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# Groups of Companies: UK National Report

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## Abstract

UK company law does not have a specialised body of rules dedicated to groups of companies. Liability within a group and toward third parties may arise based on other legal doctrines, such as piercing the corporate veil, liability of the parent company as *de facto* or shadow director of the subsidiary for various fiduciary, accounting and reporting duties, as well as duties to creditors in the vicinity of insolvency. Liability may also arise when a special relation is established between the companies in a group, such as agency, or between the parent company and a third party affected by the subsidiary's activity, such as a duty of care in negligence.

## 1 Introduction

This report is set out to answer a number of questions regarding the law surrounding groups of companies in the UK. It focuses on the following main aspects: the legal terminology relating to corporate groups (parent, subsidiary, control, dominant influence); liability within a group resulting from piercing the corporate veil, directors' duties (fiduciary duties, reporting duties, duties in the vicinity of insolvency) and the establishment of a special relation between group companies (agency, partnership, assumption of a duty of care). In answering these questions, the report relies largely on the Companies Act 2006 (CA 2006), Insolvency Act 1986 (IA 1986) and the relevant case law. The report covers the law relevant to the UK as a whole. Although there are certain specific company and insolvency law provisions applicable to each of the UK jurisdictions, they are not essential for the purposes of this report, and due to limitations of space, will not be discussed separately. For the same reasons, the report will not discuss aspects relating to tax law.

UK company law does not have a specialised body of rules dedicated to groups of companies, akin to the German *Konzernrecht* or the Portuguese *sociedades coligadas*. Historically, some of the earliest examples of a company holding the shares of another company were disputed in courts as being *ultra vires*. It was argued that a company, being an artificial person, lacked a natural person's legal capacity to hold shares. These claims were swiftly dismissed.<sup>1</sup> Currently UK law does not distinguish between the liability of a parent

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<sup>1</sup> See e.g. *Re Barned's Banking Company* (1867-68) LR 3 Ch App 105 at 112-114, per Lord Cairns LJ (noting that neither the common law nor the statutes prohibited one trading corporation from taking or accepting shares in another trading corporation); *Re Asiatic Banking Corporation* (1868-69) LR 4 Ch App 252 at 257, per Sir CJ Selwyn LJ (stating that there is nothing to prevent a corporation from being a shareholder in another trading corporation).

company, qua shareholder, for the debts of its subsidiary, and that of an individual member.<sup>2</sup> In a limited liability company, both types of shareholder are liable for the nominal value of their shares, plus any share premium, if applicable.

The absence of detailed provisions on corporate groups from the current UK company law does not mean that this matter has not been considered by the legislator. The debates surrounding the reform of insolvency law in the 1980s acknowledged that corporate group structures could present serious problems for creditors, particularly intra-group transactions such as transfers of assets at undervalue, lending on other than commercial terms, gratuitous guarantees, or dividends paid without consideration of the cash needs of the paying company.<sup>3</sup> The Cork Committee, which was tasked to review the insolvency law and practice, noted that “some of the basic principles of company and insolvency law fit uneasily with the modern commercial realities of group enterprise.”<sup>4</sup> Despite acknowledging that the law was defective,<sup>5</sup> the committee refrained from recommending legal reforms regarding corporate groups, for several reasons. First, it reasoned that altering the limited liability principle in regard to certain corporate shareholders could stifle entrepreneurship and might deter companies from embarking on new projects.<sup>6</sup> Second, the Committee highlighted the difficulties related to identifying the relationships within a group that would trigger financial responsibility and the extent of such responsibility among group entities and towards creditors. The Committee concluded that such extensive reforms could not be introduced by means of changes to insolvency law, and proposed a wide review of group enterprise liability in the near future.<sup>7</sup> Such a broad review did not happen for two reasons. First, several of the concerns raised by the Cork committee were addressed by subsequent legislation strengthening the regime of director disqualification and liability for wrongful trading.<sup>8</sup> Second, the Company Law Review Steering Group, which was in charge of drafting the 2006 Companies Act, considered this issue and saw no merit in imposing a more integrated corporate groups regime, lest it would take away from the companies’ flexibility to structure their business and erode the fundamental principle of shareholder limited liability.<sup>9</sup> Following the global financial crisis of 2007-2008, the corporate governance of financial institutions was brought into sharp focus. The Walker Review recommended measures to improve the corporate governance of UK banks and other financial institutions, particularly with regard to risk management.<sup>10</sup> It did not focus specifically on corporate groups, but included a series of principles aimed at strengthening the corporate governance responsibility of institutional investors towards their investee companies, with some relevance to corporate groups. These recommendations, drafted as a Code on the Responsibilities of Institutional Investors, highlighted the need for more meaningful engagement and stewardship, and included a recommendation to adopt robust policies for managing conflicts of interest, especially those

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<sup>2</sup> In this report the terms shareholder and member of the company are used interchangeably.

<sup>3</sup> Ferran and Ho (2014), 35.

<sup>4</sup> Cork Committee (1982), [1923].

<sup>5</sup> Cork Committee (1982), [1926].

<sup>6</sup> Cork Committee (1982), [1934].

<sup>7</sup> Cork Committee (1982), [1952].

<sup>8</sup> The relevant provisions of the CDDA 1986 and IA 1986 are discussed in sections 4.3 and 5 below.

<sup>9</sup> Company Law Review Steering Group (2000), [10.58]-[10.59].

<sup>10</sup> Walker Review (2009).

arising between parent and subsidiary.<sup>11</sup> These principles were subsequently incorporated into the UK Stewardship Code, but no further provisions on corporate groups were added. Similarly, the UK Corporate Governance Code has no such provisions.

The rest of this report is structured as follow. Part 2 discusses the definitions of groups of undertakings and groups of companies, as well as other groupings relevant to the CA 2006. Section 3 covers the doctrine of piercing the corporate veil, with a focus on the single economic unit argument. Section 4 covers the main duties of directors relevant to the group context. Section 5 covers the liability for wrongful trading, fraudulent trading and undervalue transactions. Section 6 discusses the application of the unfair prejudice provisions to the relations between parent company and minority shareholders. Section 7 addresses briefly two other instances where liability of the parent to third parties dealing with the subsidiary may arise, namely agency and negligence. Section 8 concludes.

## **2 Definition of corporate groups and related concepts**

Although it has no separate branch on corporate groups, UK company law does not completely ignore intra-group relations. The current law recognises two main types of corporate groups: (i) the parent undertaking and its subsidiaries, relevant mainly for the purposes of the accounting provisions of the Companies Acts; and (ii) the holding (parent) company and its subsidiaries, relevant to other specific statutory contexts.<sup>12</sup>

For the purposes of Part 15 of CA 2006 (“Accounts and Reports”), a group of undertakings means the parent undertaking and its subsidiaries.<sup>13</sup> The CA 2006 defines the concept of undertaking in broad terms, to ensure that the consolidation of group accounts covers substantially all entities controlled by the parent company. Thus, ‘undertaking’ includes a body corporate or partnership, as well as any unincorporated association carrying on a trade or business.<sup>14</sup> A parent undertaking is one which:

- (i) holds or controls the majority of voting rights in a subsidiary, either directly or through agreements among shareholders.<sup>15</sup> Voting rights refers to shareholder voting rights or otherwise the ability to exercise voting power at general meetings, or to direct the overall policy of the undertaking or alter its constitution;<sup>16</sup>
- (ii) has the right to appoint or remove a majority of the subsidiary’s board of directors.<sup>17</sup> This provision refers to the power to appoint or remove directors who together have a majority of voting rights at board meetings on substantially all matters;<sup>18</sup>

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<sup>11</sup> Walker Review (2009), 155, Principle 2.

<sup>12</sup> Ferran and Ho (2014), 22.

<sup>13</sup> CA 2006, s 474 (1). The definitions of parent and subsidiary undertakings derive from the Seventh Company Law Directive 83/349/EEC and the subsequent directives relevant to corporate accounts and reports.

<sup>14</sup> CA 2006, s 1161 (a)-(b). For the exceptions from the need to consolidate subsidiary undertakings see CA 2006, s 405 CA 2006.

<sup>15</sup> CA 2006, s 1162(2)(a) and (d).

<sup>16</sup> CA 2006, Schedule 7 s 2.

<sup>17</sup> CA 2006, s 1162(2)(b).

<sup>18</sup> CA 2006, Schedule 7 s 3.

- (iii) exercises a dominant influence over the subsidiary, whether by provisions in its articles or by virtue of a control contract.<sup>19</sup> Dominant influence is defined as the right to give directions on the operating and financial policies of the subsidiary undertaking, which are binding on its directors whether or not they are for the benefit of the subsidiary.<sup>20</sup> The parent undertaking's contractual right of control must stem either from a written contract permitted by the articles of the subsidiary, or from the law under which the subsidiary undertaking is established;<sup>21</sup>
- (iv) has the legal or factual power to exercise dominant influence or control over the subsidiary.<sup>22</sup> The factual control scenario is broader and harder to circumvent than the legal (contractual) control. Factual control arises when the operating and financial policies of the subsidiary undertakings are established in accordance with the express or implicit wishes and interests of the parent.<sup>23</sup> Such factual dominance may arise, for instance, when the majority of the subsidiary's shareholders are diversified passive investors, and another shareholder (the parent) has a *de facto* power to control shareholder meetings or to veto decisions.<sup>24</sup>
- (v) is managed together with a subsidiary undertaking on a unified basis.<sup>25</sup>

The UK company law provisions relevant to groups of undertakings are in line with the EU requirements on annual accounts and consolidated accounts. Most parent companies incorporated in the UK must produce annual consolidated group accounts, giving a true and fair view of the assets, liabilities, financial position and profit or loss of the undertakings included in the consolidation as a whole.<sup>26</sup>

In addition to the groups of undertakings, CA 2006 recognises the corporate group formed by a holding (parent) and one or more subsidiaries.<sup>27</sup> A subsidiary company is defined as a company which has a holding company.<sup>28</sup> A holding company, in turn, is defined as a company which holds or controls, either directly or by virtue of agreements with other members, a majority of the voting rights in the subsidiary, or has the right to appoint and remove a majority of its board.<sup>29</sup> A subsidiary is prohibited from holding shares in its parent (holding) company.<sup>30</sup> A subsidiary of another subsidiary is also a subsidiary of the original parent company.<sup>31</sup> It should be noted that the tests for the existence of a legal or factual

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<sup>19</sup> CA 2006, s 1162(2)(c).

