I. Introduction

In the following essay, I will strive to focus on two fundamental questions of contemporary corporate governance. First, the status of corporate groups under corporate law. Second, and relatedly, the question as to the ideal liability regime applicable to corporate groups and the individuals behind them. The discussion is based on my remarks on presentations by Professor Moritz Bälz on ‘The German System of Group Company Control’ and Toshikazu Miyoshi on ‘Shareholder Control over Subsidiaries in Japan’ given as part of the celebration in honour of the 25th anniversary of the University College of London Law Faculty’s Chair of Japanese Law, Professor Hiroshi Oda. Given my status as a non-expert in Japanese law, the reader will forgive me that the observations will be based mostly on Anglo-American law, with any references to Japanese law limited mostly to my knowledge of what Japan does not have: a dedicated law governing corporate groups. But Japan, of course, is not alone in this respect and the governance of corporate groups is a universal question, which is why I hope that this essay will provide some stimulating ideas for lawyers of any background and jurisdiction.

II. The (Hidden) Status of Corporate Groups

The status of corporate groups under company law is an odd one. In practice, they are widespread but ‘on the books’, that is in corporate laws and codes, they are often barely visible. In the UK – as in various other jurisdictions – the main corporate statute (the Companies Act 2006) contains only sparse references to groups, among a few other instances most notably in relation to

---

1 Senior Lecturer and Deputy Director of the Centre for Commercial Law, University College London Faculty of Laws. The following is an extended version of the author’s remarks given at the roundtable discussion on ‘Comparative Corporate Governance – the Case of Japan’ in May 2016. The author wishes to thank Professor Hiroshi Oda for organizing and inviting him to participate in this event.
accounting, reporting, and auditing obligations. Additionally, the UK Corporate Governance Code’s provisions do not explicitly mention corporate groups anymore, apart from a reference to the Financial Conduct Authority’s (FCA) Disclosure and Transparency Rules on reporting requirements for group companies.

Apart from this indirect recognition of groups and their interrelations, however, UK corporate law is clear that every company is to be treated as an independent entity. The House of Lords’ 1897 landmark decision in Salomon v. A. Salomon & Co. famously upheld statutory provisions that stipulated a company’s separate legal personality and limited liability, which also legitimized the emerging phenomenon of corporate groups and their conceptualization as connected yet legally separate companies. Consequently, directors of every company also owe their statutory duties to the respective company itself, not to a parent company or other controlling shareholder. Indeed, it would for example constitute a breach of fiduciary duty if a subsidiary’s director would blindly follow a parent company’s orders or policies without adhering to the duty to promote the success of the subsidiary company and have regard to interests of its minority shareholders, employees, the relevant community, and others.

This framework of corporate separateness is at odds with the reality of corporate groups. As exemplified for instance by Itochu Corporation’s practices described elsewhere in this volume, parent companies frequently exercise various measures of control over its subsidiaries. Examples for such measures include group wide policies on matters pertaining to health and safety, bribery, operational issues, and many others. Group companies also collaborate and support each other in manifold ways, with financial arrangements such as cash pooling being just one example. However, if there is no clarity on the status of group companies, the control and

---

2 See Parts 15 and 16 of the UK Companies Act 2006 (hereinafter ‘Companies Act’); P. Davies et al., Gower and Davies Principles of Modern Company Law (9th ed., London 2012) 247–249 and chapter 21. See also Companies Act sections 208 (approval exceptions for certain intra-group transactions), 611 (group construction relief), 682 (conditional exceptions regrading financial assistance), 834 (condition as to holdings in other companies for investment companies), 1161–1162 (meaning of undertaking and related expressions), and 1164–1165 (meaning of banking and insurance group).
3 UK Corporate Governance Code (2016), Schedule B.
4 Section 170(1) Companies Act.
5 See section 172 Companies Act.
6 See Toshikazu Miyoshi’s contribution.
uniformity that is acceptable throughout a group as a matter of corporate law, and the duties that each company’s directors and managers owe, subsidiaries and the individuals that lead them will continue to face conflicts arising from the divergence between a group’s overall interests and an individual subsidiary’s stakeholders’ interests.

One approach to deal with these issues can be found in the German Konzernrecht (law of corporate groups). Indeed, German law provides for a distinct regime of corporate group liability, providing, in short, a contractual (optional) and a mandatory model applicable to de facto groups, which both provide for instances of parent company liability. Nevertheless, it should be noted that this regime is mostly geared toward the protection of minority shareholders and contractual creditors, not the case of victims of torts or human rights violations – discussed in the subsequent part of this essay below – that have figured prominently in recent public and legal debates surrounding this issue.

