**THE DEGREE OF LAW**

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# AN EXPLORATION INTO LIABILITY OF CORPORATE GROUPS: A COMPARATIVE PERSPECTIVE

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## ABSTRACT

There is no doubt that corporations are the key players in the world and local economies today. The emergence of corporate groups is a phenomenon of these days. Along with the active growth of group corporations, the legal environment was supposed to be established and regulated, but the development of the law has lagged behind. This is a global problem in general.

Although some jurisdictions have taken initiatives to improve corporate group law, this area od the law is still insufficient. The issue of corporate groups is not only in respect of corporate law but also intersectional. Thus, group corporations are often incompletely regulated by the laws of their respective sectors. Even in the academic literature, there is still a lack of consensus upon main aspects of corporate group law. These unresolved issues cannot be resolved without addressing the underlying issue, that is the corporate group's liability. One of the basic principles of corporate law is the principle of limited liability, originated in the era of a single, solo corporation, however, it is still in force today in the context of polycorporation's liability.

This research examines the liability of corporate groups in a comparative law perspective. It discusses different ways of imposing corporate liability, reviews the application of fundamental corporate law principles to a group, and examines the relative merits of doctrinal approaches and principles in light of a collection of separate corporations. It also reviews the regulation of corporate groups and cases in various jurisdictions and the extent to which those jurisdictions' experiences and practice.

Subsidiaries of a group are also difficult to legally regulate because of their complex nature of being independent and dependent, separated and controlled. So that, it may also require dual-mode regulating strategy because of its dual nature. Enterprise liability doctrine proposes to expand the liability of the parent corporation and to hold it accountable on behalf of its affiliated corporations by neglecting separate personality of a corporation. In this study, we propose partial enterprise liability approach. This approach is based on the concept of due diligence principle which have recently been proposed by international governing bodies and the concept of control which is one of factors of the enterprise principle. The research recommends that corporate groups be regulated by a legal control test in limited areas, namely mass tort, human rights, environment and insolvency.

## TABLE OF CONTENTS

## ABBREVIATIONS AND GLOSSARY

| | |
|---|---|
| **AG** | Aktiengesellschaft |
| **BHR** | Business and Human Rights |
| **CSR** | Corporate Social Responsibility |
| **HRDD** | Human rights due diligence |
| **EU** | European Union |
| **GDP** | Gross Domestic Product |
| **GNP** | Gross National Product |
| **GVC** | Global Value Chains |
| **MNC** | Multinational Corporation |
| **MNE** | Multinational Enterprise |
| **MNT** | Mongolian tugrik |
| **NSO** | National Statistical Office |
| **OECD** | The Organisation for Economic Co-operation and Development |
| **RBC** | Responsible business conduct |
| **SO-MNE** | State-owned Multinational Enterprise |
| **TNC** | Transnational Corporations |
| **UN** | The United Nations |
| **UK** | The United Kingdom |
| **US** | The United States |
| **UNCTAD** | United Nations Conference on Trade and Development |
| **UN HRC** | United Nations Human Rights Council |
| **UNGP** | United Nations Guiding Principles on Business and Human Rights |

**List of Figures**



**List of Tables**

## CHAPTER ONE: INTRODUCTION

### 1.1. Introductory Note: Background to the Study

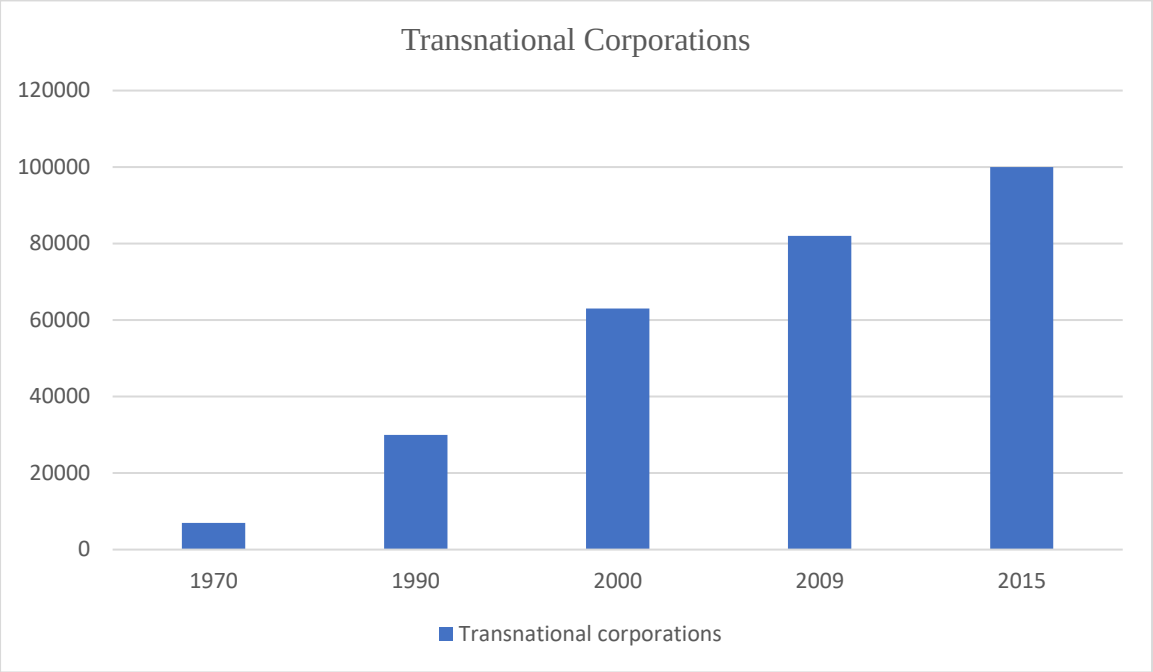
This century can be called the era of corporations. One of the key factors that contributed to the expansion and development of economic and business relationships alongside modern industrial, technological and scientific development is the establishment of a business corporation as a channel to participate business relationship locally and globally. There is no doubt that corporate groups have been shaping the world's economy these days. Nowadays, corporate groups (most of them are multinational/transnational corporations) are much more powerful than some countries; their employees outnumbering the labour force and revenue surpassing Gross Domestic Product of an entire country. Those large corporations are designated by their subsidiaries. UN stated this phenomenon that 'today's global economy is characterized by global value chains (GVCs), in which intermediate goods and services are traded in fragmented and internationally dispersed production processes'[1] in its World Investment Report 2013, and it continued as 'GVCs are typically coordinated by TNCs, with cross-border trade of inputs and outputs taking place within their networks of affiliates, contractual partners and arm's-length suppliers. TNC-coordinated GVCs account for some 80 per cent of global trade. Patterns of value-added trade in GVCs are shaped to a significant extent by the investment decisions of TNCs. TNCs coordinate GVCs through complex webs of supplier relationships and various governance modes, from direct ownership of foreign affiliates to contractual relationships to arm's-length dealings.[2] Practically, legally and politically corporate groups draw attention because of their economic power.

The vast majority of current business participants are involved through the form of a legal entity called a corporation, many of them conduct their business under the structure of a corporate group. The continuous growth of corporate group is considered a legal and business, economic and social phenomenon. The group has also mostly become conglomerates, multinational and transnational corporations. In 1970, there were approximately 7,000 transnational corporations in the world; that

[1] UNCTAD, *World Investment Report 2013, Global Value Chains: Investment and Trade for Development* (Geneva, 2013), p.10
[2] Ibid., p.22

number grew to 30,000 by 1990, to 63,000 by 2000, and to 82,000 by 2009. Today, there are more than 100,000 multinational corporations with over 900,000 foreign affiliates.[3]

*Figure 1. The Growth of Transnational Corporations*

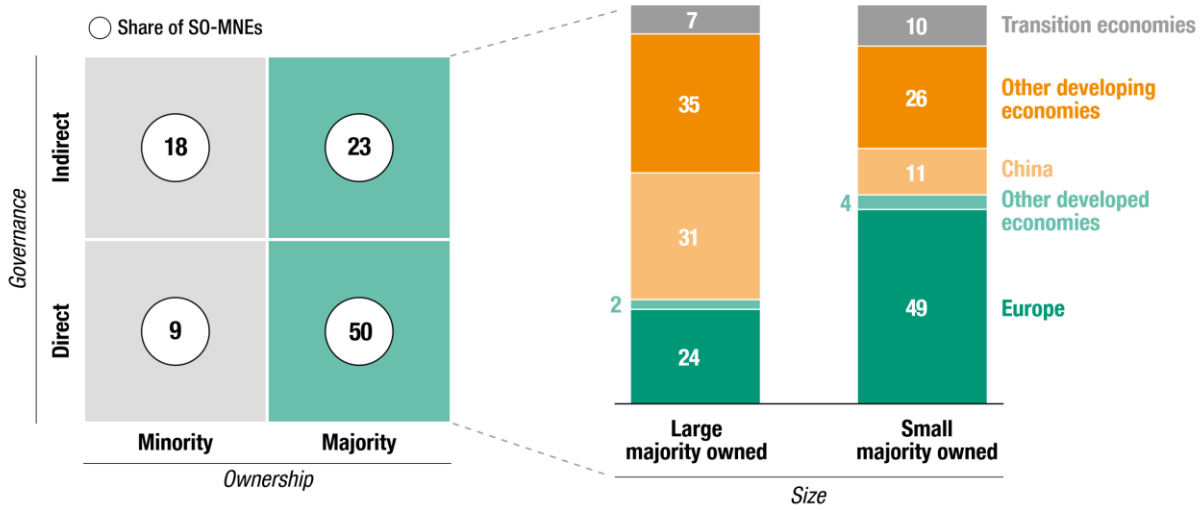



According to World Investment Report 2019 by the UN, the total assets of multinational enterprises' foreign affiliates grew up to 110468b from 6202b dollars in 1990 and 2018 respectively while employment of these foreign affiliates reached approximately 76m in 2018 that was around 29m in 1990[4]. Corporate groups are not only involved in the private sector, in many countries state owned or state-controlled corporations that are mixed ventures between public and private entities, run actively business in the economy.[5] The UNCTD's report examines only the size and transnational characteristics of state-owned multinational corporations as that 'many smaller SO-MNEs have few foreign affiliates, often in neighbouring countries, and their overseas presence remains stable over time. Large SO-MNEs have in recent years more actively invested and expanded abroad. The geographical distribution of SO-MNEs changes significantly depending on their size and on the level of participation held by the State. SO-MNEs from emerging economies are, on average, predominantly majority owned and large. The nine SO-MNEs in the top 100 with a minority State participation are all from developed countries. In Europe, many relatively small

[3] Skinner.G, *Rethinking Limited Liability of Parent Corporations for Foreign Subsidiaries' Violations of International Human Rights Law* (72 Wash. & Lee L. Rev. 1769, 2015), p.1795
[4] United Nations Conference on Trade and Development, *World Investment Report 2019*, (Geneva 2019), p.18
[5] Rafael Mariano Manóvil (eds*), Groups of Companies-A Comparative Law Overview* (Springer, 2020), p.2

utility, transportation or bank SOEs – often owned at the subnational level – maintain a few affiliates in neighbouring countries due to the integrated nature of the region's economies and small national territories. These SOEs account for almost half of majority-owned SO-MNEs with assets under $5 billion. In developed countries, many large SO-MNEs were (partially or fully) privatized in the 1990s. As a result, SO-MNEs in developed economies are split among small but majority-held SO-MNEs and a few large but minority-controlled SO-MNEs'[6].

*Figure 2. Ownership and Size of SO-MNEs*




*Source: World Investment Report*

In OECD's Guideline, multinational corporation is defined as 'these enterprises operate in all sectors of the economy. They usually comprise companies or other entities established in more than one country and so linked that they may co-ordinate their operations in various ways. While one or more of these entities may be able to exercise a significant influence over the activities of others, their degree of autonomy within the enterprise may vary widely

[6] Ownership: The influence governments can exercise on companies varies significantly according to their shareholding, from minority participation (or golden share) to majority (or total ownership). Although it is possible for governments holding a minority stake or a golden share to exercise significant control over SOEs, their influence is felt more when they hold a majority shareholding; 73 per cent of SO-MNEs are majority owned. (United Nations Conference on Trade and Development, *World Investment Report*, Geneva 2019, pp.25, 26)

from one multinational enterprise to another. Ownership may be private, State or mixed.'[7] Based on this definition, Muzzafer Eroglu outlines the main features of a multinational corporation as that:

> Accordingly, the characteristics of MNEs are these: first, they must be organised as more than one company, in a way that each and every company has its own legal personality, assuring that a subsidiary can have legal relations of its own, both within the organisation and with the outsiders. Secondly, these companies must be related each other through ownership and control and must operate as a commercial enterprise. Thirdly, the subsidiaries must perform in other countries rather than in home countries. According to these criteria, a MNE can be, in a practical approach, defined as a group companies that through foreign direct investment organise subsidiaries under common ownership and management policy in a number of countries outside its home base.[8]

So that it can be said that most of these giant corporations are multinational ones running business cross borders. Generally, multinational corporations are organised in group structure.

These groups of corporations are made up of multi-layered subsidiaries. For example, as of 1997, 89% of companies listed on the Australian Stock Exchange were parent companies, 90% of those controlled companies were wholly-owned, with an average of twenty-eight subsidiaries each[9], and the number of vertical subsidiary levels in a corporate group chain ranged from one to eleven, with an overall average in the two largest market capitalisation quartiles of three to four subsidiary levels[10]. Meanwhile, the fifty largest corporations in the UK had an average of 230 subsidiaries and their dependent companies[11]. In Germany, in 2010, about 75% of all Public Private Limited Companies and 40-50% of all are organised in corporate groups, with average of 19 subsidiaries. One of the largest corporations - Enron Corporation of the U.S had listed about 2,500 subsidiaries on its annual 10-K filing for the year 2000[12]. Therefore, it should be noted that most countries do not have complete and comprehensive statistics on group corporations.

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[7] OECD, *Guidelines for Multinational Enterprises*, 2011 Edition, p.17

[8] Eroglu.M, *Multinational Enterprises and Tort Liabilities: An Interdisciplinary and Comparative Examination*, (Edward Elgar publishing, 2008), p.71

[9] Kluver.J, *Entity vs. Enterprise Liability: Issues for Australia*, (37 Connecticut law review, 2005), p.765.

[10] Companies & Securities Advisory Committee, Corporate Groups Final Report, 2000, p.1

[11] Christian A.Witting, *Liability of Corporate Groups and Networks*, (Cambridge University Press, 2018), p.66.

[12] Rene Thomas Wieser, *Liability within Corporate Groups: Prospects of a harmonised integral law of corporate group liability (Studies on Comparative Law)* (Volume 1, Societas Verlagsgesellschaft KG, 2012), p.1.

As professor Antunes posited, corporate groups working cross-borders are that 'here, we are facing the situation of an incorporated sub-unit of a multi-corporate enterprise, which is similar to a closely held corporation rather than a publicly held corporation, which is owned by a single incorporated shareholders (parent corporation) rather than by thousands of public individual shareholders (investors), which is controlled by an external source of governance primarily pursuing an alien interest (unified management) rather than by a body of independent managers in the corporate self-interest, holding business relations with both wealthy and weak creditors (i.e. tort victims, workers, consumers) rather than exclusively proficient financial and commercial ones, and acting in the market as a mere division of a larger business enterprise rather than as an independent economic unit'[13].

Thus, the question is that while multinational and national large corporations have been dominating business world, conglomerates have been replacing simple, single corporations what is ruling and regulating them. Are the present corporate law and its basic principles able to fulfil their role in today's business world? These are motivation of this study.

This study concerns the most common form of modern business that is called corporate groups. Corporate law is one of the most converged fields of law throughout the world. The fundamental legal principles and issues around corporation are generally similar in most countries, so it is common for corporate law to be studied within the scope of comparative law. However, in the most of the countries, the research on the corporate law of the group is relatively less and so far, it has not reached an efficient legal solution. Generally, its fundamental issues still have not been resolved at the legislative, judicial and doctrinal level in world jurisprudence. So that, reviewing and analysing would help to rethink the reason for the failure. Therefore, this study is to introduce and review the global trends in corporate group law, among others, by comparing the legal regulations and cases of such jurisdictions like the European Union, the United Kingdom, German, the U.S, Australia and France etc.; they represent the legal families as well as sources of the most literature reviews. In the introduction and following parts of this study, we will have an overview at the phenomenon of corporate groups, current legal issues and challenges facing the corporate group; in the main section, the traditional veil lifting mechanism, the laws and regulations of the countries and common law cases will be described respectively.

[13] Jose.E.Antunes, *Liability of Corporate Groups*, (Kluwer Law and Taxation Publisher, 1994), p.133.

It would be said that all systems of corporate law resolve similar issues. A Comparative perspective provides us an opportunity to analyze diverse approaches to the same issue, while considering of legal and cultural backgrounds for those differences. The analysis reveals the divergences and convergence between the legal systems. As result of this, it can be recognised that whether doctrinal discrepancies across jurisdictions are relatively less or it leads to different regulative strategies. In the corporate group law context, those different jurisdictions share similar obstacles in the field of corporate group law. For instance, Muzaffer Eroglu pointed out that 'an MNE can have hundreds of subsidiaries all around the world with each subsidiary operating under its host country's regulatory arrangement, but practically they operate in accordance with the main economic and managerial policies of the group. Therefore, there is a compound multinational enterprise structure under which, according to law, companies are independent from each other, but on the other hand, according to economic reality, they are completely interrelated. Thus, even in a group of companies, it is sometimes difficult to distinguish between the legal personality of one member corporation and its wholly owned and controlled subsidiaries. This complicated structure is main characteristic of both Civil law and Common law systems, which may be the most important common statement for the area of corporate affiliated enterprise system'.[14]

In today's globalised corporate world, the same issues, the same aspirations, the same global corporate bodies, and connected businesses etc. all encourage a comparative study of corporate law and a search for common solutions to the common ground. A citation from Professor Hansmann and Kraakman expresses this convergence like that 'although some differences may persist as a result of institutional or historical contingencies, the bulk of legal development worldwide will be toward a standard legal model of the corporation. For the most part, this development will enhance the efficiency of corporate laws and practices'[15].

Thus, it would be the most efficient to study the issues of the corporate group from a comparative law point of view.

It seems that there is still no a systematic change and reform in this field. In recent years, some countries have made gradual improvements in this field, although there is still no consistent and

[14] Eroglu.M, Multinational Enterprises and Tort Liabilities: An Interdisciplinary and Comparative Examination, (Edward Elgar publishing, 2008), P.72

[15] Hansmann, Henry and Kraakman, Reinier H., *The End of History for Corporate Law* (Law and Economics Working Paper No. 235, 2000), Working Paper No. 235; NYU Working Paper No. 013; Harvard Law School Discussion Paper No. 280; Yale SOM Working Paper No. ICF - 00-09.

comprehensive approach to the regulation on corporate groups. Although nearly every jurisdiction follows traditional corporate laws principle on corporate groups there are pioneers starting some changes over groups. For instance, Latvia adopted Group of Companies Law (2000), Australia published a comprehensive research report (2000), Japan has amended Companies Act relating to corporate groups provisions (2012). It is noted that the EU frequently discussed regulating corporate groups as a part of corporate law reform, even though these initiatives did not progress as far as substantive law. Also, Germany group law (1965) which is called as a standard setter, has clearly the most developed set of provisions of corporate group. The country is definitely one of the first countries to tried governing corporate groups, and its system provides protective statutory framework regulating corporate groups.

The present law still fails to appropriately regulate corporate groups. Piercing the corporate veil has been used as only single exception to the limited liability. It seems that there are not many exceptional countries of this situation, it is one of multinational challenges. The situation is concluded by Blumberg stating that with the U.S's experience:

> The reality of the matter is that effective regulation of corporate groups or their activities inevitably requires control of all the components participating in the enterprise. Where multinational groups are concerned, this inevitably means extraterritoriality. It increasingly appears to be a world phenomenon rather than something primarily associated with American controls over foreign subsidiaries of American multinationals. From the viewpoint of effective economic regulation, it is not merely appropriate, it is essential that the legal structure match the economic structure of the enterprise subject to the regulatory system. However, the extraterritorial assertion of national law inherent in the application of enterprise principles to components of multinational groups inevitably will engender international confrontation and disrupt international trade and relations. This is the dilemma. The challenge for the world order is the evolution over the years ahead of an international legal machinery to mediate, adjust, and reduce national conflicts and to emerge with a framework that will not only facilitate the imposition of effective governmental controls over the activities of multinational groups, but will encourage the harmonious development of international economic relations. The great challenge to the national legal structures of the Western world and to the emerging new world legal order is the pressing need for the formulation of enterprise principles and a new doctrine of enterprise law in order to deal with the legal problems presented by transnational enterprises. Such a reformulation requires a fresh look at the fundamental concepts of Western legal thought. It requires a reexamination of the traditional views of what has been referred to as the corporate entity, or the corporate personality, and a reconsideration of the fundamental principles of the legal system[16].

[16] Phillip I.Blumberg, *The Multinational Challenge to Corporation Law*, (Oxford University Press, 1993), p.201

The traditional principle of limited liability based on single legal entity has been being still applied to group structures in the most jurisdictions. Parent corporations externalise the risk of liability through legally formed, separate, controlled subsidiaries under the name of 'limited liability' governing in the legal systems of the world. So that, there were and are urgent needs of new corporate law and new corporate principles to respond to the challenge presented by corporate groups. As opposed to traditional principles enterprise law principle is set up and, exploring enterprise liability over corporate group would indicate the way of adopting its basic principles in some selected scopes of modern corporate law. Enterprise principle considers of a parent and its controlled subsidiaries as one business unit.

The research has been attempting to reveal that the effects of applying traditional corporate law and doctrine on modern corporate groups' liability are causing the gap between the laws and the reality. The existing doctrines and paradigms need to be reevaluated in light of the new global economic era.

It is obvious from the foregoing, laws and practical needs conflict with each other due to shortcoming of academic study and theoretical rationale. A careful study of related to this subject will contribute to the resolution of the existing problems and the backwardness of the law and find an appropriate way forward. It must involve as many stakeholders as responsible; for the implementation to succeed, including academic and research institutions. An academic research based on international perspective in this area will provide a global overview and legal strategy. When national characteristics, global trends, corporate group's legal theories, and newly emerged multinational corporate groups demands are studied reciprocally, existing problems, further solutions and recommendations can be well revealed out.

In a nutshell, the research seeks the challenges, importance and opportunities of corporate group law in a comparative law perspective. The application of traditional corporate law and doctrine on present-day's corporate groups account for the main cause of the loophole between the laws and the reality. The present corporate law systems and its basic principles are not able to fulfil their role in today's business world. In recent years, some countries have made gradual improvements in this field, although there has been still no consistent and theory-based reform to corporate group law. Without reaching out the fundamental limited liability paradigm there continuously would be ineffective efforts among academics and legislatures.

**1.2. Concept of the Research**

### 1.2.1. Rationale for the Research

The dissertation attempts to study the present situation of corporate group in the context of responsibility, to clarify its effects and seek the ways to improve the efficiency of corporate group law. As one of the main actors in the business world, corporate groups play an important role in national and international economic development, so that regulating them efficiently and effectively in line with modern society, economics, politics, the rule of law and social values will be the basis for further sustainable development. However, current corporate groups laws of most jurisdictions have not been able to response efficiently corporate groups boom which is called as modern time phenomenon. Liability of corporate groups is still considered as one of the unresolved jurisprudential issues. The motivation of this study is to explore the reason behind the 'stuck' and analyze current legal environment and practice in some jurisdictions by focusing on the issue of liability and its influence and provide possible options to improve the current situation.

There is a need to review and introduce main approaches and principles developed up to today. Without reaching out the fundamental limited liability paradigm there will have been ineffective efforts continuously among academics and legislatures. The original legal theories, doctrines, principals of corporate law have been outdated over the realities of this modern business development, so it is necessary to scrutinise them and seek new theories and principles. In response to the issues, at first, determining what the core cause of this legal backwardness is crucial.

It is need to be simply noted that the exigencies of commercial activity and practical problems corporations presenting that are roughly similar in market economies throughout the world. Thus, the study reflects on the general international legal approaches to the liability of corporate groups and the key theoretical principles recommended by commentators in some legally and economically powerful jurisdictions, from a comparative law perspective. We will review current doctrinal trends with examples from prominent jurisdictions including German, the EU, France, the U.S., etc.

Corporate groups law is interrelated with other areas of law such as labour, insolvency, tort, environment and so on but the range of this research falls within the only limited liability of corporate groups law through exploring doctrinal references and legal approaches. It could be said that corporate group law is one of the undertheorised areas. Being the most common and universal

form of business organisation, the corporate group needs to draw more attention in national and international corporate laws at theoretical as well as practical level.

### 1.2.2. Aim and Objects of the Research

The aim of the research is to explore the current situation, facing problems, controversies on corporate groups' responsibility through analysing legislations, jurisprudences and academic literatures in order to recommend suitable theoretical background and legal framework. This research attempts to propose the most potential principle for the legislation and will contribute to global corporate law field new knowledge and understanding of current perspectives and expectations on corporate group law through its comparative study.

**The Objects of the Research**

1. To explore the history, characters, form of the corporate groups law;

2. To analyse and focus on the factors impacting on infringements of the traditional corporate law principles and modern corporate groups' practice, especially in terms of insolvency, tort, human rights, environment issues.

3. To examine the current situation facing problems, controversies on corporate groups liability and their consequencies to identify the practical need of the law reform. The research shows that is important to regulate corporate groups for the sake of sustainable economy and corporate law development. In other words, to recognise what obstacles and challenges today those corporations of the 21$^{st}$ century have been facing are;

4. To examine the legal framework of selected jurisdictions and corporate group law theories and doctrines to analyse the effectiveness of their laws;

5. To conduct a case study survey among court decisions of Mongolia to exemplify that the corporate groups law need more attention in practical, theoretical and jurisdictional field at the international and domestic level. Importantly influenced cases on corporate groups law;

6. To find a way to improve the efficiency of corporate groups liability. The successful implementation situation of some big scale mining sector projects, the important issues-local case;

7. To suggest the most optimal and adoptable strategy for governing the corporate groups;

8. To provide optimal recommendations, conclusion.

### 1.2.3. Research Question

The study focuses on the opportunities, challenges and importance in regard to corporate groups liability through selected jurisdictions' experiences. It sets out to address the following research questions:

- What is currently regulating and governing corporate groups, while those large companies are ruling the world economy?
- Why have corporate groups been still so far free from responsibility? Where is the root of this situation? Is there any possibility to fix it?
- Which kind of judicial and statutory response must be there to the emergence of corporate groups?
- Is it possible to adopt enterprise liability, if so what can be its framework?
- Where and how limited liability can be extended to a parent corporation?

## 1.3. RESEARCH METHODOLOGY AND HYPOTHESIS

### 1.3.1. Research Method

The study seeks to provide a theoretical understanding of the corporate group liability by using both qualitative and quantitative approaches in ensuring expected results. The research methodology is based on literature, case study and empirical study in the context of comparative legal perspective. With comparative approach considering positive and negative foreign jurisdiction's experience, the research's scientific findings will contribute knowledge to global corporate law field beyond the constraints of national frontiers.

The research requires relevant data and an empirical study on recent cases in some jurisdictions in order to analyse the subject and reach at a more complete understanding and practical issues of the current situation of corporate groups. Situational analysis has been undertaken from international governing bodies and comparator countries' national statistical datas, and fom previous research results and the researcher's understanding of the relevant theory by using the study of documents.

Research findings are analysed in accordance with four main sources of information: firstly, the current literature, secondly, laws and regulations, thirdly, court cases, fourthly, statistic and data.

And two types of research source used: the primary sources are assumed from published documents and literatures related to the research subject, the secondary sources are derived from the survey and field work.

The methods employed to develop this study involving comparison in historical and foreign jurisdiction's context, analyzing case and legislation, normative, perspective, explicative and descriptive legal characters on academic literatures, legislative documents, judicial decisions and empirical data.

To accomplish as objective a testing of the corporate group's liability related theory as possible, case studies examine the performance the effectiveness of the theory and principle and comparative analysis that explores the concepts developed in a comparative legal scholarship. During the research 95988 district civil courts' decisions of Mongolia between the year of 2015 and 2020 studied and analysed. The purpose of conducting a case study survey using quantitative methodology is to analyse the current situation of corporate group law awareness with the findings and to propose the most efficient and effective theoretical and regulatory framework further. Some cases from different jurisdictions are chosen as an example and compared to other jurisdictions.

There are several reasons for exercising the comparative and case study methods. At first, it allows us to identify issues globally and to learn from each other's experiences. This helps to achieve the aim and objectives of this study. The second reason of applying these research methods is that to clarify the past and present situation of how the corporate groups law is recognised and applied in court, and to determine what further legal response needs to be considered.

Therefore, it must be noted that it is difficult to collect data on corporate groups' statistics due to complexities and categorizations of holding corporations, and the fact that a subsidiary is mostly held by multiple layered parent corporations and registration system's development at national and international level. This problem is difficult not only nationally but also internationally as UNCTAD stated[17].

The research assumptions are that the issue of group corporate liability remains unresolved under the laws of most countries; there is no controversy in literature review in the implementation of enterprise theory, but only in the practical and judicial context; due to the diversity of groups'

[17] See Skinner.G, *Rethinking Limited Liability of Parent Corporations for Foreign Subsidiaries' Violations of International Human Rights Law* (72 Wash. & Lee L. Rev. 1769, 2015), p.1795

structures, internal relationships and communications, the principle of holding the parent company accountable cannot be applied over limited liability; and the principle of entreprise liability might be implemented only in certain preconceived legal areas but not as a common, fundamental legal characteristic of a corporation.

### 1.3.2. The Innovative Side of the Research

In the regulation of modern corporate groups, retaining of traditional corporate law is considered to be a key factor in creating backwardness and conflicts between the laws and the facts of the legal field of corporate groups. Today's corporate law and its fundamental principles do not meet the rule of law, social justice expectations, business transparency and sustainability. Although some countries have made some progress in recent years, there has been no systematic or comprehensive reform of corporate group laws. The situation is similar in most countries.

In the context of the present regulation, the corporate groups' relations are governed by positive laws such as civil code and corporation act, other sector's laws and case law, respectively. Regulations that are considered internationally innovative and advanced are generally based on the principle of a type of enterprise law approaches.

The most important standpoint of this study is to find an optimal recommendation through the analyses in corporate groups law environment that will contribute the development of corporate groups law. Liability is the foundation of many of the legal issues relating corporate groups such as minority shareholders' protection, governance, transaction and so on. The novelty of this study is that it proposes a new partial enterprise principle. This principle based on enterprise theory within certain branches of law, and the main difference from the previous principles is that it is not attributed by the structure, types of control, or form of the group, but on the fact that it is defined by law as a corporate group generally.

While offering the partial enterprise principle the study also investigate other principles and doctrines which provide the general background information regarding corporate groups accountability including historical and international approaches to the issue whereas some more detailed analyses on particular matters such as newly enacted acts, regulations on liability.

International research papers based on a comparative law study in the field of corporate law are important since a country's business' sectors have been widely globalised worldwide.

## 1.4. Outline of the Research Structure

### 1.4.1. The Scope of the Research

As noted above, the purpose of the research is that based on the analysis of legislation and jurisprudence to recommend handling corporate group's liability controversies through considering the experience of selected jurisdiction and to formulate a theoretical and practical proposal to regulate the settlement of legal issues of corporate groups involved in.

The foregoing discussion has related to vertical corporate groups which consist of both wholly and partly owned subsidiaries conducting integrated businesses. These classes of corporate groups present special problems that require special consideration.

This study argues for alternative approach of the corporate group liability rather than rejecting current principles altogether by reviewing and analysing them. Because it pursues in accordance with literatures which have proposed enterprise liability only in certain circumstances. This is not mean separating the notion of limited liability in all circumstances. On the other words, the principle of limited liability is not intended to be denied in all areas.

It is not intended to examine all different types of corporate groups' structure, different regulatory strategies and types of controls in detail, but mainly tried to focus on enterprise liability for a parent corporation considering more interdisciplinary context. The study not only examines current situation but also provide some possible options regarding the issue in question from the legal and socio-economic point of view. Briefly, the focus of the research will be liability corporate groups controversies while considering the experience of some jurisdictions.

Having reviewed the leading literatures which proposal various options from a revolutionary to flexible reform, and analysing from international law to national judicial decision, this research argues in favour of enterprise approach for corporate groups with revised and modified partial enterprise liability. It is worthy to note that the recommendations are intended to update the liabilities of the parent for the corporate group and are not for piercing the responsibility of the natural person- shareholders since within the law of the corporate group.

While considering the difference of exemplified jurisdictions, I argue for the common core and ultimate cause of global regulatory shortcomings lies in the liability issues.

Since this paper falls within the scope of the liability of corporate group, its main legislative and doctrinal references will be drawn from corporate group law.

### 1.4.2. The Structure of the Research

*Table 1. Research Structure*

| No | **Chapters** | **Sub parts** |
|---|---|---|
| 1 | Introduction | 1.10. Introductory Note: Background to the Study<br>1.11. Concept of the Research<br>1.11.1. Rationale for the Research<br>1.11.2. Aim and Objects of the Research<br>1.11.3. Research Question<br>1.12. Research Methodology and Hypothesis<br>1.12.1. Research Method<br>1.12.2. The Innovative Side of the Research<br>1.13. Outline of the Research Structure<br>1.13.1. The Scope of the Research<br>1.13.2. The Structure of the Research |
| 2 | Legal Theories of Corporate Groups' Liability | 2.1.Entity Liability Theory<br>2.2. Enterprise Liability Theory<br>2.3. Dualistic Approach<br>2.4. Veil Lifting Doctrine<br>2.5. Konzernrecht Doctrine<br>2.6. Rozenblum Doctrine<br>2.7. Due Diligence and Duty of Vigilance Approach<br>2.8. Summary |
| 3 | Case Study on Corporate Groups Liability | 3.1.Adams v Cape Industries Plc<br>3.2. The James Hardie v Co. v Hall<br>3.3.Union Carbide *v* the Bhopal<br>3.4.Total *v* Uganda<br>3.5.Badrakh Energy *v* EHENT |

| | | |
|---|---|---|
| | | 3.6. Summary |
| 4 | Statutory Study on Corporate Groups' Liability | 4.1.National and International Law<br>4.1.1. European Union Initiatives<br>4.1.2. Germany<br>4.1.3. Italy and Portugal<br>4.1.4. The United States<br>4.1.5. Mongolia<br>4.2.International documents<br>4.3.Corporate Group Liability in Other Branch Laws<br>4.3.1. Insolvency law<br>4.3.2. Tort Law<br>4.3.3. Human rights and Environmental Law<br>4.4.Summary |
| 5 | Towards Enterprise Liability | 5.1.The Partial Enterprise Approach<br>5.2. Counterargument to Control<br>5.3. Summary |
| 6 | Recommendations and Conclusion | 6.1.The proposal/Recommendation<br>6.2. Conclusion<br>6.3. Limitations and Future Research |

The dissertation consists of introduction, 4 other chapters, conclusion, bibliography and appendices. These chapters are divided into sub parts and conclusions of each chapters, the first chapters deal with the legal, social, economic and political situations shaping the development of corporate world in most jurisdictions and furthermore explores the evolution of corporate groups' legal environment. The final chapters are more about theoretical inference and propositions.