<sup>20</sup> CA 2006 Schedule 7 s 4(1).

<sup>21</sup> CA 2006 Schedule 7 s 4(2).

<sup>22</sup> CA 2006S 1162 (4) (a)

<sup>23</sup> Ferran and Ho (2014), 25.

<sup>24</sup> Ferran and Ho (2014), 24-25.

<sup>25</sup> CA 2006 s 1162 (4)(b).

<sup>26</sup> The duty to provide group accounts is discussed in more detail in Section 4.2 below.

<sup>27</sup> The main statutory contexts in which this concept is relevant are discussed in the following sections.

<sup>28</sup> CA 2006 s 1159 (1).

<sup>29</sup> CA 2006 s 1159(1) (a)-(c).

<sup>30</sup> CA 2006 s 136.

<sup>31</sup> CA 2006 s 1159 and Schedule 6.

control mentioned above (applicable to groups of undertakings) do not apply outside the accounting context.<sup>32</sup> Nevertheless, as discussed in the following sections, a shareholder having significant factual influence over the company and its directors may be bound by directors' duties, as a *de facto* or shadow director. A comparison of the two types of groups recognised under CA 2006 reveals that the concept of group of undertakings is broader than that of a group of companies, in two respects. First, it includes both companies and unincorporated entities. Second, in the group of undertakings context, control includes the right to exercise a dominant influence over the subsidiary, whether by provisions in its articles or by virtue of a control contract.

In addition to the provisions on groups of companies and groups of undertakings, CA 2006 recognises exceptionally other groupings. First, the act comprises a series of provisions applicable to associated companies. A parent company is associated with all its subsidiaries, and a subsidiary is associated with its holding company and all the other subsidiaries of its holding company.<sup>33</sup> The relevant provisions cover restrictions regarding loans, quasi-loans and credit transactions between associated companies,<sup>34</sup> and indemnification or provision of insurance against liability for breach of directors' duties.<sup>35</sup>

Second, CA 2006 has special provisions regarding the control of a company for the purpose of disclosure of interests in its shares. A person is regarded as having an interest in shares if he has a contractual right to acquire them, or, if he is not the registered holder, is entitled to exercise any right conferred by the shares, or to control the exercise of any such right.<sup>36</sup> Furthermore, a person is considered interested in the shares of a company if a body corporate is interested in them and the body or its directors are accustomed to act in accordance with his directions or instructions; or he is entitled to exercise or control the exercise of one-third or more of the voting power at general meetings of the body corporate.<sup>37</sup> The concept of person interested in the company's shares is relevant mainly for transparency purposes. A public company has the power to request any person whom the company knows, or has reasonable cause to believe, to be interested in the company's shares, to confirm or deny such interest and provide any relevant further information.<sup>38</sup>

For similar reasons of disclosure and transparency, new provisions have been recently introduced in CA 2006, imposing an obligation<sup>39</sup> to keep a public record of people with significant control over the company (PSC).<sup>40</sup> A company subject to this duty must take reasonable steps to determine if there is anyone who is a registrable person or a registrable relevant legal entity in relation to that company and, if so, identify them in the PSC register.

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<sup>32</sup> Ferran and Ho (2014), 26.

<sup>33</sup> CA 2006 s 256.

<sup>34</sup> CA 2006 ss 197-214.

<sup>35</sup> CA 2006 ss 232-237.

<sup>36</sup> CA 2006 s 820 (4).

<sup>37</sup> CA 2006 s 823 (1).

<sup>38</sup> CA 2006 s 793.

<sup>39</sup> Certain companies are exempt from this obligation: companies with voting shares admitted to trading on an EEA regulated market, and in other markets specified by regulations; any other companies as specified by the Secretary of State by regulations (CA 2006 s 790B).

<sup>40</sup> This duty was introduced by the Small Business, Enterprise and Employment Act 2015, s 81, Schedule 3, Pt 1, para 1. Relevant regulations include: Information about People with Significant Control (Amendment) Regulations 2017, (SI 2017/693); the Companies Act 2006 (Amendment of Part 21A) Regulations (2016 (SI 2016/136)); Register of People with Significant Control Regulations 2016 (SI 2016/339); BEIS (2016).

Only individuals can be people with significant control.<sup>41</sup> An individual has significant control if he meets one or more of the following conditions: holds, directly or indirectly, more than 25% of the shares; holds, directly or indirectly, more than 25% of the voting rights; holds the right, directly or indirectly, to appoint or remove a majority of directors; has the right to exercise, or actually exercises, significant influence or control; has the right to exercise, or actually exercises, significant control or influence over the activities of a trust or firm that does not have legal personality under its governing law, where the trustees or members of that trust or firm meet any of the conditions mentioned above.<sup>42</sup> For the purpose of applying these conditions, an individual holds a direct interest if the share is held in the individual's own name. An individual holds an indirect right where he has a majority stake in a legal entity that holds the right in question or is part of a chain of legal entities, each of which (other than the last) has a majority stake in the entity immediately below it in the chain and where the last legal entity in the chain holds the share in question.<sup>43</sup> Majority stake means: the person holds a majority of the voting rights in a legal entity; or the person is a member of the legal entity and has the right to appoint or remove a majority of the board of its directors; the person is a member and controls alone, pursuant to an agreement with other members, a majority of the voting rights of the legal entity; the person has the right to exercise, or actually exercises, dominant influence or control over the legal entity.<sup>44</sup> The breadth of these provisions is designed to ensure that every method of holding significant control over a company is potentially registrable.<sup>45</sup>

The provisions of the CA 2006 regarding groups of companies and other forms of groupings apply to rather narrow scenarios or transactions, and do not constitute a coherent corporate groups law. Therefore, the remaining sections of this report will focus on general doctrines and provisions of CA 2006 that are relevant to the issue of liability within a group of companies.

### **3 Separate personality, limited liability and piercing the corporate veil**

This section considers the impact of the corporate personality and limited liability doctrines on the relations between companies in a group. Particular attention will be paid to the doctrine of piercing the corporate veil.

Under UK law, companies have their own legal identity, separate from those of its shareholders, directors, parent or subsidiary companies. In companies limited by shares, which form the vast majority of companies in the UK, members are liable to contribute, upon winding up of the company, where the company's assets are insufficient to pay its debts and

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<sup>41</sup> For the purposes of the PSC regime, CA 2006 s 790C(12) deems the following entities to be individuals: a corporation sole (an office held by a single person that has a separate legal existence from the person occupying the office, such as ministers of the Crown, the Treasury Solicitor or the holders of various ecclesiastical offices); a government or government department of a country or territory; an international organisation whose members include two or more countries or territories (or their governments); a local authority or local government body in the United Kingdom.

<sup>42</sup> CA 2006, Schedule 1A, paragraphs 1-6.

<sup>43</sup> CA 2006, Schedule 1A, paragraph 18 (1). See also Practical Law Company, (2017).

<sup>44</sup> CA 2006, Schedule 1A, paragraph 18 (3).

<sup>45</sup> For further details on the meaning and application of these provisions see Practical Law Company, (2017).

liabilities, an amount equal to the aggregate nominal value of their shares plus any share premium, if applicable.<sup>46</sup> In limited circumstances, courts have ‘pierced the corporate veil’ and ignored the separate personalities of the company and one or more of its shareholders.

As discussed below, piercing the corporate veil is a doctrine of limited and exceptional application under UK law, due to the centrality of the separate legal personality and shareholder limited liability doctrines. Incorporation of a business by way of registration has been available in the UK since the Joint Stock Companies Act 1844.<sup>47</sup> Limited shareholder liability has been the default in Britain since the Limited Liability Act 1855.<sup>48</sup> The two principles have been firmly cemented by the seminal decision in *Salomon v Salomon & Co Ltd*,<sup>49</sup> where the House of Lords ruled that, as long as all registration formalities are complied with, a company is a completely separate legal entity from its owners, irrespective of the degree of influence and control that one shareholder exercises over the company or the other shareholders. Following from this, the assets and liabilities of the shareholders are separate from those of the company, so that former’s assets cannot be applied to cover the latter’s debts.<sup>50</sup> The company can exercise rights and powers, and is subject to obligations and liabilities, similar to natural persons. It may own in property, contract on its own behalf, and sue and be sued in its own name. These principles have been the foundation of British company law for over a century.<sup>51</sup> Nevertheless, instances arise when the separate personality and limited liability principles operate harshly and seem to unfairly shift the risk of failure from shareholder to creditors. As one author noted, “the formal legal rules provide a device for limited liability to be manipulated, avoiding the spirit of the legislation to the detriment of creditors.”<sup>52</sup> The downside consequences of limited liability often appear more severe when they arise in a corporate group context.

Consequently, a line of argument emerged holding that the principle of limited liability should be relaxed in corporate groups, which should be treated as a single economic unit. It holds that when a company owns majority or in whole another company, and the two essentially operate as one enterprise, they should be treated as one entity and their separate personalities disregarded. This argument does not have authoritative judicial support. Only one notable instance of a court’s recognition of the single economic unit argument exists. This view was espoused by Lord Denning in *DHN Food Distributors Ltd v Tower Hamlets LBC*.<sup>53</sup> He noted that in company law “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.”<sup>54</sup> Lord Goff concurred with this reasoning though warned that he was relying on the facts of this particular case and would not be willing to

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<sup>46</sup> IA 1986 s 74(2)(d).

<sup>47</sup> 7 & 8 Vict. c.110.

<sup>48</sup> 18 & 19 Vict. c.133.

<sup>49</sup> [1897] AC 22.

<sup>50</sup> *JH Ratner (Mincing Lane) Ltd v Department of Trade and Industry and Others* [1989] Ch 72 at 176, per LJ Rodger, citing Gower (1979), 100: “It follows from the fact that a corporation is a separate legal person that its members are not liable for its debts.”

<sup>51</sup> *Petrodel Resources Ltd v Prest* [2013] UKSC 34, [2013] 3 WLR 1 at 9, per Lord Sumption.

<sup>52</sup> Kershaw (2012), 39.

<sup>53</sup> [1976] 1 WLR 852.