In this respect, Japan – as well as the UK and other jurisdictions – could both benefit from a system that is more akin to the one found in Germany, where corporate law provides broader and more specific rules that recognize and formalize control and governance in corporate groups and regulate some of the consequences that arise in these settings. Although the German system is not a perfect or – among others because of its limited scope – sufficient model to serve as a blueprint for regulating corporate groups, it is a step in the right direction and can form the basis for a framework that allows courts and regulators to better address the reality of corporate groups.

III. The Issue of Liability in Corporate Groups

Especially in large groups, it will never be possible to completely avoid wrongdoing on the level of corporate subsidiaries. If there is such wrongdoing – as it for instance emerged in numerous corporate scandals in Japan and elsewhere – the question is how to regulate liability. There are two distinct layers of liability that can be distinguished in this respect: First, there is the potential

---

7 See this volume’s contribution by Moritz Bälz. See also R. Reich-Graefe, ‘Changing Paradigms: The Liability of Corporate Groups in Germany’ 37 Western Conn. L. Rev. 785 (2005); Davies et al., supra note 2, 245–247.

8 As evidenced in particular in the scandal concerning the Japanese camera maker Olympus.
of personal liability on the part of parent company directors (and managers) towards their own shareholders for failing to sufficiently monitor group companies. Second, there is the possibility of parent company liability for its subsidiaries or group companies.

A. Personal Liability

In the UK, at least in theory, directors may be liable for failing to exercise appropriate risk management and internal control, which includes oversight over subsidiaries. The general duty to monitor their company is regarded as part of the duty of care, and may also be said to follow implicitly from the duty to promote the success of the company and thus to contain elements of loyalty. Even in cases of simple negligence, directors can be liable if – as a result of their failure to implement sufficient monitoring measures or take other appropriate actions – wrongdoing occurs in a subsidiary that causes harm to a third party.

A leading case in this regard is the Barings Bank decision. Barings collapsed in 1995 after the general manager and head derivatives trader of a Singaporean Barings subsidiary engaged in unauthorized trading that resulted in enormous losses for the bank. The manager’s rogue trading led to successful proceedings seeking to disqualify three executive directors of Barings group companies as ‘unfit’ to manage a company, based on various shortcomings relating to internal control and risk management. On appeal by one of the directors, which was dismissed, the Court of Appeal approvingly cited the lower court’s summary of directors’ oversight duties, stating among others that directors have a “continuing duty to acquire and maintain a sufficient knowledge and understanding of the company’s business to enable them properly to discharge

9 P. Davies et al., supra note 2, 521.
10 Section 172 Companies Act.
11 In the sense of section 6 of the UK Company Directors Disqualification Act 1986.
12 See Secretary of State for Trade and Industry v Baker (No 5) [1999] 1 BCLC 433; Secretary of State for Trade and Industry v Baker (No 6) [2001] BCC 273 (on appeal).
their duties as directors”. Given the facts of the case, this duty includes oversight of subsidiaries or group companies.

Previously, traditional UK case law had suggested that a board can rely on the honesty of executive directors and other officials ‘in the absence of grounds for suspicion’. Conversely, the Barings decision stated that it is not enough to act only in response to warning signs and that a failure on the part of directors to engage ex ante in meaningful internal control/risk management represents a breach of their duties. While directors are still permitted to delegate tasks and rely on others, they are responsible for ensuring the latter’s supervision and also the existence of adequate controls. Both the extent of delegation and the implementation of internal controls will be governed by a reasonableness standard, which is measured against the conduct of a reasonable director.

