exploitation of workers in developing countries. The typical example of this abuse is a case in which a parent company attempts to make itself ‘judgment proof’, which means insulation from judicial scrutiny, allowing it to avoid liability or to prevent judgments against it from being enforced,¹ by having the subsidiaries exercise harmful business practices without giving them enough assets to compensate the damage caused by their activities. Parent companies are carefully exempted from the definition of ‘shadow director’ in the Companies Act 2006,² thereby it is unlikely that they can be liable for damage caused by their subsidiaries as a ‘shadow director’. In addition, a direct contractual relationship between a parent company and its subsidiary’s creditor is unlikely to be found if relevant contracts between the creditor and the

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¹ See Lynn LoPucki, ‘The Essential Structure of Judgment Proofing’ (1998) 51 Stanford Law Review 147.

² Companies Act 2006, s 251(3).

subsidiary, and between the subsidiary and the parent could consistently explain the reality.³ There are, therefore, extensive arguments which demand exceptions to separate corporate personality and limited liability in appropriate circumstances.⁴

Meanwhile, the scope of ‘veil-lifting’, which has been developed by courts to mitigate abuse of these privileges, has been severely restricted by recent judgments including *Woolfson*,⁵ *Adams*⁶ and *Prest*.⁷ In this context, two notable judgments, *Chandler*⁸ and *Thompson*,⁹ were recently handed down by the Court of Appeal. They held that a parent company could owe direct tortious liability for the health and safety of its subsidiary’s employees. Although the scope of these judgments has been analysed by Petrin¹⁰ and Morgan¹¹ from the perspective of tort law, there has been no thorough analysis on this matter from a company law perspective.

Contemporary scholars such as Hansmann and Kraakman¹² have developed the argument that the corporate veil should be pierced when, and only when, the third party is an involuntary creditor. They define an involuntary creditor as a creditor of a company who is unable to assess the risks of dealing with the company in advance, such as a tort victim who had no opportunity to assess the risks prior to the injury, and assert that the company should not be able to invoke limited liability *vis-à-vis* the alleged victim to avoid the transfer of costs from the company to the victim.¹³ The meaning of an involuntary creditor, however, may require reconsideration as this argument does not seem to straightforwardly justify the judgments of *Chandler* and *Thompson*. In those cases, the harmed employees could not be involuntary creditors in a narrow sense, as they either were or could reasonably have been aware of the risks of dealing with the company, including the possibility of serious personal

³ *James v Greenwich LBC* [2008] EWCA Civ 35, [2008] IRLR 302.

⁴ Eg Henry Hansmann and Reinier Kraakman, ‘Towards Unlimited Shareholder Liability for Corporate Torts’ (1991) 100 *Yale Law Journal* 1879; Stephen Bainbridge, ‘Abolishing Veil Piercing’ (2000) SSRN <papers.ssrn.com/paper.taf?abstract_id=236967> accessed 9 June 2016; Nina Mendelson, ‘A Control-Based Approach to Shareholder Liability for Corporate Torts’ (2002) 102 *Columbia Law Review* 1203; David Millon, ‘Piercing the Corporate Veil, Financial Responsibility, and the Limits of Limited Liability’ (2007) 56 *Emory Law Journal* 1305; Peter Muchlinski, *Multinational Enterprises and the Law* (2nd edn, OUP 2007).

⁵ *Woolfson v Strathclyde Regional Council* [1978] SC (HL) 90.

⁶ *Adams v Cape Industries Plc* [1990] Ch 433 (CA).

⁷ *Prest v Petrodel Resources Ltd* [2013] UKSC 34, [2013] 2 AC 415.

⁸ *Chandler v Cape Plc* [2012] EWCA Civ 525, [2012] 1 WLR 3111.

⁹ *Thompson v Renwick Group Plc* [2014] EWCA Civ 635, [2015] BCC 855.

¹⁰ Martin Petrin, ‘Assumption of Responsibility in Corporate Groups: *Chandler v Cape Plc*’ (2013) 76(3) *Modern Law Review* 603.

¹¹ Phillip Morgan, ‘Vicarious Liability for Group Companies: the Final Frontier of Vicarious Liability?’ (2015) 31 *Journal of Professional Negligence* 276.

¹² Hansmann and Kraakman (n 4).

¹³ Frank Easterbrook and Daniel Fischel, ‘Limited Liability and the Corporation’ (1985) 52 *The University of Chicago Law Review* 89, 104–105, 107; Hansmann and Kraakman (n 3) 1920–1921.

injuries, when they accepted the offer of employment from the employer. Although Hansmann and Kraakman briefly mention this ‘voluntariness’ of employees, they do not develop a detailed analysis of in what situations ‘involuntariness’ of employees could be found.¹⁴ Another problem with this argument is that it does not seem to provide detailed analysis of the lack of information and ability of ordinary people, such as individual consumers, who have traditionally been thought not to be involuntary creditors, to assess the risks of dealing with a company. Due to limited disclosure requirements of private companies’ information and the relatively weak bargaining power of such persons, they are usually unable to obtain sufficient information to assess the risks appropriately. If tort creditors should be protected because of the lack of opportunity to assess the risks of dealing with the company, contractual creditors who have no opportunity to assess these risks due to lack of information or ability also should be protected. Nevertheless, there have been no legal measures to achieve this outcome.

This article seeks to demonstrate that, from a company law perspective, when combined with ‘veil-lifting’ and protection against misrepresentation in UK law, the legal principle recognised in *Chandler* and *Thompson* could prevent most corporate group abuses of separate corporate personality and limited liability, including abuses against involuntary creditors in a broader sense, taking the lack of information and ability to assess the risks of dealing with the company into account. The legal principle of *Chandler* and *Thompson* is refined for this purpose, and an attempt at categorising the situations where direct tortious liability of parent companies could be recognised is made in order to ensure legal certainty and clarity. The article excludes issues related to tax and legislative reform to concentrate on an analysis of how practitioners should act based on the present UK law. A thorough analysis from a tort law perspective is also excluded, as that analysis is presented in articles by Petrin¹⁵ and Morgan.¹⁶

After reviewing the history of UK law on separate corporate personality and limited liability in section B, section C investigates the justification for limited liability to show that there are certain situations where it is not justified. An investigation into the circumstances in and methods by which limited liability should be removed is then conducted in section D to demonstrate why *Chandler’s* direct tortious liability regime should be preferred to other alternatives. Section E extends *Chandler’s* regime by referring to a theoretical discussion on

¹⁴ Hansmann and Kraakman (n 4) 1920–21.

¹⁵ Petrin (n 10).

¹⁶ Morgan (n 11).

the value of limited liability shown in the previous sections, followed by the attempts in section F to categorise the situations in which direct tortious liability of parent companies could be recognised. Finally, the conclusion and the remaining issues which should be discussed further in the future are considered in section G.

B. DEVELOPMENT OF UK LAW ON SEPARATE CORPORATE PERSONALITY AND LIMITED LIABILITY

1. Establishing separate corporate personality and limited liability in the UK

Separate corporate personality, which distinguishes the personality of a company from its shareholders,¹⁷ and limited liability, which prevents shareholders from being liable for the company's debts,¹⁸ were first established in the UK in the 19th century. Before free incorporation by registration was established in 1844, a joint stock company was only able to be established by royal charter or by an Act of Parliament.¹⁹ As Adam Smith appropriately pointed out in his *Wealth of Nation*, a joint stock company was divergent from 'the general laws' of partnership for the public purpose of promoting some particular manufacturing.²⁰ About 10 years after free incorporation was permitted, general limited liability was introduced by the Limited Liability Act of 1855.²¹ The establishment of separate corporate personality in a modern sense was complete by the end of the century.²²

Moreover, it was confirmed that these benefits could be granted not only to large joint stock companies but also to small quasi-partnership companies in *Salomon*²³ at the end of that century. In *Salomon*, while the Court of Appeal denied the application of limited liability for the 'one-man' company, emphasising the 'illegitimate purpose' of such a company's formation, the House of Lords reversed the judgment, focusing on the formality of the formation of the company.²⁴

This case had huge impacts not only on the development of corporate theory but also on the practice of corporate law. It deemed the grant of separate corporate personality and limited

¹⁷ Paul Davies and Sarah Worthington, *Gower and Davies' Principles of Modern Company Law* (9th edn, Sweet and Maxwell 2012) 35.

¹⁸ *ibid* 39.

¹⁹ Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations* (1776) <www.ibiblio.org/ml/libri/s/SmithA_WealthNations_p.pdf> accessed 26 August 2016, 574.

²⁰ *ibid* 586–587.

²¹ Paddy Ireland, 'Limited Liability, Shareholder Rights and the Problem of Corporate Irresponsibility' (2010) 34 *Cambridge Journal of Economics* 837, 837-39; Peter Muchlinski, 'Limited Liability and Multinational Enterprises: a Case for Reform?' (2010) 34 *Cambridge Journal of Economics* 915, 916.