<sup>54</sup> *Ibid.* at 860.



extend it to every case involving a group of companies.<sup>55</sup> The case involved a parent company, DHN, and several wholly owned and controlled subsidiaries, who were “bound hand and foot to the parent company and must do just what the parent company say”.<sup>56</sup> The court noted that the subsidiary clearly lacked control over its business.<sup>57</sup> This warranted piercing the corporate veil and treating the group as a single economic unit.<sup>58</sup>

Subsequent cases distinguished *DHN* as applicable to a unique set of facts, and even doubted its correctness. In *The Albazero*,<sup>59</sup> the House of Lords unanimously reiterated the principle in *Salomon* and stated that:

“[e]ach company in a group of companies... is a separate legal entity possessed of separate legal rights and liabilities so that the rights of one company in a group cannot be exercised by another company in that group even though the ultimate benefit of the exercise of those rights would enure beneficially to the same person or corporate body irrespective of the person or body in whom those rights were vested in law.”<sup>60</sup>

In *Woolfson v Strathclyde Regional Council*,<sup>61</sup> the House of Lords refused to follow *DHN*. The court relied heavily on the fact that the case did not involve a wholly-owned subsidiary to distinguish *DHN* on the facts, to reject the single economic entity argument, and also to question the cases upon which the veil lifting argument was based in *DHN*. Similarly, in *Re Southard & Co Ltd*,<sup>62</sup> Lord Templeman noted that:

“A parent company may spawn a number of subsidiary companies, all controlled directly or indirectly by the 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 the other subsidiary companies may prosper to the joy of the shareholders without any liability for the debts of the insolvent subsidiary.”<sup>63</sup>

The single economic unit case for piercing the veil was again rejected in *Adams v Cape Industries Plc*,<sup>64</sup> a decision that remains one of the strongest authorities in British law as regards veil piercing. The central issue in *Cape* was whether the UK parent of an international mining group was present in the US for the purpose of making a default judgment of a US court enforceable against it in the UK. The contention was that the group was managed as a single economic unit and the UK company was present in US via a wholly-owned subsidiary. Lord Justice Slade of the Court of Appeal observed that the law

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<sup>55</sup> *Ibid.* at 861.

<sup>56</sup> *Ibid.* at 860, per Lord Denning.

<sup>57</sup> *Ibid.*

<sup>58</sup> *Ibid.*

<sup>59</sup> [1977] AC 774, [1976] 3 WLR 419.

<sup>60</sup> *Ibid.* at 807.

<sup>61</sup> 1978 SC (HL) 90, 1978 SLT 159.

<sup>62</sup> [1979] 1 WLR 1198.

<sup>63</sup> *Ibid.* at 1208.

<sup>64</sup> [1990] Ch 433; [1990] BCLC 479.

“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.”<sup>65</sup>

The group enterprise argument resurfaced in *Re Polly Peck Plc*.<sup>66</sup> The court regarded as “persuasive”<sup>67</sup> the argument that the parent and subsidiary should be regarded as a single entity for the purpose of a debt issue, but decided that it was precluded from this approach by *Cape*, a decision of a higher court. *Cape* remained good authority after the adoption of the CA 2006. In *Newton-Sealey v ArmorGroup Services Ltd*,<sup>68</sup> for instance, the court was asked to consider, for the purpose of a summary judgment, whether an employee of a Jersey-based subsidiary would be able to hold the UK-based parent liable for negligence, given that the employee had dealt entirely with the parent, except for having an employment contract with the subsidiary. Here, the ruling of *Cape* was restated, though the judge refused to dismiss the claim, ceding that there was a real prospect of success for the tort victim’s argument that a duty of care should be established. The case was subsequently settled out of court. More recently, the issue of veil piercing in a group setting was discussed in the controversial decision in *Antonio Gramsci Shipping Corp v Stepanovs*,<sup>69</sup> where the court pierced the corporate veil to allow the controllers of a company to be sued under the company’s contracts, as if they were themselves a contracting party. This decision was criticised and doubted, and overruled in the recent Supreme Court decision in *VTB Capital Plc v Nutritek International Corpn and others*.<sup>70</sup> The Supreme Court noted that, short of fraud, the *Salomon* principle should not be derogated from when a company is controlled by another entity:

“[a] properly incorporated company is a legal person separate from its corporators and controllers...; the principle of separate corporate personality is a privilege intended to encourage investment in business by presenting a shield, protecting shareholders and those controlling the company from the potential open-ended liabilities it incurred in carrying on business.”<sup>71</sup>

The ultimate authority on piercing the veil in UK company law is *Prest v Petrodel Resources Ltd and others*.<sup>72</sup> Lord Sumption and Lord Neuberger engaged in a substantive analysis of the preceding case law and academic commentary on this matter. Lord Sumption noted the confusing and contradictory nature of the veil piercing doctrine, describing its application as

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<sup>65</sup> *Ibid.* at 513.

<sup>66</sup> [1996] BCC 486.

<sup>67</sup> *Ibid.* at 498.

<sup>68</sup> [2008] EWHC 233 (QB), 2008 WL 371042.

<sup>69</sup> [2011] EWHC 333 (Comm), [2012] BCC 182.

<sup>70</sup> [2013] UKSC 5, [2013] 2 AC 337.

<sup>71</sup> *Ibid.* at 345. The court makes a similar point at p 387, when it states that, in a contract between B and C, A should not be held responsible for B’s liabilities simply because A controls B and induced C to contract with B.

<sup>72</sup> [2013] UKSC 34, [2013] 3 WLR 1.

“characterised by incautious dicta and inadequate reasoning”.<sup>73</sup> Lord Sumption distinguished between two principles: concealment and evasion. Concealment, often referred to in caselaw with terms such as façade, device, sham, cloak, is a “legally banal” arrangement that does not involve piercing the corporate veil.<sup>74</sup> When one or more companies are interposed, so as to hide the real actor in a transaction, the court can simply look behind the “façade” to discover the corporate structure; there is no need to disregard the separate corporate personality of the “façade”. Evasion, in contrast, is a true case of veil piercing. It arises when a person is under an existing duty, liability or legal restriction which he deliberately evades or whose enforcement he deliberately frustrates by interposing a company under his control.<sup>75</sup> Evasion is abuse of corporate legal personality, and thus justifies an exception from *Salomon*. The court may pierce the corporate veil solely for the purpose of depriving the company or its controller of the advantage which he would not otherwise have obtained. The Supreme Court further clarified that, when a company has a controller, the latter does not abuse the legal personality merely by causing the company to incur liability: “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. On the contrary, that is what incorporation is all about.”<sup>76</sup> Even when evasion occurs, the veil should only be pierced only as a last resort, where no other suitable remedies are available.<sup>77</sup>

Although largely regarded as the current leading authority on veil piercing, *Prest* is not without criticism. The other Justices disputed the clear-cut distinction between concealment and evasion introduced by Lord Sumption. Baroness Hale, Lord Wilson and Lord Mance doubted that the two principles could be neatly separated and would adequately cover all cases where the veil should be pierced. Lord Walker thought that piercing the corporate veil is a metaphor rather than a coherent doctrine, and doubted that it operates independently of other doctrines, such as tort or unjustified enrichment.<sup>78</sup> Nevertheless, the court was widely in agreement that the principle should be limited and that it will be very difficult to establish further exceptions, other than the evasion principle. Moreover, Lord Sumption’s analysis of veil piercing is technically obiter since the case was decided based on a resulting trust of corporate property, rather than veil piercing.<sup>79</sup> Other authors have argued that, under Lord Sumption’s test, instances of wrongdoing on the part of a company’s controller could either be regarded as concealment or fail to be captured by the evasion principle.<sup>80</sup>

Finally, the situation of outsider reverse veil piercing should be mentioned. This form of veil piercing refers to situations where personal or business creditors of the shareholders or directors of a company attempted, and in a few instances succeeded, to gain access to, or seize the assets of the company in priority to the company’s own creditors, where such

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<sup>73</sup> *Ibid* at [19].

<sup>74</sup> *Ibid.* at [28].

<sup>75</sup> *Ibid.*

<sup>76</sup> *Ibid.* at [34].

<sup>77</sup> *Ibid.* at [35]. See also Lord Neuberger at [62].

<sup>78</sup> *Ibid* at [106].

<sup>79</sup> *Ibid.* at [55]-[56].

<sup>80</sup> Lee (2015), 30; Han (2015), 27; Hannigan (2013), 31.

shareholders or directors were not insolvent.<sup>81</sup> This uncommon form of veil piercing has been criticised as destructive to the entity shielding function of registered companies, which allows businesses to keep the corporate assets and creditors separate from those of shareholders or directors.<sup>82</sup>

#### 4 Directors' duties

Company directors are subject to the general duties listed in Chapter 2 of Part 10 of CA 2006. The codified duties replace the corresponding common law rules and equitable principles, but the latter remain relevant when interpreting and applying the statutory duties. Further relevant duties are set out elsewhere in CA 2006 (such the duty to deliver reports and accounts), while others remain uncodified (such as the duty of confidentiality). These duties are binding on “any person occupying the position of director, by whatever name called”.<sup>83</sup> This includes persons properly appointed as directors (*de jure* directors), persons who act as part of the corporate governing structure or have assumed the status and functions of a company director without being formally and dully appointed as such (*de facto* directors),<sup>84</sup> and persons who are not formally appointed but in accordance with whose direction or instructions the directors of a company are accustomed to act (*shadow* directors).<sup>85</sup> For the ‘accustomed to act’ condition to be met, the directions and instructions must be given repeatedly over a period of time and as a regular course of conduct,<sup>86</sup> and must be followed by at least a consistent majority of directors.<sup>87</sup>

In the context of corporate groups, shadow directorships are particularly likely to arise when the parent company expects to retain control over the decisions and actions of the subsidiary. It is important to highlight that the ‘accustomed to act’ condition is necessary but not sufficient for labelling a parent company as shadow director. CA 2006 s 251(3) expressly states that a body corporate is not regarded as a shadow director of any of its subsidiaries, and thus will not be bound by the provisions on general duties of directors, transactions requiring members’ approval, and contracts with the sole member who is also a director, simply because the directors of the subsidiary are accustomed to act in accordance with the directions or instructions of the parent.<sup>88</sup> This means that a parent company can impose a common policy on all group companies without the risk of becoming a shadow director. However, it may be possible for a court to find that a shadow directorship exists, if the parent goes beyond

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<sup>81</sup> See e.g. *Lonrho Ltd v Shell Petroleum Co Ltd (No 1)* [1980] 1 WLR 627; *Kensington International Ltd v Congo* [2005] EWHC 2684 (Comm), [2006] 2 BCLC 296; *Raja v Van Hoogstraten* [2006] EWHC 2564 (Ch), [2006] 8 WLUK 253.