In circumstances where at least some attempts to exercise oversight were made, however, and shortcomings are less obvious it is unclear whether UK courts will find directors to be at fault. In the context of corporate groups, it seems particularly relevant that directors’ liability exposure is mitigated if they can successfully argue that they properly delegated certain oversight duties to specific board members, board committees, management, or advisors. By extension, it could be argued that a parent company board’s duties are reduced when it comes to failures in preventing wrongdoing at the group company level as each subsidiary’s board is primarily tasked with overseeing their company. Conversely, given that some cases suggest that the standards that boards are required to adhere to will be reduced in smaller and less complex businesses, we can draw the conclusion that standards are more stringent in the case of large and complex corporate groups. Ultimately, it makes sense that parent company directors should have to protect their shareholders from losses causes by wrongdoing at the group company level, which is among the

13 Secretary of State for Trade and Industry v Baker (No 6) [2001] BCC 273, 283 (Morritt LJ).
14 See, for example, Re City Equitable Fire Insurance Co Ltd [1925] Ch 407, 429.
known risks in corporate groups. Indeed, it is also important to note in this regard that UK law, as a matter of principle, does not prevent courts from finding directors to be personally liable even in complex situations or where they appear to have been only slightly negligent.\(^{18}\)

The UK framework contrasts sharply with the law as developed in Delaware. Under Delaware law, directors can only be held liable if they consciously disregard their monitoring duties and completely failed to implement internal controls or consciously disregarded red flags. Contrary to early case law,\(^{19}\) the Delaware Chancery Court held in the seminal *Caremark* case\(^{20}\) that directors, regardless of any notice of actual wrongdoing, had a duty to assure themselves that reasonably designed information and reporting systems exist. Yet, while the standard of conduct demanded by this duty was expansive, the court formulated a narrow standard of review that severely constrained courts’ authority to hold directors liable for misguided compliance decisions. According to *Caremark*, only a sustained or systematic failure of the board to exercise oversight – such as an utter failure to attempt to assure a reasonable information and reporting system exists – will establish the lack of good faith that is a necessary condition to liability.”\(^{21}\)

Two decades later, in *Stone v. Ritter*,\(^{22}\) the Delaware Supreme Court was faced with what had come to be known as a ‘Caremark claim’, that is allegations of a lack of oversight. This case involved a shareholder derivative suit alleging that directors of a financial institution failed to implement reasonable legal compliance controls. Specifically, shareholders of AmSouth Bancorporation alleged that the directors had failed to implement controls that would have informed them of breaches of anti-money-laundering regulations that caused AmSouth and its wholly owned subsidiary to pay $50 million in governmental fines and penalties. Building upon *Caremark*, the Delaware Supreme Court restated the necessary conditions for director oversight

\(^{18}\) Still, in practice the uncertainty and obstacles surrounding oversight liability claims – and derivative claims in general – act as a strong deterrent to bringing claims.

\(^{19}\) *Graham v. Allis-Chalmers Mfg. Co.* 188 A.2d 125 (Del. 1963). The plaintiffs in this case alleged that the directors of Allis-Chalmers failed to prevent violations of antitrust laws by company employees.


\(^{21}\) ibid at 971.

\(^{22}\) 911 A.2d 362 (Del. 2006).
liability. As the Court explained, to recover successfully in an oversight case, a plaintiff must show that:

“(a) the directors utterly failed to implement any reporting or information system or controls; or (b) having implemented such a system or controls, consciously failed to monitor or oversee its operations thus disabling themselves from being informed of risks or problems requiring their attention.

In either case, imposition of liability requires a showing that the directors knew that they were not discharging their fiduciary obligations.23”

Thus, the Court reiterated and increased Caremark’s limits on liability (and, interestingly, did so in the context of a factual scenario involving a parent and subsidiary). However, it also took the position that the fiduciary duty violated by director oversight is not the duty of care, but rather the duty of loyalty.24 One notable consequence of this shift was that oversight was excluded from the breach of duties that may be covered by a Delaware corporation’s directors’ liability exculpation provisions,25 potentially increasing directors’ liability exposure. Yet, subsequent decisions affirmed Delaware’s strict limits on oversight liability, including in the context of a claim brought against Citigroup as a result of the financial crisis.26

Thus, as we have seen, UK and US law have taken very different approaches to regulating directors’ and managers’ oversight liability (including as pertaining to duties that relate to the

23 Stone, 911 A.2d at 370.
25 Delaware General Corporation Law s 102(b)(7) permits a corporation to include in its certificate of incorporation

“A provision eliminating or limiting the personal liability of a director to the corporation or its stockholders for monetary damages for breach of fiduciary duty as a director, provided that such provision shall not eliminate or limit the liability of a director: (i) For any breach of the director’s duty of loyalty to the corporation or its stockholders; (ii) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law; . . . or (iv) for any transaction from which the director derived an improper personal benefit.”

