Risky Business

The Case for Enterprise Analysis at the Intersection of Corporate Groups and Torts

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Image: Asbestos Fibre, Unrehabilitated Cape Industries Mining site, Koegas, South Africa (Hein du Plessis).

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Abstract
Modern company law is at a fork in the road: the choice between entity principles, embodied by the traditional doctrines of corporate personality and limited liability, and enterprise principles, characterised by the treating of a parent and its subsidiary companies as one business unit. This paper presents the case for adopting enterprise liability for parent companies that incorporate a subsidiary in order to conduct risky business activities. The history of limited liability and corporate groups, and the inapplicability of the benefits of limited liability to corporate groups, is discussed. An overview of current implementations of enterprise liability is given. These implementations are used to identify the possible bases for a test of enterprise liability and an economic test for enterprise liability is advocated. Finally, some factors that could be included in a test for enterprise liability are suggested, taking the first steps toward the implementation of enterprise liability at the intersection of corporate groups and torts.

Risky Business

The Case for Enterprise Analysis at the Intersection of Corporate Groups and Torts

INTRODUCTION

Modern company law is at a fork in the road:[1] the choice between entity principles, embodied by the traditional doctrines of corporate personality and limited liability, and enterprise principles, characterised by the treating of a parent and its subsidiary companies as one business enterprise. This paper will present the case for the adoption of enterprise principles at the intersection of corporate groups and torts, that is, treating a parent and subsidiary as a single enterprise for the purposes of compensating victims of a subsidiary's torts.

The focus of this paper will be on what will be termed the 'risky business' scenario, where a company incorporates a subsidiary that it wholly owns for the purposes of carrying on a dangerous activities and shielding itself from liability. In this scenario the subsidiary is typically undercapitalised in relation to the gravity of the risk it takes, resulting in the non- or under-compensation of tort victims. Thus the social costs of the activities are shifted away from the business conducting them.[2] This situation was succinctly summarised by Justice Templeman:

> *A parent company may spawn a number of subsidiary companies… If one of the subsidiary companies… turns out to be the runt of the litter and declines into insolvency… the parent company and the other subsidiary companies may prosper… without any liability for the debts of the insolvent subsidiary.*[3]

A brief history of limited liability and corporate groups will be offered and their relationship with each other, and with the law of torts, will be discussed. The application of limited liability to corporate groups and torts will be criticised and the case for enterprise liability will be made. In the latter part of the paper, some potential problems for enterprise liability will be considered and the bases for finding two or more companies to be a unified enterprise will be assessed. Finally, some factors for a test for enterprise liability will be suggested.

HISTORICAL FOUNDATIONS

(a) Limited liability

One especially enthusiastic commentator lauded limited liability as the 'greatest single invention of modern times', stating, 'even steam and electricity are far less important.'[4] Others have been less exuberant in their praise,[5] but the importance of limited liability generally seems beyond dispute: it has undoubtedly encouraged the accumulation of capital for enterprise on a scale unimaginable without it.

While its importance is seldom doubted, the exact timing of its appearance on the scene of corporate law in the UK is difficult to pinpoint.[6] Certainly, by the second half of the 17th century, people were citing limited liability as a motive for incorporation,[7] 'most charters were silent [on the matter], and it had become accepted increasingly that in the absence of charter provision, shareholders were not directly liable'.[8] The Attorney-General in 1784, stated that the 'individuals who may compose the corporation would not be

[1] See Kluver, 'Entity vs. Enterprise Liability: Issues for Australia' (2005) 37 Connecticut L Rev 765, 767.

[2] See Easterbrook and Fischel, 'Limited liability and the Corporation' (1985) 52 U of Chicago L Rev 89, 111.

[3] *In re Southard & Co.* (1979) 1 WLR 1198, 1208 (CA).

[4] Butler, *Why Should We Change Our Form of Government?* (New York: Charles Scribner's Sons, 1912) 82.

[5] E.g. Grundfest, 'The Limited Future of Limited Liability' (1992) 102 Yale L J 387, 420 ('it has its theoretical flaws. It is not a thing of perfect beauty, but at least it works').

[6] Blumberg, 'Limited Liability and Corporate Groups' (1986) 11 J of Corporation L 573, 579.

[7] Goebel (ed), DuBois, *The English Company After the Bubble Act 1720-1800* (Oxford: OUP, 1938) 95-97.

[8] Blumberg, 'Limited Liability', n 6, 580 (citations omitted).

liable in their private characters'.[9] The Joint Stock Companies Registration Act 1844 provided for unlimited liability, but this proved unworkable and was replaced shortly afterwards.[10]

The widespread acceptance of limited liability emerged from railway companies, where shares were widely dispersed, management and shareholdings were separate, and tortuous liability of individual shareholders could not be avoided: acceptance of limited liability for the railways 'foreshadowed the ultimate acceptance of limited liability generally'.[11]

In 1855, Parliament enacted the Limited Liability Act and limited liability was 'definitively accepted in English law'.[12] The dominance of limited liability was affirmed by the seminal Salomon case,[13] where the Court confirmed that all a party need do to attract the protection of limited liability is comply with the statutory requirements for company registration, rejecting any purposive approach, or any limitation on the strict wording of the Act.

(b) Corporate groups[14]

Whereas limited liability was a deliberate decision taken due to commercial pressures,[15] corporate groups seem to have emerged almost by accident. The Companies Act 1862[16] provided for incorporation, giving companies the powers specified in their memorandum of association, including, if specified, the power to acquire shares in another company. The statute did not specifically contemplate this possibility and the Courts, taking a literal approach to the statute similar to that taken in Salomon, applied the *ultra vires* doctrine: a company could purchase shares in another company so long as it was authorised by its memorandum.[17]

From these haphazard beginnings, the prominence of corporate groups has ballooned. In Britain, the top 50 companies have an average of over 200 subsidiaries[18] and corporate groups are now 'conduct of the great bulk of the economic activity of the industrialized world'.[19]

LIMITED LIABILITY, CORPORATE GROUPS AND TORT VICTIMS

The power to purchase shares was given to companies, apparently without awareness of the consequence, which was the imposition of two layers of limited liability: the original layer, protecting the ultimate investors in a company from claims against that company, and a new layer, protecting a parent company from liability from a claim against its subsidiary. Likewise the subsequent application of limited liability to corporate groups was ill considered, and a fundamental principle has been accepted, 'apparently without consideration of whether such acceptance was sound'.[20]

Just as corporate law has not paid due attention to corporate groups and limited liability, tort victims have been ill considered. When limited liability was gaining credence, the problems associated with applying the

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[9] Kenyon, *Case and Opinion of January 29, 1784*, Boulton and Watt MSS, Birmingham Collection, Assay Office, cited in DuBois, n 7, 95-96.

[10] Blumberg, 'Limited Liability', n 6, 583. Nevertheless, nearly 1000 unlimited companies were registered under the Act until it was replaced by the Limited Liability Act 1855. Hunt, *The Development of the Business Corporation in England 1800-1867* (Cambridge, Massachusetts: Harvard University Press, 1936).

[11] Ibid 584.

[12] Ibid 585.

[13] *Salomon v A Salomon & Co Ltd* [1897] AC 22.

[14] For a detailed general analysis, see Prentice, *Groups of Companies: The English Experience* in Hopt (ed), *Groups of Companies in European Law: Legal and Economic Analyses on Multinational Enterprises* (Berlin: Walter de Gruyter, 1982) 99.

[15] Blumberg, 'Limited Liability', n 6, 585.

[16] 25 & 26 Vict c89.

[17] Making some attempt to find authority for the practice in the statute, the Courts were partially persuaded by the fact that corporations were mentioned in the definition of 'persons', who could become members of a company. *In re Barned's Banking Company* (1867) 3 LR Ch 105, 112-13; *In re Asiatic Banking Corporation* (1869) 4 LR Ch 252, 257.

[18] Tricker, *Corporate Governance* (Oxford: OUP, 1984) ch 3. Given that this calculation was performed in 1981, it is likely that the number would be much higher now. BP, to take an extreme example, owned, in 1984, between 1200 to 1300 subsidiaries. Hadden, 'Inside Corporate Groups' (1984) 12 Intl J of the Sociology of L 271, 273.

[19] Blumberg, 'Limited Liability', n 6, 603.

[20] Ibid 610.

doctrine to tort creditors had not been considered.[21] Indeed, it was not thought that the doctrine would entail any more than simply protecting investors in the company from the unsatisfied claims of the creditors.[22]

The leading UK case on the law of corporate personality and the limited liability of groups is Adams v Cape.[23] Cape Industries headed a group of companies involved in asbestos mining and marketing. Asbestos mined by one subsidiary in South Africa was used, by another subsidiary, in a Texas factory resulting in 668 personal injury claims. In negating to enforce the Texas judgment for 206 claimants[24] against the UK parent of the group, the Court of Appeal refused to break with the traditional separate entity approach. The Court also refused to 'pierce the veil', further distancing tort victims from compensation.[25] Thus, the Court of Appeal vigorously reaffirmed the strict application of limited liability to corporate groups, rejecting the many arguments made for imposing liability on a subsidiary company.

Given that the approach taken to corporate groups generally has been to squeeze them into the pre-existing body of company law, and that, at the same time, consideration has not been given to tort victims in the application of limited liability, there is clearly a need for thorough a re-examination of this area of the law.

ARGUMENTS AGAINST APPLYING LIMITED LIABILITY TO A WHOLLY OWNED SUBSIDIARY COMPANY

(a) Inapplicability of justifications for limited liability

The key argument against applying limited liability in the context of corporate groups is that the arguments in favour of limited liability generally do not apply in the present context. The law was not designed with complex group structures in mind and its application in such circumstances is 'anachronistic and dysfunctional'.[26] The justifications for limited liability generally hinge on the characterisation of the shareholders as passive investors who have no interest in the business other than that their money is invested in it. However, in the 'risky business' case of subsidiary incorporation, the parent corporation is not such an 'absentee owner',[27] but is in fact the driving force behind the subsidiary. Thus, many of the advantages of limited liability that apply to absentee investors do not hold in the present situation.

