Enterprise Liability for Corporate Groups

A safeguard for creditors

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The first systematic and comprehensive review of the application of Australian corporate law to corporate groups commenced in 1998, which resulted in the Companies and Securities Advisory Committee (CASAC) the precursor to the Companies and Markets Advisory Committee (CAMAC), publishing its Corporate Groups Final Report in May 2000. Of the Final Report’s 24 Recommendations to date, only two recommendations, permitting the pooling of assets and liabilities in a liquidation of group companies have led to changes in Australian corporate law. Of the remaining 22 recommendations, ten involved no change to the current law, while the remaining 12 recommendations have not been implemented. One of the final report’s objectives was to determine whether further safeguards were needed for those dealing with corporate groups, namely minority shareholders and outsiders including creditors. Unsecured creditors transacting with corporate group members may make inefficient investments as: corporate group members may misrepresent the availability and value of group assets when such assets are insulated from creditors’ claims; there is an increased opportunity for debtor opportunism to arise within corporate groups. This article, considers, whether the adoption of enterprise liability within controlled and integrated corporate groups would efficiently enable creditors to identify and therefore price the limited recourse risk and debtor opportunism risk of transacting with such a corporate group member, thereby providing creditors with an additional level of protection.
I INTRODUCTION

In May 2000, Companies and Securities Advisory Committee (CASAC) in its Corporate Groups Final Report,\(^1\) recommended as a further safeguard to creditors\(^2\), the introduction of an enterprise approach to regulating corporate groups. However, the above recommendation, like the majority of report recommendations, was not adopted. Rather, current Australian corporate law relies upon conventional ex ante and/ or ex post protections for creditors transacting with corporate group members.

In Australia corporate groups\(^3\) pose specific dangers for creditors\(^4\) when transacting with their group member companies. Conflicts of interest between corporate group constituents\(^5\) inherently arise due to the Australian corporate governance framework\(^6\). Based on the entity approach, Australian corporate law generally requires directors to act in the best interests of the company to which they have been appointed.\(^7\) However, this duty may conflict with a director’s actions within a

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3. This article is concerned with those corporate groups which are operated and managed as single enterprises. Such groups are characterised by the following factors: control, either centralised or decentralised over day-to-day decision-making of group members; economic integration where group members collectively conduct complementary fragments of a common enterprise; financial interdependence whereby the members’ financing needs are met through loans from the group obtained by guaranteeing parent or sister subsidiaries within the group; administrative interdependence of constituent group companies to achieve economies of scale; overlapping employment structure whereby staff move around the group, training, insurance and employee benefits are offered group wide; common group persona in terms of a common group trade name, trademarks, or insignia.
4. Corporate groups exhibiting the first two characteristics of control and integration, as well as a majority of the remaining characteristics provide confirmation of the corporate group’s single business enterprise.
5. In the context of this article creditors are restricted to voluntary unsecured creditors. Such creditors include: employees; consumers or customers of the corporate group member who pay in advance for goods or services prior to delivery and trade creditors, who are individuals or companies who supply goods or services to the single enterprise group member but do not require immediate repayment. Such creditors are termed “voluntary” as their transacting with the company involves an element of choice. Although employee wages and superannuation contributions are considered unsecured debts of the corporate group member, such payments are given priority by section 556 Corporations Act 2001 (Cth). In conjunction therewith, The General Employee Entitlements and Redundancy Scheme (GEERS) covers capped unpaid wages, annual and long service leave, capped payment in lieu of notice and capped redundancy pay to assist employees who have lost their employment due to the liquidation or bankruptcy of their employer.
6. Includes directors, shareholders and creditors of each corporate group member.
8. S187 Corporations Act 2001 (Cth) does to a limited extent allow consideration of the group interest by directors if certain conditions are satisfied.
corporate group which is managed and controlled on the basis of a single enterprise. Directors / controlling shareholders may act to maximise the corporate group’s wealth at the expense of individual corporate group members and their creditors. In the context of this article such behaviour is labelled ‘debtor opportunism’.

No codified group law\(^8\) or narrowly defined group case law\(^9\) exists to deal with such conflicts specific to corporate groups. This article, considers, whether the adoption of enterprise liability within controlled and integrated corporate groups would provide creditors with an additional level of protection against such specific conflicts of interest.

In doing so, the remainder of the article will be broken down into the following parts: Part II considers briefly CASAC’s recommendations and contemplates the reasons for their non-implementation. Part III describes how unsecured creditors transacting with corporate group members may make inefficient investments due to the increased opportunity for debtor opportunism within corporate groups. Part IV highlights the weaknesses of relying upon the conventional protections to address such debtor opportunism. Part V considers whether the adoption of enterprise liability would reduce the level of debtor opportunism within corporate groups, as well as address the reasons given for the non-implementation of CASAC’s recommendations. Part VI concludes with a summary of the advantages and disadvantages of adopting enterprise liability for corporate groups.

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\(^8\) As exists in Germany, Portugal, Brazil and partially in Slovenia, the Czech Republic and Hungary. See Brigitte Haar “Corporate Group Law” J. Basedow, Klaus J. Hopt, Reinhard Zimmermann, (eds) Encyclopaedia of European Private Law 2011, 1. Available at http://ssrn.com/abstract.

II AUSTRALIA’S DRAFT REFORMS

The Companies & Securities Advisory Committee (CASAC) in its Final Report on Corporate Groups in May 2000 recommended the adoption of the single enterprise principle in regulating corporate groups. Under the proposal wholly-owned corporate groups could choose whether or not to be so regulated by choosing to be consolidated or non-consolidated. If choosing to be consolidated then a term such as “consolidated corporate group company” would be included on all public documents of the group companies. Single enterprise principles would then govern the consolidated corporate group company as ‘the Corporations Law would treat the consolidated corporate group as one legal structure’.

CASAC, however, recognized the difficulty of applying single enterprise regulation principles to corporate groups, regardless of their organisational structure or governance autonomy, by allowing wholly-owned corporate groups members to determine their inclusion in the consolidated corporate group. Once consolidated, ‘group companies could merge merely at the discretion of the directors of the holding company’ and ‘ASIC should have the power to provide appropriate relief from accounting and any other residual separate entity requirements’.

Of the report’s 24 recommendations two recommendations, dealing with the pooling of insolvent group companies’ assets and liabilities, have only lately been

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10 The purpose of the CASAC Final report was to outline, having previously reviewed Australian corporate law applying to corporate groups, various recommendations to assist the efficient and effective management of corporate groups while ensuring appropriate protection for minority shareholders and outsiders.

11 Recommendation 2: The Corporations Law should provide that a wholly-owned corporate group can “opt-in” to be a consolidated corporate group for all or some of the group companies, by resolution of the directors of each relevant group company. All companies in a consolidated corporate group should be governed by single enterprise principles.

12 By resolution of the directors of each relevant group company.

13 CASAC, Corporate Groups Final Report May 2000 39

14 Ibid. [1.59-1.63]

15 By the resolution of their directors.

16 CASAC as above note 13 39.

17 Ibid.

18 Recommendation 22: The Corporations Law should permit liquidators to pool the unsecured assets, and the liabilities of two or more group companies in liquidation with the prior approval of all unsecured creditors of those companies. Recommendation 23: The Corporations law should permit the court to make pooling orders in the liquidation of two or more companies. This power should be based on the draft provision in the Harmer Report and:

.- make clear that pooling orders do not affect the rights of external secured creditors.
.- permit individual external creditors to apply to have a pooling order adjusted to take their particular circumstances into account.
adopted. Of the remaining recommendations, 11 were successful, in that no changes were made to existing laws as stated. A further 11 recommendations have not as yet been acted upon, including CASAC’s recommendation that wholly owned corporate groups be given the option to be regulated on the basis of one economic entity. No public comment on any particular recommendation has been released, although various conjectures have been made regarding recommendation 2’s non-implementation including:

- Complications of drafting legislation to adopt a single enterprise regulatory regime within the Corporations Act meant that path dependency of no recognition prevailed;

- Significantly, there were no real incentives granted to the corporate group to encourage directors to opt in and consolidate. A suggested incentive by CASAC that directors of each wholly-owned group company could act in the overall corporate group interest without reference to the interests of their particular group company was illusory. The Corporations Law already permits directors of solvent wholly owned companies to act solely in the interests of the holding company by virtue of s187 Corporations Act 2001 (Cth). Thus Recommendation 2 only offered what was already available to corporate groups under the ASIC class orders for cross-guarantees, or was more limiting in some respects.

- Increased liability exposure was thought to impact on the corporate group’s ability to borrow, restricting efficient capital raising, risk taking and diversification;

- Recommendation 2 did not provide a satisfactory response to the long tail liability issues raised in the James Hardie Case and the Jackson Report as it specifically excluded a consolidated corporate group from being

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19 See Division 8 of Part 5.6 of Corporations Act 2001 (Cth) which was introduced by Corporations Amendment (Insolvency) Bill 2007. For a discussion of both voluntary and court ordered pooling provisions see Jennifer Dickfos, ‘Improving outcomes for creditors: Balancing efficiency with creditor protections’ (2008) 16 Insolvency Law Journal 84, 90-95.

20 CASAC, above note 13, 39.

21 Vicky Priskich, ‘CASAC’s proposals for reform of the law relating to corporate groups’, Company & Securities Law Journal, 2001, 362. Vicky Priskich identified a further disincentive with CASAC’s proposal that a company in a consolidated group may deconsolidate but cannot be sold to a third party, and that residual liability remains if a company opts out of consolidation. Namely, in comparison to the class order relief offered by ASIC in the form of deeds of cross-guarantee, which placed no restrictions on the ability to sell any of the companies within the scheme,(see Pro Forma 24, deed of cross-guarantee, [4.2(c)] where the sale is for fair and reasonable consideration) and once sold, released such companies from any liability under the deed,( See Pro Forma 24, deed of cross-guarantee, [4.2(d) (e) & (f)]) consolidation could be viewed as a punitive measure.
collectively liable for the torts of any group company merely by virtue of the consolidation.

CASAC’s enterprise approach to corporate group regulation was not adopted. Rather, reliance was placed on existing conventional creditor protections provided under the Corporations Act 2001(Cth) to address the specific conflicts of interest existing between directors and creditors of corporate group members.

III CONFLICTS OF INTEREST INHERENT TO CORPORATE GROUPS

The underlying reason for conflicts of interest to arise specifically within corporate groups was made patently apparent in the HIH Report. The report referred to the commercial practice of corporate groups being controlled and managed as an integrated enterprise, where group executives make decisions on behalf of or affecting a particular group company, regardless that they are not employed by that company, nor previously have made any decision on its behalf.