²² Ireland (n 21) 846–847.

²³ *Salomon v Salomon & Co* [1897] AC 22 (HL); *Broderip v Salomon* [1895] 2 Ch 323 (CA).

²⁴ See *Salomon* (n 23) 31 (Lord Halsbury LC).

liability to be irrelevant to the substantial aspects of the company, such as whether it was a joint stock company or a quasi-partnership company, as long as the formal requirements of the Companies Act were satisfied.

After *Salomon*, it became quite common for both small businesses and large companies to use separate corporate personality in order to obtain the benefit of limited liability. This behaviour became especially widespread in the beginning of the 20th century as corporate groups gained power in the economy. The abuse of separate corporate personality and limited liability by these groups, which employ these legal tools as ‘multiple layers of insulation’²⁵ to avoid liability for tax, personal injuries and environmental damage, has become a serious social issue.²⁶ Blumberg describes this situation as ‘a consequence unforeseen when limited liability was adopted, long before the emergence of corporate groups’.²⁷ Indeed, in the early 20th century courts rarely recognised the existence of this type of abuse in developing case law, and as a result, they tended to apply separate corporate personality and limited liability to corporate groups without discussion.²⁸

2. Transition of the case law on ‘veil-lifting’

Corresponding to an increase in social concern about the abuse of separate corporate personality, the courts attempted to fill the gap between the legal appearance as separate entities and the economic reality as a sole entity. For example, in *Gilford Motor*,²⁹ the court held that the competitive activity against the former employer by a company controlled by the former employee was in breach of the covenant between the two former employment parties. Another example is *Lipman*,³⁰ where, although the shareholder transferred his land subject to his existing contractual liability to the company he had acquired for this purpose, the court ordered both the shareholder and the company to perform the liability. Meanwhile, the judgment in *Knight*³¹ recognised the parent company’s right to be compensated in the compulsory purchase process of the land upon which its subsidiary had conducted business by seeing the subsidiary as an agent of the parent.

This tendency in favour of ‘veil-lifting’ continued until the mid-1970s. Particularly, in *Littlewoods*³² and *DHN*,³³ Lord Denning strongly encouraged ‘veil-piercing’. He noted

²⁵ Phillip Blumberg, *The Multinational Challenge to Corporate Law* (OUP, 1993) 139.

²⁶ Ireland (n 21) 848; Collective Corporate Reform, *Fighting Corporate Abuse: Beyond Predatory Capitalism* (Pluto Press, 2014) 4, 11–12, 27–28.

²⁷ Blumberg (n 25) 139.

²⁸ *ibid* 59.

²⁹ *Gilford Motor Co Ltd v Horn* [1933] Ch 935 (CA).

³⁰ *Jones v Lipman* [1962] 1 WLR 832 (Ch).

³¹ *Smith, Stone & Knight Ltd v Birmingham Corporation* [1939] 4 All ER 116 (KB).

³² *Littlewoods Mail Order Stores v Inland Revenue Commissioners* [1969] 1 WLR 1241 (CA).

caution regarding acknowledgement of the benefit of separate corporate personality and limited liability for corporate groups, emphasising their nature as a single economic entity. This movement in UK case law can be understood in the European context around that time, when ‘group liability’ (ie, the liability of companies in a corporate group to provide compensation to the creditors of other companies in that group) was introduced in Germany,³⁴ France³⁵ and the European Community.³⁶

However, two years after *DHN*, the House of Lords restricted ‘veil-piercing’ to exceptional circumstances. In *Wolfson*, Lord Keith expressed scepticism specifically about *DHN* and confined ‘veil-piercing’ to the cases of ‘a mere facade concealing the true facts’.³⁷ This position was followed by the Court of Appeal in *Adams*.³⁸ Slade LJ rejected the argument of a ‘single economic unit’ with reference to *Salomon*:

the court is not free to disregard the principle of *Salomon* ... merely because it considers that justice so requires. Our law, for better or worse, recognises the creation of subsidiary companies, which though in one sense the creatures of their parent companies, will nevertheless under the general law fall to be treated as separate legal entities with all the rights and liabilities which would normally attach to separate legal entities.³⁹

On the ‘corporate veil’ point, after affirming the ‘mere façade’ criterion of *Wolfson*, he held that the use of subsidiaries to avoid future liabilities is an insufficient justification to pierce the veil.⁴⁰ He also rejected the plaintiffs’ claim that the subsidiaries had been agents of the parent company by pointing out that they were carrying out their own businesses.⁴¹

Eventually, this unenthusiastic attitude of courts toward ‘veil-piercing’ was confirmed by the Supreme Court in *Prest*.⁴² In this divorce case, the plaintiff laid claim on the assets of the companies controlled by her husband. Although the companies were recognized as a trustee for her husband, the Supreme Court maintained their separate corporate personality.

³³ *DHN Food Distributors v Tower Hamlets LBC* [1976] 1 WLR 852 (CA).

³⁴ German Stock Corporations Act 1965 (Aktengesetz). For more detail, see Muchlinski (n 4) 318.

³⁵ Art. L251-1 to 23 of French Commercial Code. For more detail, see IBP USA, *France Company Laws and Regulations Handbook vol.1* (IBP USA, 2012) 89-91; Bryan Cave, ‘Doing Business in France’ (2015) <<https://d11m3yrngt251b.cloudfront.net/images/content/7/2/v2/72592/Bryan-Cave-Doing-Business-in-France.pdf>> accessed 16 August 2016, 13-14.

³⁶ Council Regulation 2137/85, [1985] OJ L199/1. For more detail, see Muchlinski (n 4) 73-75; Davies and Worthington (n 17) 28-29.

³⁷ *Wolfson* (n 5) 96.

³⁸ *Adams* (n 6).

³⁹ *ibid* 536.

⁴⁰ *ibid* 544.

⁴¹ *ibid* 545–49.

⁴² *Prest* (n 7).

Lord Sumption clarified the two principles behind ‘façade’, namely ‘concealment’ and ‘evasion’, and held that only in ‘evasion’ could the veil be pierced. He summarised this in the following way:

These considerations reflect the broader principle that the corporate veil may be pierced only to prevent the abuse of corporate legal personality. It may be an abuse of the separate legal personality of a company to use it to evade the law or to frustrate its enforcement. It is not an abuse to cause a legal liability to be incurred by the company in the first place. It is not an abuse to rely on the fact (if it is a fact) that a liability is not the controller's because it is the company's.⁴³

Davies and Worthington summarise the case law to date related to ‘veil-piercing’ as follows: The courts ... pierce the corporate veil so as to make the shareholder (corporate or individual) liable on the underlying obligation only where the whole purpose of establishing the corporate structure in the first place was to help perpetrate the relevant fraud.⁴⁴

In summary, UK case law has acknowledged separate corporate personality and limited liability as basic principles in company law, and has confined the application of ‘veil-piercing’ to exceptional circumstances. Although the notion of a ‘single economic entity’ was argued by Lord Denning until the mid-1970s, it was rejected in the subsequent cases based on *Salomon*. This tendency against ‘veil-piercing’ was followed by the Supreme Court in *Prest*, and it thereby became more difficult to claim ‘veil-piercing’ in courts.

3. Case law on direct tortious liability of parent companies

On the other hand, some movements which seemed to encourage ‘veil-piercing’ in a virtual manner have occurred in the field of the health and safety of employees. First, in *Connelly*,⁴⁵ the High Court recognised the possibility that a parent company could owe a direct duty of care to uranium miners of its subsidiary, although the claim was time barred. Second, in *Lubbe*,⁴⁶ a settlement with a substantial amount of compensation for asbestos victims was reached in the High Court.⁴⁷

This trend was continued by the Court of Appeal in *Chandler*⁴⁸ and *Thompson*.⁴⁹ In *Chandler*, the subsidiary’s employee, who suffered from disorders caused by asbestos in the workplace, claimed damages against the parent company. The case appeared to be the first

⁴³ *ibid* [34].

⁴⁴ Davies and Worthington (n 17) 222.

⁴⁵ *Connelly v RTZ Corp Plc (No.3)* [1999] CLC 533 (QB).

⁴⁶ *Lubbe v Cape Plc* [2000] 1 WLR 1545 (HL).

⁴⁷ Adam Dignam and John Lowry, *Company Law* (8th edn., OUP, 2014) 45.

⁴⁸ *Chandler* (n 8).