The numerous advantages of, or justifications for, limited liability generally are well expounded, and many commentators have helpfully and comprehensively identified them.[28] These justifications are considered briefly below in relation to corporate groups.

(1) Eradicates high collection costs associated with collecting from numerous dispersed shareholders

Where there are many shareholders, this argument holds because the cost of collecting from numerous ultimate investors would consume the benefit of so collecting,[29] however this argument will not apply to a wholly owned subsidiary, where collection will only be sought from one party.[30] Indeed, even where two or more different companies own another company, it is still likely that collection costs will not be so great so as to negate any benefit gained.

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[21] Leeborn, 'Limited Liability, Tort Victims and Creditors' (1991) 91 Columbia L Rev 1565, 1566.

[22] Stone, 'The Place of Enterprise Liability in the Control of Corporate Conduct' (1980) 1 Yale L J 1, 70 ('Only later, when corporate liability for serious wrongdoing had grown from the exception to the rule, could the principle of limited liability have taken on, imperceptibly, a meaning not originally signified') (citations omitted).

[23] *Adams v Cape Industries Plc* [1990] Ch 433.

[24] 462 claimants settled out of court.

[25] In other jurisdictions that utilise entity principles, there is, at least, some willingness to pierce the veil, e.g. The US and Australia. See Thompson, 'Piercing the Corporate Veil: An Empirical Study' (1991) 76 Cornell L Rev 1036 and Ramsay, 'Allocating Liability in Corporate Groups: An Australian Perspective' (1999) 13 Connecticut J of Intl L 329 respectively.

[26] Blumberg, 'The Law of Corporate Groups' (2005) 37 Connecticut L Rev 605, 660.

[27] Blumberg, 'Limited Liability', n 6, 624.

[28] See, e.g., Blumberg, 'Limited Liability', n 6, 611-616; Muscat, *The Liability of the Holding Company for the Debts of its Insolvent Subsidiary* (Aldershot: Dartmouth, 1996) 162-175; Easterbrook and Fischel, *The Economic Structure of Corporate Law* (Cambridge, Massachusetts: Harvard University Press, 1991).

[29] See Thompson, 'Unpacking Limited Liability: Direct and Vicarious Liability of Corporate Participants for Torts of the Enterprise' (1994) 47 Vanderbilt L Rev 1, 20.

[30] Leeborn, n 21, 1612.

(2) Increasing development of very large enterprises

When speaking of one company only, there is a need to encourage investment from a wide range of sources as '[l]arge scale enterprise involves enormous risks that dwarf the financial resources of all but the wealthiest shareholders'.[31] Clearly, in the group context, this is not relevant, as the only, or the dominant, shareholder is the parent company. The parent company has the ability to diversify its portfolio and spread its risks in a way that ordinary investors cannot,[32] and therefore does not require the protection of limited liability to develop its businesses further.

(3) Avoidance of increased agency costs

Jensen and Meckling[33] suggest that, in the absence of limited liability, activities prejudicial to the shareholders, undertaken due to 'divergence between [the manager's] interest and those of the outside shareholders',[34] can be limited by monitoring. However, in the group context, the need to establish congruence of these interests does not arise because the manager and shareholder is the parent company, so these interests will necessarily be congruent.[35]

(4) Avoidance of the impairment of capital market efficiency

This argument is advanced because limited liability enhances the ready transferability and uniform pricing of shares,[36] but, in the case of the wholly owned subsidiary, no adverse affect on the public market can occur as no such market exists.[37]

(5) Encouragement of risk taking

This is probably the most significant factor in the present context.[38] The argument that limited liability encourages risk taking remains applicable because, as noted, a holding company generally wishes to take advantage of the possibility of externalising risk using a subsidiary. There is, however, a danger, which appears to have come to pass in cases such as Adams, that this can encourage risk that is excessive because 'owners who engage in excessively risky activities are protected from liability'.[39]

Muscat qualifies his exposition of this justification, referring to encouraging only 'socially desirable high risk projects',[40] however, while this qualification may be a good addition in theory, in practice it seems unlikely that corporate groups are predisposed to conducting only socially-desirable projects. On the contrary, a holding company is likely to seek profit maximisation, which may take place using subsidiaries that are not necessarily engaged in socially desirable activities.[41] In addition, the law does not state that only such projects must be pursued and any attempt to so limit a company would inevitably run into a plethora of issues, not least determining what is, in fact, 'socially desirable'.

ARGUMENTS AGAINST APPLYING LIMITED LIABILITY FOR TORTS

(b) Limited liability unduly prejudices tort victims

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[31] Blumberg, 'Limited Liability', n 6, 613.

[32] It is worth noting that the same argument has been applied in relation to financial institutions who are ultimate investors. See Halpern, Trebilcock & Turnbull, 'An Economic Analysis of Limited Liability in Corporation Law (1980) 30 U of Toronto L J 117, 298. Blumberg notes that '[t]his factor would be as applicable to corporate groups as to financial institutions.' Blumberg, 'Limited Liability', n 6, 624.

[33] Jensen and Meckling, 'Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure' (1976) 3 Journal of Financial Economics, 305.

[34] Ibid.

[35] Blumberg, 'Limited Liability', n 6, 624.

[36] Murphy, 'Holding Company Liability for Debts of its Subsidiaries: Corporate Governance Implications' (1998) 10 Bond L Rev 241.

[37] See Thompson, 'Unpacking Limited Liability', n 29, 35.

[38] Blumberg, 'Limited Liability', n 6, 624.

[39] Wix, 'Piercing the Corporate Veil: Should Michigan Consider Statutory Solutions?' (2002) 79 U of Detroit Mercy L Rev 637, 656.

[40] Muscat, n 21, 162-175.

[41] See Murphy, n 36.

The key difference between a tort creditor and a voluntary creditor in the present context is that the latter can evaluate the risk associated with the business activity in advance, and consequently can charge a commensurate rate of interest[42] or seek other forms of security.[43] By contrast, a potential tort creditor cannot so readily account for the risk that his claim will go unsatisfied.[44] The charging of interest commensurate with risk incentivises the company to reduce their risk in relation to those activities,[45] whereas no such incentive exists with regard to potential tort creditors, Finally, the inability of potential tort creditors to foresee the harm means it is difficult for them to contract out of limited liability.[46] In any case it seems unlikely that potential tort creditors will have the bargaining power to do this.

(c) Conflicts with the aims of tort

The core aims of tort law include the compensation of victims, the imposition of the costs of an activity on the activity itself and discouraging negligent or intentionally harmful activities,[47] each of which is patently flouted by the application of limited liability.

Firstly, a parent company is essentially able to dictate how much compensation will be paid to tort victims because where a company undercapitalises a subsidiary which is subsequently required to compensate tort victims, those victims will not receive adequate compensation.[48] Secondly, it is not the activity itself that bears its costs, but society as a whole, as the application of limited liability to torts allows business to create externalities without paying for them. Thirdly, the justification that limited liability encourages risk taking is at odds with the need to discourage negligent or harmful activity. This is especially true in the group context, where a subsidiary may be incorporated solely for the purpose of engaging in highly risky activities. Thus, limited liability makes a mockery of deterrence.[49]

THE FAILURE OF LIMITED LIABILITY AT THE INTERSECTION OF GROUPS AND TORTS

As will be obvious from the foregoing, the present law fails to adequately address two issues:[50] corporate groups and tort creditors. As to the former, the application of limited liability to wholly owned subsidiaries is misguided. Limited liability arose not as an ‘inevitable conceptual derivation from the separate nature of the entity’,[51] but to procure advantages that do not occur in the context of a wholly owned subsidiary. As to the latter, limited liability prejudices tort victims and conflicts with the aims of tort law.

While either of these issues in isolation may suggest the need for a re-evaluation of the law, the need is even more pronounced where the two issues intersect, as in the ‘risky business’ scenario. In such a situation the ‘normative and economic realities necessitate a different regime of legal inquiry’.[52]

THE CASE FOR ENTERPRISE LIABILITY

The different regime of legal inquiry advocated herein is that of enterprise analysis, defined broadly as treating a parent and subsidiary as one company. Specifically, for present purposes, it refers to the holding of both a subsidiary and its parent liable for torts on the basis that they are part of the same enterprise.

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[42] Thompson, ‘Unpacking Limited Liability’, n 29, 36.

[43] See Stone, n 22, 68.

[44] Ibid.

[45] Easterbrook and Fischel, The Economic Structure, n 28, 51.

[46] Blumberg, ‘Limited Liability’, n 6, 617. The New South Wales Supreme Court in Australia has recognised this: see *James Hardie & Co. Pty. Ltd.* (1989) 7 ACLC 841, 863.

[47] Ibid 661-662.

[48] See *In Re Southard*, n 3.

[49] Stone, n 22, 65.

[50] These are not the only two problems, but are certainly two key problems with the present state of the law. Other commentators have recognised this. See, e.g., Thompson, ‘Piercing the Veil’, n 42, 379; Dearborn, ‘Enterprise Liability: Reviewing and Revitalizing Liability for Corporate Groups (2009) 97 California L Rev 195; Blumberg, ‘Limited Liability’, n 4, 576.

[51] Blumberg, ‘Limited Liability’, n 6, 585.

[52] Dearborn, n 50, 209.