<sup>82</sup> See Cabrelli (2010), 343.

<sup>83</sup> CA 2006 s 250. CA 2006 ss 156A–156B, introduced by the Small Business, Enterprise and Employment Act 2015 s 87, require all directors to be natural persons and prohibit the appointment of corporate bodies as directors (subject to certain exceptions). These provisions have not yet come into force.

<sup>84</sup> See *Secretary of State for Trade and Industry v Tjolle* [1998] BCC 282 at 290; *Re Kaytech International Plc* [1999] BCC 390 at 402.

<sup>85</sup> CA 2006, s 251(1). See also Palmer (1992- ), 8.217-8.224.

<sup>86</sup> *Re Unisoft Group Ltd (No 3)* [1994] BCC 766; *Secretary of State for Trade and Industry v Becker* [2003] 1 BCLC 565; *Secretary of State for Trade and Industry v Deverell* [2000] 2 BCLC 133 (CA).

<sup>87</sup> *Ultraframe (UK) Ltd v Fielding* [2005] EWHC 1638 (Ch), [2005] 7 WLUK 862.

<sup>88</sup> See also *Clydebank Football Club Ltd v Steedman* 2002 SLT 109 (OH) (holding that the parent-subsidiary relations was not enough to make the parent a shadow director of its subsidiary).

merely instructing the subsidiary board by, for instance, taking full control of the financial affairs of the subsidiary, negotiating with third parties on behalf of the subsidiary, or controlling the appointment of senior management.<sup>89</sup>

This exception expressly protects the parent and holding companies, but not their individual directors. Nevertheless, when a parent company is found to be shadow director of its subsidiary, the individual directors the parent will not automatically be considered shadow directors of the subsidiary. Such directors must separately, and by their own actions, control the subsidiary by, for instance, managing its trading or taking control of its financial affairs other than as a representative of the parent company.<sup>90</sup> It should also be noted that the exclusion of parent-subsidary relation from the definition of shadow director applies for the purpose of CA 2006 only. It does not apply to the definition of shadow director in the Company Director Disqualification Act 1986 (CDDA 1986) and Insolvency Act 1986 (IA 1986).<sup>91</sup>

Prior to CA 2006, there was some confusion regarding the extent of the duties owed by shadow directors. In *Ultraframe v Fielding* Lewison J explained that a relationship of trust and confidence of a shadow director to the company must be shown in order to apply fiduciary duties, indeed casting doubt on the fact that shadow directors may owe similar duties.<sup>92</sup> CA 2006 did little to further clarify which duties applied, stating simply that “the general duties apply to shadow directors where, and to the extent that, the corresponding common law rules of equitable principles so apply.”<sup>93</sup> In *Secretary of State for Trade and Industry v Deverell*<sup>94</sup> Morritt LJ stressed that the interpretation of this notion depends on the statutory context (a stricter construction may be more appropriate in a criminal context); that the purpose of the legislation is to identify those with “real influence” in the corporate affairs of the company, or part of them; that advice (other than professional advice) is capable of coming within the phrase “directions or instructions”; and that it is not necessary that the board should be reduced to a subservient role or surrender its discretion. The more recent case of *Vivendi v Richards* shed light on this topic in explaining that the fiduciary duties owed by a shadow director stem from undertaking or the assumption of responsibility.<sup>95</sup> There is no requirement of secrecy for the shadow director duties to apply. A majority shareholder who openly gives instructions to the directors cannot escape liability as a shadow director simply on the grounds that the instructions were known to all.<sup>96</sup>

De jure directors of a company, whether subsidiary, parent or otherwise, are bound by essentially the same duties. In a corporate group context, however, the application of these duties is more challenging, as directors’ loyalties are often split between their company, the appointing parent or the group as a whole. It is a well-established principle that directors owe

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<sup>89</sup> Kemp and Handforth, (2011) (online).

<sup>90</sup> *Secretary of State for Trade and Industry v Laing* [1996] 2 BCLC 324 (Ch), [1997] 1 WLR 104; *Re Hydrodan (Corby) Ltd (In Liquidation)* [1994] BCC 161 (holding that individual and personal instructions from a director of the parent to the directors of the subsidiary could bring the former within the definition of a shadow director).

<sup>91</sup> These provisions are discussed in Sections 4.3 and 5 below.

<sup>92</sup> *Ultraframe (UK) Ltd v Fielding* [2005] EWHC 1638 (Ch), [2005] 7 WLUK 862.

<sup>93</sup> CA 2006, s 170(5).

<sup>94</sup> [2001] Ch 340, [2000] 2 BCLC 133.

<sup>95</sup> [2013] EWHC 3006 (Ch), [2013] BCC 771.

<sup>96</sup> *Secretary of State for Trade and Industry v Deverell* [2001] Ch 340, [2000] 2 BCLC 133.

their duties to their company,<sup>97</sup> and not to its shareholders, creditors, other directors or other stakeholders.<sup>98</sup> Consequently, only the company itself, via its board, an administrator or liquidator can initiate actions against the directors. Exceptionally, the parent or any other shareholder may sue the directors derivatively, on behalf of the subsidiary.<sup>99</sup>

#### 4.1 Fiduciary duties

As mentioned before, in a corporate group, each company is a separate legal entity and its directors are not allowed to sacrifice its interests for the benefit of another group entity or the group as a whole.<sup>100</sup> From a practical perspective, however, given a parent's control over the appointment and revocation of subsidiary directors, difficulties may arise when the interests of the two companies are in conflict. When such tensions arise, the subsidiary directors cannot be compelled to act in the interests of the nominating parent company,<sup>101</sup> or in the interest of the group as a whole,<sup>102</sup> particularly when the subsidiary has separate creditors. When the interests of the two companies are aligned, directors are allowed to take into account the interests of the parent and the group as a whole,<sup>103</sup> but careful reasoning and justifications are needed to prevent a potential claim for breach of duty. Under CA 2006 s 172, directors are bound by an overarching duty to promote the success of their company for the benefit of the shareholders as a whole, having regard to, *inter alia*, the interests of various corporate stakeholders and the long-term consequences of their decision.<sup>104</sup> What constitutes the success of the company is a matter left to the directors' good faith judgment, and courts will generally refrain from reviewing such judgment. Read in its entirety, s 172 gives directors the possibility (without establishing an enforceable obligation) to act in a way that benefits the parent or the group at the expense of the subsidiary, if such action can be justified through positive long-run consequences on the subsidiary,<sup>105</sup> and the interests of the parent company coincide with those of the minority shareholders.<sup>106</sup> Where there are different

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<sup>97</sup> CA 2006 S 170(1).

<sup>98</sup> *Multinational Gas & Petrochemical Co v Multinational Gas & Petrochemical Services Ltd* [1983] Ch 258, [1983] 3 WLR 492; See also Palmer (1992- ), 8.2402

<sup>99</sup> See also Palmer (1992- ), 8.3701 ff.

<sup>100</sup> *Charterbridge Corporation v Lloyds Bank Limited* [1970] Ch 62 (Ch), [1969] 3 WLR 122.

<sup>101</sup> *Boulting v ACTT* [1963] 2 QB 606, [1963] 2 WLR 529; *Kuwait Asia Bank EC v National Mutual Life Nominees Ltd* [1991] 1 AC 187, [1990] BCC 567; *Hawkes v Cuddy* [2009] 2 BCLC 427. See also *Palmer's Company Law*, *supra* note 85 at 8.2704–8.2706.

<sup>102</sup> *Pergamon Press Ltd v Maxwell* [1970] 1 WLR 1167.

<sup>103</sup> *Charterbridge Corporation v Lloyds Bank Ltd* [1970] Ch 62 (Ch), [1969] 3 WLR 122.

<sup>104</sup> At common law, this overarching duty was known as the duty to act in good faith in what the director considers to be in the best interests of the company of which he is a director, and not for any collateral purpose (*Re Smith & Fawcett Limited* [1942] Ch 304, [1942] 1 All ER 542). The interests of the company were equated with the interests of the shareholders generally (*Greenhalgh v Arderne Cinemas* [1951] Ch 286, [1950] 2 All ER 1120). Despite the change in terminology, the courts' interpretation of this core fiduciary duty remains largely unchanged (see *West Coast Capital (Lios) Limited* [2008] CSOH 72).

<sup>105</sup> *Thompson v The Renwick Group plc* [2014] EWCA Civ 635, [2015] BCC 855.

<sup>106</sup> *Commissioner of Taxpayer Audit and Assessment v Cigarette Company of Jamaica Ltd* [2012] STC 1045, PC, at [14] per Lord Walker.

groups of shareholders with different interests, the directors must act fairly as between these different groups.<sup>107</sup>

Directors are also bound by a general duty exercise their powers independently, without subordinating their judgment to the will of others, whether by delegation or otherwise.<sup>108</sup> By way of exception, CA 2006 s 173 (2) allows directors to fetter their discretion pursuant to an agreement entered into by the company, or as provided under the company's constitution. Previous common law principles regarding the extent to which it is proper for directors to fetter their discretion remain relevant in relation to this codified duty. In a group context, this duty means that a subsidiary director cannot agree with the appointing parent company to vote at board meetings in the interests of the parent or of the groups as a whole, unless an agreement is duly concluded between the subsidiary and parent, or such a fetter is allowed by the subsidiary's constitution. When the latter conditions apply, practical difficulties are likely to arise, since, on the one hand, a director cannot abdicate *in toto* his duty to exercise independent judgment, and, on the other hand, he remains bound by the overarching duty to promote the success of his company as well as by the duty to avoid conflicts of interest.

The later duty is codified in CA 2006 s 175, which provides that a director of a company must avoid a situation in which he has a direct or indirect interest that conflicts, or possibly may conflict, with the interests of the company.<sup>109</sup> The language of this section follows the common law formulation of the no-conflict duty.<sup>110</sup> It has a broad scope, covering any actual or potential conflict between a director's duty to his company and his personal interests or duty to another company.<sup>111</sup> The section applies in particular to the exploitation of opportunities, information or property.<sup>112</sup> The duty is not infringed if the situation cannot reasonably be regarded as likely to give rise to a conflict of interest,<sup>113</sup> or if the matter is authorised by disinterested directors<sup>114</sup> or shareholders<sup>115</sup> having full knowledge of all relevant facts.<sup>116</sup> The no-conflict duty has traditionally been strictly construed and applied by courts. Breach of it does not depend on bad faith or the state of mind of the fiduciary, or on whether the company suffered a loss or benefited from the conflicted transaction.<sup>117</sup> Consequently, the test of whether there is a breach of the s. 175 duty is objective, and does not depend on whether the director is aware that what he is doing is a breach of his duty.<sup>118</sup>

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<sup>107</sup> CA 2006 s 172(1)(f). See also *Mutual Life & Insurance Co of New York v Rank Organisation Ltd* [1985] BCLC 11; *Re BSB Holdings Ltd (No 2)* [1996] 1 BCLC 155.