26 In re Citigroup Inc. Shareholder Derivative Litigation, 964 A.2d 106 (Del. Ch. 2009). The court in that case refused to second guess the substance of the board’s oversight activities, being satisfied that the board and its audit committee had done enough to make it impossible for plaintiffs to overcome the ‘extremely high burden on a plaintiff to state a claim for personal director liability for a failure to see the extent of a company’s business risk’. ibid 125.
oversight of subsidiaries). While in the UK directors can be held responsible for any degree of negligence in discharging their monitoring obligations, Delaware case law makes it clear that there will only be liability if the directors knew they were not discharging their fiduciary obligations. Short of requiring actual intent to inflict harm, one can hardly imagine a more demanding liability standard. Although in practice the UK and US regimes have thus far resulted in similar outcomes (that is, directors will only be liable when there are clear, egregious breaches), it is instructive to reflect briefly on the different approaches’ respective rationales and potential effects.

In the Citigroup case, the influential Delaware Chancery Court acknowledged that ‘Citigroup has suffered staggering losses’ and that ‘it is understandable that investors … want to find someone to hold responsible for these losses’. However, the Court also noted that ‘it is often difficult to distinguish between a desire to blame someone and a desire to force those responsible to account for their wrongdoing’. In this case, the Court found that legal and policy grounds supported its decisions to reject shareholders’ claims. It summarized the rationale behind its decision and its restrictive approach as follows:

Our law, fortunately, provides guidance for precisely these situations in the form of doctrines governing the duties owed by officers and directors of Delaware corporations. This law has been refined over hundreds of years, which no doubt included many crises, and we must not let our desire to blame someone for our losses make us lose sight of the purpose of our law. Ultimately, the discretion granted directors and managers allows them to maximize shareholder value in the long term by taking risks without the debilitating fear that they will be held personally liable if the company experiences losses. This doctrine also means, however, that when the company suffers losses, shareholders may not be able to hold the directors personally liable.

In contrast, the Barings court emphasized very different aspects of directors’ liability:

28 In re Citigroup Inc. Shareholder Derivative Litigation, 964 A.2d 106, 139 (Del. Ch. 2009).
The concept of limited liability and the sophistication of our corporate law offers great privileges and great opportunities for those who wish to trade under that regime. But the corporate environment carries with it the discipline that those who avail themselves of those privileges must accept the standards laid down and abide by the regulatory rules and disciplines in place to protect creditors and shareholders. And while some significant corporate failures will occur despite the directors exercising best managerial practice, in too many cases there have been serious breaches of those rules and disciplines, in situations where the observance of them would or at least might have prevented or reduced the scale of the failure and consequent loss to creditors and investors.

The key to understanding these two contrasting approaches lies in the diverging policies that form the backdrop to the cases dealing with managerial liability. Shareholder fiduciary duty litigation is commonly thought to serve two main goals: ex post compensation and, above all, ex ante deterrence. These aspects are reflected in the Barings’ court’s strict approach to directorial liability, with the goal being in great part to compensate ‘creditors and investors’ as well as prevent future occurrences of similar misconduct. From this perspective, directors’ and officers’ liability must necessarily be as strict as possible in order to achieve the stated goals. In such a system, however, there is a potential that the pendulum may swing to the other extreme and result in over-deterrence. Relatedly, as two commentators have observed, increasing regulation of internal control and risk management may cause courts and regulators in hindsight to label ‘any business choice with adverse consequences for shareholders and/or other stakeholders a manifestation of a faulty risk management system and deem directors liable as a consequence.’

---


In contrast, Delaware’s oversight liability is largely influenced by another aspect of directors’ liability that tends to be prioritized under US law. This approach recognizes that the potential for personal liability is a necessary check on managerial behaviour, but at the same time is wary of what is seen as a negative by-product of such liability, namely the “threat of sub-optimal risk acceptance”.

Delaware’s director-friendly liability rules thus rest on the idea that the prospect of personal liability can cause directors to be more risk-averse than the interest of diversified shareholders justifies.

As there is a correlation between risk and rewards (more risks are generally thought to translate into increased profits) – and indeed taking on risks is an essential part of doing business – courts are reluctant to impose liability that could result in companies failing to take on “healthy” levels of business risks or overinvest in safety measures. The latter may also include internal control, monitoring, and risk management systems that are not optimal from a cost-benefit perspective (their cost is higher than the losses that they help avoid), which from the perspective of diversified shareholders is undesirable. In a somewhat ironic and roundabout way, therefore, insulating boards from liability could be seen as a device to protect shareholders from themselves, in that it allows boards to take risks that will ultimately benefit shareholders as a class. This is also one of the principles that justify the business judgment rule, which however – given the typical absence of a decision (an omission) – is not applicable in oversight cases.