The reality of modern public companies is that they are managed and controlled at a group level ... with executives often employed by a subsidiary once or twice removed from the main listed entity. With some of the transactions I inquired into, a consideration of the separate legal existence of a subsidiary arose almost as an afterthought as the relevant transaction was being finally documented. Serious issues could arise (and did during the inquiry) under the current legislation as to whether the executive in question, who was neither employed by the company that became a party to the transaction and who had never previously made any particular decision concerning that individual company, nevertheless owed it the duties specified in ss180-184. A further question is whether their actions were capable of constituting a breach of the duties they might owe to the company employing them, or perhaps to the ultimate holding company of the group.

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22 Australian law has adopted enterprise principles elsewhere. Since 1 July 2002, it has been possible under the group consolidation regime for wholly-owned groups of companies (together with eligible trusts and partnerships) to consolidate for tax purposes. By consolidating, a group is treated as a single entity for tax purposes. By removing the former grouping provisions under the ITAA with respect to tax loss transfers, inter-corporate dividend rebates, transfers of excess foreign tax credits and CGT group roll-over provisions the choice to consolidate was made much more attractive. State payroll tax legislation includes grouping provisions, to determine whether or not employers should be grouped for the purposes of levying payroll tax or should be treated as independent entities. For example see Grouping Division 1A.4 Payroll Tax Act 1987 (ACT).

23 The HIH Royal Commission Report was the official investigation into the collapse of the HIH Insurance group. www.hihroyalcom.gov.au/finalreport/index.htm

Such underlying conflicts of interest pose a danger for creditors as they may affect the creditor’s perception of the riskiness of transacting with the corporate group member.

**A Creditors Assessment of Limited Recourse Risk and Debtor Opportunism Risk**

Creditors must correctly perceive the riskiness of contracting with the group member so as to demand the appropriate advance compensation. Such risks include the risk of ‘non-payment because of limited liability’ labelled “Limited Recourse Risk”, and secondly the risk that ‘after the terms of the transaction are set the debtor will take increased risk, to the detriment of the lender’, labelled “Opportunism Risk”.

Creditors’ perception of the risk of contracting with the group member, is determined by the nature of the group member’s investment; its ability to achieve completion; the group member’s financial position, namely its liabilities and assets and the likelihood of the group member undertaking activities subsequent to contracting to increase the risk of non or partial repayment.

An efficient outcome for the creditor and for the group is the creditor correctly identifying and pricing the **two risks** facing him when contracting with the group member. The group and its stakeholders will also benefit from the creditor correctly pricing the risk as only those investments whereby the compensation paid is less than the benefit of investment to the group will proceed.

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25 Frank H. Easterbrook, & Daniel R. Fischel, *The Economic Structure of Corporate Law* (1991) 41-44 Theoretically, creditors protect themselves from the above risks by private contracting measures such as the inclusion of higher interest rates, or charging higher prices for goods or services in advance.

26 Ibid 52.

27 Ibid.
However, current regulation of corporate groups prevents creditors from correctly perceiving the risks of contracting with the group member.

Legal separation and accompanying limited liability of company members, coupled with integrated control and management of group members, may accentuate agency conflicts within the group, leading to misrepresentation of the limited recourse risk of the group member, and/or greater levels of debtor opportunism.

Limited recourse risk is increased where group company shareholders/directors can misrepresent the value of corporate assets of the group member by falsely claiming that the member holds title to assets that the group company shareholders control but, that in reality, belong to other member companies within the group.

Debtor opportunism risk increases where, subsequent to contracting the debt, intra-group transactions such as intra-group financing enable assets to be siphoned from or additional liabilities incurred by a group member.  

1 Misrepresentation of Group Member Assets and Liabilities

Creditors need disclosure of the group member’s assets, liabilities and revenue to assess its ability to service its existing and future debts and thereby the riskiness of contracting with the corporate group member. However a creditor’s appraisal and pricing of a group member’s limited recourse risk may be incorrect due to inadvertent

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28 A long laundry list of industrial and creditor disputes spanning a number of decades of corporate Australian history are illustrative of such debtor opportunism made possible by the non-recognition of a corporate group boundary and the selective use of the separate legal entity notion within a corporate group setting. See Frank Clarke and Graeme Dean Indecent Disclosure Gilding the Corporate Lily (2007) 130 for examples including:

- the attempted retrenchment of Patrick Stevedores’ Maritime Union of Australia employees following the alleged intra-group shuffling of funds, other assets and capital in the late 1990s;

- the lengthy and ongoing James Hardie asbestos compensation claims by tort creditors of James Hardie subsidiaries, Amaca and Amaba, against the holding company, James Hardie;

- claims of Ansett employees in 2001 for their entitlements when Air New Zealand jettisoned its wholly owned subsidiary, Ansett Australia Pty Ltd.

The authors identify other notable instances of classes of unsecured creditors of financially stressed corporate groups finding themselves caught up in financial hassles exacerbated by the group structure, such as Adsteam, Tricontinental, Qintex, Bond Corporation.
or deliberate misleading representations by the group member as to its assets and liabilities and consequent ability to service debt repayments.

For example, the creditor’s perception of the limited recourse risk of transacting with the group member may be misconceived because of the group’s use of corporate group branding and intra group financing. Creditors transacting with the group may not distinguish between individual corporate group members, being unable to determine where the boundaries of asset partitioning lie.

(a) Use of Corporate Group Branding

Group members, whether deliberately or not, blur the distinction between group members. Having member companies use the same common name helps to exploit the relationship between corporate group members. Such exploitation maximises the value of corporate branding, increases the goodwill of the corporate group and thereby generates higher returns to shareholders. The cost of having member companies use the same common names is that it exacerbates the confusion of creditors regarding the lines of asset partitioning within the group.

The existence and exploitation of the common group persona may mean creditors are unaware of the group member’s boundary. Corporate branding through the use of corporate logos may further aggravate this problem. In Ackers v Austcorp International Ltd Rares, J. considered that the presence of Austcorp’s generic logo and name on a property investment brochure and building site ‘created an association with the group, and importantly, with the common company involved in the group’s projects- Austcorp itself."

No-one seeing the Austcorp signs on the building site, or its logo on the brochure or leaflet, would stop to ask or think about if these identified a special purpose subsidiary. The message which Austcorp wished to pass to the public was that it, as the ultimate owner of the brand, was responsible for the development. Austcorp was the hands and brains of its subsidiaries’ conduct …

29 Current corporate group disclosure requirements may further exacerbate the problem of identifying the group member’s assets and liabilities.
30 [2009] FCA 432 A holding company Austcorp International Ltd was found liable under s52 Trade Practices Act 1974(Cth) for making false and misleading representations regarding the promotion and marketing of apartments in a resort on the Central Coast of New South Wales, although the management and marketing of the development was contracted to Austcorp Development Management Pty Ltd, a subsidiary of Austcorp International.
31 [2009] FCA 432 [81], [152].
Austcorp is not an isolated case by any means. A further example of the confusion that can arise when a strong group brand is used to support the activities of the subsidiaries can be found in the case of Qintex Australia Finance Ltd v Schroders Australia Ltd\textsuperscript{33} where Rogers CJ\textsuperscript{34} recognized the divergence between commercial reality and the applicable law.

In situations where corporate groups have a common marketing brand, subsidiary companies’ names invariably include the common name. Creditors despite entering into contractual arrangements with the group member may do so, on the basis of the financial viability of the corporate brand which encompasses all of the group’s companies as a single business enterprise. Where the creditor cannot distinguish between each group member’s ownership of assets, they may assume greater apparent ownership of assets than actually exists. Such misconception of the specific contracting party’s ownership of assets may lead to creditors inaccurately perceiving and pricing the level of limited recourse risk. Inefficiencies in investment may then result, contrary to the stated aim of the corporate regulatory system (as the latter assumes transparency and efficiency between stakeholders).

(b) Intra-Group Financing

Professor Hadden\textsuperscript{35} identified the technique of integrated financing as a means of concealing from creditors the true financial position of individual companies within the group as assets and liabilities can be transferred from member to member. Examples of such financing transactions\textsuperscript{36} include reliance on cash pooling for the management of cash available within the group, often charging short-term interest rates on cash pools which in reality are long-term loans to various group members. The result being that the group member who is designated as the cash pool leader

\textsuperscript{33} (1990) 3 ACSR 267.
\textsuperscript{34} Rogers, C.J. stated: \textit{As I see it, there is today a tension between the realities of commercial life and the applicable law in circumstances such as those in this case. In the everyday rush and bustle of commercial life in the last decade it was seldom that participants to transactions involving conglomerates with a large number of subsidiaries paused to consider which of the subsidiaries should become the contracting party. A graphic example of such an attitude appears in the evidence of Ms Ferreira, a dealer in the treasury operations department of the defendant. In her written statement … she said: ‘In my discussions with either Craig Pratt or Paul Lewis when I confirmed deals undertaken for Qintex, it was not my practice to ask which of the Qintex companies was responsible for the deal. I always treated the client as Qintex and did not differentiate between companies in the group. Paul Lewis and Craig Pratt always talked as being from Qintex without reference to any specific company….}


\textsuperscript{36} See Jeff Rogers, Michael van der Breggen & Bill Yohana,Price Waterhouse Coopers, \textit{‘Tax controversy and intragroup financial transactions: An emerging battlefield.’} 2010, 55-57.

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reports the cash pool advantage, while the depositing group members who may be experiencing credit risk from the creation of the cash pool, may only receive a bank deposit rate of return. Charging credit guarantee fees within the group is a means of redeploying capital from one group member to another. Intra-group loans provide an opportunity to produce a beneficial tax loss or profit by a group member buying another member’s loan or bond at a discount out of the market. An intra group factoring arrangement increases the assets of the group member purchasing the accounts receivable. If this same group member also has third-party borrowings, such increased assets may be accepted as collateral with the effect of either lowering the cost of or increasing the amount loaned via third-party borrowings.

Intra-group debt financing may complicate the creditor’s assessment of the group members’ capacity to service debt by both overstating and in turn understating its members’ debt servicing capacity. The use of intra group debt financing can be exploited by the group. By charging the same amount of interest for intra group as well as external debt, it is possible for the debtor company to distribute profit amongst the group members. The use of a competitively determined market rate of interest as a transfer price for intra-group debt has the advantage of being tax deductible, with no offsetting bankruptcy costs and therefore allows the group to minimise its overall tax burden. Group members’ revenue and thereby debt capacity may be overstated, whereas the debtor companies’ debt capacity may be understated. To obtain accurate information of the individual corporate group member’s solvency (hence ability to repay debt as and when it falls due) at the time of contracting, may then require analysis by a credit rating agency whose costs may be prohibitive to the creditor.