<sup>108</sup> CA 2006 s 173.

<sup>109</sup> CA 2006 s 175(1).

<sup>110</sup> See *Aberdeen Railway Co v Blaikie Brothers* (1854) 1 Macq 461 at 471; *Boardman v Phipps* [1967] 2 AC 46 at 124B-C; see also *Bhullar v Bhullar* [2003] 2 BCLC 241 at [27]-[31]; *Eastford Ltd v Gillespie* [2010] CSOH 132 at [17]-[18].

<sup>111</sup> The duty-duty conflict is mentioned in CA 2006 s 175 (7).

<sup>112</sup> CA 2005 s 175(2).

<sup>113</sup> CA 2006 s 175(4)(a).

<sup>114</sup> CA 2006 s 175(4)(b).

<sup>115</sup> CA 2006 s 180(4).

<sup>116</sup> *Sharma v Sharma* [2013] EWCA Civ 1287, [2014] BCC 73.

<sup>117</sup> *Keech v Sandford* (1726) 25 ER 223; *Regal (Hastings) Ltd. v Gulliver* [1967] 2 AC 134; *Boardman v Phipps* [1967] 2 AC 46.

<sup>118</sup> *Richmond Pharmacology Ltd v Chester Overseas Ltd & Ors* [2014] EWHC 2692 (Ch), [2014] 8 WLUK 33 at [72].

Due to its broad scope and strict interpretation, the no-conflict duty is likely to cause significant practical difficulties for persons holding multiple directorships, as it is often the case in a corporate group. A subsidiary director who has a duty or a personal interest in promoting the interests of the parent company, must not allow his relation with the parent to come into an actual or potential conflict with his duty to advance the subsidiary's interests.<sup>119</sup> To avoid such practical difficulties, parent and subsidiary companies could include in their articles of association provisions on managing conflicts of interests and prioritising conflicting duties. Although there is no prima facie prohibition of serving on boards of competing companies,<sup>120</sup> when the parent and subsidiary share the same line of business, the practical difficulties of joint directorships may be insurmountable. Inaction, in the form of failure to take action to protect the interests of the subsidiary may also amount to a breach of duty. Nominee directors appointed by the parent are in breach of their duties to the subsidiary when they are aware of the parent's policy to deprive the subsidiary of business opportunities, and acquiesce to it.<sup>121</sup>

CA 2006 s 175 does not apply to transactions or arrangements between director and his company, which are covered separately by s 177 and s 182. Any director who has a direct or indirect interest in a proposed transaction or arrangement with his company must declare the nature and extent of this interest to the other directors.<sup>122</sup> No declaration is required when the interest cannot reasonably be regarded as giving rise to a conflict, when the other directors are or ought to be aware of such interest, when the director himself is not, and ought not to be, aware of his interest, or when the interest concerns the terms of a director's service contract.<sup>123</sup> S 182 imposes a similar duty of disclosure, but it refers to a transaction already entered into by the company. The requirement to disclose an indirect interest in future or existing transactions means that the director himself does not need to be a party to the transaction for the duty to apply. This scenario may arise when a subsidiary contracts with the parent company or another group company, and the subsidiary director has an interest in the co-contracting company (as a shareholder, director or other capacity). At the same time, in small corporate groups, it is likely that an interested director be exonerated from declaring their interest, given the high probability that the other directors are, or ought reasonably to be, aware of it.

It is worth underlining that s 177 imposes only an obligation of board disclosure, as opposed to the common law position of shareholder approval of self-dealing transactions. The main aim of the disclosure duty is to put the other directors on notice of the existing interest, thus enabling them to safeguard the interests of the company when deciding, on behalf of the company, whether to enter the proposed transaction or not. In certain instances, however, the law maintains the common law position of shareholder approval.

One such instance is disclosing the interest in an existing transaction or arrangement, discussed above. Another instance is substantial property transactions entered into by the

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<sup>119</sup> *Pergamon Press Limited v Maxwell* [1970] 1 WLR 1167.

<sup>120</sup> *London and Mashonaland Exploration Co v New Mashonaland Exploration Co* [1891] WN 165; *In Plus Group Ltd and others v John Albert Pyke* [2002] EWCA Civ 370, [2003] BCC 332.

<sup>121</sup> *Scottish Co-operative Wholesale Society Ltd v Meyer* [1959] AC 324, [1958] 3 WLR 404.

<sup>122</sup> CA 2006 s 177(1).

<sup>123</sup> CA 2006 s 177(5) and (6). Service contract are covered separately in CA 2006 ss 188-189.



director and his company. Any arrangement between the director and the company involving a substantial non-cash asset worth at least £100,000 or 10% of the company's net assets must be accompanied by full disclosure and shareholder approval by ordinary resolution in order to be binding on the company.<sup>124</sup> The shareholder approval requirement applies also when the contracting party is a director of the parent company, or a person connected with the director of the company or parent company.<sup>125</sup> In this case, the transaction binds the company if it is approved by the shareholders of the parent company as well as the shareholders of the contracting (subsidiary) company. The latter approval is not required when the contracting company is a wholly-owned subsidiary.<sup>126</sup> The policy reason behind the express requirement of shareholder approval of substantial property transactions between the subsidiary and a director of the parent company is that the latter usually has significant powers to influence the activity of the subsidiary, which creates a risk of unfairly dealing with the subsidiary's property. Transactions between parent companies and directors of subsidiaries, or between directors of sister companies do not seem to present the same level of risk, which is why they are not covered expressly by s 190.<sup>127</sup>

Parallel full disclosure and prior shareholder approval requirements exist as regards loans, analogous financial transactions (quasi-loans), guarantees and other credit transactions entered into between the company, on the one hand and directors, directors of holding companies, or persons connected with them, on the other hand.<sup>128</sup> The same requirements apply to a further set of "arrangements" entered into by a third party with, or for the benefit of, a director or connected person, if such arrangements (a) would have required shareholder approval if entered into by the company, or (b) the third party acquires a benefit from the company or a body corporate associated with it.<sup>129</sup> The overarching policy reason behind these requirements of full disclosure and shareholder approval is to prevent assets being siphoned out of a company by shareholders, directors or connected parties, to the detriment of the company's creditors and other relevant stakeholders.

In addition to the no-conflict and no self-dealing duties, directors are bound by the traditional no-profit fiduciary duty, codified in CA 2006 s 176. This section prohibits a director from accepting a benefit from a third party conferred by reason of him being a director or his doing (or not doing) anything as a director. The duty does not apply if the benefit cannot reasonably be regarded as likely to give rise to a conflict of interest.<sup>130</sup> This section expressly provides that third party comprises an associated corporation or a person acting for an associated corporation,<sup>131</sup> which means corporations being in a parent-subsidiary relation or having the same parent company.<sup>132</sup> Similarly to the no-conflict duty, the no-profit duty has been interpreted and enforced strictly by courts. Obtaining an unauthorised benefit

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<sup>124</sup> CA 2006 s 190 and s 191.

<sup>125</sup> Persons 'connected with' a director are defined under CA 2006 s 252, and include a body corporate connected with a directors (s 252(2)(b)). This is further defined in s 254(2) as controlling a 20% share of the share capital or being entitled to exercise or control more than 20% of the voting power in a general meeting.

<sup>126</sup> CA 2006 s 190 (2) and 4(b).

<sup>127</sup> Davies et al (2012), 528.

<sup>128</sup> CA 2006 ss 197-202.

<sup>129</sup> CA 2006 s 203.

<sup>130</sup> CA 2006 s 176 (4).

<sup>131</sup> CA 2006 s 176 (2).

<sup>132</sup> CA 2006 s 256.

will give rise to a duty to account which does not depend on fraud or lack of good faith, or on the company suffering any loss.<sup>133</sup>

## 4.2 Accounting and reporting duties

CA 2006 comprises a series of accounting and reporting obligations which are relevant for corporate groups. As mentioned in Section 2 above, for the purposes of preparing and filing of accounts, group means a parent company and its subsidiary undertakings, as defined by CA 2006. Directors of parent companies have a duty to prepare and file group accounts (also known as consolidated accounts),<sup>134</sup> in addition to a duty to prepare and filing individual annual accounts.<sup>135</sup> The group accounts comprise a consolidated balance sheet and a consolidated profit and loss account, which must give a true and fair view of the state of affairs of the parent and its subsidiary undertakings at the end of the financial year.<sup>136</sup>

Regarding the form and content of the accounts, CA 2006 distinguished between Companies Act groups accounts<sup>137</sup> (prepared in accordance with the UK Generally Accepted Accounting Practice - GAAP) and IAS accounts (prepared in accordance with the International Accounting Standards - IAS). With certain exceptions,<sup>138</sup> groups have a choice between the two accounting frameworks. Directors of a parent company must ensure that the individual accounts and those of all its subsidiary undertakings use the same financial reporting framework, unless, in their opinion, there are good reasons for not doing so.<sup>139</sup>

In addition to the annual accounts, directors are required to produce a directors' report<sup>140</sup> and, in the case of all companies that do not follow the small companies regime, a strategic report.<sup>141</sup> The directors' report imposes relatively straightforward disclosure duties. It must comprise as a list of directors throughout the year,<sup>142</sup> the recommended dividend to be paid,<sup>143</sup> any important event that has affected the company since the end of the financial year,

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<sup>133</sup> *Murad v Al-Saraj* [2005] EWCA Civ 959, [2005] WTLR 1573.

<sup>134</sup> CA 2006 s 399. One exception arises when the parent company qualifies as small. A parent company will qualify as a small company in relation to a financial year if the group headed by it qualifies as small (CA 2006 s 383(1)). The requirements that a parent company or a group must meet to qualify for the small companies' regime are provided under CA 2006 s 383. Another exception arises when the parent company is itself a subsidiary of another company established under the law of an EEA state, in which case the parent company above the intermediate parent will have the duty to prepare the group accounts (CA 2006 s 400(1) and s 401(1)).