⁴⁹ *Thompson* (n 9).

which actually imposed a duty of care to an employee of a company on that company's parent company. Arden LJ applied the three-stage test established in *Caparo*,⁵⁰ namely whether the damage is 'foreseeable', whether there is 'proximity' between the parties, and whether it is 'fair, just and reasonable' to impose the duty on the party.⁵¹ As a result, she recognised the duty of care of the parent company either to advise its subsidiary about the steps to take or to ensure the implementation of these steps due to the parent's knowledge of the working condition and its superior knowledge about the risks.⁵² She summarised her judgment as follows:

[I]n appropriate circumstances the law may impose on a parent company responsibility for the health and safety of its subsidiary's employees. Those circumstances include a situation where, as in the present case, (1) the businesses of the parent and subsidiary are in a relevant respect the same; (2) the parent has, or ought to have, superior knowledge on some relevant aspect of health and safety in the particular industry; (3) the subsidiary's system of work is unsafe as the parent company knew, or ought to have known; and (4) the parent knew or ought to have foreseen that the subsidiary or its employees would rely on its using that superior knowledge for the employees' protection.⁵³

Although her approach could have the same effect as piercing the veil, Arden LJ rejected the view of this approach as 'veil-piercing'.⁵⁴

In *Thompson*, the possibility of a direct duty of care owed by the parent company was again recognised with the criteria proposed by *Chandler*.⁵⁵ However, the claim by the employee was rejected due to lack of sufficient evidence. Tomlinson LJ stated that the four factors mentioned by Arden LJ in *Chandler* were descriptive rather than exhaustive.⁵⁶ He then rejected the claim of the plaintiff as there was no basis to confirm that the parent company, which was assumed to be a holding company not conducting any business at the time, had possessed superior knowledge of the risk.⁵⁷

As seen above, while the scope of 'veil-piercing' has been confined to the exceptional 'evasion' cases in the UK, the direct tortious liability of parent companies was recognised in

⁵⁰ *Caparo Industries plc v Dickman* [1990] 2 AC 605 (HL).

⁵¹ *Chandler* (n 8) [32].

⁵² *ibid* [78].

⁵³ *ibid* [80].

⁵⁴ *ibid* [69].

⁵⁵ *Thompson* (n 9) [37].

⁵⁶ *ibid* [33].

⁵⁷ *ibid* [38].

Chandler. Nevertheless, given the four factors Arden LJ mentioned in *Chandler* being descriptive, not exhaustive, the scope of *Chandler's* direct tortious liability regime is still ambiguous.

C. JUSTIFICATION OF LIMITED LIABILITY

1. *Justification of limited liability and types of the company*

As shown in the previous section, separate corporate personality and limited liability were historically seen not as rights but as privileges granted by a state for a certain public purpose.⁵⁸ This means that discussion regarding the removal of separate corporate personality and limited liability inevitably involves policy considerations. Generally, a privilege should be granted only with adequate justification from a public policy perspective. As demonstrated below, however, the justification of limited liability for certain company structures is insufficient.

The justifications for limited liability are generally argued as follows.⁵⁹ First, limited liability could encourage investments from non-professional investors. This is because it relieves these investors from worries about their personal assets. Second, limited liability could improve the function of stock exchange markets, because, without limited liability, investors have to think about the magnitude of other shareholders' assets in case the shareholders have to be jointly liable. Third, limited liability allows shareholders to have a diversified portfolio because they do not have to monitor each company in their portfolio closely, which could in turn encourage more low-risk investments. This aspect is particularly important in large public companies because it is impractical for their shareholders to engage in the company management effectively. Finally, limited liability could also benefit the creditors of the company because it frees them from having to assess the creditworthiness of the shareholders of the company when the creditors seek to enter into transactions with the company.

Although these reasons are generally persuasive in the case of large public companies, they may not be persuasive in the case of private companies. Private companies generally assume investments from a limited number of investors who actively engage in the companies' management. Hence, the first and third justifications above, namely the merit of encouraging investments from a large number of non-professional investors and that of diversified portfolios, are not relevant for most private companies. Moreover, investors and

⁵⁸ See also Ireland (n 21) 841; Bainbridge (n 4) 20.

⁵⁹ Davies and Worthington (n 17) 207–12; Bainbridge (n 4) 12–19; Easterbrook and Fischel (n 13) 93–97.

creditors of private companies generally have to be concerned about the nature of its shareholders because the management skills and creditworthiness of the shareholders who control a small private company are, in most cases, critical to securing payment of the company's debts. This means that the second and fourth justifications above, namely the merit that the investors and creditors do not have to consider the nature and the magnitude of assets of the shareholders, are also not persuasive in the case of private companies. Thus, the justifications of limited liability are far less persuasive for small private companies than large public companies.

Despite recognising the weaker justification of limited liability among private companies, Bainbridge still argues that limited liability could be justified for these companies.⁶⁰ According to him, limited liability should be a default rule even among private companies because it is difficult to distinguish cases in which unlimited liability applies from those in which limited liability applies. He also argues that, if necessary, the company's creditors can require its shareholders to provide a guarantee for the company's loan.

In contrast, Millon contends that all of the justifications above are insufficient in the case of private companies.⁶¹ He suggests that limited liability among private companies could be justified only if the grant of limited liability is viewed as a 'subsidy' to entrepreneurs and investors. Accordingly, this 'subsidy' would encourage entrepreneurial activities and could resultantly generate larger social benefits, such as jobs, valuable products and services, tax revenues and technological progress. These positive impacts could outweigh the negative impacts of transferring risks from companies to creditors. He also emphasises that, contrary to Bainbridge's assertion, the default rule could affect the result of the bargaining prior to the transaction between the company and its creditor, according to behavioural economics.⁶²

It is arguable that Bainbridge's contention is not sufficiently persuasive. One reason is that the existence of a few indistinguishable cases seems to constitute an insufficient justification to offer limited liability to all private companies. Another reason is that the creditors cannot necessarily bargain with the company and its shareholders equitably, as described below. Thus, as Millon argues, limited liability should be justified in the case of private companies only if the grant thereof is viewed as a beneficial 'subsidy' for entrepreneurship.

2. Difference between 'Voluntary Creditors' and 'Involuntary Creditors'

⁶⁰ Bainbridge (n 4) 29–30.

⁶¹ Millon (n 4) 1317.

⁶² *ibid* 1319.

Once limited liability is understood as a ‘subsidy’ for entrepreneurship among private companies, the next issue is to what extent this ‘subsidy’ should be affirmed. Since, as demonstrated above, this ‘subsidy’ could be justified in circumstances where the social benefits caused by entrepreneurial behaviour, such as providing jobs, valuable products and services, tax revenues and technological progress, exceed the negative impacts of risk transfer from companies to creditors. Although the quantitative comparison between these impacts is difficult, it should be noted that the negative impacts of the subsidy could be quite different in the case of voluntary creditors and involuntary creditors.

A voluntary creditor can be defined as a creditor who is able to assess the risks of dealing with the company and, if necessary, negotiate the conditions with the company prior to entering into the deal.⁶³ A typical example is a contract creditor with enough power and information for assessment and bargaining. In the case of such voluntary creditors in this meaning, there is no negative externality, at least theoretically, because the risks could reflect on the terms of the transaction, such as interest rate, the demand for mortgages and that for personal guarantees.⁶⁴ Hence, limited liability could be generally justified because of the social benefits of promoting entrepreneurship.

Although this analysis as to voluntary creditors was undertaken by Easterbrook and Fischel⁶⁵ as well as Hansmann and Kraakman,⁶⁶ their investigations on the meaning of voluntary creditors should be reconsidered. Although Easterbrook and Fischel identified employees, consumers, trade creditors and lenders as examples of voluntary creditors,⁶⁷ these contractual creditors are not necessarily able to assess the risks and bargain the conditions of the transaction sufficiently. Hansmann and Kraakman advanced the analysis on the meaning of a voluntary creditor to some extent. They mentioned some boundary cases, such as product liability and workplace injuries, where, while the consumers and the employees were contractual creditors, their claims against the company could be based on tort law. Nevertheless, while Hansmann and Kraakman identified some general criteria in these boundary cases, namely whether the creditors could assess the risks and decline the transaction before the accidents, they did not conduct a thorough analysis on the application of this criterion.⁶⁸

⁶³ See Hansmann and Kraakman (n 4) 1919–21.

⁶⁴ Easterbrook and Fischel (n 13) 105.

⁶⁵ *ibid.*

⁶⁶ Hansmann and Kraakman (n 4).

⁶⁷ Easterbrook and Fischel (n 13) 104.

⁶⁸ Hansmann and Kraakman (n 4) 1920–21.

Upon further inspection, contractual creditors do not necessarily have enough power and information to assess the risks and bargain with companies.⁶⁹ For example, ordinary employees and small individual consumers generally cannot negotiate the terms before entering into contracts with companies. They also have limited access to most of the relevant information about private companies, such as the companies' financial conditions, situations in the workplace or the processes of production, due to weak bargaining power and insufficient disclosure.⁷⁰ The default rule, which could affect the result of bargaining between two contractual parties from the perspective of behavioural economics, as Millon mentioned, is certainly more influential if it is set in favour of the party who has stronger bargaining power. Thus, even in the case of contractual creditors, a thorough analysis of their bargaining power and available information should be conducted in each case.

