

## HOW CAN PARENT COMPANIES AVOID THE LIABILITIES OF SUBSIDIARY COMPANIES?



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## **HOW CAN PARENT COMPANIES AVOID THE LIABILITIES OF SUBSIDIARY COMPANIES?**

The “corporate veil” is a legal principle founded on the fact that each company has a separate legal identity. As a result, the legal liability of a company is distinct from that of the company’s directors and shareholders and furthermore the liability of any subsidiary company is separate to that of its parent company.

Problems arise when one of the companies in a group of companies has a potential liability to a third party. The third party will want to recover as much money as possible. But, what if the company who is a party to the contract does not have any assets to enforce a judgment against? The third party may then seek to “pierce the corporate veil” if it has grounds to do so, arguing that that the courts should go beyond the corporate veil and enforce any judgment against the parent company. A similar situation could arise where a subsidiary company becomes insolvent and creditors seek to recover outstanding debts from the parent company.

Courts will lift the corporate veil in certain circumstances, for example where there is evidence of fraud or a deliberate breach of trust or where it is obvious that the corporate veil is disguising a sham or façade to avoid or limit the liabilities of the company. It is anticipated that claims to lift the corporate veil will become more prevalent in these economic times.

It is therefore very important, especially in these economic times to ensure that any restructuring within a group of companies and/or transfer of assets is carried out overtly and legitimately to ensure that the entities remain and will be viewed as separate for the purposes of lifting the corporate veil.

We have compiled a short checklist, based on established case law, of the factors which should be considered when planning a re-structure:

- Ensure that any assets are transferred at net book value.
- Ensure that there is no principal/agency relationship agreed and established between the parent and subsidiary company.
- Consider how profits are treated, as between the parent and subsidiary company.
- Consider how much control the parent company has over the subsidiary company, for example, does the parent company govern all trading activities and make decisions in respect of expenditure of capital?
- Consider if the parent company would be viewed as being in constant control of the subsidiary company.
- Overall, who is really carrying on the business?
- Further practical considerations include; who are the directors of each company? Where is the place of business of each of the companies? Who are the shareholders? Do the subsidiary companies have independent control over day-to-day activities? Who is in control of the books of the company and where are they kept?

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**Need to know more? Ask us. For information/advice on litigation issues, please contact:**

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