There are differing conceptions as to the bases for enterprise theory, which will become apparent as existing examples of enterprise law are discussed. For instance, Dearborn sees enterprise liability as 'seek[ing] to marry legal and economic realities'[53] while Antunes suggests that the control exerted by a parent company over a subsidiary is the proper foundational basis.[54] Aronofsky envisages a mixed approach, citing '[t]he degree of centralized control and economic integration, organization, market, and public identification as a unitary company' as factors to be considered.[55]

It should be noted at the outset that enterprise analysis is different from 'piercing the veil'. It does not attempt to look behind or through the corporate form, but instead goes beyond the corporate form entirely. Veil piercing is 'vertical', holding shareholders personally liable, whereas enterprise liability provides a 'horizontal form of liability' allowing the entire business enterprise to be held liable.[56] Another key difference is that while veil piercing focuses on the illegitimate use of the corporate form, enterprise liability actually utilises the parent-subsidiary relationship to allocate liability.[57] Rather than creating sporadic and incomplete exceptions to the corporate form, enterprise analysis tackles the problem at the 'critical juncture'.[58]

It is also worth noting at this point that solutions other than enterprise liability have been suggested as a means for redressing the injustice caused to tort creditors under a limited liability rule. For example insurance and price adjustments have been advocated.[59] However, the lack of availability of such insurance, market imperfections and governmental intervention make insurance ineffective in practice.[60] In any case, insurance could not eradicate the risk to tort claimants associated with unforeseeable harm.[61] Even where the harm is foreseeable, companies may fail to take out adequate insurance, the insurance company may be unable to pay a tort judgment[62] or the tort in question may not be covered by the policy.[63] Price adjustments are also ineffectual as they simply shift the problem around without actually dealing with it, continuing to move the risk away from its creator and providing little incentive for risk reduction at the outset.

Posner suggests that an alternative to insurance would be requiring companies engaging in dangerous activities to post a bond 'equal to the highest reasonable estimate of the probable extent of tort liability'.[64] This does not seem to be any better a solution than insurance because unforeseeable or unforeseen risk cannot, by its nature, be reasonably estimated in advance.

In any case, these solutions are focused on addressing the problem of under-compensation of tort victims alone and do not take account of the fact that the application of limited liability to groups was also ill-considered. Failing to take this into account, these solutions seek to maintain limited liability as the general rule. As has been seen, the arguments for limited liability do not apply to the context under discussion, so there is no need to strive to maintain it. In fact, abolition of limited liability in this context is a return to 'basic tenets of limited liability', which was created to protect human beings, rather than parent

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[53] Ibid 210.

[54] Antunes, *Liability of Corporate Groups: Autonomy and Control in Parent-Subsidiary Relationships in US, German, and EEC law: an international and comparative perspective* (Boston: Kluwer Law, 1994).

[55] Aronofsky, 'Piercing the Transnational Corporate Veil: Trends, Developments, and the Need for Widespread Adoption of Enterprise Analysis' (1985) 10 North Carolina J of Intl L and Commercial Regulation 31, 42 (citations omitted).

[56] Bainbridge and Cole, 'The Bishop's Alter Ego: Enterprise Liability and the Catholic Priest Sex Abuse Scandal' (2007) 46 J of Catholic Legal Studies 65, 81.

[57] Hofstetter, 'Parent Responsibility for Subsidiary Corporations: Evaluating European Trends' (1990) 39 Intl & Comparative Law Quarterly 576, 578; Presser, 'The Bogalusa Explosion. 'Singe Business Enterprise,' 'Alter Ego,' and Other Errors: Academics, Economics, Democracy, and Shareholder Limited Liability: Back Towards a Unitary 'Abuse' Theory of Piercing the Corporate Veil' (2006) Northwestern U L Rev 405, 425.

[58] Hofstetter, ibid.

[59] See Meiners, Mofsky and Tollinson, 'Piercing the Veil of Limited Liability' (1979) 4 Delaware J of Corporate L 364-367.

[60] Blumberg, 'Limited Liability', n 6, 617.

[61] Schwartz, 'Product Liability, Corporate Structure and Bankruptcy: Toxic Substances and the Remote Risk Relationship' (1985) 14 J of Legal Studies 689, 714.

[62] For example, if the insurance company has itself become insolvent.

[63] These three problems with using insurance as a solution to the problem of tort creditors are identified in Posner, 'The Rights of Creditors of Affiliated Corporations' (1976) 43 U of Chicago L Rev 499, 520.

[64] Ibid.

companies.[65]

Another possible solution is the strategy of using the ordinary rules of tort law to claim that the parent itself is primarily liable. This possibility seems to be almost all that is left for under-compensated tort claimants post-Adams v Cape, and may therefore at least offer some small hope of recompense absent the change in the law advocated here. In Lubbe v Cape[66] the claimants, having failed to get relief in Adams v Cape, sought to make use of this potential. Issues arise as to the difficulty of proving both a duty of care and causation: as the Court itself noted, to 'investigate, prepare and resolve these issues, in relation to each of the plaintiffs, would plainly involve a careful, detailed and cumbersome factual inquiry and, at least potentially, a very large body of expert evidence'.[67] The use of tort law in this way is plagued, as is the present law, by its deficient foundations: rather than offering reform tailored to the modern concept of corporate groups, this strategy attempts to manipulate the law to fit the modern context into rules that were never intended for it.

Enterprise liability, by contrast to these suggestions, cures both of the identified defects of the current law and 'simply makes more normative and economic sense'.[68] Enterprise liability is more in tune with reality and provides a considered approach to the specific situation. As corporate groups themselves generally disregard the separate legal entities of their constituent companies, enterprise liability reflects the economic reality of modern business and accords with companies' own internal workings.[69] With regard the unfairness to tort victims, enterprise liability is also fairer on tort victims and more in line with the aims tort. The risk of hazardous activities is reallocated; companies either adequately insure or capitalise their subsidiaries, or are deterred from carrying out hazardous activities.

ENTERPRISE ANALYSIS IN PRACTICE

Identifying legal systems that have experimented with enterprise liability will give a contextual background to enterprise liability, provide the basis for refutation of the arguments against enterprise liability and will offer some insight as to how a test for enterprise liability may be constructed.

(a) Germany70

Germany has been termed the 'standard-setter'[71] for enterprise analysis and was the first country to comprehensively approach the problem presented by corporate groups.[72]

German law defines two categories of group. The first, rarely used,[73] is the contractual corporate group, whereby a voluntary 'control agreement' is made between the parent and subsidiary,[74] pursuant to which 'the parent… exercise[s] far-reaching management powers over the subsidiary'.[75] The second is the de facto group, characterised by majority ownership of one company by another[76] and a centralised and homogenous management structure[77] in which both companies are operated as one enterprise.[78]

[65] Aronofsky, n 55, 32.

[66] *Lubbe v Cape Plc* [2000] UKHL 41.

[67] Ibid [23]. Note that this strategy has failed in Australian courts (see *James Hardie*, n 46, 579-84).

[68] Dearborn, n 50, 213.

[69] Aronofsky, n 55, 33.

[70] For a comprehensive account of the German Law on Corporate groups and its evolution, see Reich-Graefe, 'Changing Paradigms: The Liability of Corporate Groups in Germany' (2005) 37 Connecticut L Rev 785. For an account of its history, see Antunes, n 54, 342-347.

[71] Dearborn, n 50, 215.

[72] Wymeersch, 'Do We Need a Law on Corporate Groups of Companies?' in Hopt and Wymeersch (eds), *Capital Markets and Company Law* (Oxford: OUP, 2003) 573, 587.

[73] Reich-Graefe, n 70, 793 (citation omitted).

[74] Aktiengesetz 1965 s.18 (German Law on Stock Corporations). Available at http://www.gesetze-im-internet.de/bundesrecht/aktg/gesamt.pdf, accessed 16th February 2010. Translated in Schneider and Heidenhain, *The German Stock Corporation Act: Bilingual Edition with an Introduction to the Law* (London: Kluwer Law International, 2000).

[75] Reich-Graefe, n 70, 788. German Law on Stock Corporations, ibid, s.308(1).

[76] This creates a presumption that the subsidiary is not independent. German Law on Stock Corporations, n 74, ss.16(1) and 17(2).

[77] German Law on Stock Corporations §18(1).

Some important points must be made. The German legislature sought to correct a different problem to the one under discussion here. Their aim was to correct a perceived conflict between the interests of a subsidiary and its parent, who would 'presumably seek to maximize its own shareholders' welfare at the potential expense of the subsidiary's minority or passive shareholders and creditors'.[79] As a result, the law's focus is on compensation of a subsidiary by a parent for loss caused to the subsidiary and the law therefore does little to assist a tort victim trying to recover from a parent company.[80]

Also of note is that the law applies only to joint stock corporations, generally utilised by large public corporations,[81] whereas the most commonly used form of company in Germany is the limited liability company (LLC).[82] The judiciary actively extended the law to analogous situations not originally covered by the strict wording of the Act.[83] The Courts extended enterprise liability to LLCs[84] and other situations[85] to the point where it was widely understood that enterprise analysis was more generally applicable.[86] However, the court recently changed direction in this regard in the Bremer Vulkan case,[87] severely curtailing the development of the doctrine.[88] This 'complete abandonment' of the application of group liability principles[89] has been lamented as hailing a return to a 'casuistic, largely unprincipled and fragmental approach'.[90]

(b) German Law on Stock Corporations: progeny

Despite the retreat of the German Law, it has been 'more influential than any other… in spurring legal reform of the parent-subsidiary relationship',[91] and a number of countries have adopted laws influenced or inspired by Germany's example.[92] Brazil, for example, has adopted a mild form of enterprise analysis[93] that is broadly similar to the German law.[94] Unfortunately, it also follows the German law in not giving creditors a direct cause of action, based on the belief that 'experience shows that the creditor as a rule obtains protection via contractual agreement'.[95] This overlooks the fact, already identified, that tort creditors cannot contract out of limited liability, and so remain unprotected by a regime that does not allow them to bring a direct action. Portugal enacted similar provisions,[96] but they only apply where a company chooses to legally formalise its parent-subsidiary relationships.[97]

Italy, in one sense, took a step forward from the German example by creating a direct cause of action

[78] Reich-Graefe, n 70, 790.