Involuntary creditors can be defined as those creditors who can neither conduct a prior assessment of the risk nor engage in negotiations. A typical example is a certain type of tort creditors, such as a victim of a traffic accident because they had no opportunity to assess the risks and bargain with the company prior to the accident. In this case the disadvantage of limited liability, by transferring the costs from the company to the victim, could be disastrous. Hansmann and Kraakman suggest that, related to involuntary creditors, an unlimited liability regime which imposes pro rata liability on the shareholders should be introduced.⁷¹ Their argument is that pro rata unlimited liability could enable the company's share price to reflect the true value of its business because each shareholder would be personally liable for a tort judgement in proportion to their personal equity ownership in the firm, thereby rendering tort claims satisfied.⁷²

However, intense opposition has been voiced against the 'pro rata unlimited liability' suggestion. Bainbridge argues that enforcing such a regime would necessitate prohibitively high collection costs, and these costs could rise due to the continuous change in shareholder composition. He also emphasises that, from a contractarian perspective, there is no reason why liability is imposed only on shareholders among the variety of stakeholders of the

⁶⁹ Peter Muchlinski, 'Holding Multinationals to Account: Recent Developments in English Litigation and the Company Law Review' (2002) 23 *Company Lawyer* 168, 174.

⁷⁰ There are some regulatory exemptions for private companies on their disclosure duties based on the Companies Act 2006, as well as no mandatory disclosure at stock exchange markets. See, for example, Oury Clark 'Reporting Requirements for UK Private Companies' (2016) <<http://www.ouryclark.com/site-assets/pdf/quick-guides/general/OC-Quick-Guide-Reporting-requirements-for-UK-private-companies.pdf>> accessed 23 January 2017.

⁷¹ Hansmann and Kraakman (n 4) 1932–33.

⁷² *ibid* 1933.

company.⁷³ Meanwhile, Mendelson rebuts that the ‘pro rata unlimited liability’ regime does not reflect the difference between controlling shareholders and small individual shareholders as to the danger of moral hazard and the benefits of limited liability.⁷⁴ She also points out that the ‘pro rata unlimited liability’ regime is unlikely to realise full internalisation of the costs by controlling shareholders, who are likely to obtain more benefits than they would via pro rata shareholding. Among these drawbacks, the most serious problem seems to be that, as Bainbridge mentions, without a radical legislative change, involuntary creditors would have to bring claims against all of the shareholders to obtain full compensation.⁷⁵ This could impose an excessive burden on the vulnerable party, and thereby could be considered unfair.

Contrary to Hansmann and Kraakman, Bainbridge argues that limited liability should be generally maintained even in the case of involuntary creditors. He assumes that unlimited liability would encourage tort creditors to free-ride the monitoring of the company by the contractual creditors, and that sufficient incentives for the company to be precautionous and to purchase insurance would be created by the reputational risk even under limited liability.⁷⁶ Moreover, he attempts to justify limited liability even in the case of corporate groups, even though the main shareholders, namely parent companies, do not need to diversify their portfolios and are able to create ‘judgment proof’ easily by creating subsidiaries. His main justifications for limited liability in the corporate-group case are the following: unlimited liability could disturb the role of intermediary financial institutions; it could also raise undesirable incentives for corporate groups to transfer high-risk subsidiaries to individual shareholders and to conduct unnecessary intra-corporate diversification; in some cases, subdivision is required by the nature of the business or the regulation; and separation of an enterprise could result in the benefits of specialisation by allowing each subsidiaries to concentrate on its own specific business field.⁷⁷

Bainbridge’s argument in favour of general limited liability, even in the case of involuntary creditors related to corporate groups, cannot be justified. One rebuttal is the fact that he himself acknowledges the weakness of the justification for limited liability in this case. Indeed, he fails to persuasively justify limited liability in the case of corporate groups using the same reasons noted in his previous discussion on individual companies, which implicitly suggests that the justification in the corporate group case is weaker than that of

⁷³ Bainbridge (n 4) 22–28.

⁷⁴ Mendelson (n 4) 1301–302

⁷⁵ Bainbridge (n 4) 23.

⁷⁶ *ibid* 34.

⁷⁷ *ibid* 64–71.

individual companies. Another rebuttal is that most of his hypotheses mentioned above are unproven. He does not mention any empirical studies showing the negative impacts of unlimited liability on the role of intermediary financial institutions, the tendency of transferring high-risk subsidiaries to individual shareholders and the possibility of corporate diversification. The function of intermediary financial institutions will not be harmed if unlimited liability demands some additional requirements, such as a certain degree of control and foreseeability of the parent company. It is also arguable that limited liability, rather than unlimited liability, could accelerate undesirable separation of group companies to create ‘judgment proof’. In addition, unlimited liability does not necessarily harm the regulated businesses and the efficiency of specialisation in a wrongful manner. Thus, it is certainly undesirable that general limited liability would be maintained in the case of involuntary creditors related to a corporate group.

In summary, the type of company and creditor involved in each case should be investigated closely. Although limited liability is less likely to be justified in the case of a private company and a corporate group, the nature of the creditor could also affect the result. While limited liability should be generally maintained for pure voluntary creditors, the meaning of voluntary creditors should be investigated thoroughly with reference to the information available and the ability of the creditor to negotiate with the company. In terms of involuntary creditors, both the general pro rata unlimited liability proposed by Hansmann and Kraakman and the general limited liability proposed by Bainbridge are certainly inappropriate. This is mainly because the result of assessing the social benefits and costs caused by limited liability could vary depending on the facts in each case, such as the type of shareholder.

D. WHEN AND HOW SHOULD LIMITED LIABILITY BE REMOVED?

1. Categorisation of the situations where limited liability should be removed

As shown in the previous section, the value of limited liability varies depending on the situation. The type of shareholder and creditor, for example, could both affect the value. This section presents a categorisation of the situations in which limited liability should be removed and an investigation into an appropriate legal tool to achieve an appropriate result in each category.

Millon divides the situations in which limited liability should be removed into three categories.⁷⁸ The first category is *ex ante* opportunism. In this situation, the information on which the creditor's assessment and bargaining was based was wrong due to deliberate or reckless disregard by the shareholder.⁷⁹ Since the assessment and bargaining were not based on precise information, the cost of risk transfer caused by limited liability could not be reduced. Thus, limited liability should be removed in serious cases, even those involving pure voluntary creditors. A typical example is a fraudulent misrepresentation, namely, an instance in which the company deliberately withheld relevant information.

The second category is *ex post* opportunism. In this situation, the shareholder has the company transfer its assets to others after the parties have entered the contract. Since this behaviour incurs a loss that the creditor has not accepted, the negative externality of limited liability could exist. Hence, limited liability should be removed in serious cases, even those involving pure voluntary creditors.⁸⁰ A typical example can be seen in *Lipman*. As described in section B, the ownership of the shareholder's land subject to the existing liability was transferred to the company. *Elliott* is another case related to a corporate group, in which the company's property was transferred to its wholly owned subsidiary.⁸¹

The final category is involuntary creditors. Although Millon names this category 'tort creditors', he discusses their involuntariness.⁸² As analysed in the previous section, the negative costs of risk transfer caused by limited liability could outweigh the social benefits in this case.

The categorisation resembles the one provided by Easterbrook and Fischel. They state that, in US case law, 'veil piercing' is likely to occur, appropriately, in cases involving involuntary creditors and those involving fraud, misrepresentation and undercapitalisation.⁸³ Since most undercapitalisation circumstances mentioned could be included in *ex ante* or *ex post* opportunism, their argument supports Millon's three-group categorisation. Thus, the situations where limited liability should be removed can be categorised into three groups, namely *ex ante* opportunism, *ex post* opportunism and involuntary creditors.⁸⁴

2. Deployment of UK law to remove limited liability

⁷⁸ Millon (n 4) 1342–1347.

⁷⁹ *ibid* 1342–1345.

⁸⁰ *ibid* 1342, 1345–1346.

⁸¹ *Elliott and H Elliott (Builders) Ltd v Pierson* [1948] Ch 452 (Ch).

⁸² Millon (n 4) 1346–1347.

⁸³ Easterbrook and Fischel (n 13) 109, 112–13.

⁸⁴ Edwin Mujih, 'Piercing the Corporate Veil as a Remedy of Last Resort after *Prest v Petrodel Resources Ltd*: Inching towards Abolition?' (2016) 37(2) *Company Lawyer* 39, 44–49 and Peter Oh, 'Veil-Piercing' (2010) 89 *Texas Law Review* 81, 97–98 seem to be based on this Millon's classification.

