RESEARCH REPORT

CORPORATE GROUPS

IN

AUSTRALIA

Ian Ramsay
Geof Stapledon

Centre for Corporate Law and Securities Regulation
The University of Melbourne

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Ian Ramsay
Harold Ford Professor of Commercial Law
Director, Centre for Corporate Law and Securities Regulation
The University of Melbourne

Geof Stapledon
Senior Lecturer
Associate, Centre for Corporate Law and Securities Regulation
The University of Melbourne

Centre for Corporate Law and Securities Regulation
The University of Melbourne

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Centre for Corporate Law and Securities Regulation
Faculty of Law
The University of Melbourne
Parkville Vic 3052
Australia

Ph: +61 3 9344 5281
Fax: +61 3 9344 5285
E-mail: cclsr@law.unimelb.edu.au
Website: www.law.unimelb.edu.au/centres/cclsr/index.html

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CORPORATE GROUPS IN AUSTRALIA

EXECUTIVE SUMMARY

I. Introduction

- The recent Australian waterfront dispute highlighted the significance of the corporate group.

- A key aspect of the dispute was the restructuring of the Patrick group of companies just seven months earlier. In the restructured group, Patrick employees were employed by four essentially assetless Patrick companies. Industrial action on the docks led to the termination of the employer companies' labour supply contracts with another Patrick group company. This in turn led – inevitably – to the employer companies being put into administration. As Justice North said, the change in the Patrick group structure made it easier to dismiss the whole workforce.

- The issue of manipulation of corporate structures to avoid employee rights has now been referred to the Parliamentary Joint Committee on Corporations and Securities.

II. The empirical study

- This Research Report presents the results of an empirical study of the group structures in Australia's Top 500 listed companies in 1997.

- The study revealed that:

  - ◊ 89 per cent of the sample companies had at least one controlled entity.

  - ◊ On average, each listed company had 28 controlled entities – although this was skewed by those listed companies with very large numbers of controlled entities. The median figure – which adjusts for the skewing effect – was 11 controlled entities.

  - ◊ Lang Corporation Ltd – the ultimate holding company of the Patrick group – had 63 controlled entities at the time of the study.

  - ◊ The vast majority (90 per cent) of controlled entities were wholly owned.

  - ◊ 8.6 per cent were controlled by a listed company holding (either directly or indirectly) at least 50 per cent but less then 100 per cent of the shares or units.

  - ◊ Only 1.3 per cent were controlled by a listed company holding (directly or indirectly) under 50 per cent of the shares or units. However, 11.1 per cent of the sample listed companies had at least one controlled entity that was controlled with a shareholding or unitholding of under 50 per cent.

◊ There was significant variation in the average number of controlled entities in different industries. For example, the average in the Infrastructure & Utilities sector was 12 controlled entities per listed company (the median figure being only 1.5). In contrast, the average in the Diversified Industrials sector was 57 controlled entities per listed company (with the median figure being 40).

◊ As the size of the companies decreased, the number of controlled entities also decreased. Companies in the first quartile (those with the largest market capitalisation) had, on average, 72 controlled entities. Companies in the second quartile had, on average, 20 controlled entities; those in the third quartile had, on average, 12 controlled entities; and those in the fourth quartile had, on average, 9 controlled entities.

◊ A pyramid group structure – a listed company as the ultimate holding company and then a chain of subsidiaries going down several levels – is common.

◊ Several companies had only one level of controlled entities, but the highest number reported was 11 levels.

◊ The average sample company had 11 1st level controlled entities. The average number of 2nd level controlled entities was 10.4; the average at the 3rd level was 5.5, and then the numbers fell away quite sharply.

◊ The sample companies' controlled entities were incorporated in 122 countries. Not surprisingly, however, a very high proportion of them – 65 per cent – were incorporated in Australia.

III. The definition of corporate group

■ Currently in Australia different concepts of control are employed to regulate different aspects of corporate groups and their operations.

■ Indeed, reforms to the Corporations Law over the past six years have utilised a broad definition of control twice and the narrow legal concept of control once.

IV. Reasons for corporate groups

■ Reasons why a company might establish one or more subsidiaries so that its business is conducted through a corporate group rather than through a single company include:

◊ The company can reduce the exposure of its assets by establishing a subsidiary. The principle of limited liability ensures that – subject to exceptions where the courts or Parliament lift the corporate veil – the assets of the holding company will be protected from any liability incurred by the subsidiary.

◊ The operation of a business through a corporate group rather than a single company can result in lower taxation. One way in which this might be achieved is through entities incorporated in "tax havens". The study revealed that the top

20 countries of incorporation of the sample companies' controlled entities included three tax havens: British Virgin Islands, Cayman Islands and Bermuda.