[79] Dearborn, n 50, 216 (citation omitted). See also Singhof, 'Equity Holders' Liability for Limited Liability Companies' Unrecoverable Debts – Reflections on Piercing the Corporate Veil under German Law (1999) 22 Loyola of Los Angeles Intl and Comparative L Rev 166, 169.

[80] Dearborn, n 50, 218.

[81] Schneider and Heidenhain, n 74, 3.

[82] 'Gesellschaft mit beschränkter Haftung' (GmbH). Dearborn, n 50, 216.

[83] Hofstetter, n 57, 579.

[84] See Autokran case (1985) BGH 95 BGHZ 330 (FRG) (German Federal Court); Alting, 'Piercing the Veil in American and German Law – Liability of Individuals and Entities: A Comparative View (1995) 2 Tulsa J of Comparative and Intl L 187, 234.

[85] See Wirth and Arnold, *Corporate Law in Germany* (Munich: CH Beck, 2005) 181-182.

[86] Dearborn, n 50, 216.

[87] Bremer Vulkan (2001) BGH II ZR 178/99. For a detailed discussion of this case in English, see Zumbansen, 'Liability within Corporate Groups (Bremer Vulkan): Federal Court of Justice Attempts the Overhaul' (2002) 3 German L J.

[88] See Reich-Graefe, n 70, 798-802.

[89] Ibid 815.

[90] Ibid 798-810.

[91] Dearborn, n 50, 220. See also Wälde, 'Parent-Subsidiary Relations in the Integrated Corporate System: A Comparison of American and German Law' (1974) 9 J of Intl L & Economics 454, 492-493.

[92] The German model has also influenced jurisdictions other than those discussed here, such as Slovenia and Croatia; unfortunately these developments cannot be elucidated further due to language constraints and the lack of available information. Andenas and Wooldridge, *European Comparative Company Law* (Cambridge: CUP, 2009) 6.

[93] Lei das Sociedades Anónimas 1976 (Brazilian law on Limited Liability Companies).

[94] Ibid, arts 245-6. See also Antunes, n 54, 324-325.

[95] Antunes, n 54, 293.

[96] Código das Sociedades Comercais 1986 (Portugese Code on Companies).

[97] Antunes, n 54, 326-327.

against a parent company;[98] however, the cause of action applies only if the holding company causes damage through mismanagement of the subsidiary.[99] Overall, the Italian approach has been lamented as offering only piecemeal reforms, rather than an overarching system,[100] and is of doubtful significance in practice.[101]

(c) EU

Most importantly for the UK, the EU has discussed enterprise liability. While it should be noted at the outset that these advances have not progressed as far as substantive law, its 'potential as a trendsetter'[102] justifies inclusion. The initial hope that the European Company Statute would include provisions on parent liability in the case of European Companies[103] was quelled by the exclusion of such provisions in the eventual statute.[104] Thus the remaining proposal of relevance here is the Ninth Directive on company groups.[105] Under the directive the parent would have been responsible for the liabilities of subsidiaries on the basis of unified management and control.[106] Unfortunately, the provisions have been lamented as being weakened in order to stem political opposition[107] and progression of the directive has, for the time being, halted.[108] The UK has been particularly vocal in its opposition to the Ninth Directive.[109] However, the fact that enterprise liability has been discussed, despite such opposition, shows that enterprise principles are slowly creeping into awareness at the early stages of EU law.

(d) UK

There was a brief flirtation with enterprise analysis in English law, starting with Lord Denning's 'single economic unit' argument in the DHN case.[110] The issue in DHN was whether a group of three companies could be treated as one enterprise for the purposes of receiving compensation for the compulsory purchase of the group's property. Noting that groups of companies are treated as one for many other purposes, Denning held that they should be treated as one concern for the purposes of compulsory purchase compensation.[111] Enterprise analysis, he thought, was particularly relevant where the subsidiary is wholly owned, or where a high level of control is exercised over it.[112]

Although originally pertaining to compulsory purchase compensation claims, the single economic unit argument started to seep into the law at a more general level. In *Lewis Trusts*[113] garments were being made in stages by different subsidiaries and May LJ suggested obiter that it was unnecessary to distinguish between them for the purposes of copyright infringement.[114] During the debating of the Companies Act 1980, the Labour Party spokesman proposed that a parent company could be made liable for the debts of a

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[98] See Ventoruzzo, 'Experiments in Comparative Law: The Recent Italian Reform and the Dubious Virtues of a Market for Rules in the Absence of Effective Regulatory Competition' (2004) < http://papers.ssrn.com/sol3/papers.cfm?abstract_id=556601> accessed 27th February 2010, 40.

[99] Ibid 45.

[100] Ibid 40.

[101] Ibid 47-48.

[102] Hofstetter, n 57.

[103] Ibid, 587.

[104] Council Regulation (EC) No 2157/2001 of 8 October 2001 on the Statute for a European company (SE) OJ L 294, 10/11/2001, 1–21.

[105] The Ninth Directive has never been published in the Community Gazette (Orne (tr), Pasa and Benacchio, *The Harmonization of Civil and Commercial Law in Europe* (Budapest: Central European University Press, 2005) 369). A mid-1980s French draft is available in CDVA (ed), *Modes de rapprochement structurel des enterprises. Tendences actuelles en droit des affaires* (Brussels: Commission droit et vie des affaires, 1986). Some provisions of the Directive relevant to the current discussion are reprinted in English in Böhlhoff and Budde, 'Company Groups – The EEC Proposal for a Ninth Directive in Light of the Legal Situation in the Federal Republic of Germany' (1984) 6 J of Comparative Business and Capital Market L 163, 181-192.

[106] Antunes, n 54, 287-288.

[107] Hofstetter, n 57, 589.

[108] See Andenas and Wooldridge, n 92, 148-149.

[109] See Nieuwdorp, 'EEC Company Law Harmonisation' (1987) 15 Intl Business L J 177, 179-180.

[110] *DHN Food Distributors Ltd v Tower Hamlets London Borough Council* [1976] 1 WLR 852.

[111] Ibid 860.

[112] Ibid.

[113] *Lewis Trusts v Bambers Stores Limited* [1983] FSR 453.

[114] Ibid 470-71.

defaulting subsidiary.[115]

Despite these nascent movements toward a more general application of the single economic unit argument, DHN was confined to its facts in Woolfson,[116] and the separate entity approach was affirmed as a 'fundamental principle' of company law once again in Adams v Cape.[117]

(e) US[118]

In the US, Michigan has distinguished between a company as an investor, who exercises 'mere oversight of a subsidiary's business in a manner appropriate and consistent with the investment relationship', and a company that exercises 'actual participation and control over a subsidiary's functions and decision-making'.[119] Texas courts had enunciated a doctrine of 'single business enterprise';[120] however, this was recently rejected by the Texas Supreme Court.[121] A landmark Louisiana case considered that '[i]f one corporation is wholly under the control of another, the fact that it is a separate entity does not relieve the latter from liability'[122] and enumerated eighteen separate factors for consideration.[123] Though the doctrine has garnered some judicial support,[124] it has also attracted academic criticism[125] and the case has not resulted in a 'widespread movement to embrace' the doctrine.[126]

(f) India

By far the most extensive approach to enterprise liability has been taken by India. Firstly, in the wake of the Bhopal disaster, the Government assumed *parens patriae* responsibility for the resulting cases in the New York Courts,[127] arguing that a corporate group is not a set of distinct entities, but '[i]n reality… one entity, the monolithic [corporation]',[128] and that the group is in a better position to assume the risk of its activities than tort victims.[129] A year after the Bhopal disaster, the Supreme Court of India, in the Oleum Gas Leak case,[130] held that 'an enterprise [has a] duty to… ensure that no harm results… on account of [the] nature of [its] activity'[131] and that if such harm does result, the enterprise as a whole should be liable.[132]

[115] Though given that he suggested that this liability could be excluded by notification of creditors, it seems that this proposal did not include involuntary and tort creditors. The proposal was rejected. See Prentice, n 14, 111.

[116] *Woolfson v Strathclyde Regional Council* (1978) SC 90, 95-6 (Lord Keith of Kinkel).

[117] Ibid 532 (Slade LJ).

[118] Note that US Courts have been more willing to look into the structure of corporate groups when it appears to be permitted by federal regulation. See Schipani, 'The Changing Face of Parent and Subsidiary Corporations: Enterprise Theory and Federal Regulation' (2005) 37 Connecticut L Rev 691. See also Dearborn, n 50.

[119] *CPC International v Aerojet General Corporation*, 777 F Supp 549, 573 (Michigan 1991). See also *Lansford-Coaldale Joint Water Authority v Tonolli Corporation*, 4 F 3d 1209, 1222 (3d Cir 1993). This distinction tracks the argument,, that the case for limited liability is at its strongest in relation to investors, but at its weakest where a parent company operates the subsidiary.

[120] *Paramount Petroleum Co v Taylor Rental Center* (1986) 712 S W 2d 534, 536 (Texas CA). See also Blumberg and others, *Blumberg on Corporate Groups* (2nd edn Aspen, New York 2005) ss 12.04 and 66.04[A].

[121] *SSP Partners and Metro Novelties, Inc v Gladstrong Investments (USA) Corporation* (2008) 05-072 (Texas CA).

[122] *Green v Championship Insurance Co* 577 So 2d 249 (La App 1st Cir 1991) (Louisiana CA).

[123] Ibid 257-258.