2 Increased Level of Debtor Opportunism

Within a single company debtor opportunism can arise as the interests of creditors, shareholders and directors may diverge. Within the corporate group, the number, degree, and opportunity for conflicts of interest to arise and be acted upon are

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37 Arthur Stonehill and Thomas Stitzel, “Financial structure and multinational corporations”, (1969) 12 No 1 California Management Review 91-96, 93 ...parent loans to foreign affiliates are often regarded as equivalent to equity investment both by host countries and the investing corporations. A parent company loan is generally subordinated to all other kinds of debt and does not represent the same threat of insolvency as an external loan.
considerably increased. Certainly, Richard Schulte identified this problem existing between the parent and subsidiary company when he stated:

*The parent’s lack of any duty in dealing with the subsidiary means a creditor is unable to make an accurate assessment of the investment’s risk because the possible range of the parent’s conduct is very wide.*

The increased range and number of deviating stakeholder interests derive from the group’s structure, whereby there are further layers of separation of ownership and control, non-existent in the single independent company.

The *Bell Resources* case provides a undeniable illustration of the pursuit of the corporate group’s economic utilitarian goals at the expense of the interest of constituent individual corporate group members and their creditors.

The Bell Group of companies \(^3^9\) headed by The Bell Group Ltd (TGBL) (In Liquidation) relied heavily on intra-group financing. The group had unsecured banking facilities \(^4^0\) with at least six Australian banks. As well as relying on bank finance the Bell Group raised funds via five separate bond issues. The proceeds from the bond issues went directly or on-lent indirectly \(^4^1\) to Bell Group member companies.

Early in 1990 the group’s Australian and UK banks \(^4^2\) entered into refinancing arrangements with the group. Under the refinancing arrangement, the banks took security over assets of group entities to support existing borrowings of some of the corporate entities within the group. If during the currency of the facility, the group sold assets, the proceeds of sale were to go to the banks pro rata in reduction of the bank debt. All intra-group indebtedness was subordinated behind the claims of the banks. The purported purpose of these refinancing arrangements was to allow directors time to pursue the *group economic goal* of restructuring. Such restructure

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\(^{38}\) Richard Schulte, “Corporate groups and the equitable subordination of claims on insolvency” (1997) 18(1) Company Lawyer 2-18. An exception is if the parent company is a “shadow director” of the subsidiary. In such circumstances, statutory duties are then owed to the subsidiary, such as ss180,181,182, 183, a588G *Corporations Act* 2001 (Cth).

\(^{39}\) The following summary of facts is drawn from the judgement of Justice Owen in *The Bell Group Ltd v Westpac Banking Corporation (No 9)* [2008] WASC 239.

\(^{40}\) The facilities were unsecured, but supported by negative pledge arrangements whereby, the companies within the group required the banks’ consent before dealing with certain of their assets.

\(^{41}\) The on-loans were not formally documented resulting in a subsequent dispute as to whether they were made on a subordinated or unsubordinated basis (ie did the loans rank behind the existing bank loan facilities).

\(^{42}\) The Group’s bankers became alarmed about their increasing risk exposure with respect to their ranking against the bondholders.
would then enable the maximisation of the commercial worth of group assets, particularly the group's publishing assets.

On 18th April, 1991, TBGL applied for the appointment of a provisional liquidator. The banks recovered $283 m on the realisation of their securities, being the publishing assets, sale of shares and collection of debts.

The liquidators later joined by the Trustee for Bondholders instigated proceedings against the banks and directors challenging the way in which the securities were given and taken and seeking recovery of the realisation proceeds, as well as of $1.5b from the banks.

The basis for the challenge was on the grounds that at the time the securities were given the directors and banks knew the main companies within the group were insolvent. Thus,

> entry into the refinancing transactions with the banks and the giving of securities to the banks caused the Bell group companies to incur an obligation to the banks that had previously been limited to three Bell Group companies. As the borrowers were nearly insolvent, the effect of this obligation was prejudicial to the direct and indirect creditors and shareholders of the individual Bell group companies.

In effect, the directors of the Bell Group companies 'focussed on one group of creditors (the banks) to the exclusion of all others'. Central to the decision of Owen J was the failure of the directors to act in good faith in the best interests of the individual companies comprising the Bell Resources Group and to act for a proper purpose.

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43 The Bell Group Ltd v Westpac Banking Corporation (No 9) [2008] WASC 239
44 The Bell Group Ltd v Westpac Banking Corporation (No 9) [2008] WASC 239 [6111]-[6112]. Owen J determined that the Bell Group of companies were insolvent as at 26 January 1990, although he did not find that the directors were aware of this insolvency. Rather, he found that the directors were aware that the companies were nearly insolvent. Creditors and Shareholders of the following Bell Group companies were prejudiced by the transactions: TBGL, BGF, BRL, Bell Bros, WAOM, BPF, Anstead, Western Interstate and BGUK. At that time the companies' ability to pay their debts as and when they fell due depended upon the cash flow contributed by the business operation of the Bell group's publishing assets. However, there was a deficiency in such cash flows of $60 million a year. Such deficiency could not be met by the sale of Bell Group companies' assets as the bank's refinancing transaction had created a prior claim for repayment of bank debts from the proceeds of any such sales.
45 The Bell Group Ltd v Westpac Banking Corporation (No 9) [2008] WASC 239 [6065].
46 The Bell Group Ltd v Westpac Banking Corporation (No 9) [2008] WASC 239, [6045].

Owen, J stated there was:

> a marked contrast between the Australian directors and the London-based members of the boards of BGUK, TBGIL and BIL. The latter went to great pains to draw up lists of creditors who might be affected and to take steps to ensure that the interests of those creditors were protected. The list was discussed in detail at meetings and was central to their thinking. Not so the Australian directors. I am satisfied the Australian directors did not consider the detailed information that would have been necessary to enable them to decide whether, and to what extent, there was corporate benefit to each individual company called upon to enter into a transaction.

Justice Owen considered the London-based directors had breached their fiduciary duties only by failing to obtain reliable financial statements and information to verify that the letters of comfort on which they were relying were valid and reasonable.
The directors may still have satisfied their duty to act in the best interests of the corporate group members if the plan to restructure the group (of which the security transactions were but a part) had existed. However, none of the directors was able to define its parameters, its implementation, its length or how its operation would avoid the insolvency of the group companies.  

Interestingly, Owen J considered there was no breach of the duty to avoid conflicts of interest, preferring to determine the failure of the directors to consider the interests of the individual corporate group members when concentrating on the interests of the group (what he termed a ‘Bond-centric’ approach to their duties) as being a breach of their equitable duties to act in good faith, in the best interests and for proper purposes of the individual companies. Owen J’s reasoning recognizes the inevitability within corporate groups of the conflict arising from the disparity between the legal and economic entities comprising the corporate group and of the primacy of the entity approach within Australian corporate regulation.

IV CURRENT CREDITOR PROTECTIONS TO ADDRESS LIMITED RECOURSE RISK AND DEBTOR OPPORTUNISM RISK

Where the potential cost of debtor opportunism is considered especially high, it is considered efficient to rely on creditor protections provided by company law, rather than the operation of the debt market, to provide adequate creditor protection.

47 The Bell Group Ltd v Westpac Banking Corporation (No 9) [2008] WASC 239, [6039] Lack of a planned restructure may reflect the inability of the directors to negotiate a moratorium arrangement with the bondholders, which was central to any restructuring proposal.
48 The Bell Group Ltd v Westpac Banking Corporation (No 9) [2008] WASC 239, [6122] Owen J considered that some of the directors, ‘were concerned about the interests of the Bond Group rather than the interests of the Bell group companies of which they were directors’. Such directors had breached their duty to exercise their powers for a proper purpose, namely by attempting to protect Bond Corporation by removing a threat to its continuing survival.
49 To be efficient, the marginal costs of such regulation must be less than or equal to the marginal benefits and all voluntary methods to solve such agency problems have tried and failed. See SF Copp & Caroline W. Maughan, ‘The Law Commission and economic methodology: values, efficiency and directors’ duties’ [1999] Company Lawyer, 116.
51 In theory, creditors use private contracting measures such as the inclusion of higher interest rates to protect themselves from limited recourse risk and debtor opportunism risk. However, ‘the average trade creditor, does not normally attempt to draft contracts on a transaction-specific basis as normal trading arrangements may involve sums of money that are too small and time scales that are too short to justify extensive contractual stipulations’. See Vanessa Finch Corporate Insolvency Law (2002),86 as quoted in Xie,Bo “Protecting the interests of general unsecured creditors in pre-packs: the implication and implementation of SIP 16 (2010)31 Company Lawyer 189,191.
52 Ross Grantham summarises the arguments for and against the ability of private debt contracting to take into account unforeseen changes in debtor risk once the debt contract is made. The inclusion of debt/equity ratio covenants in loan

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The protection afforded by company law to creditors may be provided “ex ante” or “ex post”. Ex ante protections exist to ensure that at the time the creditor contracts with the group member, the member does not mislead the creditor as to its financial standing and stability. Alternatively, ex post protections provide a means of recourse to the creditor where the group member has misled the creditor as to its financial standing.

A Limited Recourse Risk Protections

Currently there are three creditor protection measures to assist the creditor when determining the limited recourse risk of transacting with a group member. Namely:

Ex Ante Protection: 1. Entry into a Deed of Cross Guarantee among the group members

Ex Post Protection: 2. Lifting the corporate veil within the group

3. Pooling of assets and liabilities of group members.

1 Deeds of Cross-Guarantee

A deed of cross guarantee makes each group company, who is party to the deed liable to the external creditors of every other group company for any shortfall in the event of liquidation of any group company. Parties to the deed form a closed group. Entry into the deed is purely voluntary, although in practice restricted to wholly owned subsidiaries. Directors of each group company are then obliged each year to reassess the continuing benefit of the deed to their company. Ex ante protection is provided to creditors as deeds of cross-guarantee create an incentive for deed members to monitor their fellow deed members so as to ensure that the closed group maintains an acceptable level of limited recourse risk. Deeds of cross-guarantee reduce the risk borne by risk-averse subsidiary companies and their agreements is suggested as a means of combating debtor opportunism. However, Ross Grantham cites empirical evidence that in the United States, the use of such covenants is not widespread and is considered an inappropriate response for trade creditors who are considered the least equipped to assess risk. Ross Grantham, ‘The judicial extension of directors’ duties to creditors’ [1991] Journal of Business Law 1, 3.

The entry into the deed administered by ASIC exempts the closed group of companies from preparing audited accounts and directors’ statements. There is no longer the requirement that subsidiaries are to be wholly owned subsidiaries registered in Australia. Rather, relief is extended to ‘controlled entities, including foreign registered entities, by virtue of ASIC Class Order 91/996 19th December 1991 ASC Update 41 Public Hearings Report on the Public Hearing on Accounts and Audit Relief for Wholly-Owned Subsidiaries 1991 [19]. The rationale behind the ASIC class order is that consolidated accounts ‘give a more accurate picture of the environment within which the wholly-owned subsidiary operates’.