- ◊ A company may want to acquire a business in partnership with another party. A convenient way of structuring the acquisition is for the respective interests in the new business to be represented by shares. This necessitates the new business being acquired by a purchase of the shares of the company running it rather than by a purchase of the assets of the business.

- ◊ A related point is that stamp duty and taxation considerations will frequently make it preferable to acquire a business by purchasing the shares of the company rather than by purchasing the assets.

- ◊ A company may want outside investment in part only of its business. This can be done by incorporating that part of the business as a subsidiary and allowing outsiders to acquire a minority shareholding in the subsidiary. It allows the company to raise additional capital without forfeiting control.

V. Regulatory approaches to corporate groups in Australia

- ■ A variety of approaches have been adopted in Australia to the regulation of corporate groups.

- ■ There has been no systematic reform in this area. Rather, the regulatory approaches must be regarded as piecemeal.

- ■ The approaches include:

  - ◊ tightening of financial reporting rules;

  - ◊ lifting of the corporate veil by courts;

  - ◊ statutory prohibition of certain cross shareholdings in corporate groups;

  - ◊ imposition of statutory directors' duties on "shadow directors";

  - ◊ recognition by the courts of the possibility of a parent company being vicariously liable for wrongs committed by its nominee directors on a subsidiary company's board;

  - ◊ acknowledgment by the courts and Parliament of the need for a degree of flexibility in the content of directors' duties in a group context;

  - ◊ use of the oppression provision to remedy abuses in corporate groups;

  - ◊ increased statutory regulation of financial benefits flowing from public companies to their related parties (including other companies in the corporate group);

- ◊ encouragement by the regulator of the use of cross-guarantees; and
- ◊ introduction of specific laws dealing with insolvent trading in corporate groups.

CORPORATE GROUPS IN AUSTRALIA*

I. Introduction

The protracted dispute on the Australian waterfront in 1998 highlighted the significance of the corporate group.[1] A key aspect of the dispute was the restructuring of the Patrick group of companies – itself part of a larger group headed by the listed Lang Corporation Ltd – just seven months before the escalation of the industrial dispute. It transpired that one effect of the restructuring was that the Patrick employees were employed by four companies which were effectively devoid of assets other than labour supply contracts with another Patrick group company (which, after the restructure, owned the group's stevedoring business). The stevedoring company had the right to terminate the labour supply contracts without notice if there was any interference with, delay in or hindering of the supply of labour.

Industrial action at Patrick's docks led to the termination of the labour supply contracts by the stevedoring company. This removal of the employer companies' sole source of income led swiftly to those companies being put into voluntary administration. Justice North highlighted the critical nature of the corporate group structure:

> The cancellation of the labour supply contracts and the appointment of administrators on 7 April 1998 were made possible by a complex inter-company transaction which occurred in September 1997. By dividing the functions of employing workers and owning the business between two companies, the Patrick group put in place a structure which made it easier to dismiss the whole workforce.[2]

This is just one illustration of the practical day-to-day importance of corporate groups in Australia today. This Research Report aims to bolster the level of understanding of this issue. It aims to do so principally by presenting the results of an empirical study of the group structures existing in Australia's Top 500 listed companies in 1997.

The findings of the empirical study are set out in Section II. The remainder of the Report touches on some of the key legal issues relating to corporate groups. Rather than an in-depth analysis, the issues are simply highlighted – because the Companies and Securities Advisory Committee (CASAC) is currently conducting an extensive review of the law relating to corporate groups, and a detailed discussion paper is expected to be published by CASAC shortly.

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* The authors thank Lisa Stapledon for research assistance.

1 See *Maritime Union of Australia v Patrick Stevedores No 1 Pty Ltd* (1998) 27 ACSR 497 (Federal Court, North J); *Patrick Stevedores Operations No 2 Pty Ltd v Maritime Union of Australia* (1998) 27 ACSR 521 (Full Federal Court), (1998) 27 ACSR 535 (High Court).

2 *Maritime Union of Australia v Patrick Stevedores No 1 Pty Ltd* (1998) 27 ACSR 497 at 500.

II. The empirical study

A. Background

At 30 June 1998 there were 1,097,111 companies registered in Australia. Table 1 shows those companies broken down into the various types able to be registered at that time.

TABLE 1 COMPANIES REGISTERED AT 30 JUNE 1998

State or Territory	Limited by shares Public	Limited by shares Proprietary	Limited by Guarantee	Limited by Shares & Guarantee	No Liability	Unlimited	Total
NSW	2,989	381,554	5,063	66	158	158	389,988
VIC	1,635	327,838	1,988	319	133	248	332,161
QLD	889	160,959	1,375	22	77	54	163,376
WA	900	99,902	133	10	569	31	101,545
SA	386	67,402	131	4	41	63	68,027
TAS	98	13,518	201	4	3	17	13,841
ACT	576	20,056	408	17	18	12	21,087
NT	34	7,015	25	2	8	2	7,086
TOTAL	7,507	1,078,244	9,324	444	1,007	585	1,097,111

Source: Corporate Relations Unit, Australian Securities & Investments Commission.