The first chapter describes the situation and nature of corporate groups legally and economically, its regulation history, the shortcomings limited liability and corporate personality, problem and dilemma that corporate law has been facing today, the important issue and legal scholars' standpoints in the global context of corporation law. Most importantly, here we try to present the

issues raised by the modern corporate groups phenomenon and determine the gap and tension between the reality of corporation and law when it comes to corporate groups. While collective corporations of the modern century have been replacing traditional, single corporations of the previous century in economic field, the law governing the corporations still is only for the latter. So that it starts examining the most dogmatic foundation of corporate groups law, that is liability. We will explain some of the rationales in support of corporate groups liability with literature reviews.

Second chapter of this dissertation then concentrates on theoretical and doctrinal concepts, principles and the literature review. Various international corporation law theories, from traditional to modern ones, such as entity, veil lifting, rozanblum, konzernrecht and enterprise liability. We then review the literature to analyse advantages and disadvantages of these theories and principles, and doing that would help to establish concrete hypotheses to propose theorical framework for corporate regulatory.

Third chapter examines the comparative study of regulation in corporate groups law with some developed jurisdictions. It will outline the achievements, experiences, possibilities, failures of countries and demonstrate the recognition and adoption of new corporate liability principles have started gradually in national regulations and international documents. The initiation of a few countries imposed unlimited liability on corporate groups lead to a unified, adaptable, harmonised liability principle. The willingness to extend the corporate groups liability has been reflected in international documents recent years, suggesting parent corporation's liable occasions.

Fourth chapter is dedicated to study cases in order to analyse the historical and present approach of case law. Also, this part provides to identify priority areas that must be impacted by group liability law. These cases involving corporate groups have attracted international attention, while others have been national, but are generally related to issues such as mass tort, environment, human rights and bankruptcy. Despite supporting extended liability of groups in mostly academic community, it has not been recognised broadly among legislators, courts and lawyers. We will discuss those instances in this part.

Fifth chapter is about seeking an optimal solution via developing a theoretical framework in which employing concept from enterprise liability theory, exemplifying vigilance law from some countries and emphasising priority areas from cases. Commentators have been arguing for more

than 30 years that corporate groups law, especially its liability, is still fragmented, with a variety of controls and structures of the corporation, and that it is important to adopt an appropriate responsibility strategy for each of them. We will argue for general control which to be considered within the definition set out in the relevant legal documents.

Finally, sixth chapter attempts to conclude the research by underscoring the findings from theoretical, and legislative analyse and survey and recommend a possible global regulatory strategy and principle to group liability problems. We will synthesize the findings of this research in order to propose partial enterprise liability.

### 1.14. Historical Overview of Corporate Groups

Although scholars vigorously disagree over the extent that Roman law accepted concepts of the corporate personality and limited liability, it is quite clear that modern corporation law has, directly or indirectly, Roman roots. This accounts for the fundamental similarity between English and Continental corporation law. For the U.S, the formation of the corporate group became possible in the United States only in 1888 when New Jersey first permitted one corporation to become a shareholder of another. They dropped all restrictions and expressly authorized businesses incorporated in New Jersey to acquire the stock of "any other company which the directors might deem necessary." This sweeping authorization opened the door to the formation of every type of holding company and corporate group. Although it started slowly, it soon developed into a full flood as lawyers throughout the country came to understand the opportunities presented. Corporations rushed to reincorporate in New Jersey[18].

Although limited liability could not exist without the underlying traditional legal concept of the corporation and the shareholder as separate legal units, limited liability is a different and much newer concept, emerging centuries after the mature development of the corporate concept. Prior to its acceptance corporations existed, and indeed, a growing corporate society flourished. For almost a century after its adoption in the United States, the doctrine had only spotty application, with significant areas of shareholder liability continuing. Since the acceptance of limited liability, the form of the business enterprise has changed remarkably. Limited liability triumphed when corporations were simple, when one corporation could not acquire and own shares of another.

[18] Phillip I.Blumberg, *The Multinational Challenge to Corporation Law*, (Oxford University Press, 1993), p.56

Limited liability meant protection for the ultimate investor. Decades after corporations had become a major factor in the economy, the legislature first granted corporations the legal power to acquire and hold shares of other corporations. Major business rapidly changed form into the complex, multitiered corporate structure of the modern economy. In the succeeding chapters, this volume examines the implications of this jurisprudential inheritance and historical development, starting with the historical emergence of corporate groups[19].

Because of absence of sufficient and reliable information source on corporate group history of other countries cannot be referred in this research.

### 1.5. What is a Corporate Group?

Defining the corporation itself is of course simply—it is a legal entity possessing the characteristics defined by the corporate law of its state of incorporation, by the law of the jurisdiction in which it is formed. Corporate groups are economic entities, in which two or more legal subjects are under one economic management. There is a common tendency to view a group corporation as an economic unit in general, but it should be noted that this unit has legal consequences.

Socio-economic factors of corporate groups growth include the expansion of the enterprise, diversification of its business, the organisation of management, geographical location and so on. These corporate connections can be a result of mergers, takeovers or the acquisition of controlling shareholders in context of corporate law. In this study, we focus on the fact that a subsidiary might be established as a risk mitigation tool and used for fraudulent activities.

The key defining characteristic of a corporate group is typically common ownership. The prototypical corporate group includes a parent company and its direct and indirect subsidiaries, each with a separate legal identity and its own legal rights and obligations. The attributions of groups of corporations can be assigned either by a special corporate group law or through a general corporate law and civil code provisions and principles. In either event, the key feature of these laws is the concept of control. Based on the latest national reports and information on the legal environment of the group of corporations of 23 countries, Rafael Manóvil made this conclusion- ‘in any case, the essence of what matters with regard to groups of companies lies in the decision-making power over one or more underlying companies, rather than on the question of whether a

[19] Phillip I.Blumberg, *The Multinational Challenge to Corporation Law*, (Oxford University Press, 1993), p.19.

company has property rights over others. Thus, the means to acquire and to be able to make use of such power may include a wide range of instruments, such as shares with multi-voting rights, shareholder agreements, special provisions in articles of associations and pyramid structures of several layers of holding company'[20]. Regarding this issue, it will be discussed in detailed ways in the later chapters.

Organisationally, corporate groups represent a new form of enterprise organization whose specificity consists in the conduct of a unitary business through extremely flexible governance and action structures.[21]

### 1.6.An Overview of Limited Liability

One of the core characteristics that define the business corporation is limited liability, which is derived from the nature of the corporate being a separate legal personality. Hansmann Henry and Kraakman Reinier, prominent scholars of comparative corporate law, pointed out that;

> the recognition that the law of business corporations had already achieved a remarkable degree of worldwide convergence at the end of the nineteenth century. By that time, large-scale business enterprise in every major commercial jurisdiction had come to be organized in the corporate form, and the core functional features of that form were essentially identical across these jurisdictions. Those features, which continue to characterize the corporate form today, are: (1) full legal personality, including well-defined authority to bind the firm to contracts and to bond those contracts with assets that are the property of the firm as distinct from the firm's owners,2 (2) limited liability for owners and managers, (3) shared ownership by investors of capital, (4) delegated management under a board structure, and (5) transferable shares. These core characteristics, both individually and in combination, offer important efficiencies in organizing the large firms with multiple owners that have come to dominate developed market economies[22].

The liability of a shareholder is restricted to the number of its shares, and that the corporate and its shareholders are not liable for the debts of each other. Some scholars note that this principle is "the most important discovery of the modern world, and more than the discovery of electricity, steam and light."[23] The purpose of limited liability is protecting investors from business risks and has led corporate to become a major international and national economic stakeholder over the past decades.

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[20] Rafael Mariano Manóvil (eds*), Groups of Companies-A Comparative Law Overview* (Springer, 2020), p.2

[21] Jose.E.Antunes, *Liability of Corporate Groups*, (Kluwer Law and Taxation Publisher, 1994), p.490

[22] Hansmann, Henry and Kraakman, Reinier H., *The End of History for Corporate Law* (Law and Economics Working Paper No. 235, 2000), p.1.

[23] Jose.E.Antunes, *Liability of Corporate Groups*, (Kluwer Law and Taxation Publisher, 1994), p.64.

From a view of comparative law, a legal characteristic of corporation that is the most commonly shared in both common and civil law systems is "limited liability". In England, the principle of limited liability was adopted by *Salomon v Salomon Co* (1897), which further became the standard of judicial precedent law, while the continental system was first described in the Napoleonic Code de Commerce[24]. This decision, much criticized over the years, is the foundation of entity law in England and the Commonwealth countries[25].

In the late nineteenth century, the acceptance of corporations as owners of shares in other corporations gave legal basis for group structures. At the beginning of corporation's organisational development in the United States, the structure of corporate groups was restricted by claiming that obtaining shares of the other corporations would be more control oriented rather than investment. After embracing limited liability, over fifty years later, it became known as the most advantageous organisational form of business entity. Jose Antunes stated as[26]:

> This change in the law literally opened up a new stage in enterprise organisation and structure. Enterprises, till then forced to keep their whole business within the strict boundaries of a sole corporation, began to expand through the creation or acquisition of other corporations where parts of their business were insulated and pooled together under a common strategy.

As it was a one person's solo business *Salomon v. Salomon Co* obviously was not a case involving a group of corporates. That means the very first intention of limited liability which originated from the case was not for a collection of corporations. Here we must bear in mind that at that time there was no assumption of the subsequent huge growth of multinational corporations and corporate groups[27].

In regard to the corporate group, limited liability provides 'double protection' to parent corporate, this double limitation could continue till a hundred protection for a corporate that consists of a hundred subsidiaries. In the context of justice, it is neither legally nor socially valuable one. Today's multinational and group-based relationships of corporates have been becoming increasingly difficult to adjust by traditional corporate law rules.

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[24] Phillip I.Blumberg, *The Multinational Challenge to Corporation Law*, (Oxford University Press, 1993), p.19.
[25] Ibid., p.68
[26] Jose.E.Antunes, *Liability of Corporate Groups*, (Kluwer Law and Taxation Publisher, 1994), p.50.
[27] Alison Mccourt, *A Comparative Study of the Doctrine of Corporate Groups with Special Emphasis on Insolvency*, (Oxford University, UK, June 24-26, 2007), p.5.

Limited liability for corporate groups thus opens the door to multiple layers of insulation, a consequence unforseen when limited liability was adopted long before the emergence of corporate groups[28]. An individual shareholder is protected by a single limited liability, while a shareholder corporation is protected by multiple limited liability. This double protection is described in the literature review-modern law has faced the challenge of responding to the consequences of this unwitting choice ever since. Thus, in the multitiered corporate group, with its first-tier, second-tier, and even third-tier subsidiaries, traditional entity law provides multiple layers of limited liability, with each upper-tier company insulated from liability for its lower-tier subsidiaries. Four, or even five, layers of limited liability in complex multinational groups are not uncommon. As corporate groups assumed an increasingly predominant position in the national and international economy, this doctrinal development has produced in time the serious jurisprudential challenge that today faces the legal systems[29].

The importance of corporate liability issue becomes apparent from the following findings of the commentator stating as subsequent developments have made so clear, this was a question of major importance confronting the courts for the first time. It is striking that no court apparently even recognized the existence of the issue. Certainly, no court ever discussed the problem. Limited liability of corporate groups, although one of the most important legal rules in modern economic society, appears to have emerged as a historical accident. This surprising development largely arose as a result of the formalistic jurisprudence of the times. Legal conclusions were deduced logically in syllogistic fashion.

• Limited liability protected shareholders.
• A parent corporation was a shareholder of the subsidiary.
• Ergo, limited liability protected parent corporations. Such logic ignored economic realities and made a mockery of the underlying objective of the doctrine. It overlooked the fact that the parent corporation and its subsidiaries were collectively conducting a common enterprise, that the business had been fragmented among the component corporations of the group, and that limited liability—a doctrine designed to protect investors in an enterprise, not the enterprise itself—would

[28] Phillip I.Blumberg, *The Multinational Challenge to Corporation Law*, (Oxford University Press, 1993), p.139
[29] Ibid., p.59

be extended to protect each fragment of the business from liability for the obligations of all the other fragments.[30]

Forms of business groups provide legal benefits for businesses and corporations. For example, it allows for cost savings, flexibility, adjustment, collaboration within and outside the group, and is a key reason for dividing the group's liabilities. On the other hand, problems arise when the parent and the subsidiary try to use their advantages to avoid liability. In the next part, it will be followed by discussing deeper on the detailed context of the problem in which corporate groups limited liability.

### 1.7. Literature reviews on the Dilemma Facing Corporate Groups

There are some academic literatures which can present the situation of corporation globally. With regard to the aforementioned question- how to regulate those aggregated corporations which the key players in the economy and business- Phillip Blumberg, a leading scholar of corporate group law, was writing two decades ago as 'corporate law and theories of the corporate personality shaped long before to serve the needs of a much different world have become antiquated. New corporate law and new corporate theory are required to respond to the challenge presented by corporate groups to the legal systems of the world'[31]. His following conclusion has been supported by many studies today in literature reviews.

> Today, the challenge ahead is very different. It is concerned with the increasing concentration of industrial organization, with corporate power and abuse, with the unresolved dilemma of corporate governance, and the increasing necessity of more comprehensive regulatory controls over the economy and the conduct of business. The point of group control is not to extend corporate rights but to impose statutory duties on the business enterprise. Recognizing this changed economic reality, Congress for decades has recognized that effective regulation required the abandonment of nineteenth-century law focusing on the traditional concepts of the corporate entity. Effective regulation has required a more extensive scope, going beyond the particular entity directly subject to regulation to include the parent corporation controlling it, its own subsidiaries controlled by it, and its sister subsidiaries under common control. Effective regulation of corporate groups has required a new perception of corporate law, and enterprise principles utilizing such standards as "control" have been widely accepted, particularly in complex, statutory regulation. In consequence, traditional concepts of the separate corporate entity are becoming increasingly outmoded and are being replaced by a new law of corporate groups[32].

[30] Phillip I.Blumberg, *The Multinational Challenge to Corporation Law*, (Oxford University Press, 1993), p.59
[31] Ibid, p.49, 50.
[32] Ibid.

His statement has advocated by Meredith Dearborn from University of California writing as

> 'in today's world, globalizing investment patterns have generated massive corporate webs that may involve layers of subsidiaries, loosely affiliated corporations, subcontractors, and other structurally complex corporate arrangements; moreover, corporate groups frequently cross national borders. The ordinary concepts of piercing and limited liability do not fit easily into this new reality'[33]

The present law still fails to appropriately regulate corporate groups. Piercing the corporate veil has been used as only single exception to the limited liability. It seems that there are not many exceptional countries of this situation.

There is today a tension between the realities of commercial life and the applicable law[34]. During the origination of the classic principle of limited liability, corporates had been operating solely and within the local context; hence this theory and principle are inadequate to regulate large corporations in the modern business involving multinationals, groups, and conglomerates. One reason to believe that considering disparately the relationship of one corporate's ability to control the other peers from the one as a natural person to be a shareholder is that the parent is part of the organisation of the so-called 'group' legal person, as well as its involvement in business operations. Adherence to traditional limited liability led to ignorance of that even though the subsidiary corporation's legal entity's structure to be separate, behind that it is one single ownership, one control and one business. In the case of a group of corporates, it is criticized that legal and regulatory frameworks are lagging in its economic reality. In other words, the business profit comes to 'the same pocket' whereas the legal responsibility is divided into multiple parties. The issue of the corporate group law is a controversial subject which related to not solely one country, but a matter of concern for most countries.

The most urgent, common legal issues of corporate groups include obligations arising from tort, environmental hazard and public interests, fraudulent bankruptcy, protection of minority shareholders' interests, and liability of the parent corporation. Without resolving the latter, the formers are impossible to be solved effectively and comprehensively in my opinion. The abovementioned issues in the corporate's legal issues are a global challenge throughout the world.

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[33] Dearborn, M, *Enterprise Liability: Reviewing and Revitalizing Liability for Corporate Groups,* (California Law Review, Vol.97, Issue 1, 2009), p.208

[34] Paul Hughes, *Competition law enforcement and corporate group liability –adjusting the veil*, (E.C.L.R, 2014, Issue 2), p.21.

Legal scholars considered that the issues of liability in corporate groups have been 'one of the great unsolved problems of modern company law' and noted as the following[35]

> In a negative sense, it also explains why an entire phenomenology of modern corporate life-consisting essentially of the problems raised by corporate groups (the phenomenon of intercorporate control relationships between entities conceived of as autonomous and independent) –have traditionally been ignored, or at best marginally considered, in the context of this branch of law. To regulate a corporation as an autonomous and independent entity and, at the same time, to consider its status as a controlled and dependent one, seems, at first sight, a contradictory regulatory task, impossible to achieve in a single area of law. This probably is the reason why the founding fathers of corporation law regarded intercorporate control purely and simply as an unlawful phenomenon, with no possible place within its normative framework: as Kempin wrote in 1883, 'it is obviously an anomaly that one corporation controls another corporation'. And that is the same reason why, however relevant the steps taken in the meantime to integrate such phenomena within corporate law, a leading European scholar could write precisely one hundred years later that it 'cannot live without conflicts in the fold of classical company law'.

Thus, the main reason for the lack of legal certainty of corporate group law is that most jurisdictions legalize corporate groups under general corporate or civil law which focus on separate legal personality. These fundamental, long-standing concepts and inherent of corporate law have been making countries hesitation on corporate group law reform. The problem was identified by Harry Rajak as that[36]:

> One thing, at least, is clear: the major industrial countries have identified enterprise groups as a threat on a number of fronts. At the same time, enterprise groups have been left to act with considerable freedom and flourish both within national boundaries and across borders, in the developed capitalist world and in developing countries. This conundrum is similar to, if not identical to, that which may be said to exist in relation to a single corporation and which arises from two fundamental concepts of corporate law: the independent legal personality of a corporation and the limited liability of shareholders.

He continued on potential risks to escape liability[37]:

> While it is most often the case that the members of the group are corporations in the legal sense—registered under the statute and enjoying the status of separate legal personality. In the world of private law, the entrepreneur can, for example, seek to use this facility to protect himself from liability, avoid tax, enjoy the

[35] Jose.E.Antunes, *Liability of Corporate Groups*, (Kluwer Law and Taxation Publisher, 1994), p.15.
[36] Harry Rajak, *Corporate Groups and Cross-Border Bankruptcy*, (Texas International Law Journal, 2009, vol.44, No.4), p.524.
[37] Ibid.

benefits of employee status when such benefits are unavailable to an individual trader, and seek to avoid contractual obligations.

Virginia Harper Ho, from the U.S, posited the point of view by stating as 'limited liability is also a risk allocation device. In particular, limited liability within the corporate group also allows corporations to shift costs to creditors when compensation cannot be obtained from the corporate group of which the defaulting entity or tortfeasor is a part'[38].

These points are assented with Christian A.Witting who noted that 'the powerful legal tradition of separate personality have been seized a tactical element of group planning on avoiding the liability in accordance with the law, and as such, there is no effective protection mechanism for protecting subsidiaries and their lenders. This is because of the ability of the parent company to structure relations between group companies in order to protect major assets from the reach of creditors. Limited liability is said to facilitate 'risk-sharing' between shareholders and the external parties with whom the company interacts. Within this area of the law, the fundamental concepts remain close to sacrosanct. Neither legislatures nor courts have been able to think around them with sufficient boldness'[39].

Obviously, the first purpose of limited liability was to counteract and avoid business risks for individual shareholders but ultimately it is used to do that from legal responsibility. In a nutshell, the group of corporates is a single economic unit from the view of the economy, however, legally the group is considered as plural legal units. Jose Antunes defines it as 'the tension or contradiction between diversity (multiplicity of legal entities) and unity (unity of economic entity)' [40] There is a legal loophole between these two notions. This legal improvidence raises a number of issues involving corporate groups.

As some commenters observed that 'now that the economy has attuned itself to the applicable rules, there seem to be no practical legal problems as far as the private company corporate group by

[38] Virginia Harper Ho, *Theories of Corporate groups,* (Seton Hall Law Review, Vol.42, 2012), p.900

[39] Christian A.Witting, *Liability of Corporate Groups and Networks*, (Cambridge University Press, 2018), pp.64, 234.

[40] Jose.E.Antunes, *Liability of Corporate Groups,* (Kluwer Law and Taxation Publisher, 1994), p.489.

agreement is concerned, neither from the point of view of the existing parent companies, nor from the viewpoint of the minority shareholders'[41].

Ian Ramsay, from Australia, identified the reasons which cause establishing a subsidiary in six parts:

1. The company can reduce the exposure of its assets by establishing a subsidiary. The principle of limited liability ensures that the assets of the holding company will be protected from any liability incurred by the subsidiary.
2. The operation of business by means of a corporate group rather than a single company can result in lower taxation.
3. In some countries there can be accounting considerations resulting from the fact that the accounts of the subsidiary do not have to be consolidated with those of the holding company.
4. A company may want to acquire a business in partnership with an individual and another company.
5. A company may want outside investment in only part of its business. It allows company to raise additional capital without forfeiting control.
6. The establishment of subsidiaries may allow greater flexibility with respect to debt financing.[42]

Pioneers in this field, Muscat and Blumberg, argued that the extension of limited liability from the 'one-man company situation" evident in *Salomon v A.Salomon Co Ltd* to control by a parent company was both accidental and unwitting. They contend that, in order to foster investment, it was less necessary to confer limited liability on corporate shareholders, since individual shareholders in a parent company would be protected by limited liability. Muscat argues that "the absence of control justifies limited liability', whereas the presence of corporate control will ensure that parent companies are not deterred from making investment in their subsidiaries[43].

[41] Peter Hommelhoff, *Protection of Minority Shareholders, Investors and Creditors in Corporate Groups: the Strengths and Weaknesses of German Corporate Group Law,* (Cambridge University Press, 2009), p.6

[42] Ian.R, Allocating Liability in Corporate Groups: An Australian Perspective, (13 Conn. J. Int'l L. 329 (1998-1999), p.339

[43] Paul Hughes, *Competition law enforcement and corporate group liability –adjusting the veil*, (E.C.L.R, 2014, Issue 2), p.75

Although theorists agree that strict adherence to the accountability of corporate groups needs reconsideration, legal recognition of corporate group law has still been put down. The range of legal strategies, doctrines still offered to tackle those problems, notwithstanding references related to this subject are insufficient in the doctrine. It is needless to say that all legal systems face this problem since the basic corporate attributions are the same, at least at the doctrinal level, as abovementioned.

The principle of the corporation's limited liability and separate legal personality have been the basis of the development of corporate law in countries, and investors are protected by the concept of limited liability. This principle is commonly shared in all over the jurisdictions because it is regarded that it attracts investment and is one of the legal factors of modern economic development. Blumberg observed as 'limited liability had won political acceptance when corporate groups were unknown. Limited liability for shareholders presupposed a world in which the corporation constituted the enterprise and the shareholders were investors in the enterprise. The doctrine protected the investors from the risks of the business'[44]. Behind limited liability, there are more and more limited liabilities for the parent. This multiple liability protection raises questions for corporate groups. The limited liability principle, the main governing principle of the corporation, extends to situations in which a corporation is the owner of another corporation. Commentators have concluded the situation as:

> Corporate groups dominate the modern commercial landscape. Most major business enterprises are operated not by individual companies but by groups of associated companies. Each group functions as a single economic unit, with the activities of its corporate members being coordinated and controlled so as to further the interests of the group or, more accurately the interests of the group controllers. The law recognises the separate personality of each group member but largely ignores the group structure within which those member companies operate. This legal myopia gives rise to a complex set of problems for persons both within and outside corporate groups[45]

In recent years, academic scholars have been recognizing at a greater extent that the corporate law of the group is lagging in business and due to inadequate and absence of regulation, it is still necessary to reform the law. The early mentioned countries are considered to be relatively proactive

[44] Phillip.I.Blumberg, *The Multinational Challenge to Corporation Law-the New search for a New Corporate Personality*, (Oxford University Press, 1993) p.58

[45] Michael Gillooly (ed) *The Law Relating to Corporate Groups* (Annandale, N.S.W: Federation Press, 1993) as quoted in Alison Mccourt, *A Comparative Study of the Doctrine of Corporate Groups with Special Emphasis on Insolvency*, 2007, p.31

in regulating group companies, but on the other hand, it is criticized that policymakers and courts have not been making a substantial progress in this field due to potential risks to the economic and business sector, the lack of legal framework and uncertainty of the legal principles. Most large businesses are run by a group of corporations, not by individuals. In reality, the group exists as economically unified and manages the activities of the member company of the group for the sake of the interests of the group or the interests of the parent company.

> The practical reality of how groups operate can be very different from strict legal form. In many instances, at least in the minds of the controllers, a corporate group is perceived and run as a single entity. There may be only one CEO and one CFO for the group, and all or most employees of the group may be employed by one or a few entities within the group. Also, for good commercial reasons, particular individuals may be on the boards of both the parent and one or more subsidiaries. The tension between legal form and commercial reality is particularly evident in considering the issues for directors and other officers where the business of a corporate group is conducted through subservient subsidiaries[46].

General corporate law recognises the characteristics of individual corporation as a separate legal entity but neglects specification of structure, operations, and liability of the group that those member corporations form. General corporate law contains a limited number of provisions that govern the corporate group. Currently, the most certain and global regulatory framework of the group law can be considered to be a regulation on accounting reports. While the law and lawyers still pay attention around the individual corporation law accountants have recognised realistically the issue and took legislative measurement; that adapted into most jurisdictions. In accordance with corporate acts, at the end of a financial year parent corporations have to prepare consolidated group accounting report.

In a nutshell, the fact that one person is economically but different in legal liability is considered unfair. This ‘legitimate blindness' causes many problems between the corporate group and its small shareholders and outsiders. Prof. Ochi-Ai Seichi from Japan concluded that the issue of corporate group legal regulation is one of the challenging issues of modern corporate law, and there is no single country in the world that has fully solved it[47]:

> However, just criticizing the shortcomings of corporate law in Japan is not effective here. Because globally, there are a small number of countries that have established comprehensive corporate group law, and there is no guarantee that the law governs this corporate group efficiently. In that sense, the development of

[46] John Kluver., *Entity vs. Enterprise Liability: Issues for Australia*, (37 Connecticut law review, 2005, p.776
[47] Очи-Ай Сэйчи, *Компанийн эрх зүйн үндсэн ойлголт,* УБ.2017, p.398

> comprehensive and effective corporate legal norms is one of the urgent legal issues in today's company law. Identifying the current situation is the starting point for seeking solutions to this problem.

He also noted that Japan's corporate law may be incomplete or only partial in terms of group management and that due to the fact that current corporate law regulation has not yet been established it is a great difficulty to govern a corporate group in practice, as is generally the case for other countries[48]. Briefly corporate groups are out of control. Jose Antunes, a professor of Portuguese law, explained that one of the reasons why corporate law is so controversial as regulating a corporation as an autonomous and independent entity and, at the same time, to consider its status as a controlled and dependent one, seems, at first sight, a contradictory regulatory task, impossible to achieve in a single area of law [49].

As a distinct and more complicated form of entity, corporate groups present special problems that require exceptional consideration. It is, however, stated by scholars that there are needs to re-consider traditional corporate law applying to corporate groups. For instance, it was summarised by Tom Haden:

> '…the group rather than its individual constituent companies is the significant entity for managerial, accounting and investment purposes. But the law is still focused almost exclusively on the individual company. It is consequently increasingly difficult to apply in practice. There are no clear rules on the liability of the group for the obligations of its constituent companies. And there is virtually no legal control at all on the complexity of the group structures which may be established with a view to concealing the true state of affairs within a complex group'[50].

Also Blumberg stated it as follows:

> Over the years, the scholarly discussion of the jurisprudential nature of the corporation has been enormous. ...Unfortunately, the commentaries, without exception, discuss the corporation in its early nineteenth-century model of a single corporation owned by shareholder-investors. None deals with the contemporary problems of the jurisprudential nature of the modern large corporation organised in the form of a group of corporations collectively conducting the enterprise.[51]

Additionally, Ian Ramsay justified this conclusion as '...the tension between the traditional legal principle that treats each company in a corporate group as a distinct legal entity with its own interests, and commercial reality- which commonly involves participants within a corporate group,

[48] Очи-Ай Сэйчи, *Компанийн эрх зүйн үндсэн ойлголт,* УБ.2017, p.398
[49] Jose.E.Antunes, *Liability of Corporate Groups*, (Kluwer Law and Taxation Publisher, 1994), p.15.
[50] Tom Hadden, *Regulation of Corporate Groups in Australia,* (15 U.N.S.W. Law Journal, 61, 1992), p.62

[51] Phillip.I.Blumberg, *The Multinational Challenge to Corporation Law,* (Oxford University Press, 1993), p.22

and creditors dealing with companies within that group, focusing on group principles rather than individual companies'[52]. Meanwhile, Virginia Harper Ho stated the theoretical and practical backwardness of corporate law as 'in considering such rules, theories of corporate groups can play a formative role. However, traditional theories of the corporation that have been articulated only at the entity level continue to be applied by courts and analyzed by scholars as if they can be translated seamlessly from the entity to the enterprise level. Yet unlike a discrete business entity, the "enterprise" reflects an economic reality more than a legal one. At the level of theory, the effect has been a gap between the literature articulating theories of corporate identity, described and defined most often with respect to a single legal entity, and work on established theories of the firm. Moreover, recurrent debates over the nature of corporate identity as a matter of theory have begun to lose their original connection to the realities of corporate practice in a world dominated by corporate groups'[53]. Given the shortcomings of limited liability in the intersection between the corporate group and torts, the necessity for a holistic solution is starkly apparent[54].

Many scholars and commentators have suggested that enterprise liability theory which views the corporate group as a the corporate group as a singular unit rather than viewing each subsidiary as a separate legal entity. They conclude that enterprise liability seeks to settle down legal and economic realities more that entity theory in case of corporate group. Thus, more extensive approach and holistic reform of corporate group liability ought to be taken nowadays. This point of view would be the main point of this research.

### 1.8. Summary

The fundamental legal features of a corporation, such as limited liability and separateness, have greatly contributed to the development of corporate business, but it is not such a suitable legal principle for the group structure-collective corporations. Therefore, in the case of a group corporation, the question arises as to whether there are grounds and opportunities to establish a different liability principle from a single corporation. There are a number of reasons for holding the group's parent corporation accountable: the shareholder of the corporation becomes its parent corporation, which is protected by its own limited liability and is again protected by the limited liability of its affiliated corporations; using this legitimate opportunity to get rid of responsbility,

[52] Ian Ramsay and Geof Stapledon, *Corporate Groups in Australia, research report,* (University of Melbourne, 1998), p.13
[53] Virginia Harper Ho, *Theories of Corporate groups,* (Seton Hall Law Review, Vol.42, 2012), p.951
[54] Phillip.I.Blumberg, *The Multinational Challenge to Corporation Law,* (Oxford University Press, 1993), p.210

the affiliate or subsidiary is used for fraudulent activity; as a final result, the rights of the subsidiary's involuntary and outside creditors are left out of the law, justice is in doubt.

Yet the core of the corporate groups problem is still unresolved, and the results achieved so far are still unsatisfactory, as is expressly recognised by the doctrine itself.[55]. One reason to believe that considering disparately the relationship of one corporate's ability to control the other peers from the one as a natural person to be a shareholder is that the parent is part of the organisation of the so-called 'group' legal person, as well as its involvement in business operations.

Creating subsidiaries and controlled units might be used as a vehicle to avoid and ignore liability. Parent companies use limited liability by incorporating a controlled unit to run a risky business. Most frauds and fails vis-à-vis corporate groups in banking, finance and insolvency case. Parent corporations externalise the risk of tort liability on intention through legally formed, separate, controlled subsidiaries.

It is regarded that there has been still no systematic change and reform in corporate group law worldwide. It has been clearly seen from the literature review that commentators representing different jurisdictions have acknowledged the same situation. There are some countries which are relatively successful in the field of regulating and studying corporate group law such as the EU, the U.S and Australia, academic literatures regarding those jurisdictions are considered as primary research sources. For example, German would be a great example since it has the most developed regulation on corporate groups that recognises dualist approach for liability.

The enterprise principle that contrasts with traditional principle suggests considering of a parent and its controlled corporations as one business unit.

## CHAPTER TWO: LEGAL THEORIES OF CORPORATE GROUPS' LIABILITY

In comparative corporate group law, particularly in the context of liability, the legal principles and approaches of the group can generally be divided into three lines which are entity, enterprise and dualist. In addition to these, there are some special principles may be added. We will review these main principles in the following parts.

### 2.1. Entity Liability Theory

[55] Jose.E.Antunes, *Liability of Corporate Groups*, (Kluwer Law and Taxation Publisher, 1994), p.209

*"Entity approach"* refers to a group of corporates as an independent entity. This is the conventional and fundamental principle is that each member corporate in a group structure is a separate legal entity entitled to separate legal rights and limited liabilities. This principle is based on the theory of traditional limited liability in corporate law and, in any case, the parent and subsidiary corporates assume no obligation or liability for each other. The principle remains dominant throughout the world, regardless of the legal systems. The entity view is the fundamental doctrine ruling the legal relations between corporations and their shareholders. This was discussed in detail in the previous chapter on limited liability. What the most concerning about the principle is that parent and other subsidiary corporations externalize the risk of liability through legally formed, separate, controlled units.