[124] See, e.g., *Thibodeaux v Ferrellgas, Inc,* 741 So 2d 34, 35, 42-43 (La Ct App 1999) (Louisiana CA) and *Grayson v R. B. Ammon & Assocs.* 778 So. 2d 1 (La. Ct. App. 2000) (Louisiana CA) and *Pine Tree Association v Doctors' Association, Inc,* 654 So 2d 735, 736, 738 (La Ct App 1995) (Louisiana CA), cf. *Town of Haynesville, Inc. v Entergy Corporation* 956 So 2d 192 (La App 2d Cir) 964 So 2d 334 (La 2007) (Louisiana CA).

[125] See Dunne, 'Taking the Entergy Out of Louisiana's Single Business Enterprise Theory' (2009) 69 Louisiana L Rev 691 and Presser, n 57.

[126] Strasser, 'Piercing the Veil in Corporate Groups' (2005) 37 Connecticut L Rev 637, 638.

[127] Bhopal Gas Leak Disaster (Processing of Claims) Act 1985. See also Brief of the Plaintiffs, Union of India v Union Carbide Corporation reprinted in Baxi and Paul, Mass Disasters and Multinational Liability: the Bhopal case (N.M. Tripathi, Mumbai 1986). Note that 'Union of India' in a judicial context refers to the government of India (Article 300 of the Constitution of India).

[128] Brief of the Plaintiffs, ibid 4-5.

[129] Ibid.

[130] *M.C. Mehta v. Union of India*, AIR 1987 SC 1086 (India SC) (available in part at http://www.elaw.org/node/1322, accessed 17th February 2010; also reprinted in full in Baxi, n 127.

[131] Ibid [31] (Bhagwati CJ).

[132] Ibid. While the Court framed the case in terms of the rule in Rylands v Fletcher ([1868] UKHL 1) and strict liability, the language used is that of enterprise liability and it is generally considered that this is the underlying reasoning. See Baxi, n 127, and Ramanathan, 'Business and Human Rights: the India Paper' <http://www.ielrc.org/content/w0102.pdf> accessed 17th February 2010, 13. Cf. Muchlinski, *Multinational Enterprises and the Law* (Oxford: OUP, 2007) 318).

The court noted the fact, as discussed, that the tort victim is not best placed to bear the risk and social costs of the business[133] and that the 'enterprise alone has the resource[s] to discover and guard against hazards or dangers'.[134] The court posited that the permission to carry on a risky business must come with the responsibility for the externalities generated.[135]

(g) UN Norms[136]

The UN norms,[137] while applying only to activities involving some trans-national element,[138] and so not affecting wholly internal situations, articulate very high standards for businesses and adopt a real-world view of corporate groups.[139] The norms are yet to be adopted[140] and views differ as to the likelihood of their adoption in the future.[141] A vigorous debate about their effect has ensued, with some commentators arguing that they are 'legally binding',[142] while others assert that they are of 'marginal utility'.[143] At the very least, the significance of the surfacing of enterprise liability at the international level should not be underestimated[144] and represents a key event in its development.

TOWARD A TEST FOR ENTERPRISE LIABILITY

Creating a perfect test for applying enterprise liability would 'take a roomful of experts, legislators, and businesspeople',[145] and is therefore a task that is well beyond the scope of the modest exposition offered here. That said, the discussion of enterprise liability thus suggests that a number of issues would have to be addressed. This paper will expand on these issues in an attempt to make the first steps toward the creation of a test for enterprise liability.

Such a test would, broadly, have two parts: it must apply to torts and it must apply to a group enterprise. As a preliminary matter, a test for enterprise liability must deal with the problem presented by minority shareholders.

(a) Minority shareholders

Minority shareholders present a problem for enterprise liability because a parent company, wishing to make use of limited liability by incorporating a subsidiary to carry out risky activities, is likely, under a rule that applies enterprise liability where a subsidiary is wholly owned, to sell minority shareholdings in an attempt to circumvent the application of enterprise analysis and absolve themselves of liability. As companies have been accustomed to the limited liability, it seems likely that they will be at pains to maintain it. A rule simply applying enterprise liability where a subsidiary is wholly owned would be far too easily circumvented by transfer of shares, just as the Joint Stock Companies Registration Act 1844, which provided for unlimited liability, failed to maintain that liability in the face of circumvention efforts.[146]

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133 *M.C. Mehta v. Union of India*, n 130.

134 Ibid.

135 Ibid.

136 For a detailed account of the history and content of the norms, see Weissbrodt and Kruger, 'Norms on the Responsibilities of Transnational Corporations and other Business Enterprises with Regard to Human Rights' (2003) 97 American J of Intl L 901 and Hillemanns, 'UN Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises with regard to Human Rights (2003) 40 German L J 1065.

137 United Nations Economic and Social Council Sub-Committee on the Promotion and Protection of Human Rights, 'Norms on the responsibilities of transnational corporations and other business enterprises with regard to human rights' (26th August 2003) UN Doc E/CN.4/Sub.2/2003/12/Rev.2.

138 Ibid. [20] and [21].

139 Ibid.

140 Dearborn, n 50, 229.

141 See Backer, 'Multinational Corporations, Transnational Law: The United Nations' Norms on the Responsibilities of Transnational Corporations as a Harbinger of Corporate Social Responsibility in International Law (2006) 37 Columbia Human Rights L Rev 287. Cf. Hillemanns, n 136, 1079.

142 Campagna, 'United Nations Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises with Regard to Human Rights: The International Community Asserts Binding Law on the Global Rule Makers' (2004) 37 John Marshall L Rev 1205.

143 Vagts, 'The UN Norms for Transnational Corporations' (2003) 16 Leiden J of Intl L 795 (arguing that the norms are of 'marginal utility' as the area in which they operate is already occupied by existing instruments).

144 Dearborn, n 50, 230.

145 Dearborn, n 50, 251.

146 Blumberg, 'Limited Liability', n 6, 583.

The introduction of minority shareholders reinvigorates some of the justifications for limited liability that were dismissed earlier in the case of wholly owned subsidiaries. For instance, if a company is not wholly owned by a single parent, there may well be a market where the publicly held shares are traded and therefore limited liability will facilitate the efficiency of the market.[147] Likewise, minority shareholders who would otherwise acquiesce in the management of the company may have to increase their involvement in the company's affairs or incur monitoring costs to ensure that their investment is not harmed by tort claims arising as a result of the majority shareholder's management. The need to keep agency and collection costs low would also need to be considered where minority shareholders are present.

The law could either see the prejudice caused to minority shareholders as a necessary and minor price to pay for better protection of tort victims, or construct a test that excludes minority shareholders, and makes only the parent company liable. Essentially the question is whether the benefit to the minority shareholders, and the public generally, outweighs the harm that would result to tort victims if limited liability was strictly applied. This is likely to be a matter of extent. For example, where a company is 99% owned by a parent company, the other 1% being held by independent absentee investors, it would seem absurd to suggest that the benefit accruing from a strict application of limited liability should outweigh the interests of innocent tort victims.

Fortunately, it seems that any test that looks beyond merely wholly owned subsidiaries will offer protection. This is because minority shareholders, by their nature, will not have sufficient control over the subsidiary to be considered the authors of the tort,[148] and nor will they be part of the economically unified enterprise of the parent and its subsidiary. Thus liability would not fall to them under either a control-based or economics based test.

(b) Part one: tort victims

A preliminary observation to be made with relation to the tort victims themselves is that they should have a direct cause of action as against a parent company. As already noted, existing implementations of enterprise liability, such as the German system, are entirely internal. This, whilst dealing with the objection that limited liability is ill-fitting for groups, leaves tort victims unprotected.

The precise scope of 'tort victims' under such a test needs to be discussed. Dearborn suggests that 'torts' in this context should be confined to 'mass torts, human rights disasters, and environmental harms'.[149] She offers three reasons for this, which must be considered in deciding whether enterprise liability should be limited in this way, in some other way, or not limited at all beyond requiring satisfaction of ordinary tort requirements.

Firstly she notes that confining enterprise liability to mass torts will appease the business community, who will inevitably be concerned that 'enterprise liability would cause the end of investment capitalism'.[150] The substance of this argument will be dealt with more fully below, however, in relation to the concerns of companies alluded to in this quote, it suffices to say that, while companies are very likely to oppose any measure that aims to increase their potential liability, it seems unlikely that such companies would truly think that the effects of enterprise liability, particularly only in the limited form under discussion, would be so far-reaching as to spell the end for capitalism.

Dearborn suggests that this limit on the definition of tort victims ensures that enterprise liability is 'merely a tool to check the most egregious and socially harmful of corporate behaviours'.[151] What is not clear is exactly why it is only these behaviours that should be checked. This would cause a lacuna between victims of the parent's torts and victims of the subsidiary's torts: while the former will be compensated for any tort, the latter would only be compensated where the tort that happened to befall him was of the most awful character. As the parent company in the 'risky business' scenario incorporates the subsidiary precisely for

[147] Blumberg, 'Limited Liability', n 6, 624.

[148] Though sufficient control could occur if a control-based test tied liability to a low shareholding, as is the case in US banking law. See The Bank Holding Company Act 1956 (12 U.S.C. §1841).

[149] Ibid 255.

[150] Ibid.

[151] Ibid.

the purposes of avoiding liability, it seems more logical to suggest that all victims of torts committed by the subsidiary in that situation should be included. Thus it would offer the tort victim the same protection he would have received had he been under the auspices of the parent company, had it not attempted to externalise the risks that came to fruition.

Furthermore, whereas allowing all tort claims makes for simple application, the confinement of 'torts' to mass torts, human rights disasters, and environmental harms adds a layer of difficulty in determining which tort victims are able to recover. Courts would have to answer difficult questions under a rule of enterprise liability where only victims of 'human rights disasters' could claim. For example, how many injuries or deaths are required to constitute a human rights disaster? Or is the gravity of harm, rather than the quantity, the defining factor? This formulation could cause a test to devolve into a numbers game, and would require the assessment of the relative gravity of harm suffered by tort victims. It is submitted that any harm caused as a result of deliberate externalisation of risk is unacceptable, and a more satisfactory test is one that treats the two businesses as one enterprise, causing the parent company to be liable for the torts of its subsidiary.