Of these 1.1 million companies, only about 1,200 are listed on the Australian Stock Exchange (ASX). However, listed companies are extremely significant in the Australian economy:

- in 1997-98 the market capitalisation of Australian companies listed on the ASX was equivalent to 84 per cent of Australia's Gross Domestic Product (GDP) (ASX 1998); and
- in 1995-96 the Top 500 listed Australian companies generated revenue equivalent to 36 per cent of Australia's GDP (CLERP 1997).

Every listed company must include in its annual report certain information about each "entity" that it controls.[3] As discussed at pages 11 to 13, the concept of controlled entity is a different and broader concept than the definition of "subsidiary" employed in the Corporations Law. As its title suggests, controlled entity relies on a definition of "control". Section 9 of the Corporations Law delegates the power to define "control" to the accounting standards issued by the Australian Accounting Standards Board (AASB). AASB 1024 defines "control" as:

> The capacity of an entity to dominate decision-making, directly or indirectly, in relation to the financial and operating policies of another entity so as to enable that other entity to operate with it in pursuing the objectives of the controlling entity.

B. Statistics on corporate groups in the Top 500

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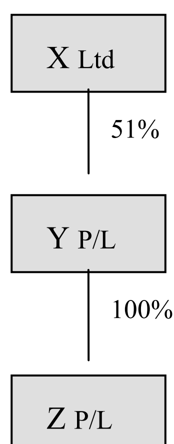
[3] See Appendix A for more details.

The present study covered 415 of the Top 500 companies (measured by market capitalisation) listed on the ASX as at 28 November 1997. The sample size of 415 companies was achieved by excluding the 41 overseas-based companies and the 44 listed property trusts that were in the Top 500 at that time.[4] The data was drawn from 1997 annual reports. In the tables below, the percentage size of the controlling interest is that of the listed company. An illustration is given in Figure 1. Z Pty Ltd is controlled directly by Y Pty Ltd and indirectly by X Ltd, a listed company. The controlling interest of X Ltd in Z Pty Ltd is 51 per cent.

FIGURE 1 AN INDIRECT CONTROLLING INTEREST



The study revealed that 370 (ie 89 per cent) of the 415 sample companies had at least one controlled entity. Table 2 shows the aggregate statistics for the controlled entities of the sample companies. Table 2, and the statistics behind it, reveal that:

- On average, each listed company had 28 controlled entities – although this was skewed by those listed companies with very large numbers of controlled entities. For instance, the companies with the three highest numbers of controlled entities had 778 (News Corporation Ltd), 379 (BHP) and 330 (Foster's Brewing Group Ltd). The median figure adjusts for the skewing effect. It shows that, if the sample listed companies were ranked according to their numbers of controlled entities, the company half-way down the list had 11 controlled entities.
- Lang Corporation Ltd – the ultimate holding company of the Patrick group – had 63 controlled entities at the time of the study.
- The vast majority of controlled entities were wholly owned: 10,612 out of the total of 11,779 – that is, 90 per cent.

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4 The reasons for excluding overseas companies and listed trusts are set out in Appendix A.

- A further 1,009 controlled entities (8.6 per cent of the total) were controlled by a listed company holding (either directly or indirectly) at least 50 per cent but less then 100 per cent of the shares or units.
- Only 158 controlled entities (1.3 per cent of the total) were controlled by a listed company holding (directly or indirectly) under 50 per cent of the shares or units. However, 46 (ie 11.1 per cent) of the 415 sample listed companies had at least one controlled entity that was controlled with a shareholding or unitholding of under 50 per cent. The company with the most controlled entities in this category was the engineering firm, Avatar Industries Ltd – 41 (ie 79 per cent) of its 52 controlled entities were controlled with a shareholding or unitholding of less than 50 per cent.