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creditors by shifting some level of risk to the remaining solvent deed members and their creditors. Such members and their creditors are the appropriate bearers of such risk where the corporate group is managed and operated as a single enterprise. In such circumstances, the deed endorsers monitor the riskiness of the corporate group’s portfolio of investments as an entirety. In this respect there is then alignment of the actual limited recourse risk and the creditor’s perception of transacting with the group member.

However, the creditor protection provided by the deed is limited protection as the decision to enter into such deeds is not mandatory but strategically one for the group to adopt. Also it is possible for the deed where adopted to be revoked or released, which has led to criticisms in the past.54

2 Lifting the Corporate Veil

In *Pioneer Concrete Services Ltd v Yelnah Pty Ltd*65 Young J. observed, two instances where the separate legal personality of a company is to be disregarded in the context of a corporate group. If the court considers there is in fact or in law:

(i) a partnership or agency between companies in a group or
(ii) the creation or use of the company was designed to enable a legal/fiduciary obligation to be evaded or a fraud to be perpetuated.

Emphasis on the entity principle, as outlined in Salomon’s Case56, by Australian courts, prevents recognition57 of the integrated group as evidence of the existence of a partnership between members. Thus, the certainty of Justice Young’s outlined exception to the separate legal entity rule is at odds with the occasions when the veil has been successfully lifted within the context of a corporate group.58 Similarly, there

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54 D. Murphy, ‘Holding Company Liability for Debts of its Subsidiaries – Corporate Governance Implications’ (1998) 10 Bond Law Review, 241. Murphy discusses whether it is for the corporate benefit of each company to enter the deed of cross guarantee, and whether the entry into such a guarantee obliges directors of group companies to monitor other group companies.
55 (1986) 11 ACLR 108 where the issue was, in an action for breach of contract, whether a contractual promise by a subsidiary company could be treated as a promise by the parent company.
57 In Salomon’s case the court held the element of control was insufficient grounds to lift the corporate veil. Australian courts require lifting of the corporate veil to prove an implied agency exists.
58 To date, there would appear to be no Australian case law where a common law partnership within a corporate group has been held to exist. Although in *Pioneer Concrete Services Ltd v Yelnah Pty Ltd & Ors* (1987) 5 ACLC 467 at 476 Young J. recognized that the court would lift the corporate veil where there was in fact or in law a partnership between the companies in a group, the particular facts of the Yelnah case did not warrant such recognition.
are no Australian authorities to support Young J.'s second instance of when the corporate veil will be lifted. The lack of certainty surrounding the availability and use of lifting the corporate veil prevents such a remedy being an efficient ex post protection measure for creditors transacting with group members, where such creditors have been misled as to the group member’s corporate boundary.

3 Pooling in External Administration

Division 8 of Part 5.6 of Corporations Act 2001(Cth) provides 'ex post” protection of creditors by two separate methods of pooling, voluntary pooling and court ordered pooling. As the pooling provisions are only available on liquidation, the protection of creditors is paramount, while returns to creditors are enhanced by the savings in transaction costs generated by pooling. Where the creditor has been misled as to the financial standing of the group member, recourse to other group members is available on a somewhat restricted basis. These restrictions arise by virtue of the limited manner of defining the companies to be included in the pool and the denial of contribution orders among corporate group members.

59 Hereafter all legislative references are to the Corporations Act 2001(Cth) unless otherwise indicated.
60 The general effect of a pooling determination, once made by the liquidator under S571(1) and enforceable on approval by the eligible unsecured creditors of each company in the group under S578 (1) is:

(i) Each company in the group is taken to be jointly and severally liable for each provable debt payable by and each provable claim against, each other company in the group.

(ii) Inter-group company debts and claims are extinguished.

(iii) The pooling determination does not alter the order of priority under ss556, 560 and 561 Corporations Act 2001 (Cth) for each company in the group.

(iv) The pooling determination does not affect a secured creditor’s interest as long as the secured debt is not an inter-group debt.

Pooling determinations are aimed to be flexible and reflect the specific circumstances of the companies in the particular pooling group. See Explanatory Memorandum to Part 4 – Facilitating Pooling in External Administration Corporations Amendment (Insolvency) Bill 2001,[ 4.251]. The consequences of a court pooling order are the same as those of a liquidator’s pooling determination.

61 See Street CJ in Kinsela v Russell Kinsela Pty Ltd (1986) 4 NSWLR 722 at 730 where he stated ‘in a solvent company the proprietary interests of the shareholders entitle them as a general body to be regarded as the company when questions of the duty of directors arise.... But where a company is insolvent the interests of the creditors intrude. They become prospectively entitled, through the mechanism of liquidation to displace the power of the shareholders and directors to deal with the company’s assets.’
(a) Boundaries Of Corporate Group Pooling

Although no definition of corporate groups is provided, the legislation places limits on when companies may be placed in the pool. To be eligible for pooling, companies must be in liquidation and be related bodies corporate, or share joint liability for one or more debts; or jointly or singularly own property used in a jointly carried on business, scheme or undertaking. Court ordered pooling provides a more accurate if somewhat limited ex post protection for creditors than voluntary pooling. This arises as the circumstances when a court may order pooling of corporate group assets follows more closely the circumstances existing within groups controlled and operated as single enterprises. Whether it is “just and equitable” to make a pooling order takes into account the relative positions of the creditors within the group of companies vis-à-vis themselves, and the respective shareholders of those companies given the management practices of those companies; the degree of intermingling of business and management between companies and the creditors knowledge thereof. To

62 S571(1) (pooling determinations) and s579E (pooling orders). “The expression “group” is not defined. It should therefore be given its ordinary meaning of a collection or plurality. A “group” will exist for these purposes simply if two or more companies are identified. The “group” terminology does not require anything more. The need for the identified companies to have certain attributes or connectedness comes from aspects of s579 other than the word “group”. See Barrett J in Allen v Feather Products Pty Ltd (2008) 26 ACLC 224, 226.

63 The restriction of pooling determinations or pooling orders to companies in liquidation may be recognition that the existing voluntary administration and deed of company arrangement procedures enable creditors to efficiently determine whether or not to pool. The IPAA has stated: Currently administrators can seek to pool a group of companies in a Voluntary Administration by taking a vote of creditors at the second meeting in respect of proposed “Pooling Deeds”. These resolutions are passed by a simple majority. Some administrators seek the approval of the Court for the pooling arrangement under s447A, some choose not to.

64 In Australia, related bodies corporate require holding/subsidiary company status to exist. In New Zealand the court may make an order that provides for the pooling of insolvent related companies and in addition may make contribution orders where a related company is in liquidation. The order is dependent on companies being “related companies”. In s2(3) Companies Act 1993 (NZ) the term “related companies” is defined to include the holding subsidiary relationship but also includes where there is a majority of shares held by the other company or other related companies as well as the position where “the business of the companies” has been carried on in a way that the separate business of that company (or a substantial part of it) is not “readily identifiable”. In contrast, the Australian provisions identify the companies subject to the possible pooling in terms of the operation of or ownership (or co-ownership) of assets used in a joint business.

65 The court has the power to make pooling orders on the application of the liquidator/s where it is satisfied that it is just and equitable to do so. See sections 579E(1) and s579E(12). The matters which the Court must take into consideration in making the order are open-ended, and echo those factors that The Law Reform Commission Report No 45 General Insolvency Inquiry, known as Harmer Report, originally identified as justification for court-ordered pooling.

66 Although Vaisey J in Re Serene Shoes Ltd [1958] 3 All ER 316 at 317 could not differentiate between the terms “just and equitable” and “just and beneficial” it is considered that the former phrase is distinct from the latter term. The expression “just and beneficial”, used in s511 (which allows the Court to determine a particular question or exercise all or any of the Court’s winding up orders if satisfied to do so would be just and beneficial) appears to take into consideration elements of cost and efficiency of function. Justice Young in Dean Willcocks v Soluble Solution Hydroponics Pty Ltd (1997) 24 ACSR 79 at 81 considered that if “the court can summarily solve the difficulty that has arisen in the liquidation by an order under the section in a cheap and efficient manner …… It is ‘just and beneficial’ to exercise the power”.

67 S579E(12) (e)
some extent the factors\textsuperscript{68} address the characteristics previously identified as indicative of a controlled and integrated corporate group. Section 579E(12)(b) is particularly relevant where the actions of a group member have led the creditor to incorrectly identify the assets and liabilities and thereby the limited recourse risk of transacting with such member. To this extent, court ordered pooling provides a much more effective ex post creditor protection for creditors than lifting the corporate veil.

A fairly recent application for court ordered pooling was heard by Barrett J. in \textit{Allen v Feather Products Pty Ltd}\textsuperscript{69}. Barrett J found that three companies which were related bodies corporate and in the process of being wound up, were engaged in activities which when performed in conjunction with the activities of the other companies constituted a single business enterprise under s579E(1)(b)(iv). Barrett J determined that the three companies, essentially a labour hire company, a manufacturing company, and a sales company, were parties to an agreement under which each contributed part of what was required to carry on a single business. Barrett J. considered that the companies need not be acting in unison for the purpose of performing the relevant activities, but held rather that the aggregation of separate efforts in juxtaposition with one another could be regarded as joint activity. The business of manufacturing, and selling the feather and down products was carried on jointly and those in the group that owned relevant physical property used it in the joint enterprise, thereby satisfying s579E(1)(b)(iv). Further it was considered by Barrett J that the just and equitable criterion would have been satisfied as the overall operations had been split amongst the three companies. If pooling did not proceed, employees would be left worse off than creditors of the manufacturing and selling companies who could have expected 100 cents in the $ to be paid, with a surplus ultimately accruing to their shareholders. The above guidelines set out by Justice Barrett ultimately are only obiter however as the liquidator’s pooling application failed. Two of the three companies had begun winding up prior to the commencement date of Division 8, namely, 31\textsuperscript{st} December 2007, such that the court lacked the power to make the order, despite the merits of the liquidator’s application.

\textsuperscript{68} Specifically s579E(12) (a)(c) and (d)
\textsuperscript{69} [2008] NSWSC 259; 65 ASCR 642
The Australian pooling provisions are similar to the New Zealand provision\textsuperscript{70}, that empowers New Zealand courts to make pooling orders in respect of related companies once one of those companies is placed into liquidation\textsuperscript{71}. The term just and equitable is used in the corresponding New Zealand provisions and Farrar has suggested that the term provides the court with the ‘\textit{widest discretion to affect a result which accords with common notions of fairness in all the circumstances}’\textsuperscript{72}. One of the three objectives of pooling orders recognized by CASAC was enhancing returns to unsecured creditors\textsuperscript{73}. Pooling can mean substantial savings on transaction costs. However, the ability to generate greater resources to insolvent group members is limited because of the manner of defining the companies to be included in the pool.