<sup>135</sup> CA 2006 s 394.

<sup>136</sup> CA 2006 s 404 (1) and (2) and s 405 (1). Exceptionally, some undertakings may be excluded from consolidation (see CA 2006 s 405 (2)-(4)).

<sup>137</sup> The form and content of these accounts must also comply with Part 1 of Schedule 6 of the Small Companies and Groups (Accounts and Directors' Report) Regulations 2008 (when a small company chooses to prepare group accounts) or Part 1 of Schedule 6 to the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008, as applicable.

<sup>138</sup> For example, UK GAAP is mandatory where the parent is a charity (CA 2006 s 403(3)); the IAS is mandatory, *inter alia*, when a company in the group has securities admitted to trading on a regulated market of an EEA state (CA 2006, s 403(1)).

<sup>139</sup> CA 2006 s 407(1).

<sup>140</sup> CA 2006 s 415.

<sup>141</sup> CA 2006 s 414A.

<sup>142</sup> CA 2006 s 416(1).

<sup>143</sup> CA 2006 s 416(3).

and the expected future development of the business.<sup>144</sup> In corporate groups that fall under the duty to prepare group accounts, the parent company must prepare a consolidated group directors' report, relating to the undertakings included in the consolidation.<sup>145</sup>

The strategic report has more wide-reaching requirements. The purpose of this report is to inform members of the company and help them assess whether the directors have fulfilled their duty to promote the success of the company for the benefit of the members as a whole. For a financial year in which the company is a parent company and the directors prepare group accounts, the strategic report must be a consolidated group strategic report, covering all undertakings included in the consolidation and explaining the group's strategy, business model and financial position at the end of the financial year.<sup>146</sup> Where appropriate, a group strategic report may give greater emphasis to the matters that are significant to the undertakings included in the consolidation, taken as a whole.<sup>147</sup>

Certain large public interest entities<sup>148</sup> are required to produce a non-financial information statement as part of their strategic report.<sup>149</sup> A parent company that produces a consolidated group strategic report must include in this report a group non-financial information statement relating to the undertakings included in the consolidation.<sup>150</sup> The consolidated non-financial information statement must include, inter alia, information regarding the consolidated undertakings' business model, the policies, outcomes and risks related to these policies that the consolidated undertakings have as regards environmental matters, employees, social matters, respect for human rights, anti-corruption and anti-bribery matters.<sup>151</sup>

### 4.3 Director disqualification

Under the CDDA 1986, the court may disqualify a person from being a director of a company or being concerned or take part, directly or indirectly, in the promotion, formation or management of a company for a specified period.<sup>152</sup> The remedy of director disqualification aims to raise the standards of conduct and responsibility for directors, and to prevent the abuse of separate corporate personality and limited liability.<sup>153</sup> When a company is insolvent (i.e. has entered liquidation, is put into administration or has an administrative receiver appointed) and the court determines that a director is unfit to be concerned in the management of a company, the court must make a disqualification order against such director for a period

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<sup>144</sup> Large Companies Regulations Schedule 7 para 7. These Regulations impose on large companies additional disclosure obligations, concerning, inter alia, practices on employee information and consultation, greenhouse gas emissions, or political donations.

<sup>145</sup> CA 2006 s 415.

<sup>146</sup> CA 2006 s 414A(3) and ss 414C(8)-(10).

<sup>147</sup> CA 2006 s 414A(4).

<sup>148</sup> The non-financial information statement must be produced by companies with at least 500 employees, who are: a traded company; a banking company; an authorised insurance company; or company carrying on insurance market activity, as defined under CA 2006 s 1164 and s 1165.

<sup>149</sup> CA 2006 s 414CA. This requirement was introduced in 2006, as part of the UK implementation of the Non-financial Reporting Directive 2014/95/EU.

<sup>150</sup> CA 2006 s 414CA(2).

<sup>151</sup> CA 2006 s 414CB(1) and (2) and s 414CB(8).

<sup>152</sup> CDDA 1986, s1.

<sup>153</sup> *Re Westmid Packing Services Ltd (No. 3)* [1998] BCC 836 at 841; *Re Swift 736 Ltd* [1993] BCC 312 at 315.

ranging between 2 and 15 years.<sup>154</sup> When determining unfitness, the court must take into account factors including the extent to which the person was responsible for the causes of a company or overseas company becoming insolvent, or the nature and extent of any loss or harm which was or could have been caused by the person's conduct in relation to a company or overseas company; any misfeasance or breach of any fiduciary duty by the director in relation to a company or overseas company.<sup>155</sup> An example of breach of fiduciary duty that attracted disqualification arose in a group context, where the court found that directors had not prioritised the interests of their own company over those of the parent company.<sup>156</sup>

When the conduct of the disqualified director has caused loss to one or more of the company's creditors, the Secretary of State can make an application to the court for a compensation order to be made against the director.<sup>157</sup> When making a compensation order, the court will instruct the disqualified director to pay a specified amount to the Secretary of State for the benefit of one or more creditors or classes of creditors specified in the order, or as a contribution to the assets of a company.<sup>158</sup>

A shadow director may also be subject to disqualification and compensation orders if the court is satisfied that the person's conduct as a shadow director renders him unfit to be involved in the management of a company. A shadow director is defined as a person in accordance with whose directions or instructions the directors of the company are accustomed to act, excluding guidance or advice given in a professional capacity or given in the exercise of a function conferred by or under an enactment, or given as a Minister of the Crown.<sup>159</sup> It should be noted that under this definition there is no exception made for parent-subsidiary companies (as is the case under CA 2006 s 251(3)), which means that the directors of a parent company who give directions to the directors of one or other of its subsidiaries can be held personally liable as shadow directors of the subsidiary. What amounts to 'directions or instructions' is a matter to be determined objectively, in light of all available evidence. The instruction or advice does not have to be followed in order for this provision to apply. In other words, a person could be liable as shadow director even if the board had not adopted a subservient role or had not surrendered its discretion.<sup>160</sup> Moreover, following the 2015 amendments to the CDDA 1986, the court has the power to make a disqualification order against any person who exercised the "requisite amount of influence" over the disqualified director.<sup>161</sup> Such an influence exists when the director's conduct in relation to which he was disqualified is the result of the person's directions or instructions, excluding advice given in a professional capacity.<sup>162</sup>

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<sup>154</sup> CDDA 1986, ss. 1, 6 and 12C and Schedule 1, as amended by the Small Business, Enterprise and Employment Act 2015, s 106(1), (6).

<sup>155</sup> CDDA 1986 Schedule 1, Part I, paras 1-7.

<sup>156</sup> *Re Genosysis Technology Management Ltd, Wallach v Secretary of State for Trade and Industry* [2006] All E R 434. See also *Charterbridge Corporation v Lloyds Bank Limited* [1970] Ch 62 (Ch), [1969] 3 WLR 122.

<sup>157</sup> CDDA 1986 s 15A.

<sup>158</sup> CDDA 1986 s 15B. The compensation order provisions were introduced by the Small Business, Enterprise and Employment Act 2015.

<sup>159</sup> CDDA 1986 s 22(5).

<sup>160</sup> *Secretary of State for Trade and Industry v Deverell & Another* [2001] Ch 340, [2000] 2 All ER 365.

<sup>161</sup> CDDA 1986 s 8ZA(1).

<sup>162</sup> *Ibid.* s 8ZA(2) and (3).

## 5 Liability for wrongful trading, fraudulent trading and undervalue transactions

When a company is solvent, the directors have a duty to promote the success of the company, having particular regard to the interests of the members as a whole.<sup>163</sup> When a company approaches insolvency is actually insolvent, the interests of the general body of the company's creditors become paramount.<sup>164</sup> Directors continue to owe their duties to the company, rather than directly to creditors,<sup>165</sup> but the interests of creditors replace those of members as the overriding consideration.<sup>166</sup>

Where a company is, or may be, in financial difficulty, a director shadow director may have additional concerns under the insolvency legislation. Significant concerns for parent companies may arise in the context of liability for wrongful trading. Under IA 1986 s 214, a director or shadow director will be personally liable to contribute to a company's assets such amount as the court thinks proper, if, at some time before the commencement of the winding up of the company, the director knew or ought to have concluded that there was no reasonable prospect that the company would avoid going into insolvent liquidation. If the director causes the company to continue to trade under these circumstances, and fails to take measures to minimise the potential loss to creditors,<sup>167</sup> liability for wrongful trading may arise. In order for liability to arise, it must be shown that the company was, at the date of liquidation, in a worse position than it would have been had trading ceased earlier.<sup>168</sup> The defence of showing that every step has been taken to minimise potential losses to creditors is a high hurdle for avoiding liability. However, every step does not mean every reasonable step,<sup>169</sup> and steps that are taken, must be done with the view to minimising loss for the body of creditors as opposed to individuals.<sup>170</sup>

Shareholders who participate in the running of the company's affairs may be held to constitute *de facto* or shadow directors, and thus be caught within the ambit of s 214. In contrast with the CA 2006 definition of a shadow director, the IA 1986 definition does not exclude parent companies in accordance with whose directions or instructions the directors of the subsidiary are accustomed to act.<sup>171</sup> The degree of control exercised by the parent in order to become a shadow director for the purposes of IA 1986 is a matter of some uncertainty. It seems that the mere establishment of business guidelines for the subsidiary is insufficient to

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<sup>163</sup> CA 2006 s 172(1).

<sup>164</sup> CA 2006 s 172(3). The same rule existed at common law - see *Re HLC Environmental Projects Ltd* [2013] EWHC 2876 (Ch), [2014] BCC 337; *West Mercia Safetywear Ltd v Dodd* [1988] BCLC 250; *GHLM Trading Ltd v Maroo* [2012] EWHC 61 (Ch), [2012] 2 BCLC 369; *In the Matter of Capitol Films Ltd* [2010] EWHC 3223 (Ch), [2011] 2 BCLC 359.

<sup>165</sup> *Yukong Lines Ltd v Rendsburg Investments Corporation and others*, TLR 30 October 1997.

<sup>166</sup> *Macpherson and another v European Strategic Bureau Limited* [2000] 2 BCLC 683 (holding that in the vicinity of insolvency directors may not make distributions to shareholders or repay shareholders' debt if this amounts to an informal winding up or a distribution of the company's assets without proper provision for all the creditors); *Capitol Films Ltd (In Administration)* [2010] EWHC 2240 (Ch), [2010] 9 WLUK 57 (holding that near insolvency, directors cannot settle a claim against a third party without taking into account the interests of the general body of the company's creditors).