The difficult task that courts face in cases alleging a lack of oversight is that they have to balance potentially negative effects of personal liability – such as increased costs and over-deterrence – against the issue of ‘risk-taking’ and optimal incentives for business that are at the core of economic activity. Developing an appropriate balance in terms of monitoring liability, including for risks arising from corporate group structures, will therefore be another task for

33 ibid 1052. See also Joy v. North, 692 F.2d 880, 885–86 (2d Cir. 1982).
34 To be sure, opting-out of internal controls will usually not make sense in the important area of accounting. Maintaining precautions in that particular area is often relatively cost-efficient and not having such controls could hardly be justified. Conversely, the case for controls that monitor business risks is more complex. On this, see Enriques and Zetsche, supra n 31.
Japanese law as it develops its own jurisprudence on internal control and risk management duties of directors of parent companies.

B. Parent Company Liability

In addition to personal liability vis-à-vis shareholders, another important issue in corporate group settings is parent company liability towards third parties that already have claims against and/or have been affected by actions and omissions by a subsidiary. As mentioned at the outset, traditional corporate law tells us that each company – whether part of a group or not – is a separate entity and that shareholders, including parent companies, are protected by limited liability, which limits their exposure when it comes to subsidiaries’ debts to the amount they contributed in return for the issuance of shares.

In keeping with these principles, piercing the corporate veil – that is disregarding the separate legal personality of a company – is difficult. In the UK, traditional veil piercing has been severely limited in the case of Adams v Cape Industries plc.\(^{35}\) Adams, decided by the Court of Appeal in 1989, effectively limited the instances in which veil piercing could be successfully invoked to three scenarios. First, when a parent’s responsibility for a subsidiary may be construed based on specific circumstances, particularly where a statute or contract allows for a broad interpretation to references to members of a group of companies. Second, in cases indicating that a company is a mere facade to conceal true facts and avoid legal obligations. Third, where a subsidiary acts as its parent company’s agent. However, the Adams court took a restrictive approach to the idea of imposing parent company liability and emphasized the legitimacy of corporate group structures as a tool to compartmentalize liability risks and insulate parent companies from such exposure. Slade LJ expressly noted that the right to use corporate structures to channel liability to a subsidiary – and thereby limit other group members’ liability – “is inherent in our corporate law”, even if the results were sometimes undesirable.\(^{36}\)

\(^{35}\) [1990] 2 WLR 657.

\(^{36}\) The reluctance to pierce the veil was further reflected in cases after Adams, most notably in Prest v Petrodel Resources Ltd. (2013) 3 WLR 1.
Given these hurdles, claimants injured by occurrences seemingly at the subsidiary level of a corporate group subsequently focused on other avenues to hold parent companies liable, most notably by invoking claims that parent companies owed them a direct duty of care. In *Chandler v. Cape*, the UK Court of Appeal developed a new test that allows tort victims that were injured by activities of a subsidiary to hold the parent company liable. In essence, under this test, a parent company is responsible for the health and safety of a subsidiary’s employees if it controls the subsidiary and if it knows or should know that the subsidiary’s system of work is unsafe. Under *Chandler’s* approach, the first inquiry is into the level of control that a parent exercises over a subsidiary. If there is sufficient control, the parent company may be found to have assumed responsibility towards subsidiary employees and incur liability.

Although the *Chandler* court did not specify what exactly would be necessary to trigger such liability, it provided a four-part test, which, if all parts could be answered in the positive, was said to be one of the situations leading to parent company liability towards employees of its subsidiaries. The factors formulated by the court are that (1) the businesses of the parent and subsidiary need to be in a relevant respect the same; (2) the parent has, or ought to have, superior knowledge on some relevant aspect of health and safety in the particular industry; (3) the subsidiary’s system of work is unsafe as the parent company knew, or ought to have known; and (4) the parent knew or ought to have foreseen that the subsidiary or its employees would rely on its using that superior knowledge for the employees’ protection.