In the New Zealand legislation the circumstances of being a pooled company include where the activity is carried on in a way that the separate business of each company is not readily identifiable. In contrast the Australian provision sets out more specific requirements relating to owning or operating property that is used in a joint undertaking.

\textbf{(b)Denial of contribution orders among corporate group members.}\n
The fact that only companies in liquidation are able to be part of the process suggests that creditors could potentially be disadvantaged where (to the extent that it is commercially possible) assets are available in a solvent company that is part of the group. Division 8 of Part 5.6 excludes solvent companies. In this respect, CAMAC’s recommendation 41 that “solvent group companies should be permitted to enter into an administration with other group companies where at least one of those companies satisfies the voluntary administration prerequisite”\textsuperscript{74} was not adopted. CAMAC considered that in certain circumstances where the affairs of the solvent group company are so intertwined with those of other group companies then pooling within the voluntary administration may be beneficial. Such circumstances may

\textsuperscript{70} the New Zealand provision does not include s579E(12)(e)
\textsuperscript{71} See s271(1)(b) Companies Act 1993 (New Zealand) However the application for pooling in New Zealand can be lodged by not only the liquidator but a creditor or shareholder.
\textsuperscript{72} J. Farrar Corporate Governance: Theories, Principles and Practice 2005, 264 referring to Casey J., in \textit{Re Home Loans Funds (NZ) Ltd} (1983) 1 NZCLC 95073
\textsuperscript{73} CASAC, above note 13, 39,166,176,180, 184.
\textsuperscript{74} Corporations and Markets Advisory Committee (CAMAC Report) Rehabilitating large and complex enterprises in financial difficulties 2004[6.4.2].
include where the solvent group company relies on information technology or other logistical or financial support from an insolvent group company. The draft Bill’s explanatory memorandum argues that this potential benefit is outweighed by the need to protect the interests of the solvent company’s shareholders. The New Zealand experience shows that at least some form of provision might be written to enable a contribution order to be made from companies that are part of the group but not in liquidation and that it need not require fundamental changes to the position of shareholders.

4 Summary
The degree of connectedness required to exist between group companies to be eligible for the award of a court ordered pooling order or liquidator’s pooling determination, mirror the circumstances existing within a controlled and integrated group. In light thereof, the pooling provisions provide the most efficient of the current corporate law creditor protections available to creditors. The disadvantages of such protection are that it is offered ex post. Pooling is available on a discretionary basis only. Thus creditors may still experience difficulty in identifying those group member’s assets, to which they may have recourse for payment of their debt as the terms of the pooling order or determination are made at the discretion of the court or liquidator of the group members.

Lastly, pooling is only available against those single enterprise members in liquidation and so may not provide adequate protection where the single enterprise group has misled the creditor into thinking there was a sufficient pool of assets in each member entity. Thus lifting the corporate veil, entry into deeds of cross guarantee, or the granting of pooling determinations or court ordered pooling offer somewhat limited protection to creditors in perceiving and correctly pricing the limited recourse risk of transacting with a group member.

B Debtor Opportunism Protections

Current Australian corporate laws offer both ex ante and/ or ex post creditor protections to reduce the incidence of debtor opportunism, which are listed below.
Ex Ante Protection

1 Share Capital Maintenance Provisions
2 S187 Corporations Act 2001
3 Liability Of Directors/ Parent Company For Insolvent Trading: S588G/S588V

Ex Post Protection

4 Liability Of Directors/ Parent Company For Insolvent Trading: S588G/S588V
5 Liquidator’s Power To Set Aside Antecedent Transactions

1 S588G, S588V Corporations Act

Where excessive risk taking or opportunistic behaviour by the holding company within the group leads to the insolvency of the group member, liability is imposed on the holding company directly under s588V or as a ‘shadow director’77 under s588G.78 To some extent S588V reflects the group’s commercial reality: economic integration, encompassing administration, financial or managerial by the holding company within the group is a key parameter in determining whether the holding company is held accountable for debts of an insolvent subsidiary.79 Section 588G and s588V provide a minimum threshold standard of conduct from the group’s holding company80.

77 S9 (b) defines a director to include a shadow director being a person who is not validly appointed as a director if (ii) the directors of the company or body are accustomed to act in accordance with the person’s instructions or wishes. In Standard Chartered Bank v Antico (1995) 18 ACSR 1 NSWSC the court held that a parent company (42% shareholder) which controlled the affairs of its subsidiary to such an extent that it was considered a shadow director.
78 The operation of s588G and s588V Corporations Act 2001 (Cth) are dependant upon the degree of control exercised by the holding company where applicable. Liability may arise under S588G or S588V when subsidiary companies are insolvent or reasonable grounds exist for suspecting that subsidiary companies are insolvent.
79 When determining whether the holding company has subjectively reasonable grounds for suspecting insolvency, or objectively, should have been aware of grounds to suspect insolvency, the court will consider the general control of the subsidiaries’ affairs by the holding company. Such control will be indicated by the corporation’s culture including:
   (a) the nature of the relationship between the holding company and subsidiary;
   (b) reporting arrangements between companies;
   (c) the nature of the enterprise carried on by the subsidiary or the parent;
   (d) the extent to which the day-to-day activities are controlled by the subsidiary;
   (e) the relevant skill of the company’s directors to perform their expected functions and the behaviour of the board in establishing mechanisms for the monitoring and control of both the holding company and of the subsidiary. Australian Commonwealth Government Corporate Law Reform Bill 1992: Draft Legislation and Explanatory Paper (1992) 1274.
80 Ian Ramsay ‘Holding Company Liability for the Debts of an Insolvent Subsidiary: A Law and Economics Perspective’ (1994) 17(2) UNSW Law Journal 520, 541 argues that s588V is efficient in terms of: providing incentives to individuals and firms to behave efficiently as the holding company is encouraged to monitor its subsidiaries to ensure that they do not contract with creditors while insolvent; correctly allocating risk among relevant holding company shareholders, or creditors, or the insolvent subsidiary directors or creditors.
However, S588G and s588V may create an incentive for the holding company to place an insolvent subsidiary into the insolvency regime, either voluntary administration or liquidation, as both sections provide as a defence against liability “if the corporation took all reasonable steps to prevent the company from incurring the debt”.¹¹ Such action would be efficient where the particular subsidiary’s assets could be used more effectively in an alternative manner. Mokal, however, labels this incentive as the ‘haste effect’ and identifies the cost from such haste as being the loss of going concern value, where the firm’s assets are more valuable together as an entirety, than if they were split up and sold piecemeal under an insolvency regime.

In Australia, this incentive may prove overly attractive as no cases of s588V being successfully litigated in Australia since its introduction to date could be found. Although another reason for the lack of successful s588V claims may be that the subsidiary’s insolvency is indicative of the financial position of the corporate group such that the holding company likewise is insolvent. In such circumstances, pursuit of s588V/s588G claim against the holding company would be costly and fruitless.

S588V imposes liability only upon the holding company as defined by s46 Corporations Act ‘thus presenting obvious strategies for evasion, such as the establishment of joint ventures to undertake particularly hazardous activities that may result in insolvency... which would be outside the scope of S588V’. By failing to impose liability upon each group member, s588V fails to recognize the corporate

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¹¹ S588X(5) and s588H(5).  
¹³ Search of corporate law cases on CCH database over the period of s588V’s introduction to date. It is acknowledged that the link between the level of reported cases and any particular law’s impact is complex and by no means uni-linear. There are concerns whether financing is available for pursuing s588V or s588G claims.  
¹⁴ Such reasoning may account for the liquidators’ contention in Ho v Akai Pty Ltd (in liquidation) (2006) 24 ACLC 1526. The corporate group had initially sought a corporate rescue. The liquidator argued that a financially sound company, Grande Group Ltd (GGL) a participant in the corporate rescue process was the holding company of the insolvent subsidiary relying on s46(a) or s46(b), Akai Pty Ltd and thereby liable under s588V in relation to a number of vulnerable transactions entered into as part of the corporate rescue. The full court, affirming the judge at first instance, found that the GGL was not a holding company of Akai Pty Ltd. The corporate rescue agreement did not extend beyond its declared purpose of managing the actual businesses of the companies concerned. The agreement was not intended to nor did it give GGL the power to control the composition of the board of Akai Pty Ltd or to control its general meeting.  
¹⁵ Ian M Ramsay ‘Allocating Liability in Corporate Groups: An Australian Perspective’ 13 (1998-1999) Connecticut Journal of International Law 329, 375. Ramsay suggests that s588V’s response to the capital boundary problem would have been stronger if reliance had been made on the broad definition of control contained in the Accounting Standards rather than the narrow legal definition of subsidiary contained in the Corporations Act.
group’s operations as a single economic entity and enterprise. Such recognition was made by the Harmer Report which sought a fuller bodied law reform by seeking to impose liability for insolvent trading of a subsidiary on not only the holding company but on “related companies”. These factors are directly relevant as they address the contribution played by the other group members in the group’s activities of debtor opportunism.

Creditors are unable to instigate recovery of their debt against the holding company where there is a breach of s588V as S588W gives power only to the company’s liquidator to recover the debt. However, there may be a further problem where the liquidator is reluctant to pursue the s588V claim. A liquidator owes fiduciary duties and duties of care to the company and thus is by nature risk-averse. He or she may not pursue a claim under s588V because of the expense and difficulty in gathering evidence, the real risk of costs, the holding company’s insolvency and the enforcement of the order.

Aside from the above criticisms s588G and s588V suffer from a disadvantage common to all creditor protections: the timing of their operation which is discussed below.

2 Timing of Creditor Protections

In real terms current corporate laws, specifically share capital maintenance provisions, antecedent transactions, and the liability of a parent company for insolvent trading in relation to the failure of one if its subsidiaries impose few restraints on the owners or directors of corporate groups, at either the organizational or operational stage of the group’s existence. Rather current creditor protections arise only when the group members’ existence is threatened, which invariably may be too late to provide adequate protection.

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86 Proponents may argue that imposing liability on the parent, equates to imposing liability on the group due to the parent’s ultimate ownership of the value of the group. However, such arguments only apply to pyramid-structured corporate groups, rather than decentralized, but controlled and integrated corporate groups.

87 The basis of such liability included: the extent to which the related company took part in the management of the company; the conduct of the related company towards the creditors of the company and the extent to which the circumstances that gave rise to the winding up of the company are attributable to the actions of the related company. The pooling provisions have imposed such liability using very much the same styled tests. See s579E (12) Corporations Act 2001 (Cth) where court ordered pooling order is made on just and equitable grounds.