Surprisingly, the first two categories set by Millon, *ex ante* opportunism and *ex post* opportunism, are already covered under UK legislation and case law. Most *ex ante* opportunism cases could be dealt with appropriately by the case law of misrepresentation in contract law and that of deceit in tort law, as well as by the Misrepresentation Act 1967. In the case law of misrepresentation, deliberate and negligent false statements, including those by conduct, could allow the opposite party to rescind the contract and to claim damages.⁸⁵ This protection is reinforced by the Misrepresentation Act 1967, wherein the burden of proof is transferred from the victim to the wrongdoer in section 2(1), and innocent misrepresentation is granted the potential to justify discretionary award in section 2(2). In the case law of deceit in tort law, false statements, including those by conduct, could cause tortious liability if the wrongdoer knows its falsity.⁸⁶ Although these legal methods focus on the company's knowledge and behaviour, they could be applied to cases in which an owner shareholder of a private company is controlling the company as its director, which is the most frequent and serious example of *ex ante* opportunism. The protection of creditors from fraudulent trading provided by section 213 of the Insolvency Act 1986 also deals with *ex ante* opportunism in the course of the termination of the company.

Similarly, most *ex post* opportunism cases can be within a scope of 'veil piercing' in UK case law. Although Hannigan⁸⁷ and Matthews⁸⁸ argue that the criteria of 'veil-piercing' are still ambiguous after *Prest*, it is arguable that the requirements and the effects of 'veil-piercing' to remove limited liability have, at the very least, been clarified to a significant extent. It can be noted that 'veil-piercing' can be recognised when separate corporate personality of a company has been abused by its influential shareholder to avoid existing liabilities, which will result in seeing the company and the shareholder as a unified sole entity in respect of those liabilities. Hence, Bainbridge's assumption that 'veil-piercing' is unprincipled and arbitrary⁸⁹ is not acceptable in the UK. Although the 'evasion' principle might not include cases in which the shareholder abuses an existing corporate structure to avoid existing liability, these cases can be dealt with appropriately by the direct tortious liability regime proposed by *Chandler* if the regime is appropriately refined as shown below. The regulations on wrongful trading, transactions at an undervalue and preferences under

⁸⁵ Ewan McKendrick, *Contract Law* (10th edn, Palgrave Macmillan 2013) ch 13.

⁸⁶ Simon Deakin, Angus Johnston and Basil Markesinis, *Markesinis and Deakin's Tort Law* (7th edn, OUP 2014) ch 14.

⁸⁷ Brenda Hannigan, 'Wedded to Salomon: Evasion, Concealment and Confusion on Piercing the Veil of the One-man Company' (2013) *Irish Jurist* 11.

⁸⁸ Rian Matthews, 'Clarification of the Doctrine of Piercing the Corporate Veil' (2013) *JIBLR* 516.

⁸⁹ Bainbridge (n 4) 72.

sections 214, 238 and 239 of the Insolvency Act 1986, respectively, also deal with *ex post* opportunism in the course of the termination of the company.

When it comes to involuntary creditors, the discussion about when and how limited liability should be removed is still in chaos. As shown below, however, it is arguable that the direct tortious liability regime proposed in *Chandler* is more suitable for this purpose than other suggestions.

Millon suggests that limited liability related to involuntary creditors should be maintained as long as reasonable corporate efforts to provide compensation to the victims have been made; otherwise the excessive removal of limited liability would lead to over-insurance in the company and a chilling effect on its business.⁹⁰ He also argues that the cost transfer from wrongdoers to victims by limited liability could only be justified from the perspective of fairness subject to this restriction.⁹¹ It is questionable, however, how likely victims are to bring a claim against the shareholders when the company has made reasonable efforts to provide compensation to them. It is also arguable that the boundary of ‘reasonable corporate efforts’ could be too ambiguous, thereby Millon’s suggestion could cause disastrous confusion in the case law. Moreover, his proposal needs legislative reform because it could not be covered by ‘veil piercing’, or by other case law and legislation, in the UK.

Meanwhile, Mendelson argues that involuntary creditors such as tort or statutory creditors, like employees who have been dismissed with violation of the statutory requirements, should be relieved if the shareholder has ‘capacity of control’.⁹² She proposes the use of ‘veil-piercing’ or the legislative introduction of vicarious liability for this purpose.⁹³ As Millon emphasises, however, determining the shareholders’ liability merely on the basis of ‘capacity of control’ could remove limited liability excessively.⁹⁴ It is certainly inappropriate if parent companies that could not have foreseen the damage at all and, as a result, could not have taken precautions against it, were held liable. In addition, Mendelson’s suggestion requires legislative reform as it could not be implemented in UK case law through ‘veil-piercing’. As Morgan admits, vicarious liability of parent companies has been recognised in England and Wales only in tort cases caused by a natural person.⁹⁵ Similarly, Muchlinski suggests a legal presumption of the parents’ liability on the basis of their actual or

⁹⁰ Millon (n 4) 1356.

⁹¹ *ibid* 1357.

⁹² Mendelson (n 4) 1271.

⁹³ *ibid* 1271. As to vicarious liability, see Morgan (n 11).

⁹⁴ Millon (n 4) 1363.

⁹⁵ Morgan (n 11) 276.

potential control.⁹⁶ Hence, a parent company could be liable for its subsidiaries' debts unless the parent proves that the opposite party had accepted the express exclusion of the parent from the liability.⁹⁷ The legal presumption, however, could only be realised by radical change in legislation or case law. Meanwhile, the same results could be obtained under existing UK law with appropriate inference of facts from the absence of evidential submission by the parent company, if the requirements of a duty of care are interpreted flexibly as shown below. One possibility is that, if the plaintiff requires the parent company to provide evidence of its insignificance to the relevant decision-making in its subsidiary and the parent does not provide it sufficiently, the parent's involvement can be inferred, taking the uneven distribution of evidence between the parties into account. The Court of Appeal judgment in *Chandler* also mentions the 'evidential burden of proof', where, if the plaintiff submits a certain amount of evidence on the involvement of the parent company, the parent has to prove its irrelevance.⁹⁸ These methods could induce appropriate results corresponding to the facts in each case.

A more radical proposal is the introduction of 'enterprise liability' suggested by Muchlinski.⁹⁹ He argues that, looking at the economic reality of a corporate group as a single economic entity, 'veil-piercing' should be recognised on the basis of the status of the third party related to the corporate group.¹⁰⁰ As mentioned above, similar legislation was introduced for 'group liability' in Germany, France and the European Community between the 1960s and 1980s. However, there could be strong opposition against this proposal as it is likely to contradict the principle of separate corporate personality by prioritising the economic reality to the legal form. Since this argument is not necessarily confined to involuntary creditors, comprehensive and radical changes in the legal system related to corporate groups would be induced by the general adoption of this regime. Hence, the adoption of 'enterprise liability', which needs the case law change from *Adams*, is unlikely to

⁹⁶ This proposal seems to correspond to recent judicial and legislative developments in French and Swiss tort law on the presumption of liability in certain situations. See Edward Tomlinson, 'Tort Liability in France for the Act of Things: A Study of Judicial Lawmaking' (1988) 48(6) *Louisiana Law Review* 1299, 1300–1301, Paula Giliker, 'Codifying Tort Law: Lessons from the Proposals for Reform of the French Civil Code' (2008) 57 *International and Comparative Law Quarterly* 561, 564; Franz Werro and Erdem Buyuksagis, 'The Bounds between Negligence and Strict Liability' in Mauro Bussani and Anthony Sebok (eds), *Comparative Tort Law: Global Perspectives* (Edward Elgar 2015) 201, 217–221.

⁹⁷ Muchlinski (n 21) 923–24; Muchlinski (n 4) 322–324.

⁹⁸ *Chandler* (n 8) [71].

⁹⁹ Muchlinski (n 21); Muchlinski (n 4). Other supporters of 'enterprise liability' are Phillip Blumberg, 'The Corporate Personality in American Law: A Summary Review' (1990) 38 *American Journal of Comparative Law* 49; Bainbridge (n 3); Anthea Nolan, 'The Position of Unsecured Creditors of Corporate Groups: Towards a Group Responsibility Solution Which Gives Fairness and Equity a Role' (1993) 11 *C&SLJ* 461.

¹⁰⁰ Muchlinski (n 21) 919; Muchlinski (n 4) 317–22.

occur in the UK for the time being. It is also arguable that the notion of ‘enterprise’ is too ambiguous to be utilised in practice,¹⁰¹ that the circumstances related to the creditors cannot be considered in this regime and that the concept of ‘relational law’ is unfamiliar in the UK.