One of the problems with this approach, however, is that it punishes parent companies that engage in control of their group companies – from a liability perspective, therefore, the less the parent company knows about safety procedures in its subsidiaries, the better. This, however, gives the wrong incentives if the aim is to minimize wrongdoing in corporate groups. Overall, the approach taken in *Chandler* was in various ways unsuitable for the facts at hand, but also seems

37 [2012] EWCA Civ 525.
38 Although the Court of Appeal did not expressly include control as an element of its test, it is clear from the holding as a whole that control is considered the starting point for analysing a parent’s liability based on assumption of responsibility. See *ibid* at [46]: ‘The issue in the present case is whether Cape, as parent company, accepted responsibility for the health and safety of employees. Thus the court has to be satisfied that there was relevant control of the subsidiary’s business.’.
39 *ibid* at [80].
flawed in general and unsuitable as a basis for future decisions. Firstly, the incentive issue mentioned above notwithstanding, it is unclear what type and level of control is needed to meet the court’s requirement for there to be ‘relevant control’. *Chandler* seems to indicate that a general practice of involvement in a subsidiary’s trading operations is sufficient, even if these interventions are unrelated to the area that led to an injury and would be insufficient to support an argument that the subsidiary was acting as the parent’s agent (which would be necessary for veil piercing) or form a basis for the court to consider the parent’s vicarious liability for its subsidiary. This seems both over- and under inclusive. It is overinclusive because it includes in its ambit practices (such as uniform policies) that are common in corporate groups; thus, almost every parent would satisfy this part of the test for liability. It is however also underinclusive because, as I will show further below, a lack of control should by itself not disqualify claims against a parent company – a parent company that does not intervene in any way in its group companies’ business may still be an appropriate defendant. The other, more specific elements of *Chandler*’s liability test are also problematic. Among others, the parent’s superior knowledge on relevant aspects of health and safety in the industry and its knowledge of safety issues at the subsidiary seems an unnecessary requirement. Similarly, reliance on the parent’s knowledge and intervention to ensure safety – either by the subsidiary or the injured third party – are not relevant. Conversely, the idea that the parent and subsidiary should broadly be in the same business – a requirement similar to the *Chandler* four-part test’s first prong – may well make sense.

Going forward, I propose that parent company liability should be understood as an effort to fully internalize business risks, which would also mean that liability will be assigned without inquiring into the parent’s state of mind and knowledge, or the injured party’s reliance. The preferred solution is thus in my view to conceptualize parent company liability not in terms of a breach of duty of the parent company but rather from the perspective of cost-benefit alignment. The notion of cost-benefit alignment has long figured prominently in the discussion surrounding justifications of vicarious and enterprise liability. The idea is, in short, that a business that reaps benefits from its activities also has to bear the costs that flow from these activities, including liability costs.\(^4\) In economic terms, this notion is known as cost internalization, which is said to

\(^4\) A famous case in this regard is *Ira S. Bushey & Sons, Inc. v. United States*, 398 F.2d 167 (2d Cir. 1968).
lead to efficient outcomes. Based on an extended version of these arguments, we can make the case that corporate groups are ‘one business’ – or a single enterprise – and we should not let corporate separateness stand in the way of letting a corporate group absorb liability costs caused by a subsidiary or group company that represents an integral part of the business.

Indeed, Lord Denning has already famously argued that corporate groups may be viewed as a “single economic unit” while US courts have developed the doctrine of enterprise liability. Both approaches are at their root similar to what I regard as the preferred approach.

Lord Denning championed the ‘single economic unity’ theory in the 1970s. In DHN Food Distributors v Tower Hamlets, a parent company operated a business on premises that belonged to its subsidiary and with vehicles that were owned by another subsidiary. The parent was allowed to claim for compensation for loss of business when the government executed a compulsory land purchase order. As this remedy was normally reserved for companies that owned both the business and the land used for this purpose, it was necessary for the court to treat the parent and its subsidiary as a common entity, which it did. However, Denning’s single economic unit approach did not gain acceptance as a general principle for veil piercing. Subsequent cases cast doubt on the validity of Denning’s reasoning and certainly in the light of Adams it can be said that DHN is now either overruled or, at most, an authority on its specific facts relating to compulsory acquisitions of business premises.