Australian Final Report on Corporate groups identified characteristics and consequences of entity approach. Corporate law in common law countries has developed from the separate entity approach. In essence, this involves three inter-related principles, originally developed for single companies, but subsequently applied to corporate groups, namely:

• separate legal personality of each group company (corporate autonomy)

• limited liability of shareholders of each group company

• directors' duties to the separate group company.

For corporate groups, entity approach has various consequences at common law, including:

• the debts incurred by each company are debts of that company, not of the controllers of that company or of the corporate group collectively. The assets of the group cannot be pooled to pay for these debts

• parent companies are not automatically parties to contracts entered into by other group companies with external persons

• a parent company cannot take into account the undistributed profits of other group companies in determining its own profits

• a group company may breach its obligations to an external party if it passes confidential information about that party to its parent company[56].

[56] Companies & Securities Advisory Committee, Corporate Groups Final Report, 2000, p.15, 16

The structure of the modern group of corporates is a continuous chain of the first, second, third, and more parent and subsidiary corporates, which means in turn, also double, triple and more protections for a single entity. Christian A.Witting argued this situation as '…corporate groups formed with several layers of subsidiary to protect the ultimate, individual shareholders…'[57]. Dignum and Lowry supported else the view of point like that allowing corporate groups to benefit from limited liability 'represents an enormous extension of the Salomon principle', the appropriateness of which the judiciary should question'[58]. The weakness of entity law principle is related to creating this superiority for holding corporates.

Entity law that insulates, a parent corporation from the regulatory obligations imposed on its subsidiaries and that permits parent corporations to sidestep regulatory obligations through the device of organizing subsidiary corporations presents serious dangers for the effective implementation of the statutory program, manifestly creates a high risk of frustration of the statutory objectives, and opens avenues for evasion and avoidance.

### 2.2. Enterprise Liability Theory

*"Enterprise approach".* Parent and subsidiary corporates are taken into account as one legal entity under a pooled responsibility; and leads into an innovative and dramatic non-conventional trend which is largely unregulated and unrecognized as far as its theoretical and practical issues are concerned. There is no 'universally harmonized general' principle that considers all corporates in a group to be regarded as one.

The notion of enterprise liability has been around for some time. It first began appearing in the literature in the early 1900s, arising initially as a tort concept that differed from the fault approach, and not necessarily addressing issues of limited liability of parent corporations. The term "enterprise liability" is credited to Albert Ehrenzweig who used it in the book Negligence Without Fault in 1951.[59]

[57] Christian A.Witting, *Liability of Corporate Groups and Networks*, (Cambridge University Press, 2018), p.173.

[58] Alan Dignam and John Lowry, *Company Law*, (Oxford University Press, 2009), p.49

[59] Skinner.G, *Rethinking Limited Liability of Parent Corporations for Foreign Subsidiaries' Violations of International Human Rights Law* (72 Wash. & Lee L. Rev. 1769, 2015), p.1890

Although it could not be said as sufficient, the EU's initiatives in enterprise law encourages other countries somehow to look up the corporate group law in a whole new way; namely Italy, Latvia, New Zealand, and Portugal were relatively well responded to this approach. Although traditional entity law continues to predominate in the legal system generally, these jurisprudential efforts have contributed substantially to the gradual development of enterprise law.

However, when considering a group of participating corporates as a single entity, this principle has been applying only to a few limited areas within the legal framework even in the aforementioned countries' jurisdictions. Particular areas of which tort law, tax, some parts of insolvency law, human rights, environmental laws are generally are the leading examples that enterprise principles are beginning to achieve recognition worldwide. In other words, it should be noted that the enterprise law is not an applicable general principle to all legal sectors involving corporate group, merely gaining attention where the traditional theory where may be considered as ineffective. The most controversial issues of pursuing this principle are that the identification of the parent's actual and potential controls, which has been separately reflected in different sectoral laws, and the absence of a legal definition of the basic elements of the law. As some commentators noted 'the courts applying enterprise principles agree that the mere existence of "control," while an essential element required for application of enterprise principles, is, in and of itself, insufficient for the imposition of common law intragroup liability'[60]. The application of enterprise principles rests on two major aspects. One is the "control" of the parent corporation over the constituent companies of the group and the collective conduct of a common enterprise under its central direction. The second is the economic integration of the business of the group. Imposing liability depends solely on the economic fact of the enterprise and called "true enterprise liability[61]. It should be understood that utilization of enterprise law relates solely to the elimination of limited liability within the group.

Enterprise law does not affect — directly or indirectly—the existing protection of limited liability that insulates the public shareholders of the parent company or minority-owned subsidiaries from group liabilities. This volume, focusing on the role of enterprise principles in the law of corporate groups, is concerned with limited liability only to the extent that the commentary throws some light

[60] Phillip.I.Blumberg, *The Multinational Challenge to Corporation Law*, (Oxford University Press, 1993), p.92

[61] Dearborn, M, *Enterprise Liability: Reviewing and Revitalizing Liability for Corporate Groups*, (California Law Review, Vol.97, Issue 1, 2009), p.215

on the relationship of the doctrine to the consideration of the imposition of intragroup liability. It assumes a continuation, without change, of the general doctrine for shareholders generally[62]. We argues regarding this issue in a detailed way in 5.1.1. sub part.

There is an example that shows regulating corporate group as one unit is not impossible approach. Taxation authority is more aware of a corporation's group structure which needs to be differently treated by ignoring the separate personality. This consolidated accounting report allows them to control the group's financial reality. It could be said that the most common and successfully applied area of enterprise principle is the financial accounting of corporate. In most countries, this kind of provision in accounting is recognized as a part of corporate law reform and harmonized worldwide. the arrangement of a financial statement with a parent corporation is common because the firm is a group of firms considering the profit as one point. In light of this consideration, the question raised is if corporate law can reflect the accounting area with enterprise principle why other remaining fields of corporate groups cannot be dealt like that.

Despite the reformative enterprise principle recommended by some, both the legislature and the courts have found it as difficult to adopt in the absence of clear legislative guidance. There were and are urgent needs of new corporate law and new corporate principles to respond to the challenge presented by corporate groups. Exploring enterprise liability over corporate group would indicate the way of adopting its basic principles in some selected scopes of modern corporate law. In general, there is a need to develop 'enterprise' theories and principles further in order to improve the coordination of group corporates. Because of the principle that the fundamental principles of the traditional corporate law are broken down, lawmakers and researchers have also been cautious and suggest alternative guidelines. It must be noted, enterprise law involves no change of the liability rule for public investors in the parent company. Thus, a legal rule imposing unlimited liability on a parent corporation for the debts of its subsidiaries under particular circumstances should not discourage nor interfere with the widespread distribution of share ownership among the public shareholders of the parent in any way[63]. Therefore, Petrin and Choudhury commented on the weakness of enterprise approach as 'perhaps the biggest problem facing enterprise liability approaches is to find an appropriate definition of what constitutes the enterprise and, relatedly, which companies should be liable within the group or how such liability is to be allocated among

[62] Ibid., pp.123, 124
[63] Ibid., p.126

them.'[64] Therefore, Blumberg argued 'these difficulties arise from two fundamental deficiencies. First, the enterprise as a legal unit lacks the legal rights characteristic of every other legal unit. It would be unique. Second, enterprise law does not treat the enterprise as a legal unit for all legal purposes. It attributes certain rights or imposes certain responsibilities only when the requirements for application of enterprise principles are satisfied. It operates only for special purposes and under special circumstances. In all other respects, entity law continues to prevail. In brief, it would be a legal unit very different from all other legal units and having recognition only intermittently in sharply demarcated areas'.[65] He also emphasised that 'in many other areas, however, the legal consequences of enterprise principles do directly involve the imposition of liability upon one or more constituent corporations of a group for the obligations of another constituent corporation. In those cases, the use of enterprise principles involves not only the abandonment of traditional principles of entity law but also the repudiation of limited liability. The focus is no longer purely conceptual; it involves issues of profound economic importance. Although there is no sign of political interest in reconsidering the principle of limited liability as the governing general rule, the doctrine has attracted considerable academic attention'[66].

He also concluded:

> In a number of areas of developing modern business law that are responding to economic developments, traditional concepts of consent and party, or entity, have similarly given way to newer doctrines of increasing prominence. Although these doctrines have received different labels, including enterprise law of corporate groups; related forms of enterprise law of franchisors/franchisees, licensor/licensees, and contractors/subcontractors; successor liability; lender liability; and product liability, they essentially rest on the same foundation. In these cases, the courts are attributing legal consequences from one legal unit to another by reason of the interrelationship that arises from participation in a common economic activity. Legal responsibilities are increasingly following the "business," rather than being confined to the legal unit.[67]

Three decades ago, Bloomberg first wrote about the benefits of preventing role of enterprise liability as 'one of the primary purposes of societal rules of liability pertaining to risky activity is to encourage producers to reduce or avoid the risks, not to externalize them. In this area, enterprise law furthers, not impedes, economic objectives. Similarly, in broadening the reach of statutory law, enterprise law fulfills the objectives of overriding importance. Enterprise principles seeking to

[64] Martin Petrin and Barnali Choudhury, *Group Company Liability,* (European Business Organisation Law Review, 19, 2018), https://doi.org/10.1007/s40804-018-0121-7

[65] Phillip.I.Blumberg, *The Multinational Challenge to Corporation Law,* (Oxford University Press, 1993), p.236

[66] Ibid., p.121

[67] Phillip.I.Blumberg, *The Multinational Challenge to Corporation Law,* (Oxford University Press, 1993), p.245

implement the underlying policies and objectives of the statute and to prevent ready evasion serve important systemic needs'[68].

Then Dearborn also emphasised that 'enterprise liability prevents risk externalization in the case of mass torts, as in ultrahazardous industries, and in situations where massive environmental or human rights harms are foreseeable, as these represent the most troubling instances of the public's absorption of the cost of doing business'[69].

The views of these researchers are being reflected in international law today, and legislation has begun to be enacted that recognises the importance of not only responsibility but also prevention of due diligence measures for corporate groups.

According to Australian Final Report, a single enterprise approach might adopt the following governing principles in contrast to a separate entity approach:

• the dominant company in a group is entitled to operate companies it controls for the benefit of the corporate group collectively, even if this is contrary to the interests of particular controlled companies or their minority shareholders

• directors of corporate group companies owe their fiduciary loyalty primarily to the parent company or to the corporate group collectively, not to their individual group companies

• the parent is liable for all the debts of its insolvent controlled companies, whether or not wholly-owned (possibly subject to any contrary voluntary arrangement with particular lenders)[70].

### 2.3. Dualistic approach

*"Dualistic approach".* This approach is named like that by Jose Antunes[71] at the doctrinal level, and proposed intermediate strategy of the two different approaches discussed earlier. In terms of legislation, the strategy is based on the German's corporate group law. This principle is based on the relationship between the parent and subsidiary and the degree to which the controls are de facto or the contractual control are in place and recommends the flexibility of implementing the appropriate strategy. The existing literature mostly recommends this kind of alternative approaches.

[68] Ibid., p.131
[69] Dearborn, M, *Enterprise Liability: Reviewing and Revitalizing Liability for Corporate Groups,* (California Law Review, Vol.97, Issue 1, 2009), p.211
[70] Companies & Securities Advisory Committee, Corporate Groups Final Report, 2000, p.24
[71] Jose.E.Antunes, *Liability of Corporate Groups,* (Kluwer Law and Taxation Publisher, 1994)

Even though gradually paced, there are some movements done with considering that the legal theory of corporate has not changed adjusting the reality of the modern multinationals and remained with laws for the 19th century's local, small corporates, and double limitations for corporate members, and offering some strategies for fairness. However, there is no systematic and complex theory and principle in the group's law, and still in a dilemma.

### 2.4. Veil Lifting Doctrine

Lifting the corporate veil became the most recognised doctrine of corporate groups liability over the years, and understanding of the corporate group's accountability was limited within capacity of this principle. A substantial legal literature emerged that analysed the numerous reported cases and attempted to formulate the legal principles on which they were based. Courts and scholars conclude that there are, particularly in the U.S, three tests to apply the principle as a legal technique.

1. the "control" by the shareholder was so intrusively exercised as to show that the corporation had no separate existence of its own;

2. the corporation had been utilized to commit some fraudulent, or wrongful, or inequitable, or "morally culpable" or "fundamentally unfair" act to the detriment of creditors;

3. the conduct had resulted in loss to creditors. The "alter ego" variant of "piercing the veil," while employing the very same elements, is expressed somewhat differently. Under the "alter ego" doctrine, "lifting the veil" is said to be appropriate when:

(1) such unity of ownership and control exists that the two affiliated corporations have ceased to be separate and the subsidiary has been relegated to the status of the "alter ego" of the parent; and (2) where recognition of the two companies as separate entities would sanction fraud or otherwise lead to an inequitable result. The "identity" doctrine is much the same. Notwithstanding the somewhat different formulations of the three variants, their substance is the same; courts and commentators generally treat them as equivalent in all respects. The foregoing standards are hopelessly general. Accordingly, the courts have recognized that application of traditional lifting the veil jurisprudence is fact-specific, depending on the "totality" of all the circumstances. This

further underscores the lack of usefulness of the standard as a guide to decision[72]. According to Thompson, the application of the method of the lifting veil by the court stands at 40 percent[73].

***The United Kingdom***

It was and is always influential throughout the world that the approach of the UK to the liability of corporate groups as the origin of the Salomon principle and one of the key players in the international business community. There are some statutory provisions to not to maintain the separate personality of corporate in certain situations, namely taxation, employment, insolvency and wrongful trading issues in the UK. Despite separate personality of a corporate is very 'sacred cow' in the UK[74] some academics and judges have been aware of the unjustified doctrine in corporate groups' world, with an attempt to apply 'veil lifting' jurisprudence. Veil lifting in the case law of the UK throughout history seems to have occasionally applied. In other words, English courts lift the corporate veil in very limited circumstances, in particular, the subsidiary is used for fraud.[75]

Alan Dignam analysed this as 'In some cases, they have upheld the principle and in others they did not'[76]. The principle of veil lifting which denies the limited liability of the corporate has been introduced in the early years relatively, especially in the English-American legal system as judicial precedent. This principle is commented as ineffective. For example, Jose Antúneses concluded as veil lifting principle is a matter of uncertainty, unpredictable use, and where the borders of the jurisdiction of independence are legal. Therefore, it is also seen in the empirical study in some countries that the application of the method is ineffective, and the result is weak. For instance, in Australia between the years 1960 and 1998, 13 cases' veil were lifted by the court[77]. Also, Christian A.Witting opined that 'failure of the common law is seen most explicitly in the doctrine of veil-piercing., …because courts have not properly determined the reasons for which this doctrine should be available independent of other common law actions. The first difficulty with veil-piercing

[72] Ibid., p.84
[73] Robert.B.Thompson, *Piercing the Corporate Veil: An Empirical Study*, USA, (Cornell Law Review 76, No 5, 1991), p.1048
[74] Harry Rajak, *Corporate Groups and Cross-Border Bankruptcy*, (Texas International Law Journal, 2009, vol.44, No.4), p.526.
[75] Paul Hughes, *Competition law enforcement and corporate group liability –adjusting the veil*, (E.C.L.R, 2014, Issue 2)
[76] Alan Dignam and John Lowry, *Company Law*, (Oxford University Press, 2009), p.34.
[77] Ian Ramsay and Geof Stapledon, *Corporate Groups in Australia*, research report, (The University of Melbourne,1998), p.18

involves the lack of consensus about what it is and about what it is supposed to achieve., …that veil-piercing is a doctrine which exists more in the minds of scholars than in actual legal practice'[78].

After all, there is an obvious inconsistency, there are no many cases that refer to the problem of applying lifting veil. Uncertainty over criteria and standards of veil lifting's straightforward application causes the lack of recognizing situations where the separateness of corporate personality, the Salomon principle can be ignored at all. Various endeavours have been taken and recommended for categorization of veil lifting application in the academic community, it is however, doubtful that legislature and judiciary regard the issue. This problem is similar to the rozenblum doctrine as well, we would say. Veil lifting is quite traditional for common law and Dignam described the principle of veil lifting in the UK historically in three ways[79]:
Classical veil lifting, 1897-1966-even though Salomon principle dominated there were some veil lifting occurred. Firstly, it was applied for *Daimler Co Ltd v Continental Tyre and Rubber Co Ltd* to determine if the company was an 'enemy' of the First World War in 1916.

The interventionist years,1966-1989-he noted that 'by the 1960s the courts were increasingly demonstrating a tendency to free themselves from old precedence they saw as increasingly unjust'[80].

Back to basics, 1989-present-the court narrowed to lift the veil of incorporation by a well-recognised case of *Adams v Cape Industries Plc (1990).*

Traditionally, the UK, Australia and the United States apply the "veil lifting" principle, which disclaims limited liability of a company, depending on the circumstance of each case. Sharon Belenzon conducted an interesting empirical study of veil lifting in a comparative context. According to the survey which indicated the tendency of their courts to lift the corporate veil in lawsuits involving corporate group affiliates, 'Germany has the highest piercing corporate veil score of 3.93 reflecting its unique attitude of considering a subsidiary an integral part of the corporation that controls it while, by contrast, the lowest piercing corporate veil rating of 1.3 for

[78] Christian A.Witting, *Liability of Corporate Groups and Networks*, (Cambridge University Press, 2018), pp1, 309.
[79] Alan.D and John.L, *Corporate Law*, (5th ed, Oxford University, 2009), pp.35-37
[80] Ibid., p.35

Great Britain reflects the country's strong bias towards the view that firms are distinct legal entities, even when they operate under the directions of a parent firm' [81].

The U.S 's score is 2.63 for piercing the veil, averaging among its 16 counterparts[82]. 'In a few number of states such as Louisiana and Texas, courts have applied an enterprise approach as an independent basis for ignoring limited liability. Louisiana courts, in particular, treat affiliated corporations as a single business enterprise if the level of control reaches a certain threshold, regardless of whether the parent abused the corporate form. In other jurisdictions, courts consider parent-subsidiary cases under the general corporate veil piercing framework, with no reference to an overarching enterprise theory[83]'. Blumberg opined the contradictory situation of the jurisdiction by stating:

> Further, "piercing" jurisprudence in many jurisdictions has become self-contradictory. Traditional "piercing" jurisprudence rests on a demonstration of three fundamental elements: the subsidiary's lack of independent existence; the fraudulent, inequitable, or wrongful use of the corporate form; and a causal relationship to the claimant's loss. Unless each of these three elements has been shown, courts have traditionally held "piercing" unavailable. However, the traditional "three-factor" doctrine has presented so many problems that some courts such as the Court of Appeals for the Second Circuit have abandoned it entirely and have adopted "single-factor piercing"" as governing law for "piercing" cases. Other courts have continued to apply "three-factor piercing," but no longer rely on it exclusively. In a separate line of decisions that do not cite the "three-factor piercing" decisions in the jurisdictions, these courts have rejected the need to demonstrate each of the elements of the traditional three-factor doctrine[84].

Ian Ramsay etc categorized the factors that may lead to a lifting of the corporate veil in Australia.

(a) agency;

(b) fraud;

(c) sham or façade;

(d) group enterprises;

(e) unfairness/justice.[85]

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[81] Belenzon, S and Lee, H and Patacconi, A, *Towards a Legal Theory of the Firm: The Effects of Enterprise Liability on Asset Partitioning, Decentralization and Corporate Group Growth*, (NBER Working Paper No. w24720, 2018), p.4

[82] Ibid., Annex.1.

[83] Ibid.

[84] Phillip.I.Blumberg, *The Transformation of Modem Corporation Law: The Law of Corporate Groups*, p.612

[85] Ian.R, and David.B.N, *Piercing the Corporate Veil in Australia*, (19 Company and Securities Law Journal 250-271, 2001), p.8

They found out the following findings regarding the situation and causes when court lifts the veil:

> Unfairness/justice was the most successful argument (60%), however the number of cases in this category was small. The categories of fraud (about 41.5%) and agency (about 39.5%) both had piercing rates close to the average for the study overall. An argument that the company was a mere sham or façade had a lower rate of piercing (37.5%). The lowest piercing rate was for group enterprise arguments (about 24%). Courts pierce the corporate veil less frequently when piercing is sought against a parent company than when piercing is sought against one or more individual shareholders. This result is surprising given that there are a number of reasons why we might expect the opposite result. We identified a number of possible explanations for this finding. …courts pierce more frequently in a contract context than in a tort context. Again, this result is surprising given that commentators have usually argued that courts should be more prepared to pierce the corporate veil in tort actions compared to contract actions. …piercing rates are highest where the ground advanced for piercing the corporate veil is one of unfairness/interests of justice. All other grounds advanced for piercing the veil had significantly lower piercing rates with the lowest being the group enterprises argument. …where a company seeks to pierce its own veil, the rate of piercing is almost identical to the results for the overall study indicating that courts are reasonably generous in allowing companies to succeed in a veil piercing argument where this will benefit the company[86].

Generally, there are two major problems with the entity, or neoclassical, theory of the corporation, with its corollary of piercing the corporate veil. First, the doctrine has dubious social and economic utility in the context of tort creditors. Second, it applies poorly and irrationally to cases of corporate groups. These problems are precisely those that corporate law at its inception did not address. In today's world, globalizing investment patterns have generated massive corporate webs that may involve layers of subsidiaries, loosely affiliated corporations, subcontractors, and other structurally complex corporate arrangements; moreover, corporate groups frequently cross national borders. The ordinary concepts of piercing and limited liability do not fit easily into this new reality[87].

Summarising the criteria for lifting the corporate veil under the single economic unit theory it is shown that the subsidiaries have to be wholly owned from the holding company. But, that is only one factor. The claimant has to show that the holding company has control over the everyday business of the subsidiary, so that the subsidiary is "merely a puppet manipulated by its masters" and does not "at least have control over a few of its own strings". Therefore, it is hard to define the line between the single economic unit theory and the façade theory. It is just clear, that the requirements of a single economic unit have to be at least a bit less than for a façade[88]. Although

[86] Ibid., pp.32, 36

[87] Dearborn, M, *Enterprise Liability: Reviewing and Revitalizing Liability for Corporate Groups,* (California Law Review, Vol.97, Issue 1, 2009), p.205

[88] Rene.T.Wieser, *Liability within Corporate Groups*, (Societas, 2012)

lifting tends to look only slightly deeper[89] in comparison to other traditional doctrines, it is not efficient and effective so far.

Petrin et al opted that 'in the UK, enterprise liability had a short-lived appearance when Lord Denning championed it in the form of the 'single economic unity' theory in DHN Food Distributors v. Tower Hamlets. However, Denning's single economic unit approach did not gain acceptance as a general principle for veil piercing.'[90] while Skinner from the U.S concluded that 'parenthetically, the fact that courts have chosen to hold parent companies liable only where plaintiffs can pierce the veil by meeting specific elements, including wrongdoing, rather than considering the benefit corporations receive from subsidiaries and the harm to the victims, may be in line with fault-based notions of tort.'[91]

Dearborn criticised the fact that the principle of lifting the veil, which until now was considered the only hope for holding the parent corporation liable, is no longer applicable to large modern corporations, and it reflects on only format of the corporation:

> Limited liability and veil piercing place excessive focus on corporate formalities, so much so that today's mega-corporations with massive legal teams can carefully guard against liability by establishing subsidiaries and maintaining distinct corporate identities. Forming a corporation is largely a matter of paperwork. Piercing tends to look only slightly deeper. Simply complying with corporate formalities can demonstrate to a court in some jurisdictions that the corporations are, in fact, separate legal entities, such that piercing is unavailable. Given that in most jurisdictions the two-part piercing test (requiring both alter-ego domination and a fraud or injustice) is a conjunctive one, liability can often be avoided when a court finds separate legal personalities. If a subsidiary and a parent corporation take simple steps, like keeping adequate minutes of meetings and maintaining separate bank accounts, liability in a piercing claim is unlikely. While this structure may be adequately indicative of the classic "sham" close corporation, in which a shareholder sets up a corporation for the sole purpose of shielding his personal assets from liability, it is well nigh meaningless in the context of a larger corporation with a watchful legal team. In fact, one case has even held that the analogous situation to the "sham" close corporation-in which a larger corporation creates a subsidiary for the express purpose of avoiding liability-is not a sufficient condition for piercing[92].

[89] Ibid., p.208
[90] Petrin.M, and Choudhury.B, *Group Company Liability*, (European Business Organisation Law Review, 2018), p.785
[91] Skinner.G, *Rethinking Limited Liability of Parent Corporations for Foreign Subsidiaries' Violations of International Human Rights Law* (72 Wash. & Lee L. Rev. 1769, 2015), p.1799
[92] Dearborn, M, *Enterprise Liability: Reviewing and Revitalizing Liability for Corporate Groups*, (California Law Review, Vol.97, Issue 1, 2009), p.208

## 2.5. Konzernrecht Doctrine

### *German*

The German *Aktiengesetz* was enacted almost four decades ago. Since it is the first ever systematic legal regulation of corporate groups, this statutory law raised extraordinary interest in many countries inside and outside Europe and gave way to the most vibrant doctrinal debate-which has been lasting even today[93]. Germany's 'konzernrecht' is the exception worldwide and is therefore often taken as an example when any alternative and enterprise approaches to corporate groups are discussed. Mostly, as a comparative tool for other jurisdictions, the set of rules relating de facto corporate groups are stated and referenced where a parent company exercises controlling power over its subsidiaries by agreement and the voting rights of the shares in the possession of the former.

The German system is criticized at the legal policy and its practical implementation. It too exclusively and too intensively focuses on corporate group existence protection and hence neglects the entrance protection[94] while meant to be implemented very strictly: every legal and factual act must be verified to determine whether it is disadvantageous[95]. As Blumberg concluded 'although the konzernrecht is clearly the most extensive adoption of enterprise principles in Western world legal systems, with enormous influence over the evolving law of the EC, its immediate impact on German law is, in fact, somewhat confined'[96].

## 2.6. Rozenblum Doctrine

A number of proposals and initiatives were made by the European Union for the purpose of improving the legal framework of the corporate group, but its initiatives were unsuccessful and left the development to member countries. Even though they pointed out the essential similarities in the fundamental challenges, it is likely that the discrepancy of approaches and principles of the corporate group laws in the Member States caused this failure. During the first attempt of the

[93] Jose Miguel Embid Irujo, *Trends and Realities in the Law of Corporate Groups*, (European Business Organisation Law Review, Vol.6, No.1.), p.66.

[94] Peter Hommelhoff*, Protection of Minority Shareholders, Investors and Creditors in Corporate Groups: The Strengths and Weaknesses of German Corporate Group Law*, (Cambridge University Press, 2009), p.8.

[95] Koji Funatsu, *Trends in European Corporate Group Law Systems and the Future of Japan's Corporate Law System*, (Policy Research Institute, Ministry of Finance, Japan, Public Policy Review, Vol.11, No.3, July 2015), p.476.

[96] Phillip.I.Blumberg, *The Multinational Challenge to Corporation Law*, (Oxford University Press, 1993), p.162

European Union's corporate group law development[97], it seemed to based on Germany's corporate group law since the country was and is the only exception, having a codified corporate group law.

Since this German principle has a tendency to criticized for being ineffective in the context of implementation, and subsequently, the following recommendations and drafts considered the doctrine of "rozenblum" of France which recognizes group interest. It is a case law based on French Supreme Court's decision in 1985. Regarding the rozenblum doctrine, directors of subsidiaries would not responsible if parent and subsidiary are closely linked to the structure and business, implementing the group's unified policy, a balanced allocation of the corporates in the group, and the subsidiary does not provide for financial support beyond its capacity.

Forum Europaeum Konzernrecht held in 1998 focused more on the Rozenblum Doctrine. In its report, in order to 'legitimise in all Member States groups which are organized on a EU market-wide basis and thereby ensure that such groups as a whole and their subsidiaries operate on a firm legal basis', a civil rule is proposed: 'If the management of a group subsidiary operates its commercial policy in the interests of the group and consequently.[98] Western European countries are mostly have been following the rozenblum trend in case law. Although the EU proposals could not become a positive law, these initiatives attract the interest of other countries. Jose Antunes argued their achievements as[99]:

> The EU legal system breaks new ground on the topic of intragroup liability. … it symbolizes, worldwide, the strongest reaction against the prevailing traditional 'entity law approach" to the legal treatment of liability questions in parent-subsidiary relationships and provides the most far-reaching institutional effort advocating a revolutionary reality-adherent approach to the topic. The limited liability for parent corporations, issued from an approach backed up by the formal dogmas of the separate legal personality and the limited liability of the shareholders, should be replaced by the opposite rule of the unlimited liability of the parent issuing from an approach dominated by the reality of the group as a single economic unity or as a single enterprise

The Forum Europaeum proposes that the regulation of corporate groups in Europe be based on the concept of 'control'. The proposal is designed to provide for legal certainty and practicality and to

[97] Corporate Group Law for Europe: *Forum Europaeum Corporate Group Law* (2000)

[98] E Koji Funatsu, *Trends in European Corporate Group Law Systems and the Future of Japan's Corporate Law System*, (Policy Research Institute, Ministry of Finance, Japan, Public Policy Review, Vol.11, No.3, July 2015), p.477.

[99] Jose.E.Antunes, *Liability of Corporate Groups,* (Kluwer Law and Taxation Publisher, 1994), p.293

be in harmony with the existing national laws of the Member States[100]. It must be noted that EU and Australian proposals made a noteworthy contribution to the academic debate and attracted attention somehow even though these documents could not lead to a holistic group regulation.

## 2.7. Due Diligence and Duty of Vigilance Approach

### *French Law on the Corporate Duty of Vigilance*

As mentioned earlier, the principle of enterprise liability has been successfully adopted in the field of taxation and accounting. Meanwhile, another area that has been trying to propose a new principle on imposing liability to the parent is human rights. The United Nations Human Rights Council endorsed the Guiding Principles for Business and Human Rights on Business and Human Rights in 2011, introduce due diligence approach. They are intended to apply universally and to all corporations, regardless of their size. It is noteworthy that due diligence related parts were tested on several corporations, and their content was debated among corporate law experts with expertise in almost 40 jurisdictions[101]. France is the first country to take the initiative to implement this UN document. The French National Assembly enacted French Law on the Corporate Duty of Vigilance for Parent and Instructing companies in 2017. Commentators noted that 'the adoption of the Guiding Principles and other standards of soft law, combined with the activities of the "new judges", including in the event of judicial disputes, have helped embed the business and human rights movement in positive law'[102]. This is a novelty and innovative step not only in the international human rights movement but also in corporate law history. The difference of the law from the UN document is that, in France the scope of the corporation under the law is limited to large multinational corporations and includes not only human rights but also the environmental issue. It covers all types of business and structures.

[100] Jukka Mähönen, *The Pervasive Issue of Liability in Corporate Groups*, **(**European Company Law, Vol 13, No. 5, 2016), p.4.

[101] French Law on the Corporate Duty of Vigilance, 2017, available *at* www.corporatejustice.org

[102] Stéphane Brabant et al, *French Law on the Corporate Duty of Vigilance*, *A Contextualised Approach*, (Revue Internationale De La Compliance Et De L'éthique Des Affaires – Supplément À La Semaine Juridique Entreprise Et Affaires N° 50 Du Jeudi 14 Décembre 2017), p.4

This legislation is unprecedented, called as a pioneering law. For the first time, national legislation - put forward by a coalition of human rights organisations, trade unions and members of parliament - is addressing the harmful impacts of multinational companies on human rights and the environment, creating binding obligations for companies, and providing judicial avenues for victims.

The legal nature of the law is considered by experts as: 'the French Duty of Vigilance law is not only a formal recognition that soft law principles and voluntary initiatives are insufficient. It also translates into legal terms an economic reality: the decisive influence of parent companies over their subsidiaries and their supply chain when it comes to preventing and remediating human rights and environmental violations. To a certain extent, the choice of *vigilance* as a new legal term has enabled this paradigm change to enter the realm of hard law. The law on the corporate duty of vigilance is in line with this trend and is a result of the "progression of the notion of due diligence from the UN sphere to the French national sphere". There are three obligations set out in the Law which relate to reporting: establish a vigilance plan, effectively implement the plan and finally, make public and include the plan and the report on how the plan is effectively implemented in the company's annual management report. However, the Law goes beyond merely reporting by seeking the effective implementation of the vigilance plan, thus confirming a recent trend in legislative developments relating to the business and human rights movement'[103].

Specifying which corporations are covered by the law as that 'Any company that at the end of two consecutive financial years, employs at least five thousand employees within the company and its direct and indirect subsidiaries, whose head office is located on French territory, or that has at least ten thousand employees in its service and in its direct or indirect subsidiaries, whose head office is located on French territory or abroad, must establish and implement an effective vigilance plan (Art. L. 225-102-4)'[104]. The following corporations are involved:

- Parent corporations- corporations headquartered in France that employ at 5,000 employees in France, and else at least 10,000 employees worldwide (including direct and indirect subsidiaries);

[103] Ibid., p.5
[104] French Law on the Corporate Duty of Vigilance for Parent and Instructing companies, 2017.

- Foreign corporations headquartered outside France, with French subsidiaries, if those subsidiaries have at least 5,000 employees in France.
- Subcontractors and suppliers.

The scope of due diligence is determined in the UNGPs based on " whether causes or contributes to an adverse impact, or its operations, products or services are directly linked to adverse impact through a business relationship", and by the severity or salience of these actual and potential impacts. According to the UNGPs, business relationships are understood to include business partners, entities in the value chain, and any other non-State or State entity directly linked to a corporation's business operations, products or services.

Notably, a company is considered to be a subsidiary if another company owns more than 50% of its capital. Multinationals that own more than 50% of a company operating in France may therefore be covered by the law.

Initially, it was an estimated 100 - 150 large companies meet the above conditions, however, the scope is much wider, one employee in the private sector out of four is covered[105].