Secondly Dearborn makes the valid point that, in terms of controlling corporate behaviours, it is mass torts and the most serious torts that 'stand to harm the corporation from a public relations and economic standpoint'.[152] While this is true, it is submitted that allowing the parent to be held liable for all torts will further increase the corporate control effects of enterprise liability by increasing the number of torts the company can be liable for. In any case, it is arguable that the control of corporate behaviour should not be the only factor taken into account. As this paper argues, the aims of tort law should take precedence and the focus should be on the injustice caused by the inability of a subsidiary to adequately compensate tort victims. The goals of compensation and deterrence will be further served by making companies liable for all torts, and any test that excludes tort victims of the subsidiary, or results in their non- or under-compensation, seems inadequate.

Aside from the issue of defining tort victims, there are two other points of note to be made. Firstly, at least one commentator has suggested that corporate groups should be able to 'opt out' of enterprise liability.[153] This is clearly antithetical to the arguments made in this paper, as an opt out provision would allow a parent company to easily preserve the limited liability that has been seen to be so problematic. It has been proposed that those companies choosing to opt out of enterprise liability could be identified by letters after their name, following the existing practice of using letters to identify the type of company the business registered as.[154] While this would be helpful to contractual creditors, tort victims cannot choose their tortfeasor and such an implementation of enterprise liability would potentially result in perverse outcomes; some victims being compensated by the parent and others receiving nothing.

Secondly, Dearborn suggests that the burden of proof should be on the parent company to disprove that their corporate group is an enterprise, once the claimant has satisfied a preliminary burden.[155] This, unlike the opt-out proposal, is in line with the need to adequately protect tort victims. As the company is in the best position to evidence its inner workings, the burden can only reasonably be on them to disprove their unity.[156]

(c) Part two: enterprise

Part two of the test would need to focus on when exactly both a subsidiary and its parent will be held liable on the basis that they are part of the same enterprise. The different bases for holding that the companies are one enterprise is much discussed in the academic literature, and a number of bases can be seen in the examples of enterprise liability currently in existence. The test for enterprise liability must protect 'real' investors, that is those investors that activate the justifications for limited liability, while maintaining liability of a company that is, in reality part of the same enterprise.

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[152] Dearborn, n 50, 255.

[153] Kluver, n 1, 781. While this suggestion is made in the context of discussing the difficulties of meeting the demands of creditors upon insolvent liquidation, there is no suggestion in the article that tort creditors would not be considered creditors for this purpose, or that an opt out would not apply to tort creditors.

[154] Ibid.

[155] Dearborn, n 50, 253.

[156] Ibid.

(1) Control-based enterprise liability

Basing a test for enterprise liability on the control exerted by the parent over the subsidiary is superficially appealing because it appears to offer simplicity. The major downside of this approach is that it may incentivise the deliberate decentralisation of management in order to make it appear that the subsidiary acts independently, thus allowing for easy circumvention, with no obvious way of determining when the decentralisation is improper. This decentralisation is problematic as the parent company allows the subsidiary to use its capital, while avoiding responsibility for torts arising out of that use. [157] Decentralisation may therefore result in less oversight of the subsidiary's activities on the part of the parent and will seemingly increase the occurrences of torts, whereas it may actually be desirable to encourage strong central management in the hope of increasing oversight and preventing torts before they occur.[158]

Also in this category are rules that establish a presumption of control based on a share holding percentage; for instance, the German law establishes a presumption where a company holds a majority of shares in another company. This is, again, attractive due to its simplicity, but, unfortunately, along with this simplicity comes the risk that the reality of the situation will not be reflected accurately by the legal standard. A company that has a majority shareholding may not actually exercise any real control over a subsidiary where the group operates under decentralised management. This is even more pronounced where the presumption is activated by a low percentage. Likewise, where the presumption is only activated by a very high threshold, the legal standard risks excluding companies that are, in reality, a unified enterprise.

It may hypothetically be though that such problems could be ironed out by finding the optimal percentage ownership at which the presumption should be activated. There are, however, issues with this that cannot be resolved because, in reality, no such level exists: any set level causes the law to be rigid and unable to adapt to the many different types and forms of business.

In its favour, control-based enterprise liability does allow a bright line to be easily drawn between passive and active shareholders. The distinction between these two types of shareholder is crucial because, as was seen at the beginning of this paper, many justifications for limited liability apply in the case of the former, but not in the latter. This argument is forceful, but there is no reason why an economic conception of enterprise liability could draw the same line, as independent investors are clearly not a part of the same economic enterprise as the parent company majority shareholder.

(2) Economic or 'true'[159] enterprise liability

An economics-based test looks at the economic structure of the group in question. While this may at first appear to be less certain than the simple control test, it is argued here that such a basis would be preferential.

Firstly, an economics-oriented test is appealing because for the view of parent and subsidiary companies acting together as a unified economic unit, a corporate group, is 'generally an accurate one'.[160] This is in contrast to a control-based test, which may obscure the reality.

Secondly, whereas a control-based approach incentivises the decentralisation of management and therefore increases the chance that torts will occur, an economic approach would incentivise the parent to invest in preventing torts before they occur, as the liability for a subsidiary's torts will fall to them.

Thirdly, this approach would mitigate the problems with the rigidity and formalism of a control-based approach. A number of factors could be considered as part of the determination of whether two companies are one for the purposes of enterprise liability. This flexibility would be invaluable to legislators and the courts in drawing up and applying the test in a way that adequately places liability on groups that are, in reality, one company, whilst protecting minority shareholders and passive corporate shareholders.

[157] Ibid 249-250.

[158] See Stone, n 22.

[159] Dearborn, n 50, 226. While it is acknowledged that the term 'true enterprise liability' is more fitting than 'economic enterprise liability', as some factors, such as public identification, are not strictly economic, the latter term is used here as it is the more common expression in the literature.

[160] Strasser, n 126, 647.

(3) Suggested factors for inclusion in an economic enterprise liability test

The following factors may be included in a test for enterprise liability, though drawing up an exhaustive list would likely be impossible: (1) whether the subsidiary was created, or acquired, for the purposes of furthering the economic aims of the parent, (3) whether the externalisation of risk plays a role in the utilisation of the subsidiary, (4) market and public identification of the group as a unified business.[161]

There are numerous real-life examples of cases where these factors could easily have been applied in practice, and allusion to some of these examples at this stage will aid understanding of how the envisaged rules of enterprise liability may apply. As to the first suggested factor, Adams v Cape provides an apt example. In that case it would have been clear to the court that, whatever the formal legal structure of the group, the subsidiary was incorporated to further the economic aims of the parent.

Determining whether the externalisation of risk was an element in the use of the subsidiary is an important factor, as in the 'risky business' scenario this is the main purpose of its creation. This may be a complex inquiry, however, there is no reason to think that determination of this factor is beyond the capacity of the courts. An example, though imperfect as the case involved contracting, rather than use of a subsidiary,[162] is the Trafigura case, which centred on a company that chartered a ship to dispose of toxic waste. While Trafigura claimed it had acted honestly and legitimately, internal emails came to light that would have informed a court that the company was purposefully externalising risk.[163]

The public identification of a group of companies as one may go some way to determining whether the group operates as one enterprise. If the group has held itself out as one unit to the extent that the public identify them as such, for instance, by using trademarks or franchising,[164] then there is an almost irresistible inference that the group operates as one economic unit. As a group benefits from holding itself out as one enterprise, it should be held to account as one enterprise where it causes torts. In contrast to the present law, this factor reflects the reality of modern corporate groups, which 'seldom, if ever, have qualms about disregarding separate legal identity when to do so would permit a maximization of profits for the company as a whole',[165] for instance, by holding itself out as one company to the public in order to make use of the value of the brand of one of the group members.

A pertinent example stems from the Unocal case.[166] Villagers living close to a pipeline under construction were gifted Unocal-branded items during construction in an attempt to find favour with them.[167] In this way, Unocal was able to hold itself out to be the company behind the construction, yet it distanced itself from the project in the formal legal structure. An analysis of public identification under an enterprise liability rule for torts could remedy this contradiction and ensure that a business cannot gain the benefits of identification as a unified enterprise without also accepting the responsibility for the actions of that enterprise.

This factor may, however, be a double-edged sword. A company may deliberately maintain a distance between itself and the subsidiary. For example, a company establishing a subsidiary to deal in asbestos may try to detach itself from that activity both in law and in the eyes of the public, due to the negative connotations or publicity that may be associated with it. In such a case, public identification is not likely to be a helpful factor as it may belie the true economic reality. So long as courts remain alert to the pitfalls of overemphasising one factor over others, this problem can be mitigated by ensuring that all factors, particularly those that may suggest economic unity, are considered.

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[161] Aronofsky, n 55.

[162] This example is used here, despite this imperfection, as the precise details of the affair is irrelevant to the present point that evidence of the parent's intention to externalise risk may often be available.

[163] See Leigh, 'How UK oil company Trafigura tried to cover up African pollution disaster' *The Guardian* (London 16 September 2009) available at <http://www.guardian.co.uk/world/2009/sep/16/trafigura-oil-ivory-coast> accessed 27th March 2010. The emails in question can be read here: <http://www.guardian.co.uk/world/2009/sep/16/trafigura-email-files-read> accessed 27th March 2010.

[164] Aronofsky, n 55, 44. See also Strasser and Blumberg, 'Legal Models and Business Realities of Enterprise Groups: Mismatch and Change' (2009) 18 Comparative Research in L & Political Economy Research Paper Series 4.