<sup>167</sup> IA 1986 s 214(2)(b); *Kudos Business Solutions Ltd (in Liquidation)* [2011] EWHC 1436 (Ch), [2012] 2 BCLC 65.

<sup>168</sup> *Re Marini Limited (The liquidator of Marini Limited v Dickenson & ors)* [2003] EWHC 334 (Ch).

<sup>169</sup> *Brooks v Armstrong* [2015] EWHC 2289 (Ch), [2004] BCC 172 at [8].

<sup>170</sup> *Ibid.* at [276].

<sup>171</sup> IA 1986, s 251.

make the parent a shadow director.<sup>172</sup> Conversely, it is not necessary for the subsidiary's board expressly to undertake a subservient role or surrender its discretion for an interfering parent company to be found shadow director.<sup>173</sup> Consequently, it seems that so long as the subsidiary is solvent, the parent may impose a common policy on its subsidiaries without being in danger of becoming (without more) a shadow director, and thus being bound by the general duties of directors. When the subsidiary's solvency becomes doubtful, the broader definition of shadow director comes into play and an interfering parent may be found liable for wrongful trading under IA 1986 s 214.

It should be noted that the impact of s 214 has been rather modest.<sup>174</sup> One of the causes is that, until recently, the claims under this section were restricted to liquidators, who have proven reluctant to bring them. This was due, among other things, to the fact that the liquidator bears the costs of an unsuccessful action,<sup>175</sup> expenses ranking after the floating charge.<sup>176</sup> The outcome of this has meant the likelihood of claims being brought has been restricted to those situations where the liquidator is confident of success.<sup>177</sup> Some of these issues have been addressed by the recent amendments to IA 1986, which allow administrators to bring wrongful trading claims, and allow administrators or liquidators to assign such claims to third parties.<sup>178</sup>

In addition to wrongful trading, shareholders are susceptible to liability for fraudulent trading. IA 1986 s 213 provides that if, in the event of insolvent administration or liquidation, the administrator or liquidator concludes that a company's business has been carried on with the intent of defrauding its creditors or for any fraudulent purpose, any person who was knowingly a party to the carrying on of such business may be liable to contribute to the assets of the company. In contrast to wrongful trading, which entails only civil liability, the fraudulent trading provisions impose both criminal<sup>179</sup> and civil liability.<sup>180</sup> It should also be noted that liability may be imposed on any person who was knowingly a party to the fraudulent business, which obviously includes a parent company and its directors. The conflation of the civil and criminal types of liability has led the judiciary to assume a strict approach to fraudulent trading,<sup>181</sup> refusing to allow a claim in the absence of "actual dishonesty, involving real moral blame".<sup>182</sup> As the case law illustrates, this is a high burden.<sup>183</sup> For this reason, the fraudulent trading provision has rarely been used successfully.

Further concerns arise in the context of related party transactions at undervalue, prohibited by IA 1986 ss 238 and 423.<sup>184</sup> An intra group transfer at undervalue may be set aside by the court, on the application of the administrator or liquidator.<sup>185</sup> Directors

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<sup>172</sup> *Re Hydrodan (Corby) Ltd* [1994] 2 BCLC 180; *Gower and Davies*, *supra* note 127 at 214.

<sup>173</sup> *Secretary of State for Trade and Industry v Deverell* [2000] 2 BCLC 133 (CA).

<sup>174</sup> Keay (2014), 63.

<sup>175</sup> *Re M.C. Bacon Ltd* [1991] Ch 127, [1990] BCLC 607 at 132.

<sup>176</sup> *Buchler v Talbot* [2004] UKHL 9, [2004] 1 BCLC 281.

<sup>177</sup> *Didcote* (2008), 374; Williams (2015), 55.

<sup>178</sup> IA 1986, ss 246ZA - 246ZC (introduced by the Small Business, Enterprise and Employment Act 2015).

<sup>179</sup> CA 2006 s 993.

<sup>180</sup> IA 1986 s 213.

<sup>181</sup> *Cork Committee* (1982), 398.

<sup>182</sup> *Re Patrick and Lyon Ltd* [1933] 1 Ch 786.

<sup>183</sup> *Re Gerald Cooper Chemicals Ltd (In Liquidation)* [1978] Ch 262, [1978] 2 WLR 866.

<sup>184</sup> Known as gratuitous alienations in Scotland.

<sup>185</sup> IA 1986 s 238.

responsible for causing the seller to make an undervalue transfer risk personal liability for breach of duty. For the transaction to be set aside, it must take place within two years from the onset of insolvency and the company must have been insolvent at the time of the transaction or become insolvent as a result.<sup>186</sup> A transaction will be at undervalue for these purposes if it is a gift or the company receives significantly less than the consideration provided by it.<sup>187</sup> The value of the consideration is assessed at the date of the transaction, by reference to what a reasonably informed purchaser in an arms' length transaction would be prepared to pay. A transaction will be found to be at undervalue if the court is satisfied that, whatever the precise values may be, the incoming value is significantly less than the outgoing value.<sup>188</sup> If an undervalue transaction is entered into with the deliberate aim of putting assets beyond the reach of creditors, or which otherwise prejudices the interests of creditors, the court, at the application of the liquidator or any other person prejudiced, can set the transaction aside irrespective of when it took place.<sup>189</sup> When a proposed intra-group transaction appears to be disadvantageous to the subsidiary but beneficial for the group as a whole, the subsidiary's board could minimise liability for transactions at undervalue by securing prior approval from the parent, confirming that the transfer is in the best interests of the parent and the group. However, when the subsidiary faces a real possibility of insolvency, the interests of the subsidiary's creditors become paramount, and approval or ratification by the parent will not prevent liability.<sup>190</sup> Evidently, shareholder approval will be ineffective when the transaction constitutes an unlawful distribution of capital or a fraud on creditors.<sup>191</sup>

Another provision of the IA 1986 that may have relevance for company groups is s 212, which introduces a summary procedure for the litigation of certain claims against directors and other office holders. When the company is in liquidation, a claim under IA 1986 s 212 can be brought against former directors of the company, anyone involved in the promotion, formation or management of the company, or anyone who has acted as liquidator or administrative receiver of the company.<sup>192</sup> For the purpose of this claim, the concept of misfeasance is broad, and includes the misapplication or retention of money or other property of the company, becoming accountable for money or other property of the company, or breaching a fiduciary or other duty in relation to the company.<sup>193</sup> It should be noted that the notion of director used in this section includes a de facto director, but it appears that it excludes a shadow director.<sup>194</sup> If, on examination of his conduct by the court, a person is found liable for misfeasance the court may order him to repay, restore or account for any misappropriated money or property to the company; or compensate the company for any misfeasance or breach of fiduciary or other duty by way of contribution to the company's assets.<sup>195</sup>

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<sup>186</sup> IA 1986 s 240.

<sup>187</sup> IA 1986 s 238(4).

<sup>188</sup> *Reid v Ramlort* [2004] EWCA Civ 800, [2005] 1 BCLC 331.

<sup>189</sup> IA 1986 s 423.

<sup>190</sup> *West Mercia Safetywear Ltd. v Dodds* [1988] BCLC 250.

<sup>191</sup> *Aveling Barford Limited v Perion Limited* [1989] BCLC 626.

<sup>192</sup> IA 1986 Schedule B1 para 75 provides for a similar claim against the administrator of a company put in administration.

<sup>193</sup> IA 1986 s 212(1).

<sup>194</sup> *Holland v Revenue and Customs and another* [2010] UKSC 51, [2011] 1 BCLC 141.

<sup>195</sup> IA 1986 s 212(3).

## **6 Liability of the parent company to the subsidiary's minority shareholders for unfair prejudice**

CA 2006 s 994 allows a shareholder of a company to seek relief for unfair prejudice if the affairs of the company are conducted in a manner that is unfairly prejudicial to the shareholders' interests as a whole, or to the interests of that particular shareholder, or for an actual or proposed act or omission of the company that is or would be so prejudicial. If the court is satisfied that the unfair prejudice petition is well founded, it may make an appropriate order. Often, the order instructs the company or the other shareholders to buy out the petitioning shareholders.

Unfair prejudice claims may arise in a group context. Minority shareholders can complain that the affairs of a subsidiary are carried on in a manner unfairly prejudicial to them. Parent companies are not, in theory, precluded from bringing such a petition, but they are unlikely to be successful, since prejudice is not considered unfair when the petitioner can easily rectify the prejudicial state of affairs.<sup>196</sup> Conversely, shareholders in the parent company may complain that the actions of the subsidiary are unfairly prejudicial to them. In such cases, courts may find that the conduct of a parent company or of its directors, towards a subsidiary, constitutes conduct of the affairs of that subsidiary,<sup>197</sup> and the conduct of a subsidiary, or of its directors, represents conduct of the affairs of the parent company.<sup>198</sup> These findings are especially likely to arise where the parent and subsidiary share the same directors.<sup>199</sup> For instance, the failure of a parent company to pay a debt due to a subsidiary company represented the affairs of the subsidiary, and could have justified an unfair prejudice petition had the withholding of payment not been necessary for the survival of the group (including the subsidiary).<sup>200</sup>

## **7 Liability arising from the relation between companies in a group: agency and assumption of a duty of care**

Liability within a group may arise if an agency relation is found between parent and subsidiary. It is important to note that there is no presumption that a subsidiary will act as the parent's agent simply because the parent controls the subsidiary, or the subsidiary acted as an intermediary between the parent and a third party, or the controlling shareholders are also directors, or because the company was created for the sole objective of benefiting the members.<sup>201</sup> Similarly, the law of undisclosed principal cannot be invoked against the

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<sup>196</sup> *Re Baltic Real Estate Ltd (No 2)* [1993] BCLC 503.

<sup>197</sup> *Scottish Co-operative Wholesale Society Ltd v Meyer* [1959] AC 324, [1958] 3 WLR 404; *Nicholas v Soundcraft Electronics Ltd* [1993] BCLC 3 (CA); *Re Grandactual Ltd* [2005] EWHC 1415 (Ch), [2006] BCC 73.

<sup>198</sup> Ferran and Ho (2014), 27; *Re Citybranch Group Ltd, Gross v Rackind* [2004] EWCA Civ 815, [2005] BCC 11.