One of the most drawing attention of legal scholars and ground breaking regulations in the implementation of this law is how to determine the concept of control. Controlled corporations whose activities must be included in the vigilance plan are determined, as specified in the Law, by reference to article L. 233-16, II of the Commercial French Code. As defined by the code corporation's controls are directly or indirectly (directly or indirectly holding a majority of voting rights; appointing for a period of two consecutive financial years the majority of the members of the administration, management or supervisory bodies, or over which it exercises a dominant influence by virtue of a contract or statutory clauses).

Brabant et al clarified on the concept of control as the following:

> The control envisaged in article L. 233-16, II is classified as "exclusive control" in that it enables the company to have decision making power, in particular over the financial and operational policies of another entity. This control can be exercised by different methods: legal control (Comm. Code, art. L. 233-16, II, 1°)7, de facto control (Comm. Code, art. L. 233- 16, II, 2°) or contractual control (Comm. Code, art. L. 233-16, II, 3°). In the case of contractual control, a company is entitled "to use or to direct the use of assets" of another company

[105] Rafael Mariano M (ed)., *Groups of Companies*, (Springer, 2020), p.103

> in the same way that it controls its own assets, by virtue of a contract or statutory clauses. This concept of exclusive control significantly expands the number of companies to be included within the ambit of the plan, especially given this control can be direct or indirect, as specified by the Law. Therefore, Sophie Schiller emphasises that the companies targeted are those "that are directly and also indirectly controlled, in other words all of those, with no limits to the chain of control, over which a company exercises a decision-making power, whether they are direct subsidiaries [filles], second tier subsidiaries, or third tier subsidiaries, etc[106].

It can be seen that the concept of control, the main problem of the principle of enterprise liability and the veil lifting, to be applied more clear and direct to implement under the French principle of duty of vigilance by referring the related law provisions (majority of voting rights, decison making power and contract). This research proposal will discuss how to combine this approach with enterprise liability principle.

Under this law, corporations are required to develop a due diligence plan and publish their reports available to the public, and this mandatory publication of both the plan and the report on its effective implementation shows that the plan is not merely declarative, but also enables stakeholders to monitor whether the corporation fullfil the vigilance obligation.

Article L. 225-102-4, Law of the Corporate Duty of Vigilance:

> "The plan shall include the reasonable vigilance measures to allow for risk identification and for the prevention of severe violations of human rights and fundamental freedoms, serious bodily injury or environmental damage or health risks resulting directly or indirectly from the operations of the company and of the companies it controls within the meaning of Article L.233-16, II, as well as from the operations of the subcontractors or suppliers with whom it maintains an established commercial relationship, when such operations derive from this relationship.

The French corporate duty of vigilance law establishes a legally binding obligation for parent corporarions to identify and prevent adverse human rights and environmental impacts resulting from their own activities, from activities of corporations they control, and from activities of their subcontractors and suppliers, with whom they have an established commercial relationship. The

[106] Stéphane Brabant et al, *French Law on the Corporate Duty of Vigilance*, *Cornerstone of the Law on the Corporate Duty of Vigilance*, (Revue Internationale De La Compliance Et De L'éthique Des Affaires – Supplément À La Semaine Juridique Entreprise Et Affaires N° 50 Du Jeudi 14 Décembre 2017), p.2

corporations covered by the law – it only applies to the largest corporations established in France - will assess and address the risks of serious harms to people and the planet under annual, public vigilance plans. Liability would apply when corporations default on their obligations, including the absence of a plan or faults in its implementation. With this new law, interested parties – including affected people and communities – are empowered to hold corporations accountable. They can require judicial authorities to order a company to establish, publish and implement a vigilance plan, or account for its absence. Interested parties may also engage the company's liability through civil action and ask for compensation if the violation of the legal obligation has caused damages. The law is an important step forward in a global context where achieving corporate accountability is hindered by the complexity, scale and reach of corporate structures; the absence of a level playing field; the legal and practical barriers faced by victims to access remedies; or the lack of enforcement of existing standards especially concerning transnational corporations with a myriad of subsidiaries and suppliers. The duty of vigilance law will ensure better prevention of adverse impacts by companies, and it will also help victims of corporate abuse overcome some of the hurdles they face in achieving justice. The law requires companies to identify key risks of severe impacts, either linked to its activities or to those of business partners and take actions to prevent them. This makes it easier for victims to argue that a company could have influenced the production of harmful impacts, and that it should have taken appropriate measures to prevent them[107].

One of the unique jurisprudential features of this law is that it is regarded as combination of soft and hard law- allowing them to self-regulate and imposing penalty. It vontains both the nature of preventive and protective laws.

Within the framework of the duty of vigilance principle, the main importance of extended liability for the parent and member corporations is to prevent risk. To summarise the advantages of the mechanism from the findings by Brabant et al, the followings can be mentioned[108]:

[107] Stéphane Brabant et al, *French Law on the Corporate Duty of Vigilance*, *Cornerstone of the Law on the Corporate Duty of Vigilance,* (Revue Internationale De La Compliance Et De L'éthique Des Affaires – Supplément À La Semaine Juridique Entreprise Et Affaires N° 50 Du Jeudi 14 Décembre 2017

[108] Stéphane Brabant et al, *French Law on the Corporate Duty of Vigilance*, (Revue Internationale De La Compliance Et De L'éthique Des Affaires – Supplément À La Semaine Juridique Entreprise Et Affaires N° 50 Du Jeudi 14 Décembre 2017

- it could help gradually shift focus towards prioritising risks to people rather than risk to the corporation. A binding framework is needed to protect people and environment and ensure fair competition for corporations who act responsibly.

-it encourages the cooperation and contribution of stakeholders of the corporation including even community members.

- Most importantly, it does not allow to dismiss the liability of the parent corporation towards public interest issues. It establishes a legally binding obligation for parent corporations to identify and prevent negative impacts in these field. As Brabany et al, viewed that 'it appears that in line with the overall philosophy of the Law, the penalties it contains will be more effective in preventing abuses than in offering an actual remedy for any abuses that do occur. Yet this observation should not be taken to detract from the Law's merits – preventive action is essential to raising company awareness, limiting the negative impact of their activities on human rights and thus reducing the number of potential victims of such impacts'[109].

Thus, the French law is considered as the most effective response to bridging the gap between current business and human rights governance. Even in terms of corporate responsibility, it is the most determined and innovative legal instrument ever done. The French law is called a new legal tool for justice and makes a hope that other jurisdictions will learn from France, and that it paves the way for more ambitious legislation in the future.

### 2.8. Summary

To achieve the main purpose of the present study, by reflecting on the topic of corporate groups liability in a comparative law context, by providing a systematic survey of the current regulatory strategies on a worldwide scale, by critically scrutinizing their shortcomings, and at the same time to propose a path for future legislature reforms in this important area of modern corporation practice and law. Differences of detail being left aside; three major types of regulatory strategies have so far been developed in comparative law. These strategic are: the traditional strategy of the

[109] Stéphane Brabant et al, *French Law on the Corporate Duty of Vigilance, A Closer Look at the Penalties Faced by Companies* (Revue Internationale De La Compliance Et De L'éthique Des Affaires – Supplément À La Semaine Juridique Entreprise Et Affaires N° 50 Du Jeudi 14 Décembre 2017, p.5

entity law approach, the revolutionary strategy of the enterprise approach and the intermediate strategy of the dualist approach[110].

*Table 2. Theories of Corporate Groups Liability*

| **Theory** | **Single corporation** | **Corporate group** |
|---|---|---|
| Entity | Limited liability | Limited liability |
| Enterprise | Limited liability | Unlimited liability |
| Dualistic | Limited liability | De facto/contract |

The focus of this chapter is to summarize doctrines and principles on corporate group's liability and provide primary understanding on sake for seeking further resolutions to problems relating corporate group. There are needs to be some reform of the law to acknowledge the reality of large corporate groups, especially with the potential for abuse existing. Exactly what doctrine and principle can be taken is subject to debate as shown above. Limited liability is not a rule of natural law. If it is inconsistent with the root of law, fairness and justice, an adjustment must be considered. Yet corporate groups law's problems are still unresolved, and the results achieved so far are still unsatisfactory and ineffective. It might be deemed that corporate groups' legal concerns left in disarray because states are unable to control these main actors of the economic system. Without resolving the limited liability issue as a foundation at first, it is completely futile trying to settle other areas of corporate group law for a complex result. Developing dedicated legal doctrines to be effective in the sense that, absent such doctrines, the corporate group could not be regulated convincingly. In most jurisdictions, lawyers, researchers and law-makers only look at traditional legal issues over the corporate but are not paying enough attention to addressing the legal issues of modern corporates that are organized as a group. The fact that the group of corporates that was left behind in the legal framework of the corporate has begun to consider the relative importance of the 1990s since then, but theoretically it is still controversial and practically inapplicable.

The principle of separate corporate legal personality has been a foundation stone in the development of corporate law in common and civil law countries, with investors being protected by the concept of limited liability. The evolution of the corporation as a vehicle for investment has

[110] Jose.E.Antunes, *Liability of Corporate Groups,* (Kluwer Law and Taxation Publisher, 1994), p.479

been credited by some with underpinning modern economic development. The argument in favour of limited liability is stronger with its longstanding classical doctrine. There is hesitation like neglecting of the traditional legal protection of the corporate as its main feature will negatively affect the economy and the business sector. This is the reason behind this backwardness.
The weakness of the entity law is related to the corporate legal personality and limited liability- which of regarding the corporation as a separate juridical person with its own rights and obligations distinct from those of its shareholders, presents obvious opportunities for manipulation, particularly where the corporation is owned and controlled by a single shareholder.

The enterprise approach pleads for a new and revolutionary regulatory strategy and has found its most expressive statement in the EU original. The following table summarizes the general characteristics of the types of enterprise theory which has been discussed in the previous sub parts.

*Table 3. Types of Enterprise Liability*

| **Type** | **Area** | **Strategy** |
|---|---|---|
| Veil lifting (in some way) | All | Due to tests |
| Konzernrecht | Corporate law | Codified law, contract |
| Rozenblum | All | Due to tests |
| Due diligence | Human rights | International document |
| Duty of Vigilance | Human rights, environment | Positive law |
| True enterprise | Tort, insolvency, tax, labour | Positive law |

While the entity approach is still the dominating regulatory strategy in the majority of common and civil law systems, the enterprise doctrine has not been universally accepted so far. According to the doctrine, corporate group liability problems would be decided according to the fundamental principle that the parent corporation shall be liable for all the unpaid debts and acts of its subsidiaries for the reason that the former controls the latter, forming thereby a unitary economic enterprise. While not yet having become positive law in corporate law, such an approach holds an deniable interest and actually since it symbolizes in a worldwide context the strongest reaction and the most far-reaching institutional undertaking against the prevailing traditional entity law approach. Having decided to overcome the formalism of the traditional posture and conceiving the filling of the gap between law and reality as its major regulatory task in this particular area, it pleads

then for a general coupling between the power of control and liability. Liability issues should not be decided according to the formal legal fiction of the separate corporateness but according to the economic reality of the allocation of power of control[111].

Even though criticized as being too radical, disseminating the enterprise approach would be most helpful in breaking traditional, fixed and predominant attitude. There is a tendency to regard the enterprise law approach relatively in some jurisdictions, but not responding with the complexity of the corporate legal regulatory framework to the phenomenon makes it difficult to apply the law. As previously stated, this principle can be seen in a few restricted areas, rather than completely disregarding the group's limited liability. Nevertheless, we should consider at least the principle of denying limited liability in the field of liquidation, bankruptcy, and environmental damages of the highest legal entity. When introducing these theoretical principles into legislation, it is important to coordinate closely with the 'real control' of the parent and the business integrity of participants. Because internal communication, management and control of corporate groups are different, how the subsidiary corporation is dependent on the parent and whether the activities are carried out in a vertical management group, should be addressed. Christian A.Witting asserted that 'theory aside, it is unsurprising that courts prefer to work with established legal concepts in the regulation of corporate groups, assigning especial importance to the concept of separate legal personality'[112].

When raises the issue of corporate group liability, it is often mistaken that there is a principle of lifting the veil and that there is sufficient legal regulation. On the contrary, it is now clear that this strategy has been ineffective. This is because the strategy is implemented by the courts only in the most extraordinary cases and in exceptional circumstances, and there is no unified standard or understanding of what constitutes an extraordinary case. Therefore, lifting is a common law doctrine but none in any legislature.

One of the innovative initiations to improve corporate responsibility is the French Corporate Duty of Vigilance Law, placing the onus on domestic and multinational corporations in France to identify and prevent risks to human rights and the environment that could occur as a result of their

[111] Jose.E.Antunes, *Liability of Corporate Groups*, (Kluwer Law and Taxation Publisher, 1994), p.479
[112] Christian A.Witting, *Liability of Corporate Groups and Networks*, (Cambridge University Press, 2018), p.184.

business activities. This tendency has been supported by other European countries. For example, Swiss has been preparing mandatory due diligence law.

The French law on the corporate duty of vigilance for parent and instructing companies sought to reflect in law the political, social and economic importance of multinational corporations, and strengthen the accountability of parent companies. It is a legislative innovation, building on both the existing soft and hard legal frameworks, thus challenging its observers on their conceptions of law and legal theory. In particular, the Law introduces into substantive law some apparently unidentified legal objects, which can be new to lawyers[113].

## CHAPTER THREE: CASE STUDY ON CORPORATE GROUPS' LIABILITY

These cases illustrate how theoretical and legislative perspectives on liability issues of the corporation influence case outcomes and how entity based views of the corporation fall short when extended to corporate groups and how veil lifting and enterprise approach can be recognised as well. These examples are not intended to canvass the entire range of issues involving corporate groups or to survey all of the analytical approaches courts may take. However, they highlight how understandings of the nature of corporate groups vary across different doctrinal domains.

In the United Kingdom, the Salomon Principle, which refers to the company's separate legal entities and limited liability, is very strong. Salomon & Salomon Co (1897) case law-based principle of limited liability where the corporation, being a legal entity, is separate from the shareholder and cannot hold liable to each other. Therefore, it is criticised that the recognition of group corporate responsibility in the UK has been lagging due the courts reluctancy[114], this attitude may have increased due to the case of *Adams v Cape Industries*. However, some court cases of English law so far the most referenced in academic research and debate. When it comes to the discussion on the extension of corporate group liability, cases often cited are related to asbestos mines and operations. These cases raised awareness around the corporate group and made a significant contribution to the academic debate as to notions of fairness and regulatory should be contemplated for a parent and subsidiary corporates.

[113] Stéphane Brabant et al, *French Law on the Corporate Duty of Vigilance*, (Revue Internationale De La Compliance Et De L'éthique Des Affaires – Supplément À La Semaine Juridique Entreprise Et Affaires N° 50 Du Jeudi 14 Décembre 2017, p.1

[114] See for example, Witting.C, *Liability of Corporate Groups and Networks*, (Cambridge University Press, 2018), p.184; Klaus J.Hopt, *Groups of Companies-A Comparative Study on the Economics, Law and Regulation of Corporate Groups*, (ECGI-Working paper No.286, 2015), p.22

### 2.1. Adams v Cape Industries Plc (1990)[115]

The Cape cases as an example of the liability within corporate groups. In Adams v Cape Industries Plc the House of Lords gave one of the rare decisions where a court examines examples of a lifting of the corporate veil.

Cape was an English company mining and trading asbestos in South Africa and was involved in the world market through its subsidiary, Capasco which locates in the UK. Their U.S. market was also operated by a NAAC, Illinois registered subsidiary. In 1974, 462 Texas employees filed lawsuits against Cape, Capasco, NAAC, and other branches in Texas. These claimants were those who suffered health damage from the asbestos. In subsequent years, the number of claimants increased, and Cape was deemed to have no legal jurisdiction to settle the Texas lawsuit; and they were gradually losing its business in America. The suit was settled for $ 20 million, including the Cape Group contributed $ 5.2 million. Then in 1978 the Cape subsidiary NAAC was liquidated and the distribution of asbestos for the Cape group in the US Market was transferred into two other companies, CPC and AMC. CPC, although not a Cape subsidiary in the formal sense, worked on the premises of its predecessor corporation NAAC and was supported financially by Cape Industries. In terms of its business policy, CPC was instructed by AMC. AMC itself was a completely dependent subsidiary of Cape Industries incorporated in Liechtenstein. Some years later, a second wave of lawsuits was hard against the Cape group. The English holding Cape Industries tried to block this suit from the beginning by denying the jurisdiction of the US court because Cape Industries Plc had no own activities in the US market. The Texas court adjudicated the claimants compensation in the amount of $ 15.65 million by a default decree because Cape did not appear to the negotiations. In the further course the claimants tried to claim directly against the British holding company before English courts[116].

The claimants went to court in the UK, where the majority of the parent company's assets existed. The court examined whether Cape was present in the US jurisdiction through its subsidiaries, whether the group could be considered as one entity and that the subsidiaries were agents or mere facades. The court limited applying the veil lifting principle further by rejecting the Cape group could be treated as a single entity and stating that the court is not free to disregard the principle of

[115] Ibid., p.37

[116] Rene.T.Wieser, Liability within Corporate Groups, (Societas, 2012)

Salomon. Upon further legal consequences of the case, Martin Petrin and Barnali Choudhury stated that:

> In the UK, however, the tendency to allow piercing in line with the traditional principles came to a halt with the 1989 decision in Adams v. Cape Industries plc. The Court acknowledged that there were three main instances in which piercing may be justified. First, when a parent's responsibility for a subsidiary may be construed based on specific circumstances, particularly where a statute or contract allows for a broad interpretation to references to members of a group of companies. Second, in cases indicating that a company is a mere façade to conceal true facts and avoid legal obligations. Third, where a subsidiary acts as its parent company's agent[117].

The House of Lords confirmed that it is possible to lift the corporate veil if statutory regulations which are concerned with liability to pay taxes are imposed on a group structure and there is a conflict between the corporate entity rule and the statutory intention of the legislation. An issue the House of Lords examined for a lifting of the corporate veil is if the subsidiaries of Cape are formed or operated to perpetrate a fraud. But, on the evidence of such fraud were limited with those three strict conditions. It is not a fraudulent abuse of corporate principles to manipulate the corporate structure of a group so as to ensure that legal liability falls on a particular member of a group. Likewise, it is not sufficient for an abuse of the legal form that a company is dominated by a majority shareholder in full and the corporation will eventually become insolvent due to economic difficulties. In the Cape case the House of Lords stated that there "was nothing illegal as such in Cape arranging its affairs[118].

### 3.2. James Hardie v Co. v Hall (1998)[119]

In Australia, researchers in the field of corporate group law have done a lot of research relatively, and they have come up with some number of ideas and initiatives, including a comprehensive research report of corporate group law, named Corporate Groups Final Report, by the Companies & Securities Advisory Committee[120]. It seems like that they were inspired by EU's initiatives steps of corporate group law. Although the advisory committee delivered an official report and proposed a legal reform on corporate group law, it did not produce full results in terms of legislation. The committee recommended to adopt single enterprise principle; however, it did not come to fruition.

[117] Petrin.M, and Choudhury.B, *Group Company Liability*, (European Business Organisation Law Review, 2018), p.775
[118] Rene.T.Wieser, Liability within Corporate Groups, (Societas, 2012)
[119] Kluver.J, *Entity vs. Enterprise Liability: Issues for Australia*, (37 Connecticut law review, 2005), pp.768-774
[120] Companies & Securities Advisory Committee, *Corporate Groups Final Report*, 2000

CASAC in its Final Report on Corporate Groups in May 2000 recommended the adoption of the single enterprise principle in regulating corporate groups. Under the proposal, wholly owned corporate groups could choose whether or not to be so regulated, by choosing to be consolidated or non-consolidated. If choosing to be consolidated then a term such as 'consolidated corporate group company' would be included on all public documents of the group companies. Single enterprise principles would then govern the consolidated corporate group company as 'the Corporations Law would treat the consolidated corporate group as one legal structure[121].

Also, Dickfos posited that 'of the Final Report's 24 Recommendations, to date, only two recommendations, permitting the pooling of assets and liabilities in a liquidation of group companies have led to changes in Australian corporate law. Of the remaining 22 recommendations, 11 involved no change to the current law, while the remaining 11 recommendations have not been implemented[122]'. Sharon Belenzon's empirical data points the country got piercing corporate veil score of 2.73[123].

Later, a controversy case, James Hardie Industries, that took attention not only the country's court and lawmakers but also the business community to looked up responsibility for the corporate group.

James Hardie Industries was an asbestos production company. It was a high-profile, operating at the international market through its two subsidiaries. Workers of the asbestos factory (its subsidiaries) suffering from the mesothelioma have filed a lawsuit with the Supreme Court of New South Wales, Australia, and demanded that lifting the veil of the parent company. The court held common law entity principles as usual. In 2001, James Hardie was requested to establish tort claimants' compensation fund when moving the parent company to the Netherlands. In 2003, they cancelled the partly paid shares held by the parent company, that freed the parent company from compensation. It led an outcry from past employees of the subsidiaries, their representative trade unions and politicians[124]. James Hardie argued that the parent company had no legal liable adequately to fund the tort liabilities of its subsidiaries, cited the 1980s court decision. In 2004 a special commission was appointed by the state government to hold a public inquiry on this issue and found that the laws of the Australian company were so flawed that it would be appropriate to

[121] Jennifer, D, *Enterprise liability for corporate groups: A more efficient outcome for creditors*, p.244
[122] Ibid., p.242
[123] Belenzon, Sharon and Lee, Honggi and Patacconi, Andrea, *Towards a Legal Theory of the Firm: The Effects of Enterprise Liability on Asset Partitioning, Decentralization and Corporate Group Growth*, 2018, Annex 1.
[124] Kluver.J, *Entity vs. Enterprise Liability: Issues for Australia*, (37 Connecticut law review, 2005), p.770

further pay attention the principle of limited liability and reflect modern and public opinion and standards. They confessed that there were significant deficiencies in Australian corporate law. While not violating the law, for the sake of moral and corporate social responsibility, the parent company agreed to pay its tort claimants compensation for at least 40 years by increasing their compensation funds.

From the Australian experience, traditional corporate law with very limited veil lifting principles, in fact, does not meet the standards required for proper legalization and operation of a corporate group, according to John Kluver, head of Corporations and Market Advisory Committee[125]. He also said in the James Hardy case that it is becoming less commonplace for the general public to rely on corporate entity law principles, especially when the group imposes risks on its subsidiary to avoid, particularly in regard to involuntary creditors. In the addition, Virginia Harper's posited from the case:

> The cases reveal a lack of systematic and consistent application of corporate theory even within discrete doctrinal arenas. In Citizens United, this discontinuity appears within the majority opinion itself. While these examples may suggest that judges are simply drawing on the theory that best suits their intended conclusion, they clearly show that corporate theory is not determinative in a mechanistic sense and that there is a need for courts to use greater care when drawing on corporate theory. The opinions also demonstrate that even if limited liability and other fundamental characteristics of the corporate form are presumed, enterprise perspectives lead to new ways of approaching decisions involving corporate groups[126].

After the case, the administration decided that it would be necessary to review the law of Australian corporate law, and in the course of their work, lawyers advised[127] them to examine where, how the principles of enterprise law could be applied, and how they were effective. However, so far no significant change has been made.

This indicates that the reform of the corporate group law remains a controversial topic throughout the world, as it stands at the midpoint of law, economics and politics. William J.Rands pointed out regarding the US's situation as 'stimulating as the academic debate has been, state legislatures have paid no attention to it. Not wanting to be left behind, virtually every state has enacted legislation that authorizes the creation of limited liability companies and limited liability partnerships, two types of entities that provide limited liability for their owners. In truth, however, their ears are more

[125] Ibid**,** p.783
[126] Virginia H.Ho, *Theories of Corporate groups*, (Seton Hall Law Review, Vol.42, 2012), p.944
[127] Kluver.J**,** *Entity vs. Enterprise Liability: Issues for Australia,* **(**37 Connecticut law review, 2005**),** p.783

attuned to the entreaties of their respective business communities. What the business community wants, the business community usually gets[128].

### 3.3. Union Carbide *v* the Bhopal

The Bhopal Litigation According to Indian sources,39 more than 2,500 people were killed and more than 200,000 were permanently injured as a result of the December 1984 disaster at the Bhopal, India, plant of the 50.9 percent-owned Indian subsidiary of Union Carbide Corporation. The government of India and numerous private claimants brought suit both in the United States and in India against the Indian subsidiary and its American parent corporation. Although five of the six causes of action asserted direct liability on the part of the parent for its own tortious acts, a sixth cause relied on enterprise doctrines, seeking to impose intragroup liability on the parent for torts of its Indian subsidiary. In the United States, the federal courts refused to assume jurisdiction on the ground of forum non conveniens on conditions not material for purposes of the discussion. The litigation thereupon proceeded in India. The Supreme Court of India ultimately upheld a $470 million settlement judgment against Carbide, resting on both its direct negligence and on intragroup liability under enterprise law. The litigation, at least in its civil dimensions, has come to an end. The settlement has made unnecessary any attempt by the claimants to obtain extraterritorial enforcement of any contested Indian judgment in the event, not unlikely, that Indian assets of Carbide and its Indian subsidiary would be insufficient to satisfy the judgment. The Deltec and Bhopal litigations present very different circumstances. Deltec broke new jurisprudential ground, resting solely on a bold assertion of enterprise law. It also involved a questionable reorganization proceeding in which the Deltec subsidiary in question had been transformed from a company with assets substantially exceeding its liabilities but suffering from cash-flow problems into a hopelessly insolvent company. Bhopal, shorn of its catastrophic dimensions, was simply a case involving the assertion of enterprise principles to impose parent company liability for a subsidiary's torts, a result frequently reached in the United States through "piercing the veil jurisprudence.[129]

India has made efforts at recognizing enterprise liability, although only in a narrow set of circumstances. After the Bhopal disaster that a gas leak accident the Indian government argued in

[128] William J. Rands, *Domination of a subsidiary by a parent,* (Indiana Law Review, Vol. 32 No.2, 1999) p.430

[129] Phillip.I.Blumberg, *The Multinational Challenge to Corporation Law,* (Oxford University Press, 1993), pp.189.190

the ensuing case that a multinational enterprise should 'necessarily assume responsibility' for harms caused by it 'for it alone has the resources to discover and guard against hazards and to provide warnings of potential hazards'. The Indian Supreme Court later recognised this argument by holding that:

> An enterprise […] engaged in a hazardous or inherently dangerous industry […] owes an absolute and non-delegable duty to the community that no harm results to any one on account of the dangerous nature of the activity it has undertaken […] If the enterprise is permitted to carry on the hazardous or inherently dangerous activity for its profit, the law must presume that such permission is conditional on the enterprise absorbing the cost of any accident. This doctrine became subsequently accepted as defining enterprise liability in India, although only with respect to corporations engaged in hazardous or inherently dangerous industries. Enterprise liability, in varying forms, has also received a great deal of interest in the academic literature. A number of scholars have analysed limited liability between parent and subsidiary companies from a law and economics perspective and found that there is only weak support for it, which has led some commentators to argue in favour of enterprise liability mechanisms. Bainbridge has found that the prospect of judgment-proofing within groups means that parent company liability alone is insufficient and that enterprise liability theories appear better suited, although not ideal, to deal with large-scale risk-externalizing.

### 3.4. Total *v* Uganda[130]

It is the first case for the new duty of vigilance law. Total is a French oil giant corporation and the main operator of a mega oil project in Lake Albert and Murchison Falls, a protected natural park in Uganda. Murchison Falls, also called Kabalega Falls, is a waterfall between Lake Kyoga and Lake Albert on the Victoria Nile River in Uganda. At the top of Murchison Falls, the Nile River forces its way through a gap in the rocks, only seven meters wide, and falls 43 m, before flowing westward into Lake Albert. Murchison Falls National Park is located in the northwestern part of Uganda. The largest national park in the country, it covers an area of about 4,000 square kilometers. It is inhabited by lions, elephants, crocodiles, hippos, buffaloes, giraffes and chimpanzees and many species of birds. Total corporation plans to drill over 400 wells in the park, extracting around 200,000 barrels of oil per day. A 1,445km long giant pipeline is planned to transport the oil, impacting communities and the environment in Tanzania as well as Uganda.

Six environmental groups in France and Uganda, led by Friends of the Earth, are taking the French multinational energy company Total to court for its failure to elaborate and implement its human rights and environmental vigilance plan in Uganda. This is the first legal action under the 2017

[130] Source: https://www.totalincourt.org/

French Duty of Vigilance law, which aims to address corporate negligence. The claimant groups are: Friends of the Earth France, Survie, the Africa Institute for Energy Governance (AFIEGO) in Uganda, Civic Response on Environment and Development (CRED) in Uganda, National Association of Professional Environmentalists (NAPE)/Friends of the Earth Uganda and NAVODA Uganda. The claimant filed a case under summary proceedings (3) against Total for failing to comply with its new obligations under the law on duty of vigilance, and asked the court to force the company: firstly, to remedy the shortcomings in its current vigilance plan, which does not include any risk identification or specific measures concerning its activities in Uganda, and secondly to effectively implement urgent measures in response to the violations and risks of violations observed in Uganda in order to improve the situation for affected populations. Total says 5,000 people have been displaced, but the groups say around 50,000 could be affected by the project.

Total claimed that the French Law on Corporate Duty of Care takes a general approach by type of risk. It does not require disclosure of risks specific to individual projects.

The hearing of the Nanterre High Court of France happened on January 30, 2020, and decision was ‘the jurisdiction is the Commercial court, not the civil court. The publication of a vigilance plan would therefore fall within the scope of "disputes relating to commercial companies" for which only the Commercial Court has jurisdiction, regardless of whether or not the claimants are companies. The six organizations strongly disagree with this interpretation of the law.

This is the first ever court decision based on the French law on duty of vigilance. This groundbreaking law is now matter for corporate lawyers not only for human rights activists.

A judge will decide if the corporation should be forced, with potential financial penalties, to review its vigilance plan, acknowledging the true impact of its oil activities on local communities and the environment. The court could also order Total to undertake urgent measures in order to prevent further human rights violations or environmental damage.

Thomas Bart, the Survie activist who coordinated the on-site investigation, explains that “Thousands of people are already acutely feeling the dire consequences of the oil project. It’s not only the people, whose homes and land have been stolen, but also the region’s exceptional biodiversity that is under attack.” Juliette Renaud, corporate accountability senior campaigner for

Friends of the Earth France said, “In addition to the urgent need to put an end to this scandalous project, this unprecedented legal case is also a legitimate sign of recognition that transnational corporations have new and very concrete legal obligations under this law. Corporations can no longer hide behind ‘good intentions.' Karin Nansen, who chairs Friends of the Earth International, said, “For too long large oil corporations like Total have acted with impunity, trampling over human rights and destroying the environment. But this new Duty of Vigilance law and court case means we have a chance to hold Total, a French transnational corporation, accountable in France for human rights violations and environmental and livelihood destruction in a Southern country. This case is a groundbreaking moment in the global movement to end corporate impunity.”

In regard to OECD due diligence guideline, it stated that n enterprise may carry out due diligence around a specific situation (a specific transaction, a specific expansion project, a new type of product) or it may be carrying out broader due diligence (such as around areas of its supply chain or new country entry). The questions below should be asked within the context of each situation. In cases where the due diligence is focused on specific situations, the analysis can be more precise about the RBC risks and the enterprise’s relationship to those risks. Where the due diligence covers broader activities, the analysis is likely instead to be based on information that helps identify the likelihood of RBC risks and the enterprise’s potential involvement with that risk.

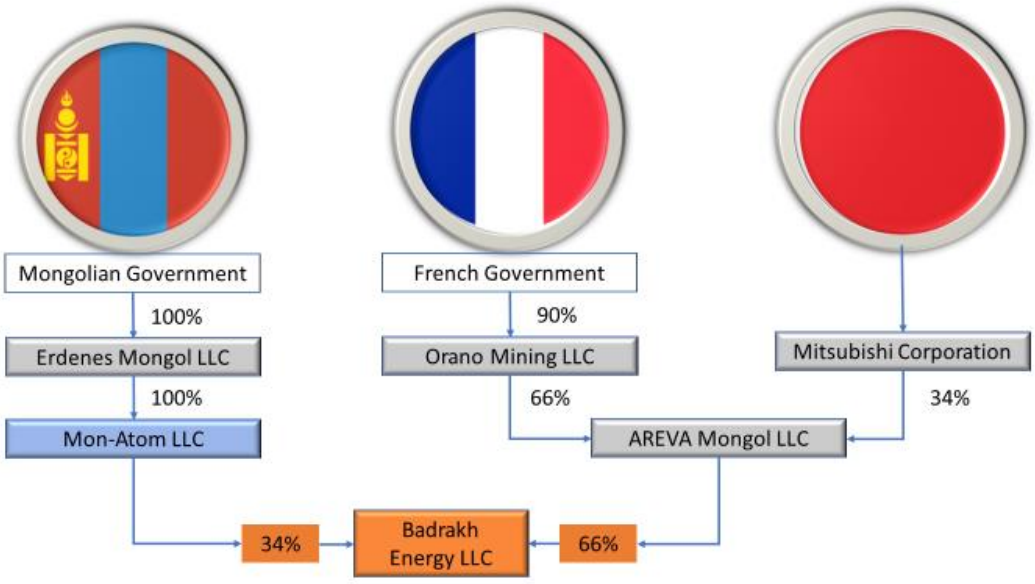
As initiatives on mandatory human rights due diligence, the French Duty of Vigilance law certainly appears as a milestone. The way it will be used by civil society and applied by judges is bound to raise interest well beyond France's borders.

### 3.5. Badrakh Energy *v* ‘EHENT’ NGO

As part of this study, we surveyed Mongolian court decisions and some community conflicts related to the application of the corporate groups law and liability issues. After that, a selection of cases is included here.

The figure shows the group structure of the defendant corporation which has a part of a 4-tier group.