88 It is argued, that the restriction requiring s588V claims to be commenced by a liquidator representing all creditors and not by individual creditors is to overcome enforcement problems where individual creditors may have insufficient incentive to commence litigation. See Ian M Ramsay ‘Holding Company Liability for the Debts of an Insolvent Subsidiary: A Law and Economics Perspective’ 17(2) 1994 UNSW Law Journal 520, 532.

89 As well as the duties to take possession of and protect the assets, to make lists of contributories, to have disputed cases adjudicated upon, to realize the assets and to apply the proceeds in due course of administration amongst the creditors and contributories. See in Re Partridge [1961] SR (NSW) 622.

90 The increase in availability of litigation funders may to some extent reduce the barriers to litigating s588V.
(a) **Share Capital Maintenance**

Share capital maintenance provisions\(^91\) do not prevent the initial undercapitalisation of the group’s subsidiaries, nor the subsequent depletion of subsidiary capital, unless through the payment of excessive dividends.

Acceptance that pursuit by directors of the maximisation of group profits satisfies such directors’ obligations to their appointed companies\(^92\) creates situations whereby transactions which ultimately contribute to the insolvency of the group member remain unchecked and where creditor interests are overlooked until the insolvency of the group member is assured.

(b) **S187 Corporations Act 2001 (Cth)**

Within a wholly-owned group, pursuit of the holding company’s interests (and thereby the group’s economic entity’s interests) at the possible expense of group members’ creditors will relying upon s187 become problematic only when such actions result in the insolvency of the member, despite the many more opportunities for creditor/ shareholder/ manager conflict to arise within the group.

Two issues arise from the imposition of such limits on the operation of s187. Firstly, there is the issue of identifying when the shift from the pursuit of corporate group pursuits to maintenance of going-concern status of individual corporate members is made. It would appear the timing of such shift should occur before the corporate group member/s becomes insolvent.

Secondly as a means of imposing a minimum threshold standard of conduct on single enterprise group controllers it may be that such protection is provided too late. Conduct by directors which does not result in the insolvency of the group member but in reality causes harm to the group member, specifically its creditors, goes

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\(^91\) Recognition of the increasing irrelevance of the capital maintenance doctrine as a creditor protection device was made apparent by the Australian Government’s recent changes to s254T by the Corporations Amendment (Corporate Reporting Reform) Act 2010. The amendments allow a company to pay dividends other than out of profits if it satisfies three tests: 1. The company’s assets exceed its liabilities immediately before the dividend is declared and the excess is sufficient for the payment of the dividend. 2. The payment of the dividend is fair and reasonable to the company’s shareholders as a whole and 3. The payment of the dividend does not materially prejudice the company’s ability to pay its creditors.

\(^92\) Reliance on s187 Corporations Act 2001 (Cth)
unchecked as long as such conduct is acting in the interests of the holding company or its shareholders.\textsuperscript{93}

Thus s187 provides protection to group directors pursuing group objectives which may place group member resources at risk and provide little protection to creditors until insolvency is reached.

\textbf{(c) Antecedent Transactions}

S187 and the remaining ex post protections, which operate only where the group member is insolvent, are thus more concerned with dealing with the repercussions of debtor opportunism, than attempting to prevent its instigation.

Certainly, the liquidator’s power to set aside antecedent transactions are more remedy-like than standard setting behaviour and deal with the specific repercussions of insolvent transactions made by the group member/s.

\textbf{(d) S588G and S588V Corporations Act 2001 (Cth)}

Dr Helen Anderson sees the need for insolvent trading as the catalyst for imposing liability on the parent company of the subsidiary as failing to address the core issues surrounding under-capitalisation. S588V ‘does not capture any of the prior transactions taking place while the subsidiary was solvent, which may have nevertheless contributed to its later insolvency.’\textsuperscript{94}

\section{3 Summary: Protection comes too late}

Existing protections are deficient because until such insolvency is reached there is little if any protection to creditors against the dissipation of the member’s resources, although such resources may be at risk given the corporate group’s pursuit of group maximisation of profit.

This deficiency is not met by relying upon statutory or fiduciary duties owing by directors to group members. While the member is solvent, the directors’ duty to the group member is satisfied by considering the interests of its shareholders. S187 is consistent with this view. While the wholly owned member is solvent, its directors, if

\textsuperscript{93} Harm to creditors can arise even though the group member is not insolvent. For example, intra-group transactions which re-direct cash from a subsidiary may cause the subsidiary to experience a temporary lack of liquidity. In turn such lack of liquidity may lead to slower payment of creditors, which may have consequential effects to the creditors’ liquidity and ultimate solvency.

authorised by the company’s constitution, by acting in the best interests of the holding company, satisfy their obligation to the group member. Only when the group member is insolvent is the director to consider the interests of creditors.\textsuperscript{95} As this duty is owed to the group member, it may only be enforced by the company and not directly by the creditors.\textsuperscript{96}

Paul Davies, like Anderson, considers the creditor protections are offered too late. Davies comments, ‘directors’ creditor-regarding duties which bite only when the company is in a state of insolvency are triggered too late in the process of corporate decline’.\textsuperscript{97} The timing of this protection is reflective however of the present law’s recognition that directors do not owe a duty directly to creditors. Rather, their duty is owed to the company, which generally is represented by the interests of shareholders unless upon the onset of insolvency when the interests of the creditors have primacy over the interests of shareholders.

Difficulty arises in pinpointing when a group member is insolvent as opposed to the so-called “intermediate” or “twilight zone”\textsuperscript{98} being the period of time when otherwise legitimate transactions take place immediately preceding the insolvency. Although there are indications that an earlier point in time than a company being insolvent, such as near or in the vicinity of insolvency\textsuperscript{99}; or doubtful solvency\textsuperscript{100} will give rise to a duty on directors to take into account creditors’ interests. Debell J in Pascoe v Lucas\textsuperscript{101} stated:

\begin{quote}
The proposition by Mason J in Walker v Wimborne (1976) 137 CLR 1 at 7; 3 ACSR 529 that directors of a company must, in the discharge of their duties, take account of its shareholders and creditors is widely expressed and requires a degree of qualification. Creditors are entitled to consideration if the company is insolvent or near insolvent or of doubtful insolvency or if a contemplated payment or other course of action would jeopardise the solvency of the company.
\end{quote}

\textsuperscript{95} Equitcorp Finance Ltd (in liq) v BNA (1993) 11 ACLC 952 at 1016
\textsuperscript{96} Sycotex Pty Ltd v Baseler (1994) 122 ALR 531,550 where Gummow J stated “the result is that there is a duty of imperfect obligation owed to creditors, one which the creditors cannot enforce save to the extent that the company acts on its own motion or through a liquidator.”
\textsuperscript{100} See Niholson v Permakraft (NZ) Ltd (1985) 3 A.C.L.C. 453 at 459,463 and 464, or comments of Templeman L.J. in Re Horsley & Weight Ltd[1982] 1 Ch 442 at 455.
\textsuperscript{101} (1998) 27 ACSR 737,769.
Academic argument supports the view that the duty to consider creditors’ interests should arise ‘where a company’s situation is such that a director can reasonably expect that the action upon which he or she is going to embark could lead to the insolvency of the company’. This viewpoint appears consistent with the wording found in the statutory duties to prevent insolvent trading under s588G and s588V. Regardless, of which trigger point is accepted, determining whether a company is or is nearing insolvency is not necessarily adjudged easily. It is certainly more than a company’s temporary lack of liquidity:

Temporary illiquidity is not the same as insolvency, even though because of a company’s temporary illiquidity, it is not, in one sense, able to pay all its debts as they become due and payable. The question is whether it would be able to pay all its debts as they became due and payable by appropriately deploying its assets or taking other steps open to it.

Although a definition of insolvency is provided in s95A of the Corporations Act, its application presents difficulties. A truly accurate determination of when a company ceases to be solvent can necessarily only be made in hindsight. It is possible that membership of the corporate group may make the determination of insolvency even more complex as each member may look to other group members for financial support.

It has been considered that this uncertainty allows the holding company and its directors the benefit of the doubt regarding their responsibilities to creditors and gives the holding company and its directors some latitude in choosing whether to try to trade out of a perceived temporary liquidity problem or to place the group member into voluntary administration. Whilst this latitude may be laudable, as it is in

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104 In ASIC v Plymin ( No1) (2003) 21 ACLA 700 Mandie J listed 14 indicia of insolvency, although in any particular case, only certain factors may have particular significance and the absence of one or more of those factors does not of itself establish solvency.
107 Such complexity arose in the case of Lewis (as Liq of Doran Constructions Pty Ltd) (in liq) & Anor v Doran [2005] NSWCA 243 The Court of Appeal in dismissing the appeal recognised, as did the judge at first instance Palmer J, that the determination of insolvency under s95A had to be ‘ascertained from a consideration of the company’s financial position taken as a whole. In doing so the Court must have regard to commercial realities’ (refering to Southern Cross Interiors Pty Ltd ( in liquidation) v Deputy commissioner of Taxation (2001) 53 NSWLR 213 at 224) The commercial reality was that ‘Constructions was solvent… as the company had available as a resource to pay its debts the voluntary extension of credit by another company’. It was clear that Holdings had acted and continued to act as “banker to the Doran Group”.
creditors’ interests for a business to be saved if possible through corporate reorganisation, anecdotal evidence\textsuperscript{109} suggests that the severity of s588G liability on directors and hence s588V liability on a holding company makes them reluctant to take on restructuring responsibilities.

This may result in wrongful allocation of risk borne by creditors as directors are motivated to act inefficiently as ‘financially viable companies (are) put into insolvency, with the adverse consequences (which) ultimately disadvantage creditors who may have been paid a higher return (or possibly full repayment) if the company were given a chance to effectively restructure itself and return to profitability\textsuperscript{110}.

Current creditor protections to reduce the incidence of debtor opportunism within groups are inefficient in that their operation is stymied until the respective group member with whom the creditor contracted is insolvent or nears insolvency. Thus, the existing protections are more concerned with dealing with the repercussions of such debtor opportunism, than attempting to prevent its instigation.

To prevent the initiation of conflicts of interest within the group, ex ante protection may be warranted. The adoption of enterprise liability for corporate groups may provide such ex ante protection.

V ENTERPRISE LIABILITY

A Addressing Criticisms of CASAC’s Enterprise Approach

The adoption of enterprise liability would address two concerns\textsuperscript{111} previously listed as possible reasons for the failure to implement CASAC’s Corporate Groups Final Report, Recommendation 2.

\textsuperscript{109} Ibid.

\textsuperscript{110} Ibid.