[165] Aronofsky, n 55, 33.

[166] See Dearborn, n 50, 196.

[167] Ibid.

The use of a factored test has been criticised. Presser contends that such an approach ‘substitut[es] lists of factors for serious purposive analysis’[168] and Hamilton and Macey suggest that problems would arise due to poor weighting of factors and the encouragement of a mechanical approach.[169] It is submitted that a factored test is not a substitute purposive analysis, it offers guidance; a framework in which courts can assess the economic unity of the enterprise. There is little reason to think that the courts, using the factors as guides rather than touchstones, and bearing in mind the overarching question of whether or not there is an economically-unified enterprise, will attach inappropriately skewed weight to different factors, or that they will approach the question in a mechanical fashion. It is almost condescending to suggest that the courts, which regularly use guided frameworks to interpret broad concepts, would struggle to apply a factored test of enterprise liability.

ARGUMENTS AGAINST ENTERPRISE LIABILITY

As with any proposal for reform, there will be detractors and arguments wielded against the implementation of enterprise liability at the intersection of corporate groups and torts. This part of the paper identifies some of the most common and most likely arguments against enterprise liability.

(a) Negative effects on the economy

One counterargument that must be carefully considered is that enterprise liability would harm the economy, and, more specifically, whether such harm outweighs the need to adequately address tort victims. Dearborn suggests ‘Germany provides an empirical example of an industrialized country that has adopted a milder form of enterprise principles without disastrous results for domestic of international investment capitalism’.[170] Unfortunately, this observation does little to refute the argument. It surely would not be expected that the effects of a ‘mild’ form of enterprise principles would be ‘disastrous’. As the practical impact of the law has been very small it is unsurprising that the economic consequences have been commensurately small.[171]

India, with its stronger form of enterprise law, perhaps provides a better refutation. However, the general difficulty of attempting to discern the effects of one provision on an entire economy is exacerbated by India’s generally rapid economic growth[172] and liberalisation of other areas of the law,[173] as this may have caused any negative effects of group liability to pale into insignificance. What this does appear to suggest, though, is that the change in the law did not bring the economy of India to its knees. This seems almost too obvious to be worth stating, but it does highlight that, at the very least, under the very limited scope for liability argued for here, non-risky businesses, and even many risky or hazardous businesses will not be deterred from operating. The former will have no cause for concern, beyond speculating that the change in the law will ‘open the floodgates’ for further changes that may affect them in the future, while most of the latter will be sufficiently cautious regardless of the change, so that they will not fear an accident or its ramifications. Thus focus is returned to the deterrent effect of the change: only the ultra-hazardous and excessively risky ventures will be deterred and any resulting decline in investment, likely to be very small, would, it is argued, be a small price to pay for bringing the present law in line with tort policy.

A contrasting example helpfully illustrates how legal change could affect the economy. When corporate tax was increased, a number of businesses left, or threatened to leave the UK.[174] This is explained by a number of factors; the most important being that this increase applies to far more businesses than the change in the

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[168] Presser, n 57, 426.

[169] Hamilton and Macey, *Cases and Materials on Corporations Including Partnerships and Limited Liability Companies* (West Publishing, 2003) 351.

[170] Dearborn, n 50, 215.

[171] Schiessl, ‘The Liability of Corporations and Shareholders for the Capitalization and Obligations of Subsidiaries under German Law’ (1987) Northwestern J of Intl L and Business 480, 501.

[172] ——, ‘Indian Economy Overview’, EconomyWatch < http://www.economywatch.com/indianeconomy/indian-economy-overview.html> accessed 5th April 2010 (India is ‘one of the best performers in the world economy in recent years’).

[173] For a detailed discussion, see Singh (ed), *Economic Liberalisation in India* (New Delhi: Ashsih Publishing House, 1995). For a much shorter, though comprehensive, outline, see Panagariya, ‘India’s Economic Reforms: What Has Been Accomplished? What Remains to Be Done?’ (2001) 2 Asian Development Bank Economics and Research Department Policy Brief Series.

[174] See Sikka, ‘Reining in the corporate monster: Big business must be forced to temper its obsession with profit and align corporate practice with social justice and democracy’ *The Guardian* (London 17 February 2010) and Goundar, ‘Does redomiciling make financial sense?’ *Financial Director* (London 26 January 2010).

law presently advocated. A related point is that the corporate tax is not fault-based and therefore a business will be affected regardless of its actions. Yet despite its broad applicability, this 'supertax',[175] has not greatly impacted the UK's economy and, despite there being many threats, the number of companies actually leaving the UK is low.[176] Like the situation in India, the negative effects of the increase in tax are tempered by a number of other factors, thus limiting the overall impact.[177]

The evidence for concluding that implementing enterprise liability at the intersection of corporate groups and torts would have any more than an imperceptible effect is weak. In sum, it seems difficult to predict exactly what the effects on the investment economy would be, but it seems clear that businesses would be unlikely to exile en masse.

(b) Inevitability of avoidance

One sweeping argument holds that companies will, inevitably, devise schemes for circumventing any new rule that seeks to impose liability on them. In some ways this is a derivative of the contention, discussed below, that the form of enterprise analysis advocated here simply does not go far enough, as unlimited liability for all companies is the only way to ensure that liability will be imposed.

While it certainly seems true that companies will make attempts to circumvent such a rule, this is not a standalone argument for not at least attempting to draft a law that will hold companies liable and attempt to identify companies seeking to circumvent the law. Furthermore, this argument seems to be either naïve or wilfully blind as to the flexible nature of the courts. As the German example shows, the courts can take an active role in ensuring the purpose and spirit of the law is upheld. It seems unthinkable that the courts would allow a company to escape their legal obligations where it has blatantly attempted to circumvent a rule of enterprise liability.

Furthermore, the precise 'knock-on effects' of the law can never be known, and simply enacting a law of enterprise liability may well have positive effects. For instance, a company considering incorporating a subsidiary for the purposes of conducting a hazardous activity and then somehow circumventing the enterprise liability rule may be deterred from doing so simply by the fear that the courts will see through such attempts and hold them liable in spite of the attempted circumvention. At the very least it seems likely that a company would be aware of the high costs of litigation that may be involved in taking this course of action.

Some of the cases already discussed illustrate the power of the law to coerce companies into compliance. In the Thor litigation, one set of claims[178] was settled out of court after the Court merely accepted that they had jurisdiction over the case.[179] Likewise, in the US, the possibility of litigation under the Alien Tort Claims Act,[180] following the rejection of a summary judgment in their favour,[181] led Unocal to settle claims against them for an undisclosed sum.[182] Thus it is postulated that compensation of victims is likely to increase further in these situations under an enterprise liability rule, as companies will be aware that the courts have the ability to hold them liable.

(c) Enterprise liability for torts or unlimited liability?

It may be argued that the application of enterprise liability propounded here does not go far enough, and that parent companies should be liable for all debts of the subsidiary.[183] In focusing on tort victims and the externalisation of risk using subsidiaries, it is possible to become myopic and lose sight of the bigger

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[175] Goundar, ibid.

[176] Ibid.

[177] Ibid.

[178] *Ngcobo v Thor Chemicals Holdings* [1995] TLR 579.

[179] De Lacy (ed), *The reform of United Kingdom Company Law* (Oxford: Routledge-Cavendish, 2002).

[180] 28 U.S.C. § 1350.

[181] Kielsgard, 'Unocal and the Demise of Corporate Neutrality' (2009) 36 California Western Intl L Rev 185, 189.

[182] Ibid.

[183] See, e.g., Landers, 'A Unified Approach to Parent, Subsidiary and Affiliate Questions in Bankruptcy' (1975) 42 U of Chicago L Rev 589.

picture: externalisation of risk is only one of many reasons that a company may wish to incorporate a subsidiary. If unlimited liability were to be imposed as the new paradigm in company law, the myriad of legitimate uses of subsidiaries would be frustrated. There are a number of reasons why a company may incorporate a subsidiary, such as simplification of management and international operations.[184] One US case aptly summarised the issue thus: 'Since society recognizes the benefits of allowing persons and organizations to limit their business risks through incorporation, sound public policy dictates that disregard of those separate corporate entities be approached with caution'.[185]

The approach taken in this paper to disregarding limited liability and implementing enterprise liability is very cautious, and would allow liability in very limited circumstances. This balances the legitimate uses of the corporate form with the need to protect tort victims from the ill-considered application of limited liability to the corporate group context. Conversely, unlimited liability would seem to throw caution to the wind, along with the recognised benefits of limited liability.

While there is at least some argument that unlimited liability would not hurt the economy,[186] application of unlimited liability to groups would almost certainly spell the end for conglomerates. Blumberg notes that the reduction of risk is particularly important for conglomerates, corporate groups that own and operate a variety of unrelated business ventures, as it enables them to diversify their business portfolio into previously unexplored areas of business,[187] an action they take on a regular basis by their very nature. In this vein, Hadden states that 'some worthwhile but risky ventures which might be taken by large groups may not be undertaken at all'.[188] Passive corporate investment may also cease, as the risk of liability or the costs of monitoring would likely outweigh the benefits.

While those that advocate unlimited liability as the solution to the externalisation of risk undoubtedly mean well, it is difficult to see how unlimited liability is an improvement on the present law. While tort creditors would indeed be protected, the application of unlimited liability seems only to replace one ill-fitting rule with another. By contrast, enterprise liability, as advocated here, it a much more nuanced solution that neatly fits at the intersection of corporate groups and torts.

(d) Uncertainty of a test for enterprise liability

A common argument made in all areas of the law is that a given test is uncertain and the proposed rule of enterprise liability is no different;[189] it has been, and undoubtedly will continue to be, attacked on the ground that 'measuring the extent of an 'economic unit' introduces an intolerable level of uncertainty into the question of liability'.[190]

For their part, a sufficiently diligent legislature could remove some uncertainty with the construction of a sufficiently certain test. Insofar as uncertainty is thought to stem from the inability of the courts to determine the boundaries of an economic entity, it must again be acknowledged that courts regularly apply complex legal standards with little difficulty and there is no reason to think that enterprise analysis would be any different.