*Figure 3. Shareholders and Structure of BE*




*Source: www.badrakhenergy.com*

Currently, Areva Mongol LLC owns 66 percent of Badrakh Energy LLC. Areva Mongol LLC is 66 percent owned by France's Orana Mining Group. The French government owns 45% of the group. The remaining 34 percent of Areva Mongol LLC is owned by Japan's Mitsubishi Corporation. Badrakh Energy LLC is a third-tier subsidiary of Orana mining of France and its 34 percent owned by Mongolia's 'Mon Atom' LLC. 'Erdenes MJL' owns 100% of the company. 'Erdenes MJL' is 100% owned by the Government of Mongolia. Orano SA is a multinational nuclear fuel cycle corporation and headquartered in Châtillon, Hauts-de-Seine, France.

The majority of the Orano SA Group is owned by the French government, which specializes in uranium mining and processing, nuclear logistics, dismantling, and nuclear cycle engineering activities. The Orano SA Group has 16,000 employees. Its fourth level's subsidiary corporation, Badrakh Energy, operates a uranium mine in the Mongolian Gobi desert. It has been two years since the NGO "Eviin Khuch for the Motherland" filed a lawsuit against "Kojegobi" LLC and "Badrakh Energy" LLC in the Administrative Court. The NGO was established by local citizens.

The claimant claims that the corporation produces uranium called "yellow powder" using the underground acid leaching method. This method of pumping acid underground is an internationally banned method that pollutes highly toxic groundwater. However, Badrakh energy continues to use the world's most toxic method, uranium mining, which is banned in some countries. As a result, in

some areas of Dornogovi aimag, large numbers of livestock deaths and malformations have been reported since 2013. In Ulaanbadrakh soum of Dornogovi aimag, seven-legged goats, multi-legged calves, skinless and hairless animals have been born for some time. They required the court to order on suspension the corporation's activities and revoke its license. The local community consider the court has been still reluctant to resolve the case, and environmental civil society groups have expressed to move to a strong demonstration.

An analysis of this case in the view of corporate group's liability law: Badrakh Energy had previously changed its name of Areva Mining two years ago. This is a new, small corporation with a small number of employees, so it may not be able to compensate. In this case, there is no legal possibility for the court to pierce the group's liability, and even there would be a lack of recognition in this area.

As the parent company of Badrakh Energy is a multinational corporation subject to the French Corporation Duty of Vigilance law, the local people can be require the parent company to develop and implement a vigilance plan to prevent human rights abuses and environmental damage, and they can go to a French court. Although there are some disputes that the vigilance plan is general-purpose and does not apply to a single project, the law's main purpose is to prevent multinational corporations from infringing human rights and environmental law in developing countries, so the law can be applied to this case in my opinion.

There is an academic scholar who identified why multinational groups are likely to be risky for developing, host countries, and developed a proposal of applying the principle of enterprise liability only in those countries at risk. Skinner determined the reasons why special strategies must be taken for those countries by writing:

> Countries would ensure causes of action exist, that their judiciaries are fair, corruption-free, and functional, and that companies, including foreign-owned subsidiaries have sufficient funds to pay any award of compensation (or are otherwise insured for negligent torts). The problem is that this is often not the case in many countries where foreign-owned subsidiaries operate (host countries), which are often developing countries seeking to attract transnational business.[131]

The factors identified by her are the followings:

[131] Skinner.G, Rethinking Limited Liability of Parent Corporations for Foreign Subsidiaries' Violations of International Human Rights Law (72 Wash. & Lee L. Rev. 1769, 2015), p.1800

1. many of these host countries do not have sufficient regulations to prevent harm; in fact, as a result of globalisation, many have done away with regulations they used to have in order to attract transnational business.

2. there is often a high level of corruption in government and business operations, as well as corruption in the judicial system. In particular, many countries hosting subsidiaries that engage in extraction or other industries have a high potential for human rights abuses, have ineffectual and corrupt judicial systems, or no mechanism for victims harmed by businesses' actions to seek or obtain redress.

3. sometimes there is simply not a statutory or common law basis to bring a claim.

4. it might be that victims bring a suit against the subsidiary in the host state and receive a verdict, but are then unable to collect due to lack of funds, underfunding, or bankruptcy.

5. due to the complexity of corporate structure, sometimes victims are simply unable to identify which subsidiary is operating in their area and thus, are unable to determine which entity to bring a claim against. What can be even more confusing is that the subsidiary may be using the "logo" of the parent company, leading to confusion about the entity operating in the area.

6. victims may have legitimate fears of retaliation by the business or the members of the community if they bring a claim.

7. victims may not have the ability to get the evidence they need to bring a lawsuit; bringing a lawsuit may be too costly; or they may simply be unable to find a lawyer in that country willing to bring a suit in court. All of these factors converge to create a situation where victims are likely to have little recourse in their own countries[132].

### 3.6. Summary

The cases reveal a lack of systematic and consistent application of corporate theory even within discrete doctrinal arenas.

[132] Skinner.G, Rethinking Limited Liability of Parent Corporations for Foreign Subsidiaries' Violations of International Human Rights Law (72 Wash. & Lee L. Rev. 1769, 2015), pp.1801-1803

At present, inconsistent understandings within even a single case can lead to incoherent decisions if not recognized and weighed in reaching a conclusion. Relatedly, these cases illustrate the need for clearer standards for delimiting the bounds of the corporate group.

It is stated in literature and recent international documents that limited liability becomes a problem when victims and creditors cannot obtain a remedy against a subsidiary of a multinational corporation in their own country. In that situation, they are left with bringing suit against a parent corporation in the parent's jurisdiction as their only form of potential remediation and compensation. But limited liability basically restrict to reach them. This is problematic for any harm. When the liability issue comes with multinational corporate groups, governing and controlling become even more difficult. Skinner wrote about that as 'in many situations of tortious conduct by a corporate subsidiary, victims are left in a quandary. Even though the parent corporations, as shareholders, receive great economic and tax benefits from their foreign subsidiaries' activities, they are able externalize the risks of their operations through their subsidiaries—such as environmental risks and violations of international human rights law—and avoid liability, leaving victims with no remedy'.[133]

To conclude with these cases, it is absolutely inevitable to agree with the statements of scholars from all over world that such investment often results in increased wages, import of technology, developments and investment in infrastructure, and even a decrease in poverty. However, where those subsidiaries cause or are involved in even the most egregious torts, the harm is absorbed by vulnerable populations. Given this juxtaposition, there is increasing recognition that it is unfair that corporations receive tax and other benefits from their use of wholly-owned subsidiaries while being able to avoid liability when those wholly-owned subsidiaries engage in human rights violations, regardless of the fault of the parent company.[134]

Applied to the situation of a corporate group, this means that the shareholders of the group are legally regarded as independent entities with all the rights and liabilities which would normally attach to separate legal entities - regardless of economic dependency and unified action of the entire group: "each company in a group of companies (a relatively modern concept) is a separate legal entity possessed of separate legal rights and liabilities so that the rights of one company in a group

[133] Skinner.G, Rethinking Limited Liability of Parent Corporations for Foreign Subsidiaries' Violations of International Human Rights Law (72 Wash. & Lee L. Rev. 1769, 2015), p.1777
[134] Ibid., p.1780

cannot be exercised by another company in that group even though the ultimate benefit of the exercise of those rights would ensure beneficially to the same person or corporate body irrespective of the person or body in whom those rights were vested in law." Consequently, there is - in general - no liability within a corporate group. It is also opposed, in principle, to consider the company or group of companies from an economic perspective: "Mr. Hoffmann suggested beguilingly that it would be technical for us to distinguish between parent and subsidiary company in this context; economically, he said, they were one. But we are concerned not with economics but with law. The distinction between the two is, in law, fundamental and cannot here be bridged."[135]

## CHAPTER FOUR: STATUTORY STUDY ON CORPORATE GROUPS' LIABLITY

### 4.1. National and International Law

This chapter will study some of the jurisdictions and international organisations that have adopted some form of enterprise liability as part of statutory law and have drawn on the theory into their proposed amendment to existing laws, guidelines and principles.

As Blumberg put it as 'with the increasing complexity of the worlds of finance and commerce and of governmental regulatory and revenue programs, modern society has seen the emergence of new forms of organizations in response to the challenges presented by contemporary needs. As with partnerships and associations, these newer forms of organizations present fundamental juridical problems of identification as legal units of their own' this is the indifference with corporate groups[136].

#### 4.1.1. European Union Initiatives

Economically and legally developed countries have attempted some measures to regulate corporate group issues. For example, namely, the European Union held the Forum Europaeum Corporate Group Law, High Level Group of Company Law Experts, and the Reflection Group [137]. Although there is not a positive law, these EU initiatives have attracted the attention of other countries. Commentators say that the legal status of the EU corporate group is still in the developing stage[138].

[135] Rene.T.Wieser, *Liability within Corporate Groups*, (Societas, 2012)
[136] Phillip.I.Blumberg, *The Multinational Challenge to Corporation Law,* (Oxford University Press, 1993), p.224
[137] Klaus Hopt, Groups of Companies-A Comparative Study on the Economics, Law and Regulation of Corporate Groups, ECGI-Working paper No.286/2015, p.11
[138] Ibid.

In order to ensure corporate law's harmonisation in European countries, developed the draft of 9th Directive on Corporate group Law in the 1970s, which was based on the German's konzernrecht system and principles. Commentators have criticised that the German corporate group law's implementation and managing group are inefficient, so that subsequent research and development was based more on the French rozenblum principle. Exemption conditions from the liability of a subsidiary corporation under this French case law: if the corporations meet the criteria that they are closely structured and business, with a unified group policy, proper distribution of positive and negative conditions within the group, and the subsidiary has no support beyond its financial capacity. The majority of western European countries now follow this principle. In Europe, corporate group regulation mainly aimed at protecting small shareholders, as German law does, but changes in the legislation since the 2000s have a tendency enabling the director of a subsidiary to be released from liability if he has followed the guidance of the parent corporation. This is a group interest approach. As Koji Funatsu concluded 'this change indicates that the law has changed from protective law to enabling law'[139]. Some scholars explain the strategy as the EU policies that promote business activities through their member states[140].

According to the Forum Europaeum Corporate Group Law, European corporate law should seek two main goals. It included protecting the small shareholders and debtors of the controlled corporation, helping the business and economy by recognizing the group's legal framework and recognizing the group as an organisation. The current legal policy of the EU, however, is aimed at establishing a basic standard and leaving the member countries to deal with specific issues related to the types and activities of group companies.

Commentators concluded European situation as 'unlike the United States, in which the courts as well as Congress have made major contributions, European acceptance of enterprise principles is largely represented by statutory law. Judicial lifting the corporate veil is far from unknown, but its application has been relatively sparse in comparison with the continued outpouring of American cases that rely on the doctrine. On the judicial level, entity law essentially remains supreme'[141].

[139] Koji Funatsu, Trends in European Corporate Group Law Systems and the Future of Japan's Corporate Law System, Policy Research Institute, Ministry of Finance, Japan, Public Policy Review, Vol.11, No.3, July 2015, p.477
[140] ibid
[141] Phillip.I.Blumberg, *The Multinational Challenge to Corporation Law,* (Oxford University Press, 1993), p.154

Jose Antunes states the EU's contribution to the development of corporate group law and its future results are as follows[142]:

> The EU legal system breaks new ground on the topic of intragroup liability. Notwithstanding the fact that the proposed regulatory strategy still remains today purely de lege ferenda (none of the above-mentioned proposals have so far been enacted), it holds an undeniable interest and actuality since it symbolizes, worldwide, the strongest reaction against the prevailing traditional 'entity law approach" to the legal treatment of liability questions in parent-subsidiary relationships and provides the most far-reaching institutional effort advocating a revolutionary reality-adherent approach to the topic. The limited liability for parent corporations, issued from an approach backed up by the formal dogmas of the separate legal personality and the limited liability of the shareholders, should be replaced by the opposite rule of the unlimited liability of the parent issuing from an approach dominated by the reality of the group as a single economic unity or as a single enterprise.

And he points out the shortcomings of the system as well by writing that the major weakness of this new 'enterprise approach' consists in the uncertainty, automatism and rigidity of the solutions worked out for intragroup liability cases. One should remember here that the entire regulatory framework of EU group law is based upon the central concept of group companies, with its constitutive elements of dominant influence and unified management. Such a strategy portrays an uncertain liability system, both for parent corporations and subsidiary creditors, since paradoxically a legal definition of such crucial statutory elements is entirely lacking here. The uncertainty of the legal environment is particularly serious for parent corporations, exposing them to a permanent threat of unexpected liability disputed potentially hazardous for the entire group's financial and economic stability whose fate would ultimately depend on the idiosyncrasies of jurisprudential construction. The liability system it provides is also too automatic. This means that imposition of liability on parent corporations for subsidiary debts would follow almost automatically from their mere formal status of parent; not distinguishing between mere potential control and actual control, nor between 'good' control and 'bad' control, the system would be holding parent corporations inescapably liable for all the debts of its subsidiaries, including those outside its actual control, those without any casual relation with it, or those stemming from a control which has been exercised in the best interests of the subsidiary itself. In consequence, finally, such a strategy provides a liability system for corporate groups that is too rigid. By imposing indiscriminately a uniform solution to all types of corporate groups, it fails to provide a flexible and differentiated

[142] Jose.E.Antunes, *Liability of Corporate Groups*, (Kluwer Law and Taxation Publisher, 1994), p.293

regime able to accommodate the diversity of organizational and governance structures and proves to be a rather inadequate regulatory framework for a large sector of group reality[143].

Despite existing these backwardness European countries were and are the most innovative in the development and improvement of corporate group law.

Meanwhile, regarding the corporate group's corporate responsibility in Europe, Weiszer concludes:

> In formulating a European regulation it must be distinguished between structure-dependent, behaviour-dependent and declaration-dependent liability. Only in Germany there is a structure based group liability because the legal policy in the other Member States does not see an increased potential of danger in a Corporate Group as such. However, behavioural and declaration-dependent liability is not group-specific, but it uses to the rules of the general corporate law in the light of the actual conditions in a Corporate Group. On the other hand the provisions of the enterprise agreement make no sense in corporate law and practice in other Member States, in particular in the UK. The dominant court law outside Germany is inherently behaviour-based. Its two lines of development, the piercing the corporate veil and the search for the responsible backers have an initially strong, but now clearly fading moral varnish. Firstly, it has to be clear that the structure-based thinking in corporate group liability in Germany is a unique development in Europe.184 A structural shortage of the German Corporate Group law of the AG is still its fixation on enterprise agreements. In this system, the legal consequences are tied on the facts of the agreement. However, it is more reasonable to look on the real dependency and relevant facts within the Corporate Group. It remains that a European law must distinguish between the different levels of Corporate Group liability. In so doing, a behaviour-based regulation would be acceptable across Europe, because is already reflected in most jurisdictions. The German way of a structural and behaviour-related liability must be returned carefully and should not be used as the basis for a European regulation[144].

### 4.1.2. Germany

Germany is the main subject of comparative research in group legal research. The reason for that the country was the first country in the world to had a specific corporate group law that was passed over 50 years ago, it has been always exemplified for other jurisdictions. German is exemplified as an industrialized country that has adopted a milder form of enterprise principles without

[143] Jose.E.Antunes, *Liability of Corporate Groups*, (Kluwer Law and Taxation Publisher, 1994), p.480
[144] Rene.T.Wieser, Liability within Corporate Groups, (Societas, 2012)

disastrous results for domestic or international investment capitalism[145]. German stock corporation (Aktiengesellschaft – 1965) regulates the Stock Corporation, adopts the Konzernrecht form.

Peter Hommelhoff identified its importance having a specific corporate codified law like German as the following:

> Many German lawyers dealing with corporate group law believe that the distinctive strength of this body of law lies first and foremost in its existence. Its rules address specific problems and conflicts that cannot be solved as satisfactorily by mere company law, at least not if it has not been adapted to suit the specific needs of corporate groups. Besides, it seems arguable whether corporate conflicts can be solved by the mechanisms of insolvency law. The penetrating force of the "shadow director's wrongful trading" as a legal concept, which was suggested by the Forum Europaeum, is met with skepticism by English law experts[146].

German corporate group law regulates two types of companies: de facto and agreement. The latter one is formed by an agreement between the parent and its subsidiary, while the former group is by the voting rights of the shares in the possession of the affiliated corporation. To regard as the agreement group, the parent corporation is allowed to operate in the common interest of the group, but it has legal responsibility for the loss and damage to the minor shareholders of the subsidiary. Legislators of the country originally expected that this form of the group would be chosen more, as it allows managing the group. However, that hope was not fulfilled[147].

In fact, the rarity of agreement groups has led to criticism of German law as ineffective. Without such an agreement, the corporationa will be de facto controlled and, all transactions which are contrary to the interests of the subsidiary, but under the parent corporation's guidance, must be fully settled by the parent. Funatsu noted that 'this rule is meant to be implemented very strictly: every legal and factual act must be verified to determine whether it is disadvantageous'[148]. This rule is implemented through a mechanism such as a group report on the parent corporation's directors' duty, auditing, the examination of the parent corporation's supervisory board, and rights of any shareholder in the parent corporation who has enabled to be examined by court order. The effect of these mechanisms is an open question for lawyers and scholars.

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[145] Dearborn, M, *Enterprise Liability: Reviewing and Revitalizing Liability for Corporate Groups,* (California Law Review, Vol.97, Issue 1, 2009), p.215

[146] Peter Hommelhoff., *Protection of Minority Shareholders, Investors and Creditors in Corporate Groups: the Strengths and Weaknesses of German Corporate Group Law,* (Cambridge University Press, 2009), p.10

[147] Hopt.J.K, *Groups of Companies-A Comparative Study on the Economics, Law and Regulation of Corporate Groups*, (ECGI-Working paper No.286, 2015), p.10

[148] Koji Funatsu, Trends in European Corporate Group Law Systems and the Future of Japan's Corporate Law System, Policy Research Institute, Ministry of Finance, Japan, Public Policy Review, Vol.11, No.3, July 2015, p.476

In light of adopting an enterprise approach in tort, human rights, environmental harms regulation, German law is else criticized as follows:

> German law recognizes group companies in this manner in an effort to address the inherent conflict of interest that exists between parents and their subsidiaries, which could benefit the parent's shareholders at the expense of the subsidiary's shareholders and creditors. However, this also means that the Konzernrecht regime is mostly geared towards the protection of minority shareholders and contractual creditors, not victims of torts or human rights violations that are the focus of the present inquiry[149].

Dearborn's citation can also be mentioned here that 'the most developed of the enterprise systems, the Konzernrecht, fails to address the problem of tort creditors because its system of liability is primarily internal, meaning that the subsidiary accrues a cause of action against the parent, but outside creditors do not.'[150]

Moreover, the Germany law has more focuses on internal protection rather than outer involuntary creditors; the situation is said as 'the most developed of the enterprise systems, the Konzernrecht, fails to address the problem of tort creditors because its system of liability is primarily internal, meaning that the subsidiary accrues a cause of action against the parent, but outside creditors do not'[151].

Alexander Scheuch provided more detailed anaylises regarding that by writing:

> a correlate to the organizational privileges, the AktG contains several protective measures for creditors and outside shareholders of the controlled AG. It is worth pointing out from the outset that the protective effect of said provisions is limited to preserving the initial assets – assessed from a balance sheet perspective. As the legislator seems to have been aware of this shortcoming it is questionable whether courts may impose further limits and requirements to protect the controlled corporation's long-term viability'. Since section 302 AktG only has effect as long as the control/ profit transfer agreement is in place the controlling enterprise could easily rid itself of the obligation by terminating the agreement. To prevent this, section 303 AktG obliges the controlling enterprise to provide creditors with security for claims that have arisen prior to the termination. Whereas sections 302 and 303 AktG are mainly aimed at protecting the controlled corporation and thereby its creditors, the following sections present 'outsiders' who hold shares alongside the controlling enterprise with a choice. Their first alternative is to retain their shares and receive compensation for their

[149] Petrin.M, and Choudhury.B, *Group Company Liability,* (European Business Organisation Law Review, 2018)
[150] Dearborn, M, *Enterprise Liability: Reviewing and Revitalizing Liability for Corporate Groups,* (California Law Review, Vol.97, Issue 1, 2009), p.254

[151] Ibid.

negatively impacted position in form of recurring payments. Profit transfer or control agreements must provide for such adequate compensation in order to not be found void[152].

It is concluded by T.Wieser, as that the German conception seeks an accordance of organizational structures and liability rules. The German corporate group liability rules are principally measured by the degree of integration: a distinction is made between the Corporate Groups based on enterprise contracts, de facto groups, qualified de facto groups and integrated groups. For example, in the regulation for contract-based groups, the comprehensive intervention options have been tried to compensate with a range of statutory security institutions for the benefit of the dependent company[153].

German's corporate group law has been copied by Brazil, Portugal, Slovenia, Croatia, and Taiwan[154]. Although their regulations are little known beyond their borders, there are some works of literatures related to Portuguese and Italian laws.

### 4.1.3. Italy and Portugal

Italy introduced a special legal regulation of the corporate group in 2004. Embid Irujo wrote as 'the Italian example is most illustrative in this regard. It is one of the systems containing significant corporate group rules from a corporate law perspective'[155]. At the heart of it are the provisions of the Italian Civil Code on the activities of parent corporations, such as "direction and co-ordination of companies". Apart from the duties and various rights of the directors and member companies of the group, the main feature of this reform was that it provided a liability of the parent and its directors to subsidiaries' shareholders and creditors when the legal requirements are met. Exemption from this liability is provided in the event that the performance of the obligation is satisfied. In addition, conflicts of interest rule have been toughened to apply not only to a separate company but also to a corporate group. In the cases provided for, minority shareholders' rights are regulated[156].

[152] Alexander Scheuch, *Konzernrecht: An Overview of the German Regulation of Corporate Groups and Resulting Liability Issues,* (European Company Law, Vol.13, Issue 5, Oct, 2016), p.195
[153] Rene.T.Wieser, Liability within Corporate Groups, (Societas, 2012)
[154] Mähönen. J**,** *The Pervasive Issue of Liability in Corporate Groups,* **(**European Company Law journal, Vol.13, No. 5, 2016), p.19
[155] Jose Miguel Embid Irujo, *Trends and Realities in the Law of Corporate Groups*, (European Business Organisation Law Review, Vol.6, No.1.), p.83
[156] Klaus J.Hopt, *Groups of Companies-A Comparative Study on the Economics, Law and Regulation of Corporate Groups,* 2015, p.10

Portugal passed the Commercial Companies Code in 1986, making it the third country[157] to attempt to regulate group corporations from an institutional point of view under a title on Affiliate Companies chapter. The rules on subordination contracts are at the core of the group system in Portugal. A part of Portugal's Corporate Law is designed to regulate group relations, and it was developed within the concept of corporate law but not a broad concept which is valid to all branches of the law[158]. The most important issue that Portuguese law tries to respond is to eliminate the gaps that arise from the regulatory differences between traditional and modern company law.

A commentator concluded Portugal's group system Portuguese law repeated the shortcomings of German law by noting 'if corporations elect to formalize their group status by contract or through the creation of a subsidiary, the parent corporation must both cover the annual losses of the subsidiary and assume joint and several liability for the creditors of the subsidiary for unpaid debts. However, since Portugal's regime is neither mandatory nor otherwise attractive to corporate groups, the rules may not actually change corporate behavior or mitigate against the externalization of risk. Portugal's system thus does not remedy the Konzernrecht's major shortcomings'. [159]

To address the deficiency of the traditional rules to govern corporate group matters and inability to provide real protection to affiliated companies, the Portuguese law was developed in the situation that all the theoretical coherence, completeness and practicality were uncertain[160]. This problem is one of the reasons why group corporate law development still is not progressing even in other countries. Unlike German law, Portuguese law does not specify general and abstract types of groups but appeared to have three organizational instruments: a fully dominant control, an agreement for a horizontally organized group, and a subordinate agreement[161]. Within these types of, it regulates how the subsidiary is protected, the rights of its shareholders and creditors, the financial obligations of the parent company, the relationships between the member corporations of the group, the participation and the transferring of shares.

### 4.1.4. The United States

[157] Rafael Mariano M (ed)., *Groups of Companies*, (Springer, 2020)
[158] Jose.E.Antunes, *The Law of Corporate Groups in Portugal*, (Institute for Law and Finance, Working paper series No.84, 05/2008), p.4
[159] Dearborn, M, *Enterprise Liability: Reviewing and Revitalizing Liability for Corporate Groups,* (California Law Review, Vol.97, Issue 1, 2009), p.221
[160] Ibid.
[161] Ibid., p.5

The U.S is no an exception in the context of group liability law, the country also has a corporate liability system based on the principle of entity liability, and the principle of enterprise liability is reflected little by little in the legislation of the sector, such as antibribery rules, antitrust, securities regulation, banking, competition, bankruptcy, and labor, concurrently with veil lifting.

However, the advantage over other countries is that the legal environment of the corporate group is relatively much more studied in the academic literature. The main problem for these commentators is that they have not yet been able to reach a consensus, which seems to be due to the fact that the country's legislation has not defined the concept of control and relied on the courts interpretation rather than legalizing the principle of enterprise. Commentators noted regarding this situation as follows:

> The American statutory experience further underscores the usefulness of supplementing such a definition of "control"—including its supporting elements, "controlling influence" and a presumption resting on a numerical benchmark of stock ownership—with the familiar formulation in American specific-application statutory law under which the scope of the statutory regulatory program is expanded to include not only the group component conducting the regulated activity in question, but also any person "directly or indirectly controlling, or controlled by, or under direct or indirect common control with" the group component in question." When, however, one turns from specific-application regulatory statutes to other areas of the law where Congress or a legislature has not provided the definitional answer, the problem of the application of enterprise law is very different indeed. It becomes a judicial, rather than a legislative, question. The problem is no longer the relatively simple issue of draftsmanship of the appropriate statutory provision; it is the much more complex one of the development of standards to guide courts in the determination of the application of enterprise principles to the decision of a case at hand in the light of the objectives of the law in the area in question[162].

On the other hand, one of the characteristics of the enterprise principle is its focus on economic integrity. The commentator expressed this as that the modern American experience in the formulation of concepts of enterprise for purposes of construing and applying general-application statutes and in common law areas, particularly torts, is beginning to provide an answer to this definitional problem. As noted, this development focuses not merely on "control," but on such aspects of the economic contours of the group as its extent of economic integration, financial and administrative interdependence, overlapping employee policies, and use of a common public persona[163].

[162] Phillip.I.Blumberg, *The Multinational Challenge to Corporation Law,* (Oxford University Press, 1993), p.115
[163] Ibid., p.116

As one of the major investors, the country must have a key role in the global reform of corporate groups law. Therefore, it is important that these major economic investors to develop and lead group accountability law system.

On the issue of parent company liability, the US courts continue to rely more on the method of the lifting veil. There are generally three tests used to rule out limited liability, but the following conditions are considered:

- Some of the corporation's documents are false and untrue
- Giving or hiding incorrect information about members
- There was not enough open communication with relevant organisations
- The corporation does not have a corporate form in terms of acts or documents
- No dividends have been allocated
- Corporation and shareholder assets are not segregated
- Fraudulent fundraising and accountability
- There is an employee or director who is not presence
- Make businesses short of capitals on purpose
- The corporation that owns the majority of the shares has out its capital
- Corporate assets are treated as personal property by individuals
- If the corporation was used to disguise the private activities of the majority shareholder.

### 4.1.5. Hungary

Hungary is one of few countries where has a codified corporate groups regulation. Civil Code legislates corporates as well as groups. However, it does not have a comprehensive set of provisions which is more like forming and ending a group. Hungarian law addresses some issues such as relationships between the management, employment, creditors of the controlling member and that of the controlled member, which are not always detailed in corporate groups regulations of most jurisdictions. However, when group liability issues raise, there is no exception adapt from the insolvency provisions.

In addition, in terms of scope, the rules on corporate groups in the Hungarian Civil Code can be considered to be a legal transplant of the German “konzernrecht” rules. It must be noted that contrary to German law, where the “konzernrecht” rules are mainly applicable to stock corporations

(aktiengesellschaft) as dominant corporations, the Hungarian implementation of the rules allow for different sort of corporations (limited liability companies, cooperative societies, and groupings). There are two types of groups: contractual and de facto. The former relies on a uniform business policy while the latter is based on controlling and controlled de facto relationships of for at least three consecutive years. Unlike most countries there is no mean of majority voting rights for controlling. Recognised groups of corporations may be formed by at least one dominant corporation and minimum three controlled members. After registration, the members of the groups operate under a common business strategy, as outlined in the control agreement.

Hungarian corporate law is said to be similar to the German group law model, but its insolvency issues for a group are similar to the rozenblum doctrine, the group's interests are considered as a priority by stating as 'Liability of the controlling member. In the event of liquidation of a controlled member of the group of companies, the controlling member shall be liable for the claims of creditors not yet satisfied. The controlling member proving that the insolvency of the controlled member was not a result of the uniform business policy of the group of companies shall be exempted of its liability. (Section 3:59)[164].

So that such arrangement is that the dominant member becomes liable for the losses incurred by the creditors of the controlled member that was liquidated. However, the dominant member may be relieved from the liability if it manages to prove that the controlled member's insolvency did not arise from the common business strategy. This arrangement may provide a solution for abuses of limited liability. Especially, when we consider how de-facto groups of corporations may be recognized by a court order upon the request of members. On the other hand, as Alexander Scheuch raised it concerning the German rules, it might become possible for shedding liability by terminating the control contract.[165]

### 4.1.6. Mongolia

In this study, we also selected Mongolia as a representative of the developing economy and law, and it will also consider and compare selected countries' corporate law situations. As noted, there

[164] Civil Code of Hungary, Act V of 2013.
[165] Alexander Scheuch, Konzernrecht: *An Overview of the German Regulation of Corporate Groups and Resulting Liability Issues*, 13 European Company Law 191-198, 195 (2016).

are also some countries which are relatively successful in the field of regulating and studying corporate group law. For example, German would be a great example since it has the most developed set of provisions on corporate groups. Mongolian civil law originates from Roman-Germany law, corporate and business law is based on Anglo-American law elements.

International research papers based on comparative law study in the field of corporate law is important since the country's business' sectors have been globalised and required an effective solution and handling.

Mongolia is one of the developing and "transition economy" countries becoming an integral part of world's economic growth trends. Since the 1990, Mongolia has transferred from a socialist to an open market economy. However, Mongolia's extensive mineral deposit and the subsequent mining industry boom have being transforming its economy to one of the fast-growth economies of the world. Foreign and domestic corporations invest in and participate in business activities at various stages and in different forms such as; joint ventures, parent-subsidiary groups, branches and limited liability companies. These multinational and national corporations have significant contribution for the overall macroeconomic performance of countries, Mongolia is not an exception in terms of that MNC dominated business world. Nearly all the foreign invested corporations in Mongolia are actually controlled units of any multinational corporation running business throughout the world, mostly in mining sector.

There is a total of 187046 business entities registered in Mongolia, of which 77 percent are companies. 99 percent of the companies limited liability corporations[166]. According to a survey conducted by National Legal Institution of Mongolia, 91% of the survey participant corporations run as a controlled unit to corporate groups[167]. With the increasing number of those subsidiaries there have been else numerous of legal issues arisen in Mongolia

Those corporations in mining industry are mostly giant corporate groups, and they are usually involved in potential harms in environment, human rights violation and torts. When the social responsibility or corporate liability issues arise, those affiliated, controlled corporations just transfer nearly all of its assets into the parent corporation existing overseas just before declaring bankruptcy to escape liability. Creating subsidiaries and controlled units has been clearly as a way to avoid and ignore liability. Parent companies use limited liability by incorporating a controlled

[166] Statistical information available at: www.nso.mn

[167] ХЗҮХ, *Хязгаарлагдмал хариуцлагыг нэвтлэх нь: Толгой ба охин компанийн хариуцлагын асуудал,* 2010

unit to carry out risky activities[168] Most frauds and fails vis-à-vis corporate groups in banking, finance and insolvency case. Parent corporations externalise the risk of tort liability on intention through legally formed, separate, controlled subsidiaries. Thus, more extensive approach and holistic reform of corporate group law ought to be taken nowadays.

However, the Company Law of Mongolia is still silent on this issue. This is not only Mongolian problem, there have not been yet a country where groups of corporations are explicitly regulated. Research analysis of domestic and foreign legal sources will reveal that the subject of the research deserves elaboration in the scientific literature. The corporate group law controversies have not yet been studied by Mongolian legal scholars. The legal system of Mongolia is one of those nations which has been struggling with the problems presented by business. Reforms to business laws over the last decade have not implicated corporate groups' legal regulating. When legal issues on corporate groups raising, law makers and researchers do not look at its regulation as complete, systematic rules must be there but just consider its single part and provision. Since no systematic examinations of corporate group law have been undertaken, a full legal analysis of the relevant law at academic level is needed. Academic research based on appropriate doctrine, with a theoretical approach is the base for solving these legal issues and difficulties. This research will provide Mongolia and other countries a legal perspective on the regulation of corporate groups due to comparative legal studies.

As a result, lawyers are faced with incomprehensible and irreconcilable court decisions in legal practice. An enormous number of international scholars, including Mongolian scholars have examined corporate governance issues, limited liability and so on but not corporate group law issues. According to a research conducted by the Mongolian National Legal Institute (2010), there is no practice nor "veil lifting" of parent and controlled corporations in Mongolia. Therefore, it recommended that creating a law to rule corporate groups, using possible provisions of corporate laws for veil lifting at court and analysing legal problems is needed.

The survey examined the influence and the goal of creating a daughter corporation. According to the country's company law, a corporate group can be determined by the following three[169]:

- a parent corporation and other corporations affiliated to the parent company

[168] Wright. G, Risky Business-The Case for Enterprise Analysis at the Intersection of Corporate Groups and Torts, (SSRN Electronic Journal, 2010), p.14
[169] Company Law of Mongolia, 2011, Art.6.14

- a corporation of which the controlling shares are held by a single person or in conjunction with its related parties, or
- corporation of which the decision of the management is possible to be determined.

There are two types of subsidiaries: controlled and daughter corporation. If 20-50 percent of the common shares issued by a company is owned by another (parent) company alone or in conjunction with its related parties, the company is deemed to be a controlled company[170]. If more than 51% of the common shares issued by an independent company is owned by another (parent) company alone or in conjunction with its related parties, the company is deemed to be a daughter company[171].