While these suggestions have some significant drawbacks, the direct tortious liability regime proposed in *Chandler* could deal with most of the cases in question appropriately. As seen in section B, the regime requires both reasonable ‘foreseeability’, as proposed by Millon, and ‘proximity’ mainly caused by control, as suggested by Mendelson. It does not demand any new legislation or amendments of case law. With minor refinements shown in the next section, the criteria could be flexible enough to distinguish appropriately between public and private companies and between individual and corporate shareholders, and comprehensive enough to include some types of contractual creditors who need to be protected. Legal certainty and clarity could be ensured by classification of the relevant cases and accumulation of the relevant judgments and discussions, as demonstrated below. Although Muchlinski states that proving direct tortious liability of a parent company is often prohibitively difficult for victims,¹⁰² proving liability could be facilitated by a variety of practical efforts such as the use of fact inference by the court, as mentioned above. Thus, the direct tortious liability regime could be a strong tool to protect involuntary creditors in appropriate cases.

In summary, two of the three situations which demand the removal of limited liability, namely *ex ante* opportunism and *ex post* opportunism, have already been dealt with appropriately by UK law in most cases through as the use of ‘veil-piercing’ and the law of misrepresentation. The third situation, namely involuntary creditors, could also be dealt with appropriately by the direct tortious liability of parent companies suggested by *Chandler*, if the regime is appropriately refined.

E. REFINING *CHANDLER*’S DIRECT TORTIOUS LIABILITY REGIME

1. The scope of Chandler’s direct tortious liability regime

The previous section confirmed that *Chandler*’s direct tortious liability regime could appropriately deal with cases involving involuntary creditors if the regime is refined. In this section, the Court of Appeal judgments in *Chandler* and *Thompson* are considered to clarify the regime’s scope.

¹⁰¹ Lynn LoPucki, ‘The Death of Liability’ (1996) 106 Yale Law Journal 1, 67.

¹⁰² Muchlinski (n 21) 919.

In the Court of Appeal judgment in *Chandler*, Arden LJ first set out the ‘assumption of responsibility’, which is required to hold a duty of care for third parties not to harm others, as a criterion to recognise a duty of care.¹⁰³ She confirmed that this criterion involves the second and third requirements of the *Caparo* test, namely ‘proximity’ and being ‘fair, just and reasonable’ to impose a duty. The notable point here is that she affirmed that these two requirements were essentially the same question, namely whether a duty of care existed or not.¹⁰⁴ Then, after confirming the unnecessary of the parent’s ‘absolute control’ over the subsidiary,¹⁰⁵ she analysed the facts in the present case. She found a policy in this group which forced the subsidiaries to follow the parent’s directions in certain matters, as well as systemic causes of the damage such as the fact that the factory did not have any sidewalls despite the danger of scattering toxic asbestos.¹⁰⁶ Hence the parent’s irresponsibility for the actual implementation of health and safety steps in the subsidiary was not held decisive in this case.¹⁰⁷ Subsequently, she held that, given the parent’s knowledge of the working conditions and its superior knowledge of the risks of asbestos, the parent had a duty of care either to advise the subsidiary on the reasonable steps to be adopted for safe working conditions or to ensure those steps to be taken.¹⁰⁸ Finally, she summarised her discussion by identifying four factors which were decisive in this case: (1) the same business in a relevant respect; (2) the parent’s superior knowledge on the relevant aspect; (3) the parent’s knowledge on the subsidiary’s working condition; and (4) the subsidiary’s reliance on the parent’s superior knowledge.¹⁰⁹

As Petrin mentions, the notable point in this judgment is the manner in which the three requirements from *Caparo* were considered. The requirements of ‘proximity’ and ‘fairness’ were integrated, and the facts relating to ‘foreseeability’ were also considered. Petrin appropriately justifies this approach by stating that there have been many cases, such as *Reeman*,¹¹⁰ where the three requirements of a duty of care were considered in an integrated manner.¹¹¹

¹⁰³ *Chandler* (n 8) [62]–[63].

¹⁰⁴ *ibid* [62].

¹⁰⁵ *ibid* [66].

¹⁰⁶ *ibid* [73], [74], [77].

¹⁰⁷ *ibid* [74].

¹⁰⁸ *ibid* [78].

¹⁰⁹ *ibid* [80].

¹¹⁰ *Reeman v Department of Transport* [1997] PNLR 618 (CA) 625.

¹¹¹ Petrin (n 10) 612.

Another critical point in Petrin's article is that the value of limited liability should be considered in the requirement of 'fairness'.¹¹² This means that the difference in the extent which limited liability can be justified analysed in the previous sections could be considered in the direct tortious liability regime. Such policy consideration by the court is also mentioned by other academics. For example, Muchlinski contends that public policy could affect the notion of the duty of care in serious tort cases,¹¹³ and Deakin et al state that policy consideration by the courts in tort claims is becoming popular.¹¹⁴

With reference to these discussions, the scope of *Chandler's* direct liability regime could be extended as follows. As mentioned above, *Caparo's* three requirements should be considered in an integrated manner. Since the requirement of 'fairness' could involve consideration of the value of limited liability, the extent of 'foreseeability' and 'proximity' required could be smaller if the justification of limited liability is relatively weak. The cases involving a private company or a corporate group and those involving an involuntary creditor in a broad sense could be seen as examples of situations in which the justification of limited liability could be weak. This does not mean that foreseeability and proximity are unnecessary in these cases. In the individual shareholder cases, it is more likely that the requirements of foreseeability and proximity will not be established because of difficulty in collecting relevant information and lack of involvement in the company's decision, although this is not the case when the individual is an owner shareholder of a small private company. The definition of involuntary creditors does not confine qualifying parties to tort creditors. Rather, it could extend to certain types of contractual creditors and statutory creditors who have insufficient information and lack the ability to assess the risks of the transaction and to bargain with the company before entering the transaction. Employees facing unforeseeable health and safety risks and consumers claiming product liability are good examples of involuntary creditors in a broad sense because, generally, both have insufficient bargaining power and could not be expected to anticipate the occurrence of an accident before entering the transaction.

This approach is supported by the High Court decision of *ArmorGroup*.¹¹⁵ In this case, the confusing use of the group's and the parent's names in the course of the subsidiary's recruitment was held as one of the significant factors to recognise the parent's duty of care

¹¹² *ibid* 615.

¹¹³ Muchlinski (n 69) 174.

¹¹⁴ Deakin, Johnston and Markesinis (n 86) 255.

¹¹⁵ *Newton-Sealey v ArmorGroup Services Ltd* (2008) EWHC 233 (QB), [2008] All ER (D) 195 (Feb).

for the health and safety of the subsidiary's employee.¹¹⁶ This judgment can be understood as constituting a finding that the misleading information provided by the group before the parties entered into the employment contract prevented the employee from assessing the risks appropriately, rendering the existence of a duty of care fair.

2. *Appropriate understandings of Chandler and Thompson*

From this integrated approach of direct tortious liability, *Chandler* could be understood as follows: since this case involves a health and safety issue between a subsidiary of a corporate group and its employee, the degree of fairness is relatively high. Hence, the levels of foreseeability and proximity required should be relatively low. Given the parent's control over the subsidiary, the parent's knowledge of the working conditions and its superior knowledge of the risks of asbestos, foreseeability and proximity were established in this sense. Thus, it is arguable that this is a distinct case where the parent's duty of care should be upheld.

Meanwhile, in *Thompson*, the direct duty of care owed by the holding company to the employee of its subsidiary was denied. In this case, although the degree of fairness was as high as in *Chandler*, there was no evidence of the parent's knowledge and control related to foreseeability and proximity. Hence, the parent's direct duty of care could not be recognised. Once *Chandler's* direct tortious liability regime is understood as above, Petrin's criticism against the judgment in *Chandler* can be rebutted. He argues that, if the requirement of relevant control could be satisfied merely with the parent's voting rights and the existence of group policies, most ordinary corporate groups would suffer from claims from a wide range of third parties.¹¹⁷ However, the extent of required control will depend on the degree of fairness in each case, so it is unlikely that such a range of claims would succeed. His other criticism is that *Chandler's* direct tortious liability regime, which does not exclude individual shareholders, would have a chilling effect on entrepreneurship due to the investors' risk to be liable for the company's activities.¹¹⁸ However, as stated above, most of the individual shareholders will be excluded as a result of the application of this regime, thereby any chilling effect would be insignificant. Although controlling shareholders of small private companies could be directly liable in this regime, this result is appropriate because the degree of fairness is generally high in these cases. Although Petrin also criticises that the judgment

¹¹⁶ *ibid* [28], [39].

¹¹⁷ Petrin (n 10) 614.

¹¹⁸ *ibid* 615.

did not require the actual reliance and its reasonableness, particularly by the employee himself,¹¹⁹ the reliance of the employee is not always necessary to establish proximity.

From the perspective of the refined direct tortious liability regime, the four key factors shown by Arden LJ in *Chandler* should be reconsidered. The third factor, namely the parent's knowledge of the working conditions, could support the parent's foreseeability, and the second and fourth factors – namely the parent's superior knowledge of the risk and the subsidiary's reliance on that knowledge – could support the parent's proximity. However, the first factor, namely managing the same business, could not have a position in the refined direct tortious liability regime. Although *Thompson* seems to affirm this requirement of *Chandler*,¹²⁰ this attitude is inappropriate because no holding companies would have direct liability even if they have significant control and influence on the subsidiary's business.