In contrast, enterprise liability is a recognized judicial doctrine in the US. There, as a supplementary doctrine to veil piercing as ‘vertical’ liability, this doctrine allows courts to hold a company that is part of a corporate group liable for the debts of a sister company (‘horizontal’ liability). More broadly defined, the doctrine may enable a subsidiary’s creditors to reach the collective assets of all of the companies that form a corporate group. Enterprise liability is thus particularly useful where a group company is unable to satisfy debts or claims but the corporate

41 See, for example, G. Calabresi, Some Thoughts on Risk Distribution and the Law of Torts, 70 YALE L.J. 499, 509 (1961).
group as a whole, albeit not necessarily the insolvent company’s parent company, has sufficient assets. The test for enterprise liability normally consists of two elements. First, there has to be such a high degree of unity between the entities in question that their separate existence has de facto ceased. Second, in light of this unity, treating the entities as separate would promote injustice. Although courts have taken differing approaches to interpreting the precise requirements under this test, elements that show how the separateness of group entities was disregarded (such as intermingling of assets or other evidence that they were not treated as independent entities) as well as an improper fraudulent motive behind using a group structure will likely have to be shown.

From a theoretical perspective, the idea of more encompassing liability of corporate groups is also supported by theoretical considerations. Even strong proponents of limited liability have suggested that limited liability may be less appropriate or even wholly inappropriate in the parent company context (as opposed to the liability of a company’s ultimate individual shareholders). The general thrust of these arguments is that the economic reasons that justify limited liability for individual shareholders and lead to its overall welfare-enhancing effect do not apply – or not with the same force – when we deal with companies that hold shares in other companies. For example, Frank Easterbrook and Daniel Fischel noted among others that allowing creditors to reach the assets of parent corporations does not create unlimited liability for individual investors, which means that limited liability’s benefits of encouraging diversification and allowing for reduced monitoring costs by investors are unaffected. They also found that the moral-hazard problem stemming from limited liability is greater in parent-subsidiary situations and creates incentives to engage in excessively risky behaviour.

Finally, it is worth mentioning the currently ongoing international negotiations concerning a proposed UN-sanctioned business and human rights treaty,\(^{48}\) which may also affect parent or group company liability. As part of these negotiations, an inter-governmental working group has been tasked with exploring the future contours of parent companies’ civil liability for human rights abuses.\(^{49}\) At present, the working group’s proposals include four options on how the treaty could impose such liability.\(^{50}\) One of the options consists of recognizing an ‘enterprise liability principle’ that would ‘bring legal reality of corporate groups closer to their economic reality’.\(^{51}\) In the context of the working group’s proposal, this would involve treating all companies in a group as a single enterprise for the purposes of human rights claims brought against any entity forming part of the group, thus negating the separate legal personality principle of corporate entities.

While broader parent company or group liability, such as in the form of a regime akin to what is today known as enterprise liability, is desirable, such a solution is not without its own problems. The main difficulty with enterprise liability lies in defining the boundaries of the enterprise and deciding which companies should be included in the notion of the ‘enterprise’.\(^{52}\) In terms of these boundaries, hard rules, such as the inclusion only of wholly owned or majority owned companies that are ultimately held by the same shareholder or group of shareholders are possible but may be too narrow. Control-based approaches beyond capital ownership, including contractual or factual control, would be another option, although this is difficult to identify and could lead to overly expansive definitions of enterprise. Finally, there is also the question of how to treat companies that are purely passive investors in other companies, be that as part of what


\(^{51}\) See ibid.

\(^{52}\) Additionally, in terms of the US test for enterprise liability, the inclusion of an inquiry into the injustice of not treating separate entities as one seems both too difficult and imprecise to handle in practice. However, since economic justifications support at least certain forms of enterprise liability, it seems that this type of liability could actually be solved without reference to fairness.
would be considered a corporate group (such as a holding that is the parent company of two groups of subsidiaries that are active in different industries) or financial investors. These are complex questions without easy answers, which must be developed further in the future.

**IV. Conclusion**

Despite their prevalence and importance, corporate groups often continue to live an existence that is separate from or parallel to basic corporate law, which still only contains very limited recognition of connected legal entities. Yet, corporate groups raise difficult and important practical issues surrounding control, accountability, and responsibility between connected companies. This essay has developed some thoughts on two specific aspects, namely personal liability of directors and managers for oversight of group companies and, additionally, the liability of parent companies – or corporate groups as a whole – beyond traditional veil piercing principles. While drastic changes to parent company liability have long seemed unlikely, with the currently ongoing negotiations concerning an international business and human rights treaty, which may include new approaches to parent or group company liability, a real possibility of substantial reform is now on the horizon. With regards to this and other issues arising from corporate groups discussed in this essay, I remain curious and look forward to seeing which direction Japanese law will take in the future.