According to a survey with judges, subsidiaries are often set up to obtain loans, evade taxes, and obtain exploration and mining licenses. In this regard, the following restrictions are included in the sampling of the relevant provisions of the Minerals Law, the Corporate Income Tax Law, and the Banking Law. As mining becomes a priority in the country's economy, the issue of licensing is one of the reasons for establishing a legal entity. Since it is legally possible to pledge a license to a banking and financial institution together with the relevant documents, a subsidiary is established to prove financial ability using the license. In particular, a license may be the easiest option to obtain a loan, which requires the creation of a single legal entity without a credit history in the bank's database.

According to our research of legal environment under Mongolian laws, these purposes also influences the establishment of a subsidiary. These include avoiding corporate liability, owning mineral licenses, evading corporate income tax, obtaining bank loans.

*Table 4. Survey of Regulations*

| Company Law |
| --- |
| **6.5. A controlled or daughter corporation shall not be liable for the debts of its parent corporation and the parent corporation shall not be liable for the debts of its controlled or daughter corporation, unless otherwise provided by law or the agreement concluded between them[172].** |
| Corporate Tax Income Law |

[170] Company Law of Mongolia, 2011, Art.6.1
[171] Ibid., Art.6.3
[172] Company Law of Mongolia, 2011, Art.6.5

**20. 10% applies to the first 6 billion Mongolian tugrik (MNT) of annual taxable income. If annual chargeable income exceeds MNT 6 billion, the tax shall be MNT 600 million plus 25% of income exceeding MNT 6 billion[173].**

Banking Law

**7.1.The total value of loans, loan equivalent assets, guarantees, warranties and other contracts provided to one person and/or his/her related or connected persons shall not exceed 20 percent of the capital of the bank[174].**

Minerals Law

**7.4 One license may be granted to one legal person only[175].**

In this study, we surveyed a total of 95988 decisions of the courts of districts level during last five years. An analysis of these decisions reveals that very few cases have been resolved in accordance with company law, especially in the case of a corporate group related provisions.

*Table 5. Survey of Court Decisions*

| | |
|---|---|
| Total corporations | 144025 |
| Civil court decisions (2015-2020) | 95988 |
| Corporate law related case | 67 |
| Corporate group law related case | 1 |

In practice, there are many disputes which corporate groups involved in over loans, bankruptcies, mining licenses, fraud, and environmental rehabilitation, but there are two reasons why the courts have not resolved the issue as a group corporation's law: the legal environment of the corporate group, in particular the regulation of liability, is insufficient, almost absent; the court do not recognize that the group had used the corporation's organisational structure to take advantage of the lack of a legal framework for liability. In other words, the absence of a court decision does not mean that there is no such dispute. As noted in previous chapters, principles of corporate group's unlimited liability have been used very little in other jurisdictions as well, due to the strong dominance of traditional limited liability and independent legal personality principles.

[173] Corporate Tax Income Law of Mongolia, 2019, Art.20
[174] Banking Law of Mongolia, 2010, Art.17.1
[175] Minerals Law of Mongolia, 2006, Art.7.4

In the course of this study, we highlighted four cases that could have been resolved based on the group's liability principle. As mentioned in the previous chapters, a group structure is used to defraud and eliminate risk by setting up a subsidiary. The case we have chosen also applies to this type of conflict. 'AD' group operated a gold mine in Mongolia with Russian state investment, and a tax dispute arose with the government. The corporation, which refused to pay the 50 bn tax debt, transferred all its assets to one of its subsidiaries and began preparing to declare bankruptcy. The government has also demanded compensation for environmental damage. The company appealed to international arbitration in Germany, Frankfurt. After several years of unresolved disputes, another Mongolian company bought the company with its debts. Our conclusion is that the problem would have been easier to resolve if there had been a group liability principle at the time and a legal framework to hold the parent company accountable.

Here is we exampled another case from the survey conducted 10 years ago, because the dispute of the corporations is still controversial in the society. However, it has still unresolved. It was concluded that the reason for the bankruptcy of Anod Bank, which went bankrupt in 2009, was the large amount of non-performing and overdue loans. According to the survey,[176] the bank suffered damages in the amount of principal, interest and receivables due to violation of the provision "the total amount of loans, other asset-equivalent assets, guarantees and sureties to be issued by the bank to one borrower and related persons shall not exceed 20% of the bank's equity", but one of the bank's borrowers was a large corporation called "G", which established an average of about 20 subsidiaries and borrowed from each of them. Some of the loans were mentioned in the study, for example:

Parent corporation's loan: 2.1bn, overdue debt

1 daughter corporation's loan: 0.3bn, overdue debt: 32.5bn

2 daughter corporation's loan: 0.3bn, overdue debt: 2.5bn

3 daughter corporation's loan: 02bn, overdue debt: 4.6bn

4 daughter corporation's loan: 0.3bn, overdue debt: 4.6bn

In this way, the corporation looks like used group structure by establishing subsidiaries obtain loans. At the time, no one mentioned this legal shortcoming, and even if it did, it would probably

[176] ХЗҮХ, *Хязгаарлагдмал хариуцлагыг нэвтлэх нь: Толгой ба охин компанийн хариуцлагын асуудал*, 2010, p.14

be considered all done within the law. The corporation has been embroiled in a dispute again this year, this time borrowing huge amount of loan from the government's agricultural fund through its 40 subsidiaries. It seems that many independent corporations are involved in the government support, but it is a dispute that one person is taking all of them. The director of the parent corporation was involved in the dispute on behalf of a subsidiary. It is called a 'façade' in veil lifting doctrine.

There is limitation on the amount of bank loans available to one entity, so that many subsidiaries set up on paper to obtain loans. It is stated in the survey as that:

> Commercial banks impose certain restrictions on lending to legal entities depending on the purpose of the loan, the maximum amount of which, for example, is 14 billion MNT or about 10 million USD for the Trade and Development Bank. This is another reason for setting up a company, as it is not sufficient for the mining sector, which is said to be the most capital-intensive, and on the other hand, these types of businesses are not able to make a profit during the loan period. In other words, you have no choice but to take out another loan because it takes time to repay the loan before it is time to repay the loan. This is one of the reasons for establishing a subsidiary[177].

Even judges and tax experts who participated the survey have speculated that subsidiaries may be established under some law's provisions, but the registration system is incomplete, most registered subsidiaries are not at their registered addresses, and some regulations prohibit the disclosure of information to third parties[178].

It is also common in other countries to set up dependent corporations to raise additional capital. Australian Professor Hadden identified the following reasons for establishing a subsidiary corporation in terms of manipulation and abuses:

(i) the techniques of group control, notably those involving interlocking shareholdings and directorships, may be used to entrench the positions of incumbent managers against any possible threat from external shareholders;

(ii) the techniques of integrated financing, notably the freedom to pass assets and liabilities from company to company within the group, and the creation of complex group structures may be used to conceal the true financial position of individual companies or of the group as a whole from their shareholders or creditors;

[177] ХЗҮХ, *Хязгаарлагдмал хариуцлагыг нэвтлэх нь: Толгой ба охин компанийн хариуцлагын асуудал,* 2010, p.13
[178] ХЗҮХ, *Хязгаарлагдмал хариуцлагыг нэвтлэх нь: Толгой ба охин компанийн хариуцлагын асуудал,* 2010, p.12

(iii) both techniques may be used to ensure that the interests of shareholders and directors of the group are preferred to those of minority shareholders in subsidiaries and to conceal that this has been done;

(iv) the techniques of integrated financing may be used to avoid taxation by ensuring that maximum profit is generated in forms or in jurisdictions which attract low levels of tax;

(v) the creation of separate companies for particular operations, supplemented by the techniques of integrated financing, may be used to avoid liability to external creditors by relying on the limited liability of each constituent company within the group;

(vi) more or less complex group structures may be used to avoid the impact of regulatory measures on a wide range of matters, such as monopolies and mergers legislation, health and safety provisions, employee participation and planning requirements.[179]

The few of cases identified in our study have all the reasons listed in these categories.

Following such cases, Mongolia made some of the above-mentioned changes to its corporate law. However, the Bankruptcy Law of Mongolia does not provide for group liability methods such as pooling which is being adopted in other countries.

Although not sufficient and effective, these amendments to the Company Law to some extent reflect the principle of enterprise liability. Article 6.6 of the Company Law states 'If the subsidiary becomes insolvent as a result of a decision made by the parent company, the parent company shall be jointly liable for the debt', and Art.6.7 indicates that 'If it is deemed that the loss incurred by the subsidiary is due to the decision of the parent company, the shareholders of the subsidiary shall have the right to sue the parent company for damages caused to the subsidiary'.

One of the new regulations in the history of Mongolian jurisprudence is the legalization of legal entities as subjects of criminal offenses. The new law also introduces a provision that allows the parent company to be held criminal punishment on behalf of its subsidiary. Article 9.7-1.5 of Criminal Law (2015) directly states that 'If the company has committed a crime in the interests of the parent company, its founders or shareholders, the parent company'.

The legal environment and practice of neglecting limited liability are very limited, and Art.9.5 of Company Law of Mongolia is one of the few grounds provided by stating as 'If the property and

[179] Hadden.T, *Regulation of Corporate Groups in Australia,* (15 UNSW. Law Journal, 61, 1992), p.65

property rights contributed to a company by a shareholder is not distinguished from the personal property and property rights of such shareholder, such shareholder shall be liable for the company` s liabilities by all property and property rights concurrently'. Although it seems from the National Legal Institute's following research, that property segregation averages about 20 percent among the survey participant corporations, our survey of court decisions found that only one case was resolved in accordance with this provision.

*Table 6. Property relations. Whether the subsidiary and the parent corporation jointly own property that is not completely separated*

| | There are fully segregated assets that are jointly owned |
|---|---|
| Workplace | 3 or 20% |
| Official car | 1 or 17% |
| Land and other real estate | 4 or 27% |
| Other property for official use | 2 or 13% |
| Property rights | 3 or 20% |
| No answer | 2 or 13% |

*Source:* Х3YX, *Хязгаарлагдмал хариуцлагыг нэвтлэх нь: Толгой ба охин компанийн хариуцлагын асуудал*, 2010 *(Piercing Limited Liability: Liability of parent and subsidiary companies)*

**Golomt v Khet[180]**

In a dispute between Golomt Bank against Khet LLC, the first instance court analysed the sole shareholder and other affiliated entities of Khet LLC should be liable for the debts of the corporation.

Claims: The Claimant demanded MNT 34bn for the loan, interest and accrued interest, secured the performance of the obligation with collateral and a guarantee contract, and to consider the separation of "Khet" LLC and "Khet Motors" LLC is illegal. The Defendant company received a loan of USD 2,275,000 from Golomt Bank in accordance with a loan contract in 2009. About two years have passed since the fixed date, but the defendant has not yet repaid the loan in full.

For "Khet" LLC, "Khett Motors" LLC, "Transcon" LLC and "Erchim Impex" LLC:

[180] District Court No.637, 23.01.2015, www.shuukh.mn

1. The sole shareholder owns 100% of the shares of all the above companies

2. The sole sharehoder manages all companies independently

4. Golomt Bank's loan disbursements and assets are consolidated

5. The source of loan repayment is not differentiated

6. there are no detailed boundaries for the financial statements

7. the addresses of the companies are the same.

From the above, it is reasonable to assume that the assets of these companies and A.Gantumur are mixed and not clearly separated.

Claimant argued that “Khet” LLC, “Khet Motors” LLC, “Erchim Impex” LLC, “Transcon” LLC and A.Gantumur, a citizen who owns 100% of these companies and is the sole manager, are mixed in terms of operations, finances and assets. There is reason to consider that Article 9.5 of the Company Law states, “Unless the shareholder's property and property rights contributed to the company are clearly separated from private property and property rights, the shareholder shall be liable for the company's liabilities with all its property and property rights". Therefore, “Khet Motors” LLC, “Erchim Impex” LLC, “Transcon” LLC and citizen A.Gantumur are considered to be jointly and severally liable for the debts of “Khet” LLC or the payment specified in the claim.

The Defendant: This is because “Khet” LLC, “Khet Motors” LLC, “Transcon” LLC and “Erchim Impex” LLC did not use the loans under the loan contract. Only “Khet” LLC has a loan contract with Golomt Bank has a loan contract. Therefore, there are no legal grounds to pay Golomt Bank's claim to other companies and the shareholder, A.Gantumur.

The Judge: The shareholder A.Gantumur is a 100 percent owner of “Khet” LLC. When establishing “Khet Motors” LLC, he created a share capital of “Khet” LLC and real estate and money, and 100% of “Khet Motors” LLC. The fact that A.Gantumur is a sole shareholder of “Khet” LLC and the sole executor of the executive management does not create grounds for the property and property rights invested in the company not to be separated from his personal property and property rights. Therefore, here are no grounds to be liable for the debts of “Khet” LLC with the shareholder’s private property and property rights.

In rendering its decision, the district court accepted the fact that the sole shareholder of Khet LLC himself had established a separate corporation, Khet Motors LLC, but that the assets contributed by him to Khet Motors LLC’s share capital was immovable property owned by Khet LLC. Despite

such acknowledgement, the court continued in its reasoning that 'The fact that the A.Gantumur is the sole shareholder of Khet LLC and the that he exercise the management power of the corporation solely should not be a ground to establish that his personal assets and the corporation's assets are indistinguishable'. However, it is not clear whether A.Gantumur owns 100% of Erchim Impex LLC and Transcon LLC, and whether these companies and Khet Motors LLC are shareholders of Khet LLC, and the defendant has not proved this. These companies have no grounds to be liable for the debts of "Khet" LLC.

The reasoning of the judgment on this point is not particularly detailed nor clear, and therefore the exact criteria for determining whether there has been a commingling of assets within the meaning of Article 9.5 of the Company Law remains vague. At most, the judgment confirms that the corporate veil lifting under Mongolian law solely focuses on the financial separateness of legal persons.

### 4.2. International documents

Group corporate law is an issue that should be considered not only by one national or regional level, but also by international governance bodies. Because group corporations are often multinational corporations, they need to be regulated internationally. Regulation at the international level is important to balance business and investment on the one hand, and to prevent human rights and environmental violations on the other hand.

It is observed by commentators as 'a very different type of problem arises when a host country applying enterprise principles to a domestic subsidiary of a foreign-based multinational group asserts jurisdiction over, or imposes liability upon, the foreign parent or affiliates of the group. This is host country extraterritoriality. The consequence of extraterritoriality, whether exercised by the home or host countries of the group, is the inevitable clash of conflicting national legal policies applied to worldwide business enterprises. In a world economy where developed countries jostle for competitive position in world markets and developing countries compete for capital investment, it is clear that extraterritorial application of national law may involve very serious economic, as well as political, costs. These costs affect both the world-power home countries attempting to export their own national interests and foreign policy concerns through attempts to regulate the conduct of national-based worldwide businesses and to host countries striking out at alleged exploitation by foreign multinational enterprises. While wealthy, developed home countries may more readily absorb such self-imposed costs, underdeveloped host countries are particularly

vulnerable. For the capital-hungry host country, fearful of creating disincentives to local investment, the costs may well be insupportable, and such policies may be reversed if the reaction in the developed world is severe. In the marketplace, disincentives to capital investment are not the only deterrent operating in this arena. The loss of competitive position in the international economy is a factor to be reckoned with as well. World business operates in a world market, and the economic pressures from domestic law may render a local industry simply noncompetitive in the world market. In such a posture, a society may well have to choose between giving up on its worldwide application of domestic law that is in conflict with the law of other powerful market factors and exposing local industry to serious impairment of its competitive position in the world market. It is the goal of international law to develop legal principles to avoid or resolve such disputes. However, the principles of international law developed thus far are grounded on entity law, and they therefore utterly fail to address the underlying legal problems presented by multinational corporate groups. Nations, particularly the United States but including a number of other countries as well, have accordingly have felt free to act in ways contrary to past concepts of international law, and the international world is in urgent need of the emergence of commonly acceptable, newer principles reflecting more accurately, and responding more adequately to, the underlying economic realities. The problem presented by enterprise law and extraterritoriality is a formidable part of the major challenge to the legal systems of the world arising from the prominence of multinational enterprise in world business[181].

Large MNCs continue to expand as they increase their foreign investment. The activities of these large multinational corporations are hampered by human rights abuses, environmental damage, and mass tort, which cannot be resolved by a single national law, and by insufficient corporate liability. One of the initiatives to address this situation internationally and nationally is the UN Human Rights Council's Business and Human Rights Guidelines (2011), which mandates large corporations to take action to prevent human rights abuses, environmental damage and risks in doing business as well as French Law on Vigilance (2017). Other European countries, such as Switzerland and Germany, are taking steps to support the initiative. The above-mentioned conflicts are common among multinational corporations in developing countries, such as mining and oil projects, asbestos production, and trade in pharmaceuticals and medical products. Countries like

[181] Phillip.I.Blumberg, *The Multinational Challenge to Corporation Law*, (Oxford University Press, 1993), p.170

Mongolia where has a developing economy but rich in natural resource, it is common to use natural resources and implement joint projects with large foreign corporations in the mining sector. Thus, the study of these principles and regulations, which are being implemented in international organizations and countries with high legal and economic development, is helpful to prevent environmental damage and human rights violations caused by multinational corporations, and further improving the group's liability regulation.

In most countries, the accounting industry has been successful in arranging for unified reporting between the group's member corporation and the parent corporations as a one entity. At the same time, another area in which the principle is being sought is the human rights sector. In 2011, the UN Human Rights Council adopted the Guidelines for Business and Human Rights. The implementation of this document is based on three areas: 1. The government's role in protecting human rights 2. The role of corporation in respecting human rights by not violating human rights and eliminating potential negative impacts 3. access to remedy for victims of business-related abuses due to the courts and non-courts mechanism.

Businesses need to conduct *due diligence* plan to prevent human rights abuses and eliminate any negative impacts, and to be held accountable for violations. From corporate law's point of view, it is a very new step that this responsibility is assigned to the subsidiary and the parent corporation, regardless of the structure, organization, size or scope of operations of the corporation. Before this endorsing this document some researchers still had suggested the introduction of corporate liability in the human rights sector. For example, researchers such as Skinner warn[182] that developing countries are most likely to be affected by the activities of multinational corporations, and that victims are unable to defend their rights in those countries.

During the development of the document, empirical studies were conducted to determine whether it would adversely affect business relationships. The principles of the guidelines, especially those related to due diligence, have been tested with about 40 companies. France is the first country to implement the initiative of this UN document.

Also, OECD developed due diligence guidelines in a detailed way recent years. It stated regarding the importance of due diligence action: due diligence is an on-going, proactive and reactive process through which companies can ensure that they respect human rights and do not contribute to

[182] Skinner.G, Rethinking Limited Liability of Parent Corporations for Foreign Subsidiaries' Violations of International Human Rights Law (72 Wash. & Lee L. Rev. 1769, 2015)

conflict. Due diligence can also help companies ensure they observe international law and comply with domestic laws, including those governing the illicit trade in minerals and United Nations sanctions. Risk-based due diligence refers to the steps companies should take to identify and address actual or potential risks in order to prevent or mitigate adverse impacts associated with their activities or sourcing decisions[183]. In addition, the organization's 2018 guidelines set out the scope of corporations to be involved in due diligence:

*Table 7. Scope of the OECD Due Diligence Guidance for RBC*

| | |
|---|---|
| **Enterprises** | • All multinational enterprises (MNEs), regardless of their ownership structure, in all sectors and of all sizes operating or based in countries adhering to the OECD Guidelines for MNEs, including multinational, small and medium-sized enterprises (SMEs)<br>• All the entities within the MNE group – parent and local entities, including subsidiaries.<br>• Multinational and domestic enterprises are subject to the same expectations in respect of their conduct wherever the OECD Guidelines for MNEs are relevant to both |
| **Topics covered in due diligence (RBC issues)*** | • Human Rights (OECD, 2011, Chapter IV)<br>• Employment and Industrial Relations (OECD, 2011, Chapter V )<br>• Environment (OECD, 2011, Chapter VI)<br>• Combating Bribery, Bribe Solicitation and Extortion (O E C D , 2 011, Chapter VII)<br>• Consumer Interests (OECD, 2011, Chapter VIII)<br>• Disclosure (OECD, 2011, Chapter III) |
| **Business relationships covered by due diligence** | All types of business relationships of the enterprise – suppliers, franchisees, licensees, joint ventures, investors, clients, contractors, customers, consultants, financial, legal and other advisers, and any other non-State or State entities linked to its business operations, products or services |

[183] OECD, *Due Diligence Guidance for Responsible supply Chains of Minerals from Conflict-Affected and High-Risk Areas*, Second edition, 2013, p.13

*Source: OECD Due* Diligence Guidance *for Responsible Business Conduct, 2018*

According to OECD, applying the principle of due diligence is necessary because business operations may not be inherently risky, but circumstances (e.g. rule of law issues, lack of enforcement of standards, behaviour of business relationships) may result in risks of adverse impacts. Due diligence should help enterprises anticipate and prevent or mitigate these impacts. Effectively preventing and mitigating adverse impacts may in turn also help an enterprise maximise positive contributions to society, improve stakeholder relationships and protect its reputation. Due diligence can help enterprises create more value, including by: identifying opportunities to reduce costs; improving understanding of markets and strategic sources of supply; strengthening management of company-specific business and operational risks; decreasing the probability of incidents etc.

The principle of due diligence has the following characteristics:

1.Due diligence is preventative. The purpose of due diligence is first and foremost to avoid causing or contributing to adverse impacts on people, the environment and society, and to seek to prevent adverse impacts directly linked to operations, products or services through business relationships. When involvement in adverse impacts cannot be avoided, due diligence should enable enterprises to mitigate them, prevent their recurrence and, where relevant, remediate them.

2. Due diligence involves multiple processes and objectives. The concept of due diligence under the OECD Guidelines for MNEs involves a bundle of interrelated processes to identify adverse impacts, prevent and mitigate them, track implementation and results and communicate on how adverse impacts are addressed with respect to the enterprises' own operations, their supply chains and other business relationships. Due diligence should be an integral part of enterprise decision-making and risk management. In this respect it can build off (although it is broader than) traditional transactional or “know your counterparty” due diligence processes. Embedding RBC into policies and management systems helps enterprises prevent adverse impacts on RBC issues and also supports effective due diligence by clarifying an enterprise’s strategy, building staff capacity, ensuring availability of resources, and communicating a clear tone from the top.

3. Due diligence is commensurate with risk (risk-based). Due diligence is risk-based. The measures that an enterprise takes to conduct due diligence should be commensurate to the severity and likelihood of the adverse impact. When the likelihood and severity of an adverse impact is high, then due diligence should be more extensive. Due diligence should also be adapted to the nature of the adverse impact on RBC issues, such as human rights, the environment and corruption. This involves tailoring approaches for specific risks and taking into account how these risks affect different groups, such as applying a gender perspective to due diligence.

4. Due diligence can involve prioritisation (risk-based). Where it is not feasible to address all identified impacts at once, an enterprise should prioritise the order in which it takes action based on the severity and likelihood of the adverse impact. Once the most significant impacts are identified and dealt with, the enterprise should move on to address less significant impacts. Where an enterprise is causing or contributing to an adverse impact on RBC issues, it should always stop the activities that are causing or contributing to the impact and provide for or cooperate in their remediation. The process of prioritisation is also ongoing, and in some instances new or emerging adverse impacts may arise and be prioritised before moving on to less significant impacts. In the case of prioritising risks to human rights, the severity of a potential adverse impact, such as where a delayed response would make the impact irremediable, is the predominant factor in prioritising responses.

5. Due diligence is dynamic. The due diligence process is not static, but ongoing, responsive and changing. It includes feedback loops so that the enterprise can learn from what worked and what did not work. Enterprises should aim to progressively improve their systems and processes to avoid and address adverse impacts. Through the due diligence process, an enterprise should be able to adequately respond to potential changes in its risk profile as circumstances evolve (e.g. changes in a country's regulatory framework, emerging risks in the sector, the development of new products or new business relationships).

6. Due diligence does not shift responsibilities. Each enterprise in a business relationship has its own responsibility to identify and address adverse impacts. The due diligence recommendations of the OECD Guidelines for MNEs are not intended to shift responsibilities

from governments to enterprises, or from enterprises causing or contributing to adverse impacts to the enterprises that are directly linked to adverse impacts through their business relationships. Instead, they recommend that each enterprise addresses its own responsibility with respect to adverse impacts. In cases where impacts are directly linked to an enterprise's operations, products or services, the enterprise should seek, to the extent possible, to use its leverage to effect change, individually or in collaboration with others.

7. Due diligence concerns internationally recognised standards of RBC. The OECD Guidelines for MNEs provide principles and standards of RBC consistent with applicable laws and internationally recognised standards. They state that obeying domestic laws in the jurisdictions in which the enterprise operates and/or where they are domiciled is the first obligation of enterprises. Due diligence can help enterprises observe their legal obligations on matters pertaining to the OECD Guidelines for MNEs. In countries where domestic laws and regulations conflict with the principles and standards of the OECD Guidelines for MNEs, due diligence can also help enterprises honour the OECD Guidelines for MNEs to the fullest extent which does not place them in violation of domestic law. Domestic law may also in some instances require an enterprise to take action on a specific RBC issue, (e.g. laws pertaining to specific RBC issues such as foreign bribery, modern slavery or minerals from conflict-affected and high-risk areas).

8. Due diligence is appropriate to an enterprise's circumstances. The nature and extent of due diligence can be affected by factors such as the size of the enterprise, the context of its operations, its business model, its position in supply chains, and the nature of its products or services. Large enterprises with expansive operations and many products or services may need more formalised and extensive systems than smaller enterprises with a limited range of products or services to effectively identify and manage risks.

9. Due diligence can be adapted to deal with the limitations of working with business relationships. Enterprises may face practical and legal limitations to how they can influence or affect business relationships to cease, prevent or mitigate adverse impacts on RBC issues or remedy them. Enterprises, in particular SMEs, may not have the market power to influence their business relationships by themselves. Enterprises can seek to overcome these challenges

to influence business relationships through contractual arrangements, pre-qualification requirements, voting trusts, license or franchise agreements, and also through collaborative efforts to pool leverage in industry associations or cross-sectoral initiatives.

10. Due diligence is informed by engagement with stakeholders. Stakeholders are persons or groups who have interests that could be affected by an enterprise's activities. Stakeholder engagement is characterised by two-way communication. It involves the timely sharing of the relevant information needed for stakeholders to make informed decisions in a format that they can understand and access. To be meaningful, engagement involves the good faith of all parties. Meaningful engagement with relevant stakeholders is important throughout the due diligence process. In particular, when the enterprise may cause or contribute to, or has caused or contributed to an adverse impact, engagement with impacted or potentially impacted stakeholders and rightsholders will be important. For example, depending on the nature of the adverse impact being addressed, this could include participating in and sharing results of on-site assessments, developing risk mitigation measures, ongoing monitoring and designing of grievance mechanisms.

11. Due diligence involves ongoing communication. Communicating information on due diligence processes, findings and plans is part of the due diligence process itself. It enables the enterprise to build trust in its actions and decision-making and demonstrate good faith. An enterprise should account for how it identifies and addresses actual or potential adverse impacts and should communicate accordingly. Information should be accessible to its intended audiences (e.g. stakeholders, investors, consumers, etc.) and be sufficient to demonstrate the adequacy of an enterprise's response to impacts. Communication should be carried out with due regard for commercial confidentiality and other competitive or security concerns. Various strategies may be useful in communicating to the extent possible while respecting confidentiality concerns[184].

Due to these characteristics of the principle of due diligence, its preventive properties and significance are fully apparent. In addition, this principle helps to strengthen the corporation's external and internal communication and cooperation. The part of due diligence that overlaps with the principle of enterprise liability is that the extended liability to the parent corporation. There

[184] *OECD Due* Diligence Guidance *for Responsible Business Conduct*, 2018, pp.16-19

may be a need for further research on the development of an enterprise liability approach that focuses more on preventive characters. Guided by these fundamental international principles, the French law of duty of vigilance enshrines corporate responsibility in more detailed and developed ways when adopted into the national legal system.

In addition to the United Nations, there are other international initiatives in scope of corporate responsibility. The G7 Leaders Declaration (June 2015) put forward the need to enhance corporate transparency and accountability and recognized the joint responsibility of governments and business to foster sustainable supply chains. In March 2016, the Council of Europe Recommendation called on States to require business enterprises to conduct mandatory human rights due diligence where risks are significant, also recognizing the need to enhance access to justice for victims of corporate abuse. The EU Council Conclusions on Global Value Chains (May 2016) highlighted the joint responsibility of governments and business to foster responsible supply chains, and called on the Commission and Member States to enhance the implementation of due diligence in order to achieve a global level playing field.

### 4.3. Corporate Group Liability in Other Branch Laws

As noted that enterprise liability principle is mostly recognised and supported in selective are with limited application under certain circumstances.

Apart from the fundamental issues of corporate law, there are also other legal areas where the corporate responsibility of the group is a priority. When transforming the dynamic approach into legal rules, company law obviously demands a key role, but other branches of law must also be considered[185] because there is need to deal with the problem of intercompany relationships. Adopting the enterprise law principle into other branches deems as a priority. It is assumed by Blumberg stating as in selected areas, the law is beginning to recognize corporate groups rather than a particular subsidiary company, as the juridical unit, and to impose group obligations and, less frequently, to recognize group rights as well. In this movement, still in its early stages, the enterprise theory of the corporation is beginning to emerge[186]. Virginia H.Ho pointed out that

[185] Jose Miguel Embid Irujo, *Trends and Realities in the Law of Corporate Groups*, (European Business Organisation Law Review, Vol.6, No.1.), p.77

[186] Phillip.I.Blumberg, *The Corporate Entity in an Era of Multinational Corporation*, (Delaware Journal of Corporate Law, 1990, Vo.15, No.2), p.298

‘despite the acceptance of enterprise principles in many areas of the law, Professor Blumberg—whose writings form the foundation of legal scholarship on corporate groups—concludes, based on a comprehensive survey across different areas of the law, that “enterprise law is not transcendental. It is applied only in selected areas of the law where it more effectively implements the underlying purposes and objectives of the law. In other respects, entity law continues unaffected.’[187]

These law sectors are accounting, taxation, auditing, conflict of interest, securities regulation, banking and financial institutions, bankruptcy, insolvency, employment relations, competition, human rights and environment. Particularly, there are some measures initiated in human rights and environmental area at the domestic and international level. France and Switzerland have taken steps which companies even the groups have liability to vigilant risks to environmental harms, human rights, injuries via due diligence actions[188].

### 4.3.1. Insolvency law

Insolvency regulation is the most commonly discussed issue. This is because it is necessary to prevent the corporate group structure from being used for fraud bankruptcy. So, we here have a brief look at some examples of legal bankruptcy and insolvency in a corporate group. The insolvency case of the group, and especially the transnational group, is problematic because of the inadequate legal framework between the parent corporation and its subsidiary corporation.

According to Petrin and Choudhury, ‘enterprise liability is therefore particularly useful where a subsidiary corporation is unable to satisfy debts or claims but the corporate group as a whole, but not necessarily the insolvent company’s parent company, has sufficient assets’[189]. So, there are more jurisdictions with acceptance enterprise approach in insolvency law, compared to other branches of laws.

In many countries, there are two common mechanisms of insolvency: subordination and substantive consolidation. The subordination mechanism is used in many countries: Austria, Germany, Italy, Spain, USA, New Zealand[190]. The regulation that combines the assets of

[187] Virginia H.Ho, *Theories of Corporate groups,* (Seton Hall Law Review, Vol.42, 2012), p.901

[188] Petrin.M, and Choudhury.B, *Group Company Liability,* (European Business Organisation Law Review, 2018), p.784

[189] Ibid., p.786

[190] Klaus J.Hopt, *Groups of Companies-A Comparative Study on the Economics, Law and Regulation of Corporate Groups*, 2015, p.23

independent legal entities in bankruptcy and insolvency proceedings is theoretically an example of adhering to the principle of enterprise law.

The proceedings of several members of the corporate group may be pooled with a court decision in the event of insolvency if the member corporations of the group are considered as one entity. In other words, a merger considers corporations that belong to a corporate group to be a unit of bankruptcy. Different mechanisms can be used to consolidate the assets and debt of members of different groups of corporations. Subject to the New Zealand Companies Act of 1993 as well as substantive consolidation is allowed for under United States insolvency laws. Unlike New Zealand and Australia, there is no specific law in the United States to handle group insolvency issues. Of these, the regulations set forth in the New Zealand company laws are special. In the context of practical implementation, it is analysed that the courts have shown reluctance to use these provisions and therefore pooling has not been a common occurrence. The New Zealand courts are beginning to develop a jurisprudence regarding when the court will exercise its powers under these provisions[191].

The Australian Corporate Law contains few provisions that specifically regulating the corporate group. For example, a parent must list its affiliates each year in its report and provide consolidated accounts for itself and other subsidiaries. The most specific enterprise law approach (not covered in most other countries)[192] reflection on corporate law is that if a subsidiary is considered insolvent, the parent company will be liable for any debt incurred. This insolvency settlement creates a parent company's ability to control its subsidiary's operations and to prevent any loss to the subsidiary's creditors, and ceases trading in the subsidiary when it becomes insolvent. It provides incentives to constantly monitor the financial situation of subsidiaries and to prevent financial risks.

### 4.3.2. Tort Law

Corporate group law scholars claim that limited liability was never meant to apply to tort claims. Some have made a historical study that limited liability for tortious behavior was not originally intended due to the fact that individuals and communities might suffer such torts but be left without a remedy, whereas limited liability for contracts does not result in the same sort of injustice[193] and

[191] Alison Mccourt, *A Comparative Study of the Doctrine of Corporate Groups with Special Emphasis on Insolvency*, p.26
[192] Kluver.J, Entity vs. Enterprise Liability: Issues for Australia, 37 Connecticut law review, 2005, p.767
[193] Skinner.G, *Rethinking Limited Liability of Parent Corporations for Foreign Subsidiaries' Violations of International Human Rights Law* (72 Wash. & Lee L. Rev. 1769, 2015), 1792

agreed on the shortcomings of limited liability in the intersection between the corporate group and torts, the necessity for a holistic solution is starkly apparent[194].