3. *Rebuttal against possible criticisms*

Whilst there are a number of further potential criticisms of the refined direct tortious liability regime, they can be rebutted as follows. Possibly the most frequent criticism will be that the regime would be arbitrary and harm legal certainty. However, this regime can carefully remove arbitrariness as much as possible by putting itself in the existing framework of tort law. In addition, legal certainty and clarity could be improved by the classification of the relevant cases, as will be attempted in the following section, as well as the accumulation of the relevant judgments and discussions.

Another possible criticism is that the courts should not intervene with policy decisions. Although, as shown in section C, the consideration of the value of limited liability inevitably involves a policy decision to some extent, this is acceptable because the courts intervene in policy decisions only to the extent necessary in tort law, which inherently includes certain political goals such as the deterrence of tortious behaviour and justice by compensation. It is also arguable that, as mentioned in section B and section C, limited liability was historically a privilege granted by a state for a certain public purpose; thus, there should be policy considerations in judgments on limited liability. If such considerations by the judiciary are deemed inappropriate, the legislature can restrict their ability to do so. Some might also argue that the refined regime is beyond the scope of the existing tort law framework. As shown above, however, it is arguable that the regime can be logically traced back to existing UK case law and legal theories. Finally, some might criticise that the regime would contradict separate corporate personality, which is one of the basic principles of UK

¹¹⁹ *ibid* 616–18.

¹²⁰ *Thompson* (n 9) [37].

company law. However, this regime does not contradict the principle at all because it imposes direct liability on the parent company due to the parent's own conduct or omission. As Arden LJ in *Chandler* appropriately stated, the parent's direct liability is not 'veil piercing'.¹²¹

To summarise, *Chandler's* direct tortious liability regime could be refined as a flexible tool to deal appropriately with a variety of cases involving involuntary creditors. The significance of *Chandler* and *Thompson* could then be understood from a broader perspective. Despite the potential for some criticism, such as the lack of legal certainty, judicial intervention in the policy decision, and potential conflict with separate corporate personality, these can be reasonably rebutted if the legal certainty could be established by categorisation of relevant cases, as attempted in the following section, and accumulation of relevant judgments and discussions in the near future.

F. CATEGORISATION OF THE CIRCUMSTANCES WHERE THE PARENTS' DIRECT TORTIOUS LIABILITY COULD BE RECOGNISED

1. Four categories where the parents' direct tortious liability could be recognised

Consideration of prior cases allows for an argument to be made regarding the existence of four categories in which the parents' direct tortious liability could be recognised. Although this categorisation is not exhaustive, it could significantly improve the legal certainty and clarity of this regime.

a) Reliance on superior knowledge

The first category is reliance on superior knowledge. This category mainly includes physical torts which cannot be prevented without relevant scientific knowledge such as certain types of industrial accidents, product liabilities and environmental problems. *Chandler* and *Thompson*, where up-to-date scientific knowledge about the risk of asbestos was crucial to preventing the harm, could be included in this category. The parent company could be liable when it has superior knowledge about the risk upon which its subsidiary relied on, or could reasonably be expected to rely on, but does not utilise that knowledge to prevent possible harms. Since the victims are generally involuntary creditors, the high degree of fairness could lower the requirements for foreseeability and proximity. In addition, the parent's superior knowledge and the subsidiary's reliance on it could constitute a high level of proximity. Hence, it is likely that the parent's direct tortious liability is recognised even if the degree of control was not very strong.

¹²¹ *Chandler* (n 8) [69].

The subsidiary's reliance could be established from relevant facts such as the degree of the parent's involvement in the subsidiary's business, the method of management of health and safety issues in the group and the degree of uneven distribution of relevant knowledge and experts within the group. For example, if the parent company has formulated the group's health and safety policy to be carried out by its subsidiaries and the policy failed to prevent the harm, the parent is likely to be directly liable. Another example is the situation where the parent company has formed a business model based on its superior knowledge, its subsidiaries carry out day-to-day operations and the risk is inherent in the business model. Arden LJ in *Chandler* appropriately mentions these situations as a 'systemic risk'.¹²²

The latest case in this category is *Lungowe*,¹²³ where water contamination by the subsidiary's copper mine injured the neighbouring residents.¹²⁴ The Hon. Mr Justice Coulson mentioned the following factors which could support the parent's direct liability: the report issued by the parent, a holding company, suggested the existence of governance framework formulated by the parent to prevent water contamination; the agreement between the parent and the subsidiary suggested that the parent provided relevant services including project development and management; employees of the parent and other group companies played an important role in the business; and the parent had significant control over the subsidiary.¹²⁵ Although the judgment did not directly mention the parent's superior knowledge, the involvement of the parent in the subsidiary's business could suggest the parent's superior knowledge about the contamination risk and the subsidiary's reliance on that knowledge.

b) Confusing representation

The second category is confusing representation. It mainly includes economic torts, although it also includes physical torts preceded by a contract such as product liability and industrial accidents. In this category, the party who entered the transaction with the subsidiary confused the opposite party as its parent or the group itself at that time due to a confusing manner of representation. Although some cases in this category could also be dealt with through traditional misrepresentation law, the direct tortious liability regime could satisfy certain creditors who cannot be compensated in the traditional framework.

A typical example is *ArmorGroup*, where, as mentioned above, although the name of the employer, the subsidiary, on the employment contract document was correct, the names

¹²² *ibid* [74].

¹²³ *Lungowe v Vedanta Resources Plc* (2016) EWHC 975 (TCC), [2016] BCC 774.

¹²⁴ *ibid* [1], [2], [13]–[15].

¹²⁵ *ibid* [119].

of its parent and the group were used in a confusing manner in the course of recruitment.¹²⁶ Another possible example is the situation where the name of the parent or the group itself were disproportionately emphasised to evoke a sense of security to the opposite party, which can frequently be seen particularly in invitations to potential employees and individual consumers. In this category, the degree of fairness could be high because the opposite party did not have sufficient information to assess the risk of the transaction, thereby the demands for the other two requirements, foreseeability and proximity, could be lower. In *VTB*, although the individual controller of the company was held liable for the misrepresentation of the company ownership,¹²⁷ he would also have direct tortious liability if he gave the correct information in a confusing manner.

c) Business integration

The third category is business integration. Although this category can include both physical and economic torts and could overlap the former two categories, the parent's direct tortious liability is more likely to be affirmed even if the degree of fairness is not very high. Most undercapitalisation cases could be included in this category. For example, if the parent company intervenes in the subsidiary's financial decision-making and siphons profits from the subsidiary, the parent could be liable to the subsidiary's creditors in the event of the subsidiary's bankruptcy even if neither 'veil-piercing' nor protection under the Insolvency Act 1986 cannot be applied. In cases where an existing corporate structure was abused, which could fall out of the scope of 'veil-piercing' as mentioned in section D, it is useful for the creditors to claim the shareholder's direct tortious liability.

Another typical example is the circumstance where a subsidiary is just a part of the group business controlled by the parent. If the parent has set up the whole business and the business has a 'systemic' risk, the parent could be directly liable even if the parent did not directly involve the business. The direct tortious liability regime could have applied in *Kensington*,¹²⁸ where 'veil-piercing' was affirmed mainly because the whole group was integrated for a single business. *Adams* could also be included in this category because the worldwide production and sales of asbestos governed by the parent company seemed to involve some 'systemic' problems, such as not warning of the possible dangers.¹²⁹ The judgment in *Chandler* focused on superior knowledge perhaps because the judges could not

¹²⁶ *Armorgroup* (n 117) [11], [28].

¹²⁷ *VTB Capital Plc v Nutritek International Corp* (2013) UKSC 5, [2013] 2 AC 337 [139], [146].

¹²⁸ *Kensington International Ltd v Congo* (2005) EWHC 2684 (Comm), [2006] 2 BCLC 296.

¹²⁹ *Adams* (n 6) 505–506.

find a high level of business integration due to the parent's withdrawal from running the factory in question.