<sup>199</sup> *Gross v Rackind* [2004] EWCA Civ 815, [2005] BCC 11; *Hawkes v Cuddy* [2009] EWCA Civ 291, [2009] 2 BCLC 427.

<sup>200</sup> *Re Soundcraft Magnetics* [1993] BCLC 360.

<sup>201</sup> *Gas Lightning Improvement Co Ltd v Commissioners of Inland Revenue* [1923] AC 723, [1923] 5 WLK 56; *British Thomson Houston Co Ltd v Sterling Accessories Ltd* [1924] 2 Ch 33 at 38.



controller of a company to support a claim of veil piercing, based on control alone.<sup>202</sup> In *Ebbw Vale Urban District Council v South Wales Traffic Area Licencing Authority*, Cohen LJ emphasised that “under the ordinary rules of law, a parent company and a subsidiary company, even a 100 per cent subsidiary company, are distinct legal entities and in the absence of an agency contract between the two companies, one cannot be said to be an agent of the other.”<sup>203</sup> The agency relation must be established taking into account all relevant considerations, which may include insufficient capitalisation of the subsidiary,<sup>204</sup> overlapping directors and senior manager positions,<sup>205</sup> or when a business nominally carried out by the subsidiary is in fact run by the parent.<sup>206</sup> When the agency relation is established, liability will attach to the parent as principal on ordinary agency principles.<sup>207</sup>

Assumption of a duty of care is another avenue for transferring liability from the subsidiary to the parent. A parent company will not be liable for the acts of a subsidiary by reason only of its shareholding, but it may owe a direct duty of care to employees of the subsidiary. In *Chandler v Cape plc*<sup>208</sup> the Court of Appeal held that a subsidiary and its parent company are distinct entities and there is no assumption of responsibility by reason solely that a company is the parent of another company. However, in special circumstances a holding company could assume liability towards the subsidiary’s employees. The court applied the three-part test established in *Caparo Industries PLC v Dickman*<sup>209</sup> to the parent and subsidiary relationship,<sup>210</sup> to assess whether “what the parent company did amounted to taking on a direct duty to the subsidiary’s employees”.<sup>211</sup> Under the *Caparo* test, a duty of care will arise if the requirements of foreseeability, proximity and reasonableness are met under the particular facts of the case. The court noted that the parent company had expert knowledge in the health and safety of the operation, which it ought to have advised its subsidiary about.<sup>212</sup> Evidence demonstrated that the parent company had assumed responsibility for the health and safety measures for the entire group, the parent company knew or ought to have known that the subsidiary’s work system was unsafe, and it knew or should have foreseen that employees would rely on the parent’s superior knowledge for their protection.<sup>213</sup> The court therefore found that the parent company owed a duty of care to the employee of the subsidiary and imposed liability without having to resort to piercing the corporate veil. In *Thompson v Renwick Group Plc*,<sup>214</sup> a case with similar facts, the court reaffirmed the ruling in *Chandler*, but found that the parent did not have extensive knowledge

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<sup>202</sup> *VTB Capital Plc v Nutritek International Corp* [2013] UKSC 5, [2013] 1 BCLC 179, at [141], per Lord Neuberger.

<sup>203</sup> [1951] 2 KB 366, [1951] 1 All ER 806, at 370

<sup>204</sup> *Re FG Films* [1953] 1 All ER 615.

<sup>205</sup> *Re Polly Peck plc* [1996] 2 All ER 433 at 445-446.

<sup>206</sup> *Smith, Stone and Knight Ltd v Birmingham Corporation* [1939] 4 All ER 116.

<sup>207</sup> Ferran and Ho (2014), 32; *Smith Stone and Knight Ltd v Birmingham* [1939] 4 All ER 116; *Canada Rice Mills Ltd v R* [1939] 3 All ER 991, PC; *Firestone Tyre and Rubber Co Lts v Lewellyn (Inspector of Taxes)* [1957] 1 All ER 561 (HL).

<sup>208</sup> [2012] EWCA Civ 525, [2012] 3 All ER 640.

<sup>209</sup> [1990] 2 AC 605, [1990] 2 WLR 358.

<sup>210</sup> [2012] EWCA Civ 525 [2012] 3 All ER 640 at [63].

<sup>211</sup> *Ibid* at [70].

<sup>212</sup> *Ibid* at [80].

<sup>213</sup> *Ibid* at [73]-[80].

<sup>214</sup> [2014] EWCA Civ 635, [2014] 2 BCLC 97.

in health and safety regarding asbestos. Since the parent's expertise was not superior to that of its subsidiary, no relationship of proximity existed and thus no duty of care was established.

More recently, in *AAA v Unilever Plc*,<sup>215</sup> the Court of Appeal clarified that *Chandler* did not lay down a separate test for liability of parent companies, but only provided guidance on relevant considerations to be taken into account.<sup>216</sup> Circumstances where the relevant test is capable of being met usually fall into two categories: (i) where the parent has in substance taken over the management of the relevant activity of the subsidiary, individually or jointly with the subsidiary's own management; or (ii) where the parent has given relevant advice to the subsidiary about how it should manage a particular risk.<sup>217</sup> The Court found that neither of these two categories arose on the facts of *Unilever*, and therefore the proximity between the parent and subsidiary required under the *Caparo* test was not met. The Court of Appeal reinforced this approach in *Okpabi & Ors v Royal Dutch Shell Plc and Shell Petroleum Development Company of Nigeria Ltd.*<sup>218</sup> Following the *Caparo* test, the court held that the frequency, scale and location of the oil spills from pipelines operated by the subsidiary made the harm inflicted to the appellants foreseeable by the parent company. The element of proximity, however, was not met, given the insufficient degree of control by the parent of its subsidiary's operations in Nigeria.<sup>219</sup> Furthermore, in *Lungowe v Vedanta Resources Plc*<sup>220</sup>, the Court of Appeal analysed the existing authorities on whether a parent company (Vedanta Resources) owes a duty of care to the employees of its subsidiary (KCM), or to those affected by its subsidiary's operations, and made the following observations. First, the starting point in evaluating a duty of care claim is the three-part test of foreseeability, proximity and reasonableness established in *Caparo*. In determining whether the test is met, the court should investigate whether the parent company (a) has undertaken direct responsibility for devising a material health and safety policy of the subsidiary, which is relevant to the claim, or (b) the parent controls the operations of the subsidiary which give rise to the claim.<sup>221</sup> Following *Chandler*, the court underlined that a relevant circumstance in applying the *Caparo* test is the whether the parent has special knowledge and expertise that places it in a position to protect the employees of the subsidiary or the persons affected by its operations. If both parent and subsidiary have similar knowledge and expertise and they take the relevant decisions jointly, both companies may owe a duty of care.<sup>222</sup> Vedanta Resources appealed, but the UK Supreme Court dismissed the appeal. In a unanimous judgment,<sup>223</sup> the court ruled that English courts have jurisdiction over these proceedings.<sup>224</sup> In determining the issue of jurisdiction, the Supreme Court investigated whether the claimants had a good arguable case that Vedanta Resources had sufficiently intervened in KMC's operations so as to warrant a duty of care to

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<sup>215</sup> [2018] EWCA Civ 1532; [2018] BCC 959.

<sup>216</sup> *Ibid.* at 966.

<sup>217</sup> *Ibid.* at 967.

<sup>218</sup> [2018] EWCA Civ 191; [2018] B.C.C. 668.

<sup>219</sup> The claimants *Unilever* and *Okpabi* applied for permission to appeal to the UK Supreme Court, but as at the time of writing this report no decision has been made.

<sup>220</sup> [2017] EWCA Civ 1528, [2018] 1 WLR 3575 (under appeal with the UK Supreme Court).

<sup>221</sup> *Ibid.* at 3529.

<sup>222</sup> [2017] EWCA Civ 1528, [2018] 1 WLR 3575 at 3529.

<sup>223</sup> *Vedanta Resources Plc v Lungowe*, [2019] UKSC 20; [2019] 2 WLR 1051.

<sup>224</sup> *Ibid.* at [102].

the claimants. The court was reluctant to limit a parent's liability to the two scenarios mentioned by *Unilever*. Instead, it underlined that the issue of parent liability is highly fact-sensitive and should be determined on a case-by-case basis. Lord Briggs stated that the facts in *Vedanta* show that there is well arguable that Vedanta Resources exercised a sufficient degree of involvement and control over the conduct of the relevant operations of KCM to give rise to a duty of care.<sup>225</sup> He based this view on the sustainability reports and other documents published by Vedanta Resources, which may support the conclusion that the parent company (i) asserted its own assumption of responsibility for the maintenance of proper standards of environmental control by its subsidiaries, and (ii) undertook responsibility to establish and implement these standards through training, monitoring and enforcement.<sup>226</sup>

As these cases show, the question of liability of a parent company is firmly rooted in the principle that parent and subsidiary companies are separate legal persons, each responsible for its own separate activities. In certain circumstances, a parent company may be subject to a duty of care in relation to its subsidiary's activities if the general principles of tort regarding the imposition of such a duty are satisfied. The assessment of whether the duty of care exists will follow the normal private law test, but is nonetheless highly fact-sensitive. As the UK Supreme Court decision in *Vedanta* held, elements that are directly relevant to this assessment include evidence of active steps by the parent to establish, implement and enforce group-wide policies across its subsidiaries, and public statements by the parent asserting its supervision and control over the relevant operations of its subsidiaries.

## 8 Conclusion

Although the UK company law does not have a unitary body of provisions dedicated to corporate groups, liability within a group and to third parties may arise based on other legal doctrines. These include piercing the corporate veil, liability of *de facto* or shadow directors for various fiduciary, accounting and reporting duties, as well as duties to creditors in the vicinity of insolvency. Liability may also arise when a special relation is established between the companies in a group, such as agency, or between the parent and a third party affected by the subsidiary's activity, such as a duty of care in negligence. Some of these grounds of liability can be avoided or mitigated by certain practical steps, such as avoiding common directorships between parent and subsidiary, appointing external non-executive directors, adopting clear group policies on matters such as keeping clear records of the justifications for board decisions, policies on conflicts of interest, related party transactions, intra-group lending or guarantees. Moreover, the recent litigation around a parent's responsibility in tort for the effects of its subsidiary's activities emphasise the importance of carefully drafting the parent's public statements regarding group-wide policies and standards, so as to avoid being interpreted as evidence of an assumption of responsibility.

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<sup>225</sup> Ibid. at [61].

<sup>226</sup> Ibid.

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