One of the most exemplified doctrinal proposal in corporate groups liability is recommended by Hansmann and Kraakman[195] who porposing an unlimited liability regime for corporate torts. However, the unlimited liability doctrine has not been widely advocated because it proposes unlimited liability not only for corporations but also for individuals.

Even though there are many scholars who are disagree on unified, extended or joint liability system for the group, whatever their views on the general issue, most commentators agree that limited liability presents serious problems when applied in the case of tort and other involuntary creditors. Limited liability for shareholders of corporations unable to satisfy tort claims is inefficient because it causes externalities. Under limited liability, costs of a corporation's tortious behavior are costs of the business that are involuntarily imposed on the victims rather than on the business and then spread generally over those benefiting from the behavior, such as shareholders and consumers generally. Further, it frequently has the inhumane consequence of imposing costs that may be heavy or even catastrophic upon victims without adequate resources to meet them. Finally, insulation from shareholder liability defeats a primary objective of tort law by undermining the pressures deterring excessively risky conduct[196].

These tort-based concerns are at their sharpest when mass personal injury torts, environmental harms, and human rights violations are at issue. These harms carry the most normative weight and impose the greatest costs on society. In addition, they are the most likely causes of bankruptcy for a subsidiary or affiliate tortfeasor, as the subsidiary or affiliate is usually not insured against, nor adequately capitalized for, harms of this magnitude. If the subsidiary cannot pay for the damages caused by the tort or harm, the tort victim's only option is to proceed against the corporate shareholder-the parent corporation[197].

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[194] Dearborn, M, *Enterprise Liability: Reviewing and Revitalizing Liability for Corporate Groups,* (California Law Review, Vol.97, Issue 1, 2009), p.210

[195] Hansmann.H, and Kraakman.R, Toward unlimited shareholder liability for corporate torts, (Yale Law J 100:1879–1990, 1991)

[196] Phillip.I.Blumberg, *The Multinational Challenge to Corporation Law,* (Oxford University Press, 1993), p.135

[197] Dearborn, M, *Enterprise Liability: Reviewing and Revitalizing Liability for Corporate Groups,* (California Law Review, Vol.97, Issue 1, 2009), p.207

Some tort law scholars suggest the principle of vicarious liability. In tort law, for example, vicarious liability achieves such fundamental purposes as creating incentives for the controlling unit to use its control to deter risky conduct by the controlled unit, to spread loss as a cost of the undertaking on all dealing with it, and to provide victims with an additional source of recovery typically possessing a "deeper pocket" than an employee or agent. The common features of the cases of derivative liability appear to resemble closely the very factors present in the case of corporate groups: the existence of a close economic interrelationship and the right of control to direct the conduct of the related unit on the part of the unit subjected to liability. Under such circumstances, the imposition of liability upon the controlling unit and its assets for obligations of the controlled unit arising in the course of the closely integrated relationship may achieve underlying objectives of the law. Thus, insofar as the imposition of liability is concerned, enterprise law, with its similar emphasis on control and close interrelationship, appears to be hardly distinguishable from these examples of derivative liability as a matter of jurisprudential conception. One should hasten to point out, however, that although enterprise law resembles derivative liability in terms of jurisprudential process, it is very different indeed in the circumstances giving rise to liability. Further, enterprise law concerns subsidiary corporations, not employees or agents. Although a parent corporation may become liable for its subsidiary's acts that had been performed by the subsidiary's employees and agents, the latter remain the subsidiary's employees and agents[198].

In comparison to limited liability, enterprise liability better addresses the problem of tort creditors because it reallocates risk and forces parent corporations to internalize the risks of their subsidiaries. Under a limited liability regime, parent corporations have no incentive to purchase insurance or adequately capitalize subsidiaries because limited liability artificially removes these operating costs. Enterprise liability, in contrast, forces the parent corporation to absorb these costs by purchasing insurance or adequately capitalizing the subsidiary. Enterprise liability thus leads to "more efficient investment decision-making, including the allocation of capital, and removes the moral hazard aspect of limited liability[199].

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[198] Phillip.I.Blumberg, *The Multinational Challenge to Corporation Law,* (Oxford University Press, 1993), p.139

[199] Dearborn, M, *Enterprise Liability: Reviewing and Revitalizing Liability for Corporate Groups,* (California Law Review, Vol.97, Issue 1, 2009), p.212

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### 4.3.3. Human Rights and Environmental Law

Previous chapters detailed discussion has been taken upon holding the corporate group accountable in the field of human rights and environmental protection. In France, a newly introduced statutory duty of vigilance now requires certain corporations to take reasonable care in identifying and preventing risks to human rights and fundamental freedoms, serious bodily injury or environmental damage or health risks resulting directly or indirectly from the operations of the company. The vigilance obligations are relevant for group liability as they extend to subsidiaries as well as subcontractors or suppliers. Similarly, a popular initiative 'for responsible enterprises' in Swiss proposes a due diligence obligation on companies to respect human rights and environmental standards. If accepted, this duty would require companies to identify real and potential impacts on internationally recognised human rights and the environment; take appropriate measures to prevent violation of these standards, and account for the actions taken. This obligation extends to both the parent company as well as any domestic and foreign companies it controls. Both the French law and the Swiss initiative aim to hold corporations liable for failure to adhere to the delineated obligations unless the company can demonstrate that it took due care, for which it bears the onus of proof[201].

Academic scholars propose various suggestions on how to properly integrate enterprise law approach and other branch laws, and in this regard, Petrin.M, and Choudhury summarized the following:

> While Blumberg acknowledges the relevance of added elements such as administrative and financial interdependence, integration of employee relationships, and use of a common group persona, control remains the central tenet of conceptualizing corporate groups and as such, according to Blumberg, accordingly also justifies a 'control-based form of enterprise liability'. In recent years, notable scholarly proposals building

[200] Ibid., p.212
[201] Petrin.M, and Choudhury.B, *Group Company Liability,* (European Business Organisation Law Review, 2018), 784-785

> upon enterprise liability concepts have also been outlined by other commentators. Skinner suggests, for instance, that parent company liability be imposed through a statutory enactment for violations of customary international human rights and serious environmental torts. However, she limits her suggestion of imposing statutory liability to corporations operating as part of a unified economic enterprise in 'high risk host countries'. Conversely, Dearborn proposes a model of enterprise liability that requires an economically integrated enterprise, which is defined on a case specific 'inquiry of economic, and not behavioral, control'; and an instance of a mass tort, human rights violation, or environmental harm[202].

### 3.1. Summary

In this chapter, we have investigated some of the jurisdictions and international governance bodies that have adopted some version of enterprise liability as part of their statutory or common law or have drawn on the theory as part of a proposed amendment to existing laws or guidelines. These examples provide context for a discussion of enterprise principles. Collectively, they demonstrate that enterprise liability has some possible forms, from which lessons may be drawn in crafting enterprise principles in these jurisdictions. Moreover, these examples show that enterprise principles are beginning to surface in foreign jurisdictions and international governance documents in a globalising economy while attempting to over the greatest shortcomings of limited liability.

Antunes summed up the general state of corporate legislation more than two decades ago as the following, and we still agree with this conclusion.

> We do not have any group law, but we have indeed groups, both nationally and internationally' such was Gebler's verdict on the general position of legislatures regarding the problem of the corporate group in the overwhelming number of countries. In comparative law, apart from the existence of what could be called 'partial regulations' on corporate groups, only four national legal orders have implemented a specific law on groups of companies (Germany, Brazil, Portugal and Hungary) and the international initiatives on legal harmonization on the problem have not yet become positive law (namely, EU directives on company law)[203].

Except from Germany, only Latvia, Portugal and Italy have a systematic regulation of corporate groups within the EU, probably in the world. The former is the most studied, while the last three are the least studied in comparative corporate law studies.

[202] Petrin.M, and Choudhury.B, *Group Company Liability*, (European Business Organisation Law Review, 2018), p.787
[203] Jose.E.Antunes, Liability of Corporate Groups, (Kluwer Law and Taxation Publisher, 1994), p.225

Although some researchers believe that innovative principles such as due diligence / vigilance are not against limited liability of corporation or it is not kind of enterprise liability, it is obvious in the sense that the principles make the parent corporation responsible for its subsidiary and penetrate the barrier of independent legal entity of the parent corporation from our point of view. The principle of due diligence offers extended, joint responsibility when it comes in group corporations' context, but seems to be more emphasised on prevention, and broader than the enterprise liability principle. So, it is our supporting point of view in which as some commentators stating that 'the business and human rights movement also requires taking a stance with regard to a new way of doing business in the 21st century, in a context where the trend in many countries is leading towards the emergence of new expectations regarding companies' contributions to society, whether through sustainable investments or corporate citizenship. Furthermore, in jurisdictions that subject companies to obligations related to the respect of human rights, compliance with these requirements represents a competitive advantage'[204].

As corporate group issues have become more and more of an interdisciplinary law, the recent major reforms and driving forces behind the handling of this phenomenon may rely upon not only corporate law as well as other sectors of law.

The most developed of the enterprise systems, the konzernrecht, fails to address the problem of tort creditors because its system of liability is primarily internal, meaning that the subsidiary accrues a cause of action against the parent, but outside creditors do not. The ideal test for enterprise liability should follow in the line of jurisdictions that have explicitly remedied this deficiency by providing a direct cause of action to tort creditors, thus acknowledging and remedying limited liability's deficiency in this area[205].

According to Dearborn, the definition of "mass tort" should be narrow, encompassing only mass torts, human rights disasters, and environmental harms. And she explained that this narrow scope helps alleviate the inevitable concerns of the business community that enterprise liability would cause the end of investment capitalism. The anecdotal evidence presented by the examples of India, the konzernrecht, as well as the regulatory statutes in the United States shows that enterprise

[204] Brabant.S et al, Law on Corporate Duty of Vigilance-Contextualised Approach, (Revue Internationale De La Compliance Et De L'Éthique Des Affaires – Supplement À La Semaine Juridque Entreprise Et Affaires N° 50 Du Jeudi 14 Decembre 2017), p.4

[205] Dearborn, M, *Enterprise Liability: Reviewing and Revitalizing Liability for Corporate Groups*, (California Law Review, Vol.97, Issue 1, 2009), p.254

principles need not be at odds with a robust investment economy. Limiting the scope of the doctrine helps to ensure that it is merely a tool to check the most egregious and socially harmful of corporate behaviors-not a tool for frivolous litigation. And more importantly, enterprise liability's advantage is that it helps to reorder the decision-making structure in the corporate conglomerate's nerve center in order to prevent foreseeable disastrous harms. The harms that enterprise liability has the best chance of preventing are, therefore, those costly legal judgments that stand to harm the parent corporation from a public relations and economic standpoint, because the larger the threatened judgment and public relations scandal, the more likely that the corporation will wish to prevent the harm in the first place. The imposition of joint and several liability provides an incentive for the corporate nerve center to take preventative measures that ensure these costliest of corporate torts do not occur, and enterprise liability is in a good position to shift those costs. From a perspective of equity and justice, the prevention of mass torts, human rights violations, and environmental harms would provide the type of important regulatory goal that limited liability should not, from a policy perspective, be able to subvert[206].

## CHAPTER FIVE: TOWARDS PARTLY ENTERPRISE LIABILITY

In the previous chapters, we have covered these issues: reviewing the phenomenon of corporate groups in modern days, specifying and clarifying theoretical concepts in which corporate groups law; analysing case and statutory circumstance and development around parent and subsidiary relationships; disregarding corporate's limited liability through changes in other law area such as insolvency, tort, human rights and environment law; and the adoption and recognition of the principle of enterprise liability. The purpose is to explore and understand these issues that proposing some upgrading in this area. In doing so, the focus is on a potential approach to reforming corporate group's liability in this chapter.

This is how Petrin and et al formulated enterprise liability and its signification as 'another option for reform consists of moving towards a form of 'enterprise liability'. Although there is no singular definition of this term, enterprise liability is often equated with treating all companies in a group as a single enterprise and holding the single enterprise responsible for harm caused by any individual company within the group. This negates the separate legal personality of related

[206] Dearborn, M, *Enterprise Liability: Reviewing and Revitalizing Liability for Corporate Groups,* (California Law Review, Vol.97, Issue 1, 2009), p.255

corporate entities and allows for both horizontal and vertical piercing—that is directing claims against parent and/or sister companies. This approach is thought to bring the 'legal reality of corporate groups closer to their economic reality' and to force group companies to assess business activities that are potentially harmful for third parties 'holistically for the entire group, rather than move risky or hazardous businesses to distant or under-funded subsidiaries'[207].

Most of the arguments in favor of limited liability are made on the basis of economic efficiency[208]. Expansion of liability is justified by the fear that it would slow down business development, reduce investment, and increase investor risk.

However, the major challenge facing the legal systems of the world is the establishment of a jurisprudential framework for the imposition of responsibilities on corporate groups[209]. Commentators have expressed the following views on the advantages and benefits of the enterprise liability principle and whether the above concerns are realistic.

Dearborn, who proposes the principle of true enterprise liability approach based more on economic perspective, made the following analysis. Several commentators have hypothesized that investment, while admittedly riskier in the case of enterprise liability, would likely still thrive if tort costs were imposed in an enterprise context. In comparison to limited liability, enterprise liability better addresses the problem of tort creditors because it reallocates risk and forces parent corporations to internalize the risks of their subsidiaries. Under a limited liability regime, parent corporations have no incentive to purchase insurance or adequately capitalize subsidiaries because limited liability artificially removes these operating costs. Enterprise liability, in contrast, forces the parent corporation to absorb these costs by purchasing insurance or adequately capitalizing the subsidiary. Enterprise liability thus leads to "more efficient investment decision-making, including the allocation of capital, and removes the moral hazard aspect of limited liability. Furthermore, if an industry is unable to internalize its own costs, it may either cease to exist or may petition public officials for a grant of limited liability or direct subsidization. This shifts policy and regulatory decisions away from the market and into public decision-makers' hands, which is a beneficial move since "political decision to subsidize an enterprise that is unable to internalize its expected costs ... is preferable to a unilateral decision to engage in a possibly overly risky activity under the

[207] Petrin.M, and Choudhury.B, *Group Company Liability,* (European Business Organisation Law Review, 2018), p.785

[208] Schipani.A.C. *The Changing Face of Parent and Subsidiary Corporations: Enterprise Theory and Federal Regulation,* (37 Conn. L. Rev. 691 2004-2005), p.693

[209] Phillip.I.Blumberg, *The Multinational Challenge to Corporation Law,* (Oxford University Press, 1993), p.230

protective umbrella of limited liability." In addition, enterprise liability remedies the deficiencies of limited liability as applied to corporate groups. First, it tracks the expectations of the public more closely. Second, enterprise liability is not tethered to a moralistic view of fault, and instead seeks accountability by "threatening corporate profits." Enterprise theory speaks an economic language-which corporations and their directors are bound to understand and internalize, as corporations are legally required to maximize shareholder wealth[210].

Vagueness A final frequent criticism of enterprise liability is that any test would be too vague. "While enterprise liability may offer some appeal, measuring the extent of an 'economic unit' introduces an intolerable level of uncertainty into the question of liability." This is because courts will be forced to determine the boundaries of the economic enterprise, which will rarely be clear. Of course, this same criticism applies to the doctrine of veiling the corporate veil. There must, however, be some law allowing plaintiffs to recover against the primarily responsible party in a corporate web.

### 5.1. The Partial Enterprise Approach

The principle of opposition to the principle of entity has already become an enterprise principle, at least in theory. Therefore, it is important to recognise how to apply this principle properly. In this study, we consider the responsibilities of the group corporations in light of vertical liability-between parents and subsidiaries rather than horizontal liability-between subsidiaries and subsidiaries.

The problem in applying these principles is to accommodate the organisational complexities of corporate groups. If applied inflexibly, they may expose a parent company to full liability for all the group’s debts, even where group governance is decentralised and particular group companies exercise considerable autonomy. They may also encourage managers to structure the group in a highly hierarchical and centralised manner, even where this is inefficient, to reduce the parent’s financial exposure[211].

There is wariness that enterprise liability is too radical, and risks discourage investment. The previous chapters have shown that enterprise liability exists in various forms internationally as well

[210] Dearborn, M, *Enterprise Liability: Reviewing and Revitalizing Liability for Corporate Groups,* (California Law Review, Vol.97, Issue 1, 2009), p.212
[211] Companies & Securities Advisory Committee, Corporate Groups Final Report, 2000, p.24

as some high economic countries already adopting some forms of the liability in corporate law context. The evidence is that these countries never ever claimed as their corporate accountability system has had a negative impact on the economic development.

The main argument against enterprise theory is that it could be disastrous for the investment economy. Experiences to refute this argument have been made in Germany and France, and even in literatures this hypothesis have been contradicted. For example, Dearborn argued that enterprise liability would not destroy investment capitalism by putting her analysing and citing other scholars. She summed up scholar's suggestions as the following:

> Several commentators have hypothesized that investment, while admittedly riskier in the case of enterprise liability, would likely still thrive if tort costs were imposed in an enterprise context. In particular, Daniel Leebron has concluded that even though "investments under a limited liability regime have greater expected value and are less risky to investors" than investments would be under an enterprise liability scheme, the efficient allocation of tort risk offsets these consequences. Indeed, Leebron points out that "there may be no efficiency consequences" from a societal point of view. Similarly, Hansmann and Kraakman explain that "a well crafted rule of unlimited liability would neither impair the marketability of securities nor impose excessive collection costs.' Though the cost of equity might rise, this increase in the price of securities is actually more efficient, since it causes share prices to reflect the cost of torts. They conclude that "a regime of unlimited liability is administrable and . . . corporations with publicly-traded shares can survive and prosper under it." Importantly, in reaching their conclusions, Professors Leebron, Hansmann, and Kraakman spoke to the economic consequences of unlimited liability, not enterprise liability. The former would not differentiate between corporate and individual shareholders. The investment harms become even more negligible when enterprise liability encompasses only the parentsubsidiary context. "Within corporate groups, the traditional policy concerns supporting limited investor liability mostly do not apply."[212]

Furthermore, she acknowledged the issue by commenting as 'by further narrowing liability to the context of mass torts, human rights violations, and environmental harms, the changes in investment would be even more limited and the resulting changes in corporate behavior based on reallocation of risk would more than pay for themselves in avoiding catastrophe. Moreover, some versions of enterprise liability, while relatively isolated, are well-established and extant-and have not caused a concomitant crash in investment. Germany, while employing a weaker version of enterprise liability than still one of the world's leading industrial economies. California had a statutory regime of unlimited liability from 1849 until 1931, "evidently without crippling industrial and commercial development" and bank holding companies have been subject to enterprise liability for half a

[212] Dearborn, M, *Enterprise Liability: Reviewing and Revitalizing Liability for Corporate Groups,* (California Law Review, Vol.97, Issue 1, 2009), p.257

century, without failure in investment in either industry. Enterprise principles have also persisted in India and have corresponded with increases in foreign direct investment'.[213]

Hansmann and Kraakman noted that part of the reason why the securities market will not be "seriously damaged" by a move to unlimited liability for corporate torts is that courts may easily determine "which costs are efficiently and equitably borne by a corporation and its shareholders and which are not .... Shareholders who benefit, for example, from intentional dumping of toxic wastes, from marketing hazardous products without warnings, or from exposing employees without their knowledge and consent to working conditions known by the firm to pose substantial health risks, should not be able to avoid the resulting costs simply by limiting the capitalization of the firm." Of course, this kind of decision as to who is the most efficient cost-bearer is what tort law is all about. Moreover, Hansmann and Kraakman make an important observation that the damages imposed by courts could depend on whether the shareholder is a parent corporation, as "the prospect that a judgment might exceed the corporation's net assets and thus spill over onto its parent shareholder should generally not, in itself, affect the size of the judgment. When the firm's shareholders are individuals, however, the prospect of shareholder liability might sometimes be a reason to temper the amount of damages assessed."

From the point of view of jurisprudence, character of enterprise law is more of a liability rather than a right, regarding that Blumberg noted as:

> Enterprise attribution of rights occurs only in isolated, peripheral areas, including res judicata and collateral estoppel; discovery; some aspects of set-off law in procedural law; severance condemnation damages in property law; and in some areas of statutory law, including bankruptcy, patent, and trademark law and the filing of consolidated returns in tax law. Enterprise law is overwhelmingly concerned with the imposition of responsibilities, and attribution of rights plays a relatively minor role[214].

The statutes and cases applying enterprise principles in dealing with the legal problems of parent and subsidiary corporations organized in corporate groups—the materials comprising the law of corporate groups —have several features of fundamental jurisprudential significance. First, although they are overwhelmingly concerned with imposing obligations on group affiliates by reason of the actions of a constituent corporation of the group, in a number of instances enterprise principles attribute certain rights as well. Second, enterprise law is not transcendental. It is applied

[213] Ibid., p.258

[214] Phillip.I.Blumberg, *The Multinational Challenge to Corporation Law,* (Oxford University Press, 1993), p.237

only in selected areas of the law where it more effectively implements the underlying purposes and objectives of the law. In other respects, entity law continues unaffected. These two distinguishing features play a fundamental role in shaping Jurisprudential analysis of the juridical nature of the corporate group and the application of enterprise principles[215].

The criteria for enterprise liability proposed in the case and statutory laws of the countries and in academic literature can be divided into the following sections.

- structure based
- control based
- behaviour based
- economic based

Many scholars and commentators have suggested enterprise liability theory which views the corporate group as the corporate group as a singular unit rather than viewing each subsidiary as a separate legal entity. They conclude that enterprise liability seeks to settle down legal and economic realities more that entity theory in case of the corporate group. The reason of enterprise liability may be seen as more realistic is that it is based on economic situation rather than legal fiction. Dearborn stated that:

> In contrast to entity theory's formalism, enterprise liability seeks to marry legal and economic realities. The legal entity of the limited liability corporation has contours that are different from the economic fact of the enterprise-a gap that enterprise liability attempts to close. As one commentator put it: The economic entity does not have any corporate charter. It is an economic choice of management. It ties in legal entities for operation in a common endeavor or enterprise. The idea behind economic entity is joinder or merger of activity-unity of life-in the goal of the common the undertaking or enterprise. In an economic entity, each legal entity has dedicated itself and its property to the success of the common undertaking. Since subsidiaries (especially wholly-owned subsidiaries) at least theoretically act for the benefit of the corporation as a whole, enterprise theory follows the profit and holds the various corporate actors in a given web accountable for the actions of other actors.[216]

In addition to its economic compatibility, the fairness and moralistic approach of the enterprise liability law overweigh its counterarguments. The most important point to note is that most commentators who advocate for enterprise liability propose the principle in only certain 'emergency' field. Namely, Blumberg and Dearborn did not suggest elimination of limited liability

[215] Phillip.I.Blumberg, *The Multinational Challenge to Corporation Law,* (Oxford University Press, 1993), p.230

[216] Dearborn, M, *Enterprise Liability: Reviewing and Revitalizing Liability for Corporate Groups,* (California Law Review, Vol.97, Issue 1, 2009), p.210

in all situations. Mass tort, environmental damages, human rights violation, insolvency, bankruptcy issues are 'emergency' fields which are more likely effected by the group when the corporation externalises risks. Those corporations in ultrahazardous industry are mostly giant corporate groups, and they are usually involved in potential harms in environment, human rights violation and torts. When the social responsibility or corporate liability issues arise, those affiliated, controlled corporations just transfer nearly all of its assets into the parent corporation existing overseas just before declaring bankruptcy to escape liability. So that, Dearborn claimed as these represent the most troubling instances of the public's absorption of the cost of doing business[217]. This contour is derived from the case law and academic literatures. For instance, Dearborn wrote as the following while she proposed her true enterprise liability for tort liability.

> These tort-based concerns are at their sharpest when mass personal injury torts, environmental harms, and human rights violations are at issue. These harms carry the most normative weight and impose the greatest costs on society. In addition, they are the most likely causes of bankruptcy for a subsidiary or affiliate tortfeasor, as the subsidiary or affiliate is usually not insured against, nor adequately capitalized for, harms of this magnitude. If the subsidiary cannot pay for the damages caused by the tort or harm, the tort victim's only option is to proceed against the corporate shareholder-the parent corporation.[218]

Much scholarly literature suggest that the application of enterprise principle of liability is difficult, since the structure, control, relationship and interconnected activities of a corporate group are diverse. Witting and Rankin apparently posited that statement by writing as 'there are various problems with enterprise liability, which substantially weaken its potential in resolving problems of insolvent subsidiary liabilities. At the most general level, there is a lack of criteria in determining whether or not companies are sufficiently economically integrated. This blends into a second problem, which is the potential cost of evidence-gathering and expert opinion in determining that issue. But a more fundamental problem is that it does not seem possible to allow the enterprise liability 'genie' only half way out of the bottle. This is to say that the results of an inquiry into economic interdependencies might be that 'everything is connected to everything else' and that there is no confining the enterprise to any pre-conceived notion of the corporate group'[219]. Perhaps this is one reason why the principle is still unanimous. However, we may disagree with these

[217] Ibid
[218] Ibid., p.207
[219] Witting. C, and Rankin. J, *Tortious Liability of Corporate Groups: From Control to Coordination,* 2014, p.11. Available at: https://ore.exeter.ac.uk/repository/handle/10871/16770

findings, because it is not so important to determine the existence of a group structure, internal relationships or genuine control when adopting the principle over a particular selected area of the law, but having a legitimate parent-subsidiary relationship can be justification for legal responsibility. If any test begins to be put into the enterprise liability, it can mean that the difficulties and ineffectiveness with applying the lifting the veil principle will also same for the principle. Just as the principle of limited liability and separate entity is not applied to any criterion as fundamental, the enterprise principle must be treated with the same approach.

True enterprise liability that requires an economically integrated enterprise, which is defined as 'inquiry of economic, and not behavioral, control'. In contrary to it, Blumberg, suggested that such groups are characterized by the unifying factors of control and economic interrelationship, 'control-based form of enterprise liability'. Due to that, protracted disputes around various control based rule among academic debate have weakened recognising principle**.**

Another reason why the principle of enterprise liability is not globally accepted is due to the proposals based on these different approaches. For example, real enterprise doctrine offers economic integration based, veil lifting doctrine based more behaviour based, konzernrecht approach is more structure based etc. while arguing regarding the concept of control. Therefore, group structure and internal relationships are very diverse, so to consider them all as standards and tests for enterprise principles would be as vague, subjectively relevant, and limited as the veil lifting principle. In addition, legal scholars' researches on this principle often end in a general opinion, as mentioned above, without finding solution for the diversity of corporations. The practice that put an end to this indecision of the enterprise principle is considered to be the law that established the French principle of viglance. This is because the law imposes obligations to the parent corporations regardless the group's structure and type, but only on the basis of whether the corporation has a relationship of a group, specified in the relevant law where the issues such as control, dominance, structure, shares to be provided. The legal attribution and the debate over theoretical understanding of these concepts may be more related to the topic of what defines a group corporation. The issue of accountability is a separate issue that will arise after that, at least in the context of our study. The due diligence/vigilance principle is based on the key indicator of 'parent-subsidiary relationship', which is defined in the country's law as a 'corporate group'. How this relationship works internally is not a priority. As noted, there are some naysayers against vigilance principle is not enterprise principle, however, there is not grounds for this argument.

Commentators opted that the principle of enterprise liability has also preventive character, as vigilance has, that is exercised through control. For instance, true enterprise theorist Dearborn stated:

> true enterprise liability only investigates control to the extent that shifting a parent corporation's decision-making processes would prevent costly torts. This type of control eschews the fault-based standards inherent in direct control and instead focuses on the incentive structure within the corporate conglomerate as a lens toward shifting costs and preventing harms. The latter is closer to a true enterprise standard. Thus, the difference between the control test as used in enterprise liability and the control inquiry as used in piercing is merely one of degree. In the former, control is the source of liability; in the latter, the ability to directly control the behavior of the subsidiary as a puppet master is one evidentiary means to arrive at the conclusion of "alter ego" or "mere shell." The differences between these systems should not be understated, and the control test in enterprise liability still represents a move away from typical piercing principle[220].

We need to avoid these 'case by case' approaches so as not to repeat the veil lifting principle when introducing the enterprise principle. the principle of limited liability and entity law is used as a direct basic general principle regardless these various standards, stages,. Similarly, applying the principle of enterprise liability is like allowing the equal possibility. But of course in selected sectors. More than twenty years ago, Blumberg noted as [court] 'they must also determine whether, in the case before them, the relationship between the affiliated corporations is so intertwined as an economic reality that the application of enterprise principles is appropriate. Although such an undertaking could be avoided by providing for the application of enterprise law in every parent subsidiary relationship, this presents many problems. In any event, such a far-reaching step, even if deemed desirable, is clearly not feasible at the present stage of American law. The modern American experience is beginning to provide an answer to this definitional problem[221]. Today, enterprise liability development is not so successful, but has been recognised and accepted relatively more at national and international level it's time to start taking more reformative measures.

The legitimate normative problems associated with shareholder liability for corporate debts, stemming from the general desire to protect individual investment freedom, do not apply in the parent-subsidiary context. "Piercing the corporate veil of subsidiary corporations does not create

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[220] Dearborn, M, *Enterprise Liability: Reviewing and Revitalizing Liability for Corporate Groups,* (California Law Review, Vol.97, Issue 1, 2009), p.248

[221] Phillip.I.Blumberg, *The Multinational Challenge to Corporation Law,* (Oxford University Press, 1993), p.93

unlimited liability for any people. The only assets reached for the debts of the subsidiary are corporate assets meaning that no individual investor's personal property can be reached. Thus, the original goals of limited liability in general would remain unaffected by the internalization of a parent corporation's risk. In practice, adopting this theory of the corporation would allow claimants of one actor in a corporate group to recover from another member of the group under ordinary tort circumstances. While the result may be a parent being held liable for the actions of a subsidiary, so-called "horizontal" piercing through which a claimant may recover for the torts of a subsidiary from a sister subsidiary might result as well[222].

Dearborn noted 'enterprise liability is not tethered to a moralistic view of fault, and instead seeks accountability by threatening corporate profits. Enterprise theory speaks an economic language- which corporation and their directors are bound to understand and internalize, as corporations are legally required to maximize shareholder wealth'[223].

The test for enterprise liability as developed by certain US courts tends to consist of two elements. First, there has to be such a high degree of unity between the entities in question that their separate existence has de facto ceased. Second, in light of this unity, treating the entities as separate would promote injustice. Although courts have taken differing approaches to interpreting the precise requirements under this test, elements that show how the separateness of the group entities was disregarded (such as intermingling of assets or other evidence that they were not treated as independent entities) as well as an improper fraudulent motive for using group structures is normally required[224].

The jurisprudential significance of the law of corporate groups may be best understood as another manifestation of the increasing emergence of relational law. In this case, it rests on the economic interrelationship between the parent and subsidiary corporations. The affiliated corporations are collectively conducting a common business. In the areas recognized by the law of corporate groups, the attribution of rights and the imposition of liabilities may be seen as the law, unconfined by traditional notions of entity, following the business and allocating legal consequences to the business. As has been seen, the law of corporate groups rests on two unifying factors that lead, in

[222] Dearborn, M, *Enterprise Liability: Reviewing and Revitalizing Liability for Corporate Groups,* (California Law Review, Vol.97, Issue 1, 2009), p.209

[223] Dearborn, M, *Enterprise Liability: Reviewing and Revitalizing Liability for Corporate Groups,* (California Law Review, Vol.97, Issue 1, 2009), p.213

[224] Petrin.M, and Choudhury.B, *Group Company Liability,* (European Business Organisation Law Review, 2018), p.787

appropriate cases, to the application of enterprise principles to impose intragroup liability or other legal consequences in place of traditional entity law. These primary unifying factors are "control," typically arising from ownership or control of voting stock, and economic interrelationship[225].

In Germany, the law of corporate groups provides for a distinct regime of corporate group liability—this is in contrast to EU law, where proposals for the purpose of developing a common body of law for corporate groups were developed in the 1970s but did not come to fruition. It provides among others, in short, a contractual (optional) and a mandatory model applicable to de facto groups, which both provide for instances of the parent's or dominating company's liability. German law recognizes group companies in this manner in an effort to address the inherent conflict of interest that exists between parents and their subsidiaries, which could benefit the parent's shareholders at the expense of the subsidiary's shareholders and creditors. However, this also means that the konzernrecht regime is mostly geared towards the protection of minority shareholders and contractual creditors, not victims of torts or human rights violations that are the focus of the present inquiry

Petrin and et al summarises how they proposed different approaches within the concept of enterprise liability.

> Blumberg has suggested that such groups are characterized by the unifying factors of control and economic interrelationship. While Blumberg acknowledges the relevance of added elements such as administrative and financial interdependence, integration of employee relationships, and use of a common group persona, control remains the central tenet of conceptualizing corporate groups and as such, according to Blumberg, accordingly also justifies a 'control-based form of enterprise liability'. In recent years, notable scholarly proposals building upon enterprise liability concepts have also been outlined by other commentators. Skinner suggests, for instance, that parent company liability be imposed through a statutory enactment for violations of customary international human rights and serious environmental torts. However, she limits her suggestion of imposing statutory liability to corporations operating as part of a unified economic enterprise in 'high risk host countries'. Conversely, Dearborn proposes a model of enterprise liability that requires an economically integrated enterprise, which is defined on a case specific 'inquiry of economic, and not behavioral, control'; and an instance of a mass tort, human rights violation, or environmental harm[226].