Other examples can be seen in US case law. In *Unocal*,¹³⁰ the US Court of Appeals for the Ninth Circuit held that direct tortious liability of the joint venture partner for forced labour could be affirmed even if it had only aided the use of forced labour. Similarly, in *Amoco Cadiz*,¹³¹ the US District Court affirmed the parent's direct tortious liability for the oil spill, due to the grounding of a tanker caused by a failure of the steering mechanism, mainly on the grounds of significant integrity and control. After analysing *Amoco Cadiz*, Muchlinski concluded the following:

[W]here decision-making is so centralised that major policies could not have been formulated or put into operation without the direct involvement of the parent company, ... the parent is likely to be aware, or ought to be aware, of the risk to potential claimants of such group actions, and to be sufficiently proximate to hold a duty of care towards them.¹³²

One significant difference between this category and the first category (reliance on superior knowledge), is that the latter category could include cases where businesses of the parent and its subsidiary are completely different. A parent which produces steel and its subsidiary which runs construction business is such an example. If the parent knows the possible danger inherent in a certain type of steel and the subsidiary does not have enough resources to determine the danger, the parent could be responsible for utilising its superior knowledge to prevent accidents related to the subsidiary's business. Another possible example is a holding company which does not run any business, but has superior knowledge and significant control over its subsidiary as to the relevant issue.

d) Fairness for other reasons

The final category is fairness for other reasons, where, instead of a weak justification for limited liability, there are some other factors which could cause a high degree of fairness. For example, when a shareholder obtained profits by utilising the company in an illegal manner, it is certainly unfair and unjust to grant the shareholder the benefit of limited liability. Therefore, claims from the company's creditors against the shareholder should be broadly affirmed.

¹³⁰ *Doe v Unocal Corporation*, 395 F.3d 932 (9th Cir. 2002). For more detail, see Muchlinski (n 4) 527–528.

¹³¹ Oil Spill by the *Amoco Cadiz* off the Coast of France on March 16, 1978, In Re (1984) AMC 2123 (US District Court, Northern District of Illinois). For more detail, see Muchlinski (n 21) 922.

¹³² Muchlinski, *ibid* 922.

There have been many cases where, although not in the context of removing limited liability, the corporate veil of the company, which had been used for crime and other illegal activities, was lifted or pierced: for example, *Hare*,¹³³ *DPP*¹³⁴ and *Airbus Operations*.¹³⁵ Diversion of the company's money is another typical example. In *Trustor AB*,¹³⁶ where the former director of the insolvent company forced the company to send a large amount of money to his controlling company, the judgment mentioned 'impropriety' in its justification for piercing the veil.¹³⁷ *Gencor ACP*¹³⁸ and *Antonio Gramsci*¹³⁹ also affirmed veil lifting or piercing in the case of diversion of the company's profits by the former director to another company controlled by him.

2. Supporting empirical studies

The four-group categorisation shown above is supported by the empirical study of 'veil-lifting' cases in the United States. Since it is said that 'veil-lifting' is more likely to be affirmed in the US than in the UK,¹⁴⁰ a certain proportion of US 'veil-lifting' cases would be dealt with by the direct liability regime if they were tried in the UK.

Matheson's investigation demonstrates that 'veil-lifting' occurred in 31.86% out of 929 cases since 1990.¹⁴¹ Additionally, 'fraud/misrepresentation' and 'control' were discussed in about half of the cases and, if these factors were found, 'veil-piercing' was affirmed in 88.2% and 76.4% of cases respectively.¹⁴² 'Undercapitalisation' was discussed in nearly one-third of cases and, if this factor was found, 'veil-piercing' was recognised in 76.9% of cases, particularly in 78.8% of cases where the shareholder had withdrawn profits from the company.¹⁴³ 'Unfairness/injustice' was discussed in 28.53% of cases and, if this factor was found, 'veil-piercing' was affirmed in 93.5% of cases.¹⁴⁴

Thompson had previously conducted a similar investigation.¹⁴⁵ He analysed 1583 US cases prior to 1990 with the following findings. The percentage of the cases in which 'veil-

¹³³ *Customs and Excise Commissioners v Hare* [1996] 2 All ER 391 (CA).

¹³⁴ *DPP v Compton* [2002] EWCA Civ 1720, Times, December 11, 2002.

¹³⁵ *Airbus Operations Ltd v Withey* [2014] EWHC 1126 (QB).

¹³⁶ *Trustor AB v Smallbone (No.2)* [2001] 1 WLR 1177 (Ch).

¹³⁷ *ibid* [22], [24], [25]

¹³⁸ *Gencor ACP Ltd v Dalby* [2000] 2 BCLC 734 (Ch).

¹³⁹ *Antonio Gramsci Shipping Corp v Stepanovs* (2011) EWHC 333 (Comm), [2012] 1 All ER (Comm) 293.

¹⁴⁰ Davies and Worthington (n 17) 223.

¹⁴¹ John Matheson, 'Why Courts Pierce: An Empirical Study of Piercing the Corporate Veil' (2010) 7 Berkeley Business Law Journal 3, 14.

¹⁴² *ibid* 29.

¹⁴³ *ibid* 30.

¹⁴⁴ *ibid*.

¹⁴⁵ Robert Thompson, 'Piercing the Corporate Veil: An Empirical Study' (1991) 76 Cornell Law Review 1036.

lifting’ was affirmed is 40.18%.¹⁴⁶ ‘Veil-piercing’ was affirmed in 94.08% of the 169 ‘misrepresentation’ cases, in 73.33% of the 120 ‘undercapitalisation’ cases, in 56.99% of the 551 ‘domination and control’ cases and in 81.40% of the 43 ‘overlap in business activity’ cases.¹⁴⁷ These results evidently correspond to the categorisation attempted in this section.

In the UK, Mitchell investigates 290 cases prior to 1998, although he does not analyse the reasons why ‘veil-piercing’ was affirmed.¹⁴⁸ In terms of the shareholdings of company, he demonstrates that ‘veil-lifting’ is the least likely to occur in the case of subsidiaries (40.00% of cases) compared to that of companies closely controlled by human shareholders (54.31% of cases) and even that of companies which have dispersed ownership by human shareholders (48.33% of cases).¹⁴⁹ As to the type of claim, ‘veil-lifting’ is less likely to occur in the case of tortious liability (27.78% of cases) than that of contractual liability (42.86% of cases).¹⁵⁰ Similar tendencies can also be seen in the US according to the observations of Matheson and Thompson.¹⁵¹

The findings that ‘veil-piercing’ is more likely to occur in cases involving closely controlled companies as opposed to dispersed-ownership companies are supported by the discussion on the justification of limited liability presented above. On the other hand, the findings that ‘veil-piercing’ is less likely to occur in cases involving corporate shareholders and tort creditors than in those involving either individual shareholders or contractual creditors apparently contradict the discussion above. However, this apparent contradiction could be resolved with reference to the facts that: (1) in the case of individual shareholders and contractual creditors, it is more likely that shareholders’ opportunism occurs, which could easily induce ‘veil-piercing’; (2) there could be a selection bias in the cases involving corporate shareholders and tort creditors because they are more likely to be published due to social attention; and (3) in these cases the parties are more likely to refuse the settlement and demand the judgment for their emotional satisfaction.¹⁵²

G. CONCLUSION

¹⁴⁶ *ibid* 1048.

¹⁴⁷ *ibid* 1063.

¹⁴⁸ Charles Mitchell, ‘Lifting the Corporate Veil in the English Courts: An Empirical Study’. (1999) 3 *Company Financial and Insolvency Law Review* 15.

¹⁴⁹ *ibid* 22.

¹⁵⁰ *ibid* 24.

¹⁵¹ Matheson (n 141) 14, 20; Thompson (n 145) 1055, 1058.

¹⁵² The similar discussion to the latter two reasons can be seen in Thompson (n 145) 1068–69.

This article clarified, with reference to theoretical justification of limited liability, that the situations where limited liability should be removed can be categorised in three groups: *ex ante* opportunism, *ex post* opportunism, and involuntary creditors. The former two categories have already been substantially covered by existing UK law. The remaining category of involuntary creditors could be dealt with appropriately by *Chandler*'s direct tortious liability regime if the regime is refined to be more flexible. Specifically, *Caparo*'s three requirements, namely foreseeability, proximity and fairness, should be considered in an integrated manner, and the justification for limited liability should be considered as the requirement of fairness in each case. If the degree of fairness in that case is high because, for example, the case involves a private company, and an involuntary creditor in a broad sense or misleading information during the initial transaction, then the level of foreseeability and proximity required should be relatively low. With these refinements, *Chandler*'s direct tortious liability regime will be able to deal with a variety of cases involving involuntary creditors appropriately without any legislation. Furthermore, this article categorised the circumstances in which the parent's direct tortious liability could be recognised into four groups, namely reliance on superior knowledge, confusing representation, business integration and fairness for other reasons, although these are not exhaustive. This categorisation demonstrated that the validity of the direct tortious liability regime could not be denied due to ambiguity.

In the near future, it is anticipated that the accumulation of relevant judgments and discussion will further establish the legal certainty of this regime. It is also anticipated that practical attempts in the manner in which rules of evidence are formed and applied, including appropriate inference of facts, will be made to overcome the difficulties in operating this regime, such as the uneven distribution of relevant evidence. Through these efforts, the refined direct tortious liability regime is expected to supplement 'veil-piercing' to a significant extent.

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