In any case, while it is true that any test is likely to be less certain than the current law, which sacrifices suitability and flexibility for certainty, it must be considered whether the benefits of enterprise analysis outweigh any potential uncertainty. Given the minimal level of uncertainty that the test is likely to introduce, enterprise analysis is surely not so uncertain as to outweigh its benefits. If it is accepted, as it is in this paper, that some law should exist to enable an unprotected victim of a tort to recover, then the inevitable introduction of at least some certainty is acceptable as a necessary, albeit minor, evil.

(e) Uncertainty of Goals of Enterprise Liability

[184] Douglas and Shanks, 'Insulation from Liability Through Subsidiary Corporations' (1929) 39 Yale L J 193.

[185] *Pacific Landmark Hotel, Ltd. v. Marriott Hotels, Inc.*, 23 Cal. Rptr. 2d 555, 563 (Ct. App. 1993) (US CA) (citation omitted).

[186] See and Meiners, Mofsky and Tollinson, n 59.

[187] Blumberg, 'Limited Liability', n 6, 624.

[188] Hadden, n 18, 281.

[189] See Dearborn, n 50, 259.

[190] Kors, 'Altered Egos: Deciphering Substantive Consolidation' (1998) 59 U of Pittsburgh L Rev 381, 437-8.

Sommer[191] has contended that, while enterprise theory is intellectually preferable to entity theory, it suffers from a 'haziness of goals' because 'it is difficult to see why jurisdiction or liability should attach to an active investment and not a passive one'; he calls this an 'enormous flaw'.[192]

There is no difficulty in seeing why liability should attach to an active investment and not a passive one. Firstly, in the 'risky business' scenario, the actively invested parent corporation is responsible for the tort as it incorporated a subsidiary precisely for the purposes of externalising the risk that materialised. By contrast, an inactive investor plays no part in such a course of action. Secondly, by virtue of this passivity, an inactive investor is not in a position to oversee the activities of the subsidiary, so applying liability to them will not encourage the pre-emption of torts, whereas the imposition of liability on a parent company is likely, as discussed, to cause greater centralisation of management and greater oversight. Finally, the advantages that arise from limited liability still apply in the case of an inactive investor, so it makes little sense to impose liability on them.

In a similar, though more general, vein, Addo has suggested that '[e]nterprise law needs a clear and distinct rationale to rival the facilitation of entrepreneurial spirit… upon which entity law principles… are built'.[193] Strasser and Blumberg have also noted the need for identification of the 'underlying policies of the law in the specific area of the law at issue'.[194] These commentators have identified the need to ensure a driving rationale for enterprise liability and this need is satisfied by the current proposal. In the conception of enterprise liability proposed here, the principles of tort law are the driving rationale, as enterprise liability would be guided by the need to adequately protect tort victims.

THE REASON FOR INACTION

Given the weight of the arguments for the application of enterprise liability to the risky business situation, it may be asked why this necessary change in the law has been so neglected. In the UK the courts have, at first, played a role developing the law, but have subsequently moved to curtail or eradicate the advancement of enterprise analysis.[195] Why do courts 'remain so willing to provide limited liability to parent corporations in tort cases'?[196]

Thompson suggests that one reason is that the risks under discussion are seen as remote, so that even if courts did impose liability in these circumstances, 'no extra preventative actions would be taken'.[197] This explanation is unsatisfactory. Firstly, because many cases involve the use of a subsidiary company precisely to avoid the consequences of risks that they are aware of, as opposed to remote and unforeseen risks, and, secondly, even if imposition of liability would not stop such torts occurring, it would at least allow the courts to redress harm to tort victims.

A much more likely explanation for the courts reluctance is a predisposition of deference to the legislature. Certainly in the UK this explanation is prevalent and has been proffered by the courts on a number of occasions. For instance, in the Salomon case,[198] Lord Davey considered that the legislature may not have considered the possibility of the 'one man company' leaving a defect in the machinery of the Act, but nevertheless he held that the wording decided upon by parliament must stand.[199] Likewise, Lord Halsbury, refusing to go beyond the express words of parliament, noted that '[t]he sole guide must be the statute itself'.[200] In some cases the deference has manifested as a reluctance to make exceptions to the strict rules,[201] while in Adams v Cape, this deference took the form of curtailing existing judicially developed

[191] Sommer, 'The Subsidiary: Doctrine Without a Cause?' (1990) 59 Fordham L Rev 227.

[192] Ibid 268-70.

[193] Addo, 'Human Rights Perspectives of Corporate Groups' (2005) 37 Connecticut L Rev 667, 668.

[194] Strasser and Blumberg, n 164.

[195] This tendency is not unique to the UK. As noted previously, the German and US courts have also acted in a similar manner.

[196] Thompson, 'Unpacking Limited Liability', n 29, 40.

[197] Ibid (citing Schwartz, n 61, 689).

[198] N 13.

[199] Ibid [54].

[200] Ibid [29].

[201] See, e.g., *Ord v Belhaven Pubs Ltd* [1998] BCC 607.

doctrines and severely limiting the scope for future judicial intervention.

Given this deference, the pertinent question is therefore why the legislature has not opted to implement the necessary reform. One reason has been put forward by Hansman and Kramaan.[202] They query why limited liability has been universally accepted as the rule,[203] even in situations where 'normative and economic realities necessitate a different regime of legal inquiry'.[204] They suggest that the answer is obvious: markets and politics do not well represent the interests of the tort victims, who bear the direct costs of the rule.[205] As previously noted, tort creditors cannot contract around limited liability, while, at the same time, tort victims, particularly potential tort victims, owing to their inherently disparate nature, 'do not constitute an easily organized political interest group'.[206]

This explanation is disarmingly simple and is supported by experience. In India it was a disaster on a massive scale that was the impetus for reform; an estimated 5,000 people died in the Bhopal disaster, while around 500,000 people were affected overall.[207] Due to this scale, it was not tort victims alone providing the impetus for implementing reform, but a whole nation and its government:[208] 'the Bhopal disaster shook off the lethargy of everyone and triggered off a new wave of consciousness'.[209]

CONCLUSION

This paper started by observing two major problems with the strict application of corporate personality and limited liability at the intersection of corporate groups and torts: the law fails to take a considered approach to corporate groups and it prejudices tort victims. The former arose because the modern phenomenon of corporate groups has been awkwardly squeezed into the concepts of the separate entity and limited liability, apparently without acknowledging that the foundational justifications for those concepts do not apply where two or more companies are one in economic terms. The latter arose because this uncritical acceptance of limited liability meant that the interests of tort victims were not considered.

Despite these beginnings, the strict separation of companies, especially where the tortuous liability of a subsidiary is concerned, has remained fairly consistent, and has been reaffirmed as a cornerstone of UK company law. Yet common sense suggests that retention of the doctrine simply because of its historical roots is a flawed course of action,[210] and this paper has argued that the time for reconsideration and change is long overdue.

The change advocated in this paper is enterprise liability. While as early as 1947 the theory was proposed as an alternative paradigm in company law,[211] the focus of this paper has been the intersection of corporate groups and torts, and the potentially sweeping and revolutionary nature of enterprise theory has been tempered by a narrowing of its application to deal with the two issues identified. This narrowed application of enterprise theory solves the issues discussed by reflecting both the economic realities of modern enterprise and the aims of the law of tort.

Some key considerations to be made when formulating a test for enterprise liability have been suggested and the use of an economics-centred approach has been advocated. A test for enterprise liability would take inspiration from Germany, India, the UN, and Lord Denning's previous attempt to include enterprise principles into UK law and tie enterprise liability to the economic reality. Such a test would look to economic factors, as well as public identification and unity of purpose. The presence of an enterprise

[202] Hansmann and Krakmaan, 'The End of History for Corporate Law (2001) 89 Georgetown L J 439.

[203] Ibid 466.

[204] Dearborn, n 50, 209.

[205] Hansmann and Krakmaan, n 202, 466-467.

[206] Ibid 467 (citation omitted).

[207] See Eckerman, *The Bhopal saga: causes and consequences of the world's largest industrial disaster* (Hyderabad: Universities Press India, 2005).

[208] The Government of India's position is illustrated by its assumption of *parens patriae* responsibility for the cases in the New York Courts and the arguments it put forward in that capacity. See Brief of the Plaintiffs, n 127.

[209] *M.C. Mehta v Union of India and Shriram Food and Fertilizer Industries*, Writ Petition 12739/1985 (1986.02.17) available at <http://www.elaw.org/node/2719>, accessed 17th February 2010 [2] (Bhagwati CJ).

[210] Kahan, 'Shareholder Liability for Corporate Torts: A Historical Perspective' (2009) 97 Georgetown L Rev 1085, 1109.

[211] Berle, 'The Theory of Enterprise Entity' (1947) 47 Columbia L Rev 343.

liability rule alone would likely cause a gradual shift in corporate attitudes, hopefully reducing the number of tort claims arising. In the meantime tort victims could rely on the direct cause of action accorded to them to ‘cut through the layers of risk externalizing subsidiaries’[212] and seek compensation.

Should we wait for a large-scale human tragedy to close this lamentable gap in the law? The answer, it is submitted, is no. It is time to replace the dysfunctional and anachronistic law at the intersection of corporate groups and torts with an appropriate set of rules based on enterprise analysis.

[212] Dearborn, n 50, 260.

——, ‘Indian Economy Overview’, EconomyWatch < http://www.economywatch.com/indianeconomy/indian-economy-overview.html> accessed 5th April 2010.

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