Enterprise law may be alternatively perceived as being no more than a limitation on the application of limited liability. In this view, it simply directs that, under certain circumstances, the principle of limited liability developed to protect investors in the enterprise is inapplicable to insulate a parent

[225] Phillip.I.Blumberg, *The Multinational Challenge to Corporation Law,* (Oxford University Press, 1993), p.245

[226] Petrin.M, and Choudhury.B, *Group Company Liability,* (European Business Organisation Law Review, 2018), p.787

corporation collectively conducting a common business with an integrated subsidiary from liabilities incurred by the subsidiary in the conduct of the business. Under enterprise law, limited liability is confined to protection of ultimate investors. It does not extend to protecting the constituent companies of a corporate group from liability for the obligations of an affiliated corporation where all have been engaged in conducting fragments of a common business through adoption of separate corporate forms. In this view, enterprise law may be seen as an effort by the legal system to find a way around the problems created by the late nineteenth-century courts when they automatically extended limited liability to protect parent corporations as well as the shareholders of the parent. Such courts were apparently unaware of the significance of their application of the accepted doctrine for the protection of shareholder-investors to a newer and fundamentally different type of shareholder: the parent corporation or subholding company that was both a shareholder and a constituent part of the business. Enterprise liability is in compliance with the principles of social justice in addition to economic reality.

While Skinner advocated imposing liability on parent corporation regardless control in limited-high risk countries for human rights and environment related areas, she listed the following reasons for not adopting the principle of enterprise liability.

1. enterprise liability as typically discussed and applied requires a showing of functional, or behavioural, control over the subsidiary. In this way it is not all that different from piercing the corporate veil.

2. similar to piercing the corporate veil, requiring control can actually serve as a disincentive for parents to maintain due diligence over subsidiaries' actions—they will want to distance themselves as much as possible—and any approach should create an incentive for parent corporations to assess risks and do all in their power to prevent abuses.

3. given that corporate entities are complex and that the enterprise maintains control over documents, being able to determine, let alone establish, control would prove daunting and simply too burdensome for most victims.

4. there is no consistent definition of how much control a parent would need to assert over the subsidiary.

5. this type of enterprise liability does not take into account those situations where the parent, although not in functional control of the subsidiary, still financially benefits from the subsidiary's

actions at the expense of non-consenting victims. Enterprise liability based simply on financial control of subsidiaries or related companies with no limitations whatsoever—such as requiring that the subsidiary be part of an integrated business rather than simply an investment; limiting liability to certain torts; or limiting it to situations where the victims cannot otherwise obtain a remedy—is also not feasible. It is simply too broad. This approach would hold parent corporations liable for subsidiaries' acts regardless of the situation or location of the subsidiary. In being too broad, it offers a solution to situations that may not be problematic at all, such as where victims have the ability to seek redress from the subsidiary in a court in the host country where the victims live. In addition, because of its broadness, it is questionable whether this approach's benefits outweigh the risks of unanticipated economic and financial repercussions[227].

We argue against/for the above arguments as follows respectively:

1. Since the parent-subsidiary relationship is based on the nature of control, it is clear that control is the backbone if discuss about corporate group's issues. The type, criteria and standard of control is a separate issue. In a brief, imposing liability the parent corporation means imposing the controller. There is no parent corporation without control basically.

2. As it mentioned earlier, scholars posited that taking responsibility for own subsidiary can lead the parent corporation to focus on risk prevention. Thus, they would consider 'due diligence' actively.

3. This is true. Therefore, we propose a test for parent-subsidiary relationship-control only as defined by law, rather than for actual control. Practically, it can be determined by the registration document.

4. This argument has more to do with the U.S. In most jurisdictions, control, at least the parent and affiliated corporations, are defined in the relevant laws. This is a legislative burden rather than a theoretical one.

5. Relying solely on economic integrity, like the true enterprise principle, can lead to these consequences she stated. Therefore, it may be more appropriate to rely on a system of consolidated financial statements that has been relatively common recognised into the law of many jurisdictions rather than to prove the real unified economy. Skinner proposed the principle of holding the parent

[227] Skinner.G, *Rethinking Limited Liability of Parent Corporations for Foreign Subsidiaries' Violations of International Human Rights Law* (72 Wash. & Lee L. Rev. 1769, 2015), pp.1823-1825

corporation accountable only in risky countries with underdeveloped legal system. However, it is worth noting that the issue of group liability law is still lacking in most countries. In addition, regulating of the issue in developed countries will set an example for other countries and free them from the fear of losing investment only because of their country's ‘unique’ legal environment for corporation.

### 5.2. Counterargument to control oriented concept

Application of enterprise principles requires two additional fundamental factors. One relates to the economic unity of the group; the other is concerned with implementation of the objectives of the law in the area in question. First, the application of enterprise principles requires highly intertwined operational and economic relationships between parent and subsidiary corporations. Second, enterprise law must better implement and prevent frustration of the underlying purposes and objectives of the law in the area in question than utilization of traditional entity law would. Unless such objectives are served, economic unity of the group is unlikely to be sufficient for application of enterprise principles. Where the foregoing factors can be shown, the increasing number of common law courts applying enterprise law will do so, notwithstanding the absence of other factors essential for application of traditional "piercing the veil jurisprudence." Such elements, unnecessary for enterprise law, are the lack of indicia of the separate existence of the subsidiary, including lack of respect for corporate formalities or lack of offices, equipment, employees, and so on; and the presence of inequitable or wrongful conduct detrimental to creditors. In selected areas, the courts have increasingly been fashioning new doctrines of enterprise law and have taken a radically different approach to the attribution of legal consequences from one constituent company to another. These courts are attributing legal consequences to one legal unit by reason of its special relationship to another one. Most often, they are concerned with the imposition of liability; on occasion, they are dealing only with the recognition of rights. In procedure, they sometimes may be doing neither, only shaping rules for the conduct of judicial business. In this attribution of legal consequences, the courts may be perceived as fashioning a new concept of judicial identity in which the decision is supported by deeming the constituent corporations of a corporate group, notwithstanding their separate corporate forms, to comprise but a single legal unit for the purposes at hand. American courts have made considerable progress in the difficult case-by-case evolution of a doctrinal standard for application of enterprise principles. In the more forward-looking decisions, both in common law controversies and in construction of statutes of general application, the courts have moved well beyond emphasis on the formalistic factors that had constituted

previously the core of traditional "piercing the veil jurisprudence." This may be termed "liberalized piercing the veil jurisprudence." The courts are concerned instead with the economic realities[228].

It seems like that Dearborn believes that control is not the key to applying the principle of enterprise liablility by stating that ‘many of these examples discuss control, but they do so in a variety of ways; some hinge liability on the parent's ability to directly control the subsidiary's actions, and others on the parent's economic interest in the subsidiary. Though I will generally discuss these examples under the basic division of "control" enterprise liability, where liability flows from a parent's control over a subsidiary, versus "true" enterprise liability, where the flow of profits and unified economic purpose dictate the imposition of liability, such categories are just guideposts …the control-based enterprise liability is legally and economically problematic[229].

Most commentators argue that the enterprise liability principle cannot be applied directly due to the difficulty of the concept of control varieties. Antunes summed up about this situation as: from the point of view of economic science, one should bear in mind here that this debate has been for many years a recurrent topic in business administration science and organization theory, especially as applied to the problem of the modern multinational enterprise and choice of its best organizational patterns, But the topic is also well known in legal science. For a long time, this distinction has been regarded as constituting a crucial question with far-reaching consequences for the resolution of the main problems raised by the corporate groups. In particular, the distinction between centralized and decentralized groups has been proposed by some leading scholars as a possible regulatory criterion for the resolution of intragroup liability problems and thus as a means of solving the classic problem of the protection of creditors of subsidiary corporation[230].

Meanwhile others put the argument that these control concepts are not important in the implementation of the principle of enterprise law rather than economic control by stating that:

> With regard to the enterprise prong, the test for finding the existence of an enterprise should have at its basis an inquiry of economic, and not behavioral, control. This again highlights the difference between behavioral and economic control. Even if a parent corporation does not control the instrumentalities that cause torts, its position at the nerve center of a conglomerate enterprise may allow it to make business decisions and allocate resources that would prevent catastrophic torts in the first place. This need not mean that the parent corporation knew or even should have known that the possibility of a tort would occur. Rather, economic control attempts to restructure the allocation of liability such that the parent corporation has the incentive to prevent torts before they occur. Enterprise liability targets the economic decisions made at the nerve center

[228] Phillip.I.Blumberg, *The Multinational Challenge to Corporation Law,* (Oxford University Press, 1993), p.92

[229] Dearborn, M, *Enterprise Liability: Reviewing and Revitalizing Liability for Corporate Groups,* (California Law Review, Vol.97, Issue 1, 2009), p.213

[230] Jose.E.Antunes, Liability of Corporate Groups, (Kluwer Law and Taxation Publisher, 1994), p.180

> of the corporation, and forces those with the ability to internalize the costs of doing business to do so. Thus, enterprise liability retains the benefits of moral hazard avoidance and information access that formulations pegging liability to behavioral control provide, while eschewing the control doctrine's problems of formalism, moralization, and incentivized decentralization[231].

Definitions of control vary from country to country and between different fields of law. In general the definition is attached to the real or potential power to exercise over a company a dominant or prevailing influence by means of a majority shareholding or by majority voting rights (adding direct and indirect shareholdings and other means, such as multiple voting rights in countries where it is permitted), or a less than majority shareholding that de facto (because of regular shareholder's absence) allows to permanently prevail at ordinary shareholders meetings, or to appoint or remove the majority of the members of the board[232].

Corporation and capital market laws of the various jurisdictions show differences, but there is a substantial coincidence with regard to the concept of organic control or domination: as mentioned above, all the jurisdictions refer to a direct or indirect influence on the internal decision-making process, by various means. To that end, some national laws set definitions, both in general and for specific purposes, not only of control and domination but also of concepts like subsidiary, parent, affiliated companies, linked, related companies or the like. National reports detail some more differences and similarities, which are of lesser importance for the overall picture[233].

When twentieth-century statutory law gradually began to deal expressly with the problems presented by statutory groups, the concept of "control," long established in the corporation law, was utilized from the start as the principal foundation in the selective application of enterprise law[234]. Of course, this issue should not be skipped, as control is one of the main characteristics of a group corporation. However, since most countries' corporate laws define what control means, it would be more efficient to refer directly on the law when imposing group's liability, so it is not necessary to look at the various types of control in detail in this study and try to identify the appropriate type of liability. Control in most jurisdictions is defined with the following attribution:

- ownership of a majority voting interest of the corporation's shares
- or by a contract

[231] Dearborn, M, *Enterprise Liability: Reviewing and Revitalizing Liability for Corporate Groups,* (California Law Review, Vol.97, Issue 1, 2009), pp.251, 252

[232] Rafael Mariano.M (eds), Groups of Companies-A Comparative Law Overview (Springer, 2020), p.6

[233] Ibid.,

[234] Phillip.I.Blumberg, *The Multinational Challenge to Corporation Law,* (Oxford University Press, 1993), p.60

- power to select the board of directors and managerial level bodies.

The benchmarks of a majority voting shares are various between 25 and 100 percentage. Here are some examples related to regulative definitions of jurisdictions.

In the case of the European Union, many member countries follow the definition of controls which is defined in Seventh Council Directive as follows:

1. A Member State shall require any undertaking governed by its national law to draw up consolidated accounts and a consolidated annual report if that undertaking (a parent undertaking):

> (a) has a majority of the shareholders' or members' voting rights in another undertaking (a subsidiary undertaking); or
>
> (b) has the right to appoint or remove a majority of the members of the administrative, management or supervisory body of another undertaking (a subsidiary undertaking) and is at the same time a shareholder in or member of that undertaking; or
>
> (c) has the right to exercise a dominant influence over an undertaking (a subsidiary undertaking) of which it is a shareholder or member, pursuant to a contract entered into with that undertaking or to a provision in its memorandum or articles of association, where the law governing that subsidiary undertaking permits its being subject to such contracts or provisions. A Member State need not prescribe that a parent undertaking must be a shareholder in or member of its subsidiary undertaking. Those Member States the laws of which do not provide for such contracts or clauses shall not be required to apply this provision; or
>
> (d) is a shareholder in or member of an undertaking, and:
>
> (aa) a majority of the members of the administrative, management or supervisory bodies of that undertaking (a subsidiary undertaking) who have held office during the financial year, during the preceding financial year and up to the time when the consolidated accounts are drawn up, have been appointed solely as a result of the exercise of its voting rights; or

(bb) controls alone, pursuant to an agreement with other shareholders in or members of that undertaking (a subsidiary undertaking), a majority of shareholders' or members' voting rights in that undertaking. The Member States may introduce more detailed provisions concerning the form and contents of such agreements.

Germany's corporate group law, Aktiengesetz (1965) provides legal definitions in Sections 16–18. Summed up these provisions- 'Enterprises Under Majority Ownership Section 16 concerns 'enterprises under majority ownership' by another enterprise. The definition is met when a shareholder holds either the capital majority or the voting majority. Controlled Enterprises Section 17 defines 'control', a pivotal term for German konzernrecht. Not only does it constitute a key requirement for a 'group', but 'control'–rather than the existence of a 'group'–also leads to the application of the rules on de facto groups in the absence of a formal control agreement. According to this, 'control' requires a direct or indirect controlling influence'[235].

Portuguese Company Law, Article 486 defines relationship of control as 'It shall be considered that two companies are in a relationship of control whenever one of them, the dominant one, is in a position to exercise an influence of dominance over the other company, the controlled company, either directly or through companies or persons fulfilling the pre-requisites indicated in article 483'. It shall be assumed that the company is controlled by another, directly or indirectly, when the dominant company:

a) Holds a majority equity interest in the capital;

b) Controls more than half of the votes;

c) Is in a position to appoint more than half of the members of the board of directors or supervisory body of the company.

Dutch law defines the concept of subsidiary rather than that of control, but the definition is still in line with the one provided by most other European jurisdictions, in the sense that in all cases a controlling relationship must exist, either by means of a majority shareholding or by the power to appoint or remove the majority of the members of the management board[236].

[235] Scheuch.A, Konzernrecht: An Overview of the German Regulation of Corporate Groups and Resulting Liability Issues (European Company Law, 2016, Vol.13, Issue 5), p.192

[236] Rafael Mariano.M (eds), Groups of Companies-A Comparative Law Overview (Springer, 2020), p.8

Australian Corporate Law also defines a subsidiary corporation as follows:

A body corporate (in this section called the *first body* ) is a subsidiary of another body corporate if, and only if:

(a) the other body:

(i) controls the composition of the first body's board; or

(ii) is in a position to cast, or control the casting of, more than one-half of the maximum number of votes that might be cast at a general meeting of the first body; or

(iii) holds more than one-half of the issued share capital of the first body (excluding any part of that issued share capital that carries no right to participate beyond a specified amount in a distribution of either profits or capital);

(b) the first body is a subsidiary of a subsidiary of the other body.[237]

Enterprise law theorists often argue that enterprise law takes various types of corporations into account. Although enterprise law is often directed at hierarchical groups resting on ownership of a majority or other percentage of voting shares, the concepts of de facto "control," controlling influence over the management or policies, "participating interest" and "dominant influence" are flexible enough to respond not only to hierarchical groups, but also to newer forms of groups such as networks or other interrelationships[238]. Parent corporations could then routinely avoid unlimited group liability by converting wholly owned subsidiaries into companies with small minority interests. Confronted with this problem, professors Hansmann and Kraakman abandon a corporate law solution in this area, completely eliminating limited liability for all corporate groups. Instead, they argue for a tort law solution restricted to elimination of limited liability in tort[239]. On the contrary, Blumberg stated that ‘under this principle of having liability follow the control group, rather than shareholder status generally, the rule for intergroup liability is the same without regard to whether the subsidiary is fully or partly owned. In a regime of unlimited liability, this principle

[237] Corporations Act of Australia, 2001, Section 46.
[238] Phillip.I.Blumberg, *The Multinational Challenge to Corporation Law,* (Oxford University Press, 1993), p.246
[239] Hansmann.H, and Kraakman.R, Toward unlimited shareholder liability for corporate torts, (Yale Law J 100:1879–1990, 1991)

would seemingly avoid the problem'[240]. In addition to this, he recommended the veil lifting for partly owned corporations.

We consider here that the key criterion is neither wholly owned nor partly owned but owned a majority of shares that is enough to control. That means including both.

With such factors as "control" and economic integration not fundamentally distinguishable from those operating in the case of corporate groups and franchisors/franchisees and licensors/licensees, the law has similarly responded in isolated cases with a comparable application of enterprise doctrines to contractors and subcontractors[241].

Blumberg also noted additional elements such as financial, administrative, labour interdependence[242]. In all cases it has been accepted that the existence of the parent corporation's control over the decision-making of the subsidiary, even when combined with the presence of common officers and directors, is not decisive in and of itself. These cases go further and inquire into the extent that such control has been exercised. They are particularly concerned as to whether there has been an excessively intrusive intervention by the parent and its personnel into the decision-making of the subsidiary when compared to normal management patterns in the contemporary business world. The parent's exercise of control over day-to-day decision-making, for example, is already widely recognized as one form of unacceptable exercise of control that will lead to imposition of liability (or other legal consequences) on the parent. Control by the group over such matters as determination of general policy; planning; budgets and capital expenditures; executive salaries and bonuses; and group use of manuals and guidelines setting forth group policies with respect to such matters as personnel, safety, purchasing, labor relations, public relations and affairs, accounting, finance, ethical standards, and the like have received differing receptions by different courts[243].

Researchers have different opinions on whether it is right or wrong to assign responsibility for risk prevention to a parent corporation. For example, Antunas expressed the following opinion:

> By exposing parent corporations to potential liability for the default risk of each subsidiary and thus to a permanent threat of group insolvency, such a system is likely to indirectly constrain group headquarters to

[240] Phillip.I.Blumberg, *The Multinational Challenge to Corporation Law,* (Oxford University Press, 1993), p.143
[241] Ibid., p.246

[242] Ibid.
[243] Ibid., p.96

> narrow strategic choices so as to avoid risk exposure: and that means to exercise a very tight unified management, exerting a complete control and oversight of the entire affairs of the subsidiaries in order to prevent undesirable or unexpected liabilities which could risk dragging the entire group into insolvency. Such a system would thus entail not only a strong deterrent effect on the formation of future corporate groups or on the expansion of existing ones (by dissuading the undertaking of new investments economically and socially desirable), but also would seriously curtail their organizational freedom, forcing them indirectly to adopt in advance those strongly hierarchical and centralised organizational structures that seem nowadays largely bypassed. Only when in possession of a coherent and global conception of the very nature of this, may a solid legal strategy be developed to cope with the concrete problems it raises, or, more ambitiously, to seize it as a whole.[244].

Contrary to this common precaution, Deaborn makes the following comment in favour of the enterprise liabity: enterprise principles, rooted in economic reality rather than legal fiction, remedy this disjunction by focusing solely on the profits and unitary purpose of the business when imposing liability. Furthermore, behavioral control-based liability may incentivize the very type of decentralization, and subsequent risk externalization, that enterprise doctrine seeks to combat. Tying liability to control naturally incentivizes corporations to take a hands-off approach to governance in order to avoid liability-an incentive that is particularly strong in ultrahazardous activities. If a corporation is more likely to be held liable if it does not control the day-today operations of the subsidiary, this encourages parent corporations to provide less oversight. As a consequence, if liability is pegged to direct control, corporations will seek to avoid liability through decentralization, allowing subsidiaries to more or less govern themselves. However, presumably, the parent corporation would still' financially or logistically support the activities of the subsidiary to a degree that the subsidiary, acting alone, might not obtain. This creates the potential for subsidiaries to engage in risky behavior with a parent's capital while the parent is not held liable for the consequences of the risk. From a normative standpoint, society might desire just the opposite, because parental oversight of the subsidiary provides more layers of safety and can prevent disasters before they occur[245].

Skinner has recommended a more reformative proposal that ‘enact legislation to disregard limited liability of parent corporations for claims of customary international human rights violations and serious environmental torts’ subject to a number of conditions such as operations in a high-risk

[244] Jose.E.Antunes, Liability of Corporate Groups, (Kluwer Law and Taxation Publisher, 1994), p.483

[245] Dearborn, M, *Enterprise Liability: Reviewing and Revitalizing Liability for Corporate Groups,* (California Law Review, Vol.97, Issue 1, 2009), pp.250

host country and victims being unable to obtain remediation in the host country. The proposal is addressed to US lawmakers and has a narrow coverage of rights and situations, but is coupled with strong remediation through a strict liability standard favourable to claimants. This prioritization of severe abuses for a legalization effort is consistent with Ruggie's end of mandate suggestion on international legalization. In this way, Skinner's proposal carves an exception from the limited liability principle rather than downplaying its importance or proposing a wholesale rejection. Skinner considered that the 'enterprise liability' doctrine of holding MNEs liable without careful limitations is 'not feasible… is simply too broad, and as such, would not likely gain any traction with legislators.'[246]

It is almost impossible to have a perfect legal strategy and regulation, so that it is our direction to look for a more balanced approach.

### 3.1. Summary

Since we investigated the existing theories and principles that impose liability on parent corporations, an exploration of developing them further to reach the study's aim.

Even though the scope of this study does not consider regarding how the law would recognise the organisational form and control related to the definition of corporate group, because of two reasons, the issues around control are briefly addressed: 1. the proposed approach in this study is legal control-based; 2. in order to clarify that there is no need to obscure the issue of accountability due to the complexity of the controls as discussed in previous literatures.

In spite of the parent corporation is the sole or dominant shareholder of its subsidiaries, it is not merely an investor. The parent is itself engaged in the business. Along with its subsidiaries, it collectively conducts a common business under its central control[247].

Theoretical researchers have argued that it is difficult to apply the principle of enterprise law directly because control cannot be defined and resolved. For example, Antune observed that it is also impossible to lay down a general borderline between these two basic forms of governance structure since it varies from group to group, from subsidiary to subsidiary, from function to function, from decision to decision. The degree of parent control varies from group to group and it

[246] Radu Mares, Legalizing Human Rights Due Diligence and the Separation of Entities Principle, (Chapter, October 2017)
[247] Phillip.I.Blumberg, *The Multinational Challenge to Corporation Law,* (Oxford University Press, 1993), p.232

is virtually impossible to generalize due to the variety of factors according to which the balance between autonomy/control can vary and to numberless available combinations[248].

We propose partially enterprise liability, which is in the range of mass torts, insolvency, fraud issues, human rights violations, and environmental harms. Adopting the principle of entreprise liability to be applied directly to certain areas as a basic principle without many tests and criteria it will avoid repeating the metaphors and unpredictability of the veil lifting technique. As noted, this approach focuses not merely on "control," but also not denied like the advocates who concentrate more on economic perspective.

Although commentators who advocate enterprise liability law criticize the principle of veil lifting, they themselves make equally unclear and vague proposals. However, some, especially in areas such as mass tort, bankruptcy, human rights, and the environment, offer more specific and straightforward suggestions. Dearborn stated that a final frequent criticism of enterprise liability is that any test would be too vague. "While enterprise liability may offer some appeal, measuring the extent of an 'economic unit' introduces an intolerable level of uncertainty into the question of liability." This is because courts will be forced to determine the boundaries of the economic enterprise, which will rarely be clear. Of course, this same criticism applies to the doctrine of piercing the corporate veil. There must, however, be some law allowing claimants to recover against the primarily responsible party in a corporate web[249].

The corporate responsibility analysis outlined in this study optimizes enterprise liability theory by imposing liability on a parent corporation in the selected area, based on parent-subsidiary relationship in accordance with regulatory definition. Those areas are namely mass tort, human rights, environmental harm and insolvency. The main reasons for prioritising on these sectors are, as evidenced by the current case study and case law, which are the most challenging in reality. Also, in these areas, social justice is most likely to be lost. However, this does not mean that the scope of application of enterprise principle should be limited to only these areas such as minority shareholders, labour, governance, competition and so on.

## CHAPTER SIX: RECOMMENDATIONS AND CONCLUSIONS

[248] Jose.E.Antunes, Liability of Corporate Groups, (Kluwer Law and Taxation Publisher, 1994), p.207

[249] Dearborn, M, *Enterprise Liability: Reviewing and Revitalizing Liability for Corporate Groups*, (California Law Review, Vol.97, Issue 1, 2009)

### 6.1. Recommended proposal

I will ultimately draw conclusions based on the lessons and variations of these differing doctrinal approaches to the enterprise issue. By building off the volume of academic literature in this area, learning from the history of limited liability, and looking to the jurisdictions and areas where enterprise liability has crept into the landscape of corporate law, some conclusions can help inform the construction of a new proposal for enterprise liability.

To sum up proposals and doctrines from the main literature review sources of this study: the classic enterprise theory, proposed by Blumberg and others, based on more functional control, and Dearborn's true enterprise is relied on economic control, and these approaches have not been accepted broadly. But it has not accepted into a positive law; just as it is difficult to define control in a veil lifting approach, it is difficult to define a real economic integration. Yet, Skinner's approach is in line with international and national law concept. The scope is limited by the test based on a country’s development. The issue of group liability is viewed in terms of in terms of international human rights and environmental law but not as a problematic issue of corporate law. The approach of duty of vigilance / due diligence adopted in international law is currently applied only to human rights violations and environmental damage, and its main feature is that it does not take into account the specifics of corporate structures, which have so far been unresolved. This is more straight-forward solution.

The approach we propose is that maintaining control based character of the enterprise principle but take parent corporation to extended liability, regardless of the group’s type, structure, size. Same as the principle of duty of vigilance / due diligence, this means that the type and structure of the group are not taken into account. In terms of coverage, it would cover areas such as human rights, environmental protection, mass tort, and bankruptcy, in other words, it can be a partial enterprise liability approach. Although it governs other areas of law, the basic principles should be adopted into corporate law. In this way, it can be considered to be one of the principles of corporate law, limiting the dogma of limited liability principle of corporate law.

Proponents of entreprise liability theory have proposed a variety of standardised tests, which may lead to the same criticism as the veil lifting doctrine faces that:

- it is difficult that court distinguish whether the parent corporation has violated a standard of care. Although it remains an option, a test is typically very difficult to satisfy, and impossible to satisfy without showing that the parent controlled the subsidiary.
- It is too vague and inconsistent, relying on high standards of control, the application is too narrow. Similar to lifting the corporate veil, requiring very tight, centralised, close control can actually serve as a disincentive for parents to maintain due diligence over subsidiaries' actions—they will want to distance themselves as much as possible—and any approach should create an incentive for parent corporations to assess risks and do all in their power to prevent abuses.

The major weakness of this new 'enterprise approach' consists in the uncertainty, automatism and rigidity of the solutions worked out for intragroup liability cases. Therefore, the response needs to be relatively flexible.

The principle of entreprise liability must be provided with equal opportunities like limited liability principle that is applied without any restrictions or criteria for any type of corporation, but of course in certain sectors. Subsidiaries of a group are also difficult to legally regulate because of their complex nature of being independent and dependent, separated and controlled. So that, it may also require dual-mode regulating strategy because of its dual nature.

This research's proposal has two meanings: 1. legal control in addition to economic integration 2. limted areas. Legal control means that it refers directly on the control definition provisions set out in the relevant law of the country. This model is adopted in international human rights law and in French due diligence/duty of vigilance law which disregards whether the group has centralised or decentralised structures. To mention again, this study only addresses the issue of joint liability of the parent corporation.

Adopting the principle of enterprise liability only partially to certain areas- mass tort, human rights, environment, insolvency- may make this principle more flexible attribution. It also renders that limited liability, which is a fundamental principle of corporate law, does not need to be modified in its entirety. This does not, however, preclude the application of the principle of enterprise as a fundamental principle in these areas as limited liability. Because the principle of limited liability is applied to the corporate group, regardless of its form, structure or size, so it should be equally serve to the principle of entreprise liability.

## 6.2. Conclusion

Despite the existence of some academic proposals to modify the legal approach, the first of which was made over a century ago, it is important to recall that the group is not recognised as a unified business organisation, nor it is a legal entity, nor does it have its own standing before the courts of any country. There are however some situations for certain limited purposes, the law looks into the corporate groups.

Moreover, more than 25 years of intensive academic debate have rendered evident the difficulty for legal scholarship itself to provide a safe basis for the filling of this statutory gap (in particular, the crucial problem of the determination of the minimum level of centralization required by the existence of unified management), doctrine considering this concept to be an 'undetermined fill-wanting juridical concept[250].

The long corporate group story has been still unfolding. Blumberg and others who support the enterprise law approach concluding that the application of the limited liability principle to a corporate group happened historically unplanned and accidental[251]. Mostly, lawyers, researchers, and legislators pay attention to the traditional legal issues regarding corporations, but they do not look out sufficiently to the legal issues of modern corporations operating through group structure. Even though some regulations and provisions of group relations have been in few countries since the 1960s, they have been discussed only in a few academic studies and court documents. In today's business world, corporate groups have become dominant, we are facing the challenge to develop a compatible regulation with modern reality for the groups. It is complicated to regulate the groups, as the subsidiary corporation has the contradictory features: on the one hand, independent, separate entity but on the other hand, controlled unit. Therefore, legislators might be wary that denying the traditional legal protection of the corporation could adversely affect the economy and business. These are the main reason why the legislation in the corporation is left behind.

The theory of enterprise liability posited in this research revitalizes and updates Adolf Berle's groundbreaking theory by imposing joint and several liability on corporate groups in the context

[250] Jose.E.Antunes, Liability of Corporate Groups, (Kluwer Law and Taxation Publisher, 1994), p.297
[251] See Phillip.I.Blumberg, *The Multinational Challenge to Corporation Law,* (Oxford University Press, 1993); Phillip.I.Blumberg, *The Transformation of Modem Corporation Law: The Law of Corporate Groups*, (Connecticut Law Review, 2005, Vo.37, No.5)

of mass torts, human rights violations, and environmental harms. A new test for enterprise liability would remedy entity liability's deficiencies with regard to involuntary creditors by providing a direct cause of action against the parent corporation. With regard to the corporate group, the test would address the deficiencies of entity liability's failure to recognize the economic unity and legal control of the corporate family by reference to other jurisdictions' experiments in this area.

Limited liability is a principle recognised by all market-oriented legal systems around the world as promoting optimal economic and enterprise efficiency. However, that recognition has been made indiscriminately for both single independent corporations and dependent subsidiary corporations, without any apparent consideration of the soundness or desirability of that extension.

The corporate law system of most jurisdictions generally, is grounded on entity law—the view that each corporation is a separate juridical person, even when owned and controlled by another corporation with which it conducts a common business enterprise. However, in an era of multinational corporations, where the economies of the world are closely interlocked and major economic activity is overwhelmingly conducted by centrally controlled corporate groups consisting of scores or even hundreds of affiliated corporations functioning in many different countries, entity law—however accurately it reflected the economic society of the early nineteenth century when it developed—has become hopelessly anachronistic. The entity law concept of the corporate juridical personality no longer matches the economic reality. Legal systems the world over are accordingly struggling with the development of new concepts of corporate personality to deal with this urgent problem.[252]

Since separate personality and limited liability is one of the fundamental stone of corporations, this study does not argue for a complete elimination from them but does for some targeted area partly**.** Even though the exaggerated dogma of limited liability has long been a major barrier to corporate liability, gradual changes have succeeded recent years.

This research attempts to advocate the acceptance of joint and shared liability within the corporate group based on the latest and the most innovative jurisprudential principles and doctrines. These pioneering laws will provide the most encouraging building blocks available for future doctrines of enterprise law.

[252] Phillip.I.Blumberg, *The Multinational Challenge to Corporation Law,* (Oxford University Press, 1993), p.100

Enterprise law is the conceptual solution being developed by courts and legislatures to respond to the inadequacies of anachronistic entity law inherited from the small-business world of the nineteenth century. It seeks to formulate a legal system capable of dealing adequately with the activities of giant, worldwide corporate groups. It plays a role of increasing importance in the legal systems of the modern world. The acceptance of enterprise law thus far has been incremental, selective, and supplemental. Enterprise law is not intended to replace entity law in whole corporate law, but more like in discrete areas where it better serves the underlying policies and objectives of the law. Entity law continues unchanged in other respects. Enterprise law is a pragmatic response of the legal and political system to changing political, social, and economic realities. In a selective manner, where enterprise principles implement its underlying policies and objectives, the law is matching responsibilities to the collective economic activity. Like the evolution of such legal phenomena as derivative liability and successor liability, which it resembles closely insofar as the attribution of responsibilities are concerned, it is part of the continuing process of adaptation of older doctrines of law to accommodate the new challenges of changing realities. Developed to serve the needs of a contemporary economic society so very different from that of the past, enterprise law is an evolutionary development moving beyond the outmoded doctrine of legal entity. Closely resembling other modern legal developments adapting older doctrines to accommodate economic developments, enterprise law is a product of the modern age, an age in which the law is increasingly concerned with multifactor factual analysis, rather than with transcendental legal constructs. In several jurisdictions, certain forms of enterprise liability are recognised.

The limitations and uncertainties of lifting the corporate veil cannot provide the regulation of the corporate groups which need a selective and specific manner. The principle of veil lifting is ineffective and incomplete, and it does not have a proper legal response to the dynamics and the reality of corporate business activities, so it may be more efficient to adhere to enterprise law approach in further legislation. This mechanism has the advantage of flexibility but lacks the certainty that suitable theory-based legislation would present. There is a tendency that countries are beginning to apply the enterprise principle somehow, nevertheless, the corporate group law's failure to formulate comprehensive and coherent group regulations and laws do make it difficult for the court to apply it.

Rather than completely denying the limited liability of corporate groups, because of avoiding adverse economic consequences and radical changes, the tendency to legitimize this principle may

be proper today in some areas of the law. It would be recommended to introduce the principle of extended liability in the areas of insolvency, mass tort, compensation for harm and damage to the environment at first. A broader perspective of regulation here is demanded. In doing so, consideration should be given further to when adopting enterprise liability principle, whether there must be criteria for the relationship and structure of the subsidiaries and parent or not. Understanding the distinct mechanisms of corporate groups may be a key to a fresh approach-enterprise liability.

When legal issues on corporate groups raising, law makers and researchers do not look at its regulation as complete, systematic rules must be there but just consider its single part and provision. As a result, lawyers are faced with incomprehensible and irreconcilable court decisions in legal practice. Since no systematic examinations of corporate group law have been undertaken, a full legal analysis of the relevant law at academic level is needed. Academic research based on an appropriate doctrine, with a theoretical approach is the base for solving these legal issues and difficulties.

Ideally, this partially enterprise liability framework would restructure the decisional processes within corporate groups to prevent catastrophic harms, while it enhances the reputation of the business and in compliance with justice.

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