\textsuperscript{111} The third possible reason for non-implementation of CASAC’s Recommendation 2 is not addressed by this article, as the article’s analysis is restricted to protection of voluntary unsecured creditors not tort creditors.
1 Drafting New Legislation

Firstly, adopting enterprise liability for controlled and integrated corporate groups, rather than treating the consolidated corporate group as one legal structure \(^{112}\) would mean substantially less drafting of new legislation.\(^{113}\)

Enterprise liability may be imposed by making limited changes to the present Corporations Act. As each group member company would still retain its legal entity status under the *Corporations Act 2001 (Cth)* substantive reform would not be required. For example, registration of group company members would need to comply with the existing company registration requirements found in Chapter 2A *Corporations Act 2001 (Cth)*. However, s112(1) would be amended to include an additional registration requirement for those companies who are members of a controlled and integrated group. Membership would require registration under the Act as a ‘Single enterprise group member’ whose liability would be ‘joint and several for the debts of its single enterprise group members’. Amendments to s9 would include definitions of a “single enterprise group”\(^{114}\) and “single enterprise group member”\(^{115}\).

On registration as a single enterprise group member, as well as the imposition of enterprise liability, various regulations would automatically apply, including disclosure mandates, and the protection of any minority shareholders of the single enterprise group members. Where minority interest shareholders of group members

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\(^{112}\) CASAC Corporate Groups Final Report May 2000 Recommendation 2

\(^{113}\) See earlier Part III of this article

\(^{114}\) A *single enterprise group* would be defined as one or more companies which are controlled by one or more companies for the purposes of operating parts of the same business.

Factors providing evidence of the same business operations are:

1. Shared or intermingled resources such as premises, equipment, facilities, management, accounting services, employees or corporate brand name so as to present a unified enterprise to the public.
2. Financial relationships or dependencies such as common banking relationships, the existence of intra-company loans, cross-guarantees, cross-securities, and mortgages;
3. Substantive trade between companies, the existence of common suppliers, or trade/agency agreements; purchases of one company constitute a large proportion of the sales of another company
4. Common Customers; customers of one company automatically become customers of other companies; companies provide complementary services; companies add value to the goods/services provided by other companies.

\(^{115}\) A *single enterprise group member company* would be defined in s9 Corporations Act 2001 as: a company registered under s117 Corporations Act who is a member of a single enterprise group. *Member* is defined as: a company under control of, or a company which controls, another company for the purposes of conducting a single enterprise. *Control* is to be defined as per s50AA(1) and (2) *Corporations Act 2001 (Cth)*.
exist, they may exercise buy-out rights.\textsuperscript{116} If such minority interests are retained in the group member, their liability remains limited.

Where membership of the single enterprise group ceases or an existing company joins a single enterprise group then the company’s status would be altered by complying with the provisions under Part 2B.7. Amendments to ss163 and 164 would ensure that a company leaving the group would retain residual joint and several liability for the debts of the group incurred while a member, unless otherwise agreed. Similarly, a company would only be jointly and severally liable for debts incurred after obtaining membership of the group, unless otherwise agreed.

2. \textit{Mandatory Registration by ASIC}

ASIC would have the power to require a company to seek registration as a single enterprise group member where it is satisfied on the balance of probabilities that there is sufficient evidence of a single enterprise group in existence of which the company is a member. Alternatively, a company may seek such registration on its own volition. Where a company objects to registration as a single enterprise group member then it may apply to the court to show that there is insufficient evidence of its participation in the group’s shared business operations to warrant registration.

Mandatory registration as a “single enterprise group member” avoids the difficulties\textsuperscript{117} of granting substantial and attractive incentives to corporate groups to opt in to enterprise liability.

\section*{B PREVENTION OF LIMITED RESOURCE RISK MISREPRESENTATION}

The creditor’s misperception of the limited recourse risk of contracting with the group member germinates from a lack of information regarding the company member’s boundary. The adoption of enterprise liability for corporate group members would address the creditor’s information deficiency in two ways.

\textsuperscript{116}The best protection for minority shareholders in a subsidiary within an integrated corporate group, however, would be a general right to require the holding company to buy them out at a fair price. This principle has been adopted in the context of take-over bids in most jurisdictions. There is no reason in principle why it should not be extended on a more general basis. Tom Hadden “The Regulation of Corporate Groups in Australia” [1992] 15 University of NSW Law Journal 61, 77.

\textsuperscript{117}See earlier discussion in Part III as to the possible reasons for failure to implement CASAC’s Recommendation 2.
First, enterprise liability means each group member is jointly and severally liable for the debts of its remaining group members, subject to any contrary agreement. Enterprise liability reflects those creditors’ expectations, who, through reliance on corporate group branding and accompanying use of the common name for corporate subsidiaries, have been led to believe they are doing business with the group as a whole and can rely on the overall group’s credit-worthiness.\footnote{118}

Secondly, all group members should be required to disclose on all public documents and on the ASIC database that they are members of that corporate group. Such disclosure is a matter of public record. The mandatory public disclosure of the members of the group and foregoing the preparation of consolidated financial statements\footnote{119} in lieu of alternative means of reporting the group’s solvency may be an efficient means of eliminating this information deficiency.

The adoption of enterprise liability would mean that rather than the solvency of the particular group member, the solvency of the group would be of paramount importance in the creditor’s assessment of limited recourse risk. Such solvency would be dependent upon those assets and liabilities externally generated by the group members such that all unsecured intra-group transactions, would be eliminated. To that end, unsecured inter-group company debts and claims would be extinguished, effectively preventing the group member overstating or understating its debt servicing capabilities.

The disadvantages of relying upon the existing pooling provisions, discussed in Part IV are overcome as the protection provided to creditors by enterprise liability is offered ex ante. Creditors, at the time of contracting with the group members, are aware of the members’ joint and several liability. Assessment by creditors of the limited recourse risk is made, specifically identifying those group member’s assets to which they may have recourse, regardless of whether such member is solvent,

\footnote{118}{Those creditors without such misperception when contracting may be said to obtain a windfall gain from the imposition of joint and several liability among the group’s members.}

\footnote{119}{Frank Clarke & Graeme Dean, Indecent Disclosure Gilding the Corporate Lily (1 ed 2007) 195, 197. Current criticism levelled at such consolidated statements is based on the group’s economic entity not being the legal entity, and the consolidated totals of assets and liabilities of the group being a mishmash of differently derived values. Clarke and Dean question the notion of determining group solvency from a perusal of such financial statements. Instead, Clarke and Dean proscribe wholly owned subsidiaries with recourse to branch operations and branch accounting; disaggregation of consolidated financial statements and market pricing for corporate groups as alternatives to the preparation of consolidated financial statements.}
insolvent or approaching insolvency. Thus possibly identifying at an earlier stage where the single enterprise group has an insufficient pool of assets to meet the liabilities of its members.

Possible savings in regulatory costs may also follow from the adoption of enterprise liability. The elimination of intra-group liability would ensure that the analysis of cascading demands evident in the Bell resources case would be unnecessary as insolvency of the enterprise would be determined only by consideration of debtors and creditors extraneous to the enterprise.

C ELIMINATION OF DEBTOR OPPORTUNISM WITHIN THE GROUP

Part IV of the article identified that current creditor protections impose few restraints on the owners or directors of groups, at either the organizational or operational stage of the group’s existence. The existing protections are more concerned with dealing with the repercussions of such debtor opportunism, than attempting to prevent its instigation. Certainly, the current protections against fraudulent phoenix activity within groups are illustrative of ex post protections which ‘provide little incentive not to phoenix and remedial action is conducted on a case by case basis, well after the damage has been done’\textsuperscript{121}. The adoption of enterprise liability within single enterprise groups would be an ex ante protection against such phoenix activity, as entities within the group would be jointly and severally liable for the payroll obligations, and direct and indirect tax obligations for another member of the group. Further, depending upon group membership, liability may extend to “the risen company”\textsuperscript{122}. The use of a similar grouping provision in Commonwealth legislation was suggested by the Cole Royal Commission as a means of addressing fraudulent phoenix activity.\textsuperscript{123}

\textsuperscript{120} Specifically share capital maintenance provisions, antecedent transactions, and the liability of a parent company for insolvent trading in relation to the failure of one of its subsidiaries under s588V or s588G (if parent company is a shadow director).

\textsuperscript{121} Australian Government Treasury Department “Action against fraudulent phoenix activity” Proposals Paper, November 2009,7.

\textsuperscript{122} Ibid. 3.” The risen company is the entity which becomes active once the first entity has transferred all workers into it, and/or the first entity has gone into liquidation.”

\textsuperscript{123} Australian Government Treasury Department, above note 120,16. In 2003 the Cole Royal Commission considered the prevalence and problems of fraudulent phoenix activity in the building and construction industry often associated with tax avoidance and the avoidance or underpayment of workers’ compensation premiums.
The adoption of enterprise liability, where creditors have a direct claim against the remaining members of the group, may be a more effective deterrent for directors or shareholders of a group to establish undercapitalised subsidiaries, as well as create an incentive for earlier identification of detrimental transactions. Where the group is operated and managed as one economic entity, enterprise liability reallocates risk, forcing the group’s members to internalize such risks of operating as one enterprise; reducing the likelihood of excessive risk taking occurring by limiting the opportunities to exploit the sub-incorporation of the economic entity. Enterprise liability removes the moral hazard associated with limited liability, by making all group members accountable at the time of their joint and unified action. The imposition of joint and several liability, on the members of the group reduces the opportunities for ex post creditor expropriation, thereby allowing enterprise members to bond to creditors’ interests. The imposition of enterprise liability has a deterring effect. By making group members jointly and severally liable, intra-group transfers or financing arrangements to shift assets away from the reach of creditors are pointless.

The recognition of enterprise liability with an accompanying obligation upon member company directors (whether such member companies are solvent or insolvent, wholly or partly owned) to act in best interests of the enterprise may well mean earlier intervention by directors or creditors in identifying when enterprise members approach insolvency or are insolvent. The proviso being that the action of directors in exercising the power should not materially prejudice the ability of enterprise members to pay creditors. Relying upon procedures, which exist under the current Corporations Act 2001 (Cth), creditors would have the right to seek an injunction to prevent the pursuit of enterprise goals where such pursuit materially prejudices the interests of enterprise member creditors.

Identifying controlled and integrated groups as “single enterprise groups” and legally obligating directors to act in the best interests of such enterprises would relieve

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126 S1324 (1) & (1A) Corporations Act 2001 (Cth) grants a creditor or a member of a company the right to apply to the court for an injunction to prevent the company contravening the Corporations Act 2001 (Cth), where the creditor or member are persons whose interests are affected by a company’s contravening conduct.
directors of the potential risk of conflicts of interest, as the disconnect between the corporate structure and the management of the economic enterprise/s is reduced.

VII ADVANTAGES AND DISADVANTAGES OF ENTERPRISE LIABILITY

The lack of empirical evidence supporting either limited liability or unlimited liability in terms of voluntary creditors has been previously recognised. 127

Because liability systems within societies tend to be unitary, empirical work has generally been difficult to undertake. There are a few examples of parallel systems of limited and unlimited liability, but the evidence on the effects of limited liability (and therefore unlimited liability) remains extremely limited. 128

Ultimately, the article can only canvass the theoretical economic arguments of the efficiency of enterprise liability over limited liability for corporate groups.

A Effect on Monitoring Costs

According to orthodox economic theory, it does not matter, in the absence of transaction costs, if the default rule is one of limited or unlimited liability as the parties will bargain to the efficient result. 129

However, the choice of liability regime impacts on the magnitude of creditors’ information costs, otherwise known as “monitoring, enforcement and surveillance costs”. 130 Under enterprise liability the risk to the creditor depends upon the member’s earning power and the ability of the remaining members to pay any unsatisfied claims and bankruptcy costs. The remaining members’ net assets provide part of the collateral for the credit extended. Creditors wanting to ensure that this collateral is maintained will face increased costs of surveillance with regard to the activities of the group members. Thus, monitoring costs of creditors would

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increase. On contracting, and throughout the duration of the debt, the creditors would need to monitor, not only the net assets of the contracting member but the net assets of all the group members. Ultimately creditors would, where possible, pass these costs onto the group in the form of increased borrowing costs charged to members. David Goddard identifies such increased monitoring costs as a potential competitive disadvantage suffered by corporate groups over single companies.\textsuperscript{131} However, he fails to identify a compensating decrease in risk enjoyed by creditors of the group.

Off-setting such increased monitoring costs, is the reduction in debtor opportunistic risk and the likelihood of debtor opportunism. The imposition of enterprise liability creates a “system of mutual surveillance,”\textsuperscript{132} in which group members monitor the level of debt within the group, thus bonding with creditor interests and diminishing the need for monitoring by creditors. The adoption of enterprise liability creates an inverse relationship of potentially higher creditor monitoring costs but decreased likelihood of debtor opportunism. A reduction in the likelihood of debtor opportunism should be reflected in reduced corporate borrowing costs. Whether the costs counterbalance, such that the cost of raising debt under limited and enterprise liability is unaltered, is an empirical question. Certainly, in 1931 when California adopted limited liability in lieu of pro-rata unlimited liability, the change was vigorously opposed by trade creditors\textsuperscript{133} who might otherwise been thought to have benefitted from the saving in monitoring costs.

\section*{B Effect on Enterprise and Investment}

Although the majority of economic justifications for limited liability do not apply within the single enterprise group\textsuperscript{134}, the greatest hurdle to overcome is the effect on

\begin{footnotes}
\item[132] See Tobias H. Troger, “Asset Partitioning, Debt-Equity Agency Conflicts and Choice of Organisational Form” Eberhard-Karls-University Tubingen Law School Research Paper 2007, 31 who uses this term to describe the effect of joint and several liability on partners within a partnership.
\item[133] Mark I Weinstein, “Limited Liability in California: 1928-1931” [2001] University of Southern California Law School Olin Research Paper No 00-17, 41, available at http://papers.ssrn.com/paper.taf?abstract id=244333. Citing as evidence minutes from a meeting of the State Bar Committee on Revision of the Corporation Laws (whose function was to draft the revised corporate code) “the San Francisco Association of Credit Men is at present in favour of the unlimited stockholders’ liability in connection with extending credit to corporations”. While some in favour of the change argued that the existing regime of unlimited liability reduced the supply of equity capital.
\item[134] R. Thompson, “Piercing the Corporate Veil: An Empirical Study” (1991) 76 Cornell Law Review 136 at 1071. See also J.Antunes Liability of Corporate Groups: Autonomy and Control in Parent-subsidiary Relationships in US, German and EU Law. 1994 Where the author argues that the justifications for limited liability for investor shareholders simply don’t fit the economic reality of parent companies as shareholders.
\end{footnotes}
investment in the group from the adoption of enterprise liability. In Australia, the cost of capital for group members may rise due to: pressure to adopt risk-adverse investment strategies as costs previously incurred by creditors, are now borne by group members; the increase in transaction costs as group members contract around joint liability. In either case, the cost of capital for the group may rise leading to the rejection of marginal investment projects whose rate of return is less than the group’s cost of capital. In turn, smaller returns on investment by group members may result in a decline in the market value of the group members’ shares. This factor previously influenced the rejection of an enterprise approach in Australia. 135

The effect enterprise liability would have on the investment economy 136 is ultimately an empirical question. Some support can be gained from a study 137 undertaken of the change from pro-rata unlimited to limited liability in California in 1931. The study indicated there was no evidence that adopting limited liability led to any significant change in corporate activity, and no detectable increase in shareholder wealth. 138 Germany provides the only substantial empirical evidence of a version of enterprise liability operating today. However, the circumstances of its adoption are unique to Germany and its continued use has, it is postulated, continued the preference in Germany to rely upon bank financing, rather than equity financing.

135 See Part II for the failure of the CASAC Corporate Group Final Report recommendations. In Germany, which boasts an enterprise approach to corporate group regulation, such influence is not as great. Rather, there exists a preference for bank financing, rather than a reliance on equity funding.

136 Meredith Dearborn, “Enterprise Liability: Reviewing and Revitalizing Liability for Corporate Groups” 97 (2009) California Law Review, 256. “Economists argue that limited liability is indispensable to the functioning of an efficient capital market. They maintain that limited liability facilitates business organization, promotes investment in capital, reduces the investor’s need to monitor investments, makes it feasible to invest in multiple business ventures and generally contains administrative costs associated with investments.”


138 Ibid. The study’s limitations are noted by the author: it examines only one USA state at one particular point in time; “limitations on the pro-rata limited liability in California may have already served to insulate shareholders from the worst possible outcomes. Shareholders were only liable for debts for a period of three years after they were incurred, and there is no instance of creditors ever being able to collect from the shareholders of a publicly traded corporation.”
This article is not advocating a blanket abolition of corporate limited liability. Only those members of controlled and integrated corporate groups would share joint and several liability for the debts of each group member. Unlimited liability does not extend to the individual shareholders or to corporate shareholders of such members unless they too form part of the controlled and integrated enterprise. To that end, shareholder’s monitoring costs are not likely to increase, as joint and several unlimited liability does not extend to such passive shareholders. Monitoring group members is considered less costly than monitoring individual shareholder wealth, given modern financial reporting techniques. Likewise, the significant costs associated with administering a regime whereby company liability is unlimited would not apply to imposing enterprise liability on such corporate groups. As group membership is a matter of public record there would be no need for complicated liability tracing mechanisms.


Contributors to the special issue on limited liability and the modern corporation made clear that “calls for a blanket abolition of corporate limited liability and a return to the full liability norm of early nineteenth century partnerships are as a-historically blind and counter-productive, both politically, as well as economically, as the insistence of mainstream corporate theory on the ‘bedrock’ nature of corporate limited liability.

140 William J. Carney, “Limited Liability” Encyclopedia of Law & Economics (1999), 670 http://encyclo.findlaw.com/5620book.pdf. “It has long been argued that joint and several unlimited liability would discourage wealth investors from investing in risky enterprises, particularly when they intended to play a passive role where they could not monitor and supervise the firm’s risky activities.” citing Blumber; Diamond; Easterbrook and Fischel; Grossman; Halpern, Trebilcock and Turnbull; Hansmann and Kraakman; Leebron; Manne; Woodward.

141 Lewis T. Evans and Neil C. Quigley, “Shareholder Liability Regimes, Principal-Agent Relationship and Banking Industry Performance”, (1995) 38 Journal of Law and Economics, 497-520. Corporate level information systems such as BPI (Business Process Integration); ERP (Enterprise Resource Planning); SCM (Supply Chain Management); CRM (Customer Relationship Management) are designed to ensure an efficient, effective and integrated information flow within large business organisations. See Albert Huang, David C. Yin, David C. Chou & Yurong Xu, “Corporate Applications Integration: Challenges, Opportunities & Implementation Strategies”[ Spring 2003] Journal of Business Management, 137.

142 David Goddard, ‘Corporate Personality- Limited Recourse and its Limits’ in Charles E.F.Rickett & Ross B. Grantham Corporate Personality in the 20th Century 1998, 24 The author suggests the need for mechanism for identifying which shareholders bore liability for particular events and the practical difficulty in tracing shareholders at the time of a wrongful act or series of acts would be significant.
VII CONCLUSION

Certainly, the operation of the ‘endowment effect’ makes changing basic liability rules, and the adoption of enterprise liability unlikely.\textsuperscript{143} However, the adoption of enterprise liability within controlled and fully integrated groups may be a more efficient response to the problems of misrepresenting the limited recourse risk of such group members, as well as debtor opportunism arising within such groups. Commentators defining good corporate law argue that a key ingredient is the continuous evolution of law.\textsuperscript{144} ‘Successful legal systems encourage and facilitate this adaption process of corporations and then respond to changed circumstances.’\textsuperscript{145} Commentators\textsuperscript{146} on the debate between limited and unlimited liability, while considering a limited liability regime as a general rule to be the most efficient regime for large, widely held companies, consider that an unlimited liability regime would be a more efficient regime for small, closely held companies. This article has tried to illustrate by drawing an analogy with such small, closely held companies that for controlled and integrated corporate groups it is time to consider the adoption of enterprise liability as a means of providing protection to creditors when contracting with such group members.

\textsuperscript{143} Lynn M LoPucki, “The Death of Liability? A Systems/Strategic Analysis”, (1996) 106 Yale Law Journal, 1-92. The endowment effect has been documented by numerous experiments which demonstrate that people tend to demand more money if they are selling a piece of property or other entitlement than they would be willing to pay for the same item outright if they did not already own it. Although experiments have focused primarily on a subjects’ valuation of property rights or other legal entitlements, experimental evidence indicates that the endowment effect is at work in the valuation of contractual default rules as well as property rights. Daniel Kahneman, Jack L Knetsch & Richard Thaler, Experimental Tests of the Endowment Effect and the Coase Theorem, 98 J. Pl. Econ 1325 (note 39) and Russell Korobikin, The Status Quo Bias and Contract Default rules, 83 Cornell L. Rev. 608,631 (note 41) as quoted in David Millon, “Piercing the corporate veil, financial responsibility, and the limits of limited liability”, 2006 Washington & Lee Public Legal Studies Research Paper Series Working Paper no 2006-08 11.


\textsuperscript{145} Ibid.