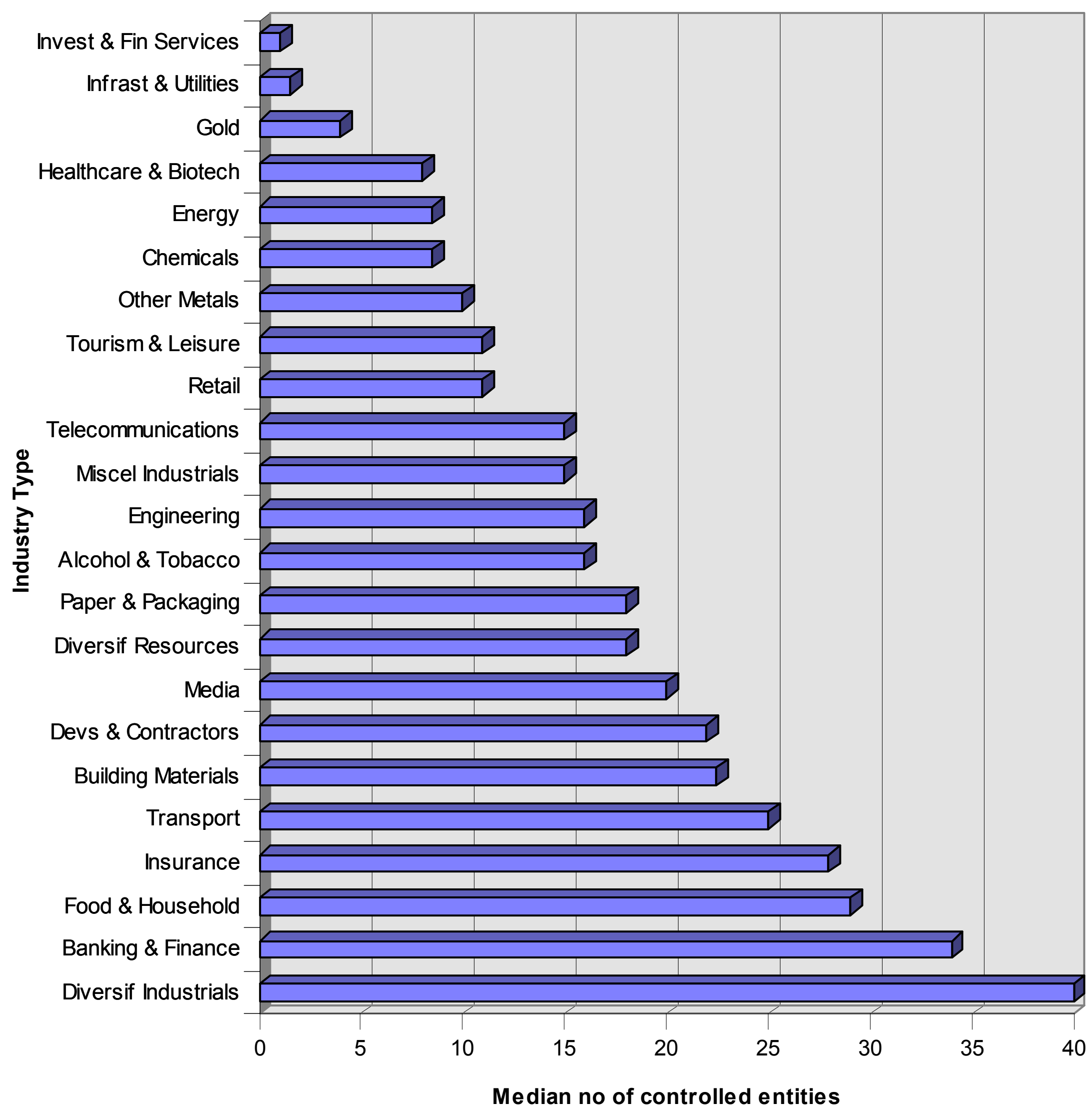
TABLE 2 STATISTICS ON CONTROLLED ENTITIES

	Mkt Cap ($m)	Total CE	100% CE	50-99% CE	<50% CE
Total	380,855.5	11,779	10,612	1,009	158
Average (mean)	917.7	28.4	25.6	2.4	0.4
Median	155.8	11	9	0	0

Legend

Mkt Cap	market capitalisation of the sample listed companies
Total CE	total number of controlled entities
100% CE	number of entities in which the listed company has a 100% interest (directly or indirectly)
50-99% CE	number of entities in which the listed company has an interest (directly or indirectly) of at least 50% but less than 100%
<50% CE	number of entities in which the listed company has a controlling interest (directly or indirectly) of less than 50%

FIGURE 2 INDUSTRY TYPE AND NUMBER OF CONTROLLED ENTITIES



The industry classification of the sample companies was examined. Figure 2 shows the *median* number of controlled entities for the sample listed companies in each industry type.[5] The industries with the highest number of controlled entities were Diversified Industrials –

where the median company had 40 controlled entities, followed by Banking & Finance (median: 34 controlled entities), Food & Household (median: 29 controlled entities) and Insurance (median: 28 controlled entities).

If the focus is shifted from the median to the average (or mean), the ranking of the industries changes. Table B1 on pages 31 to 33 shows that the industries with the highest average number of controlled entities were Diversified Resources (average: 105 controlled entities), Media (average: 67 controlled entities), Transport (average: 59 controlled entities) and Diversified Industrials (average: 57 controlled entities). These average figures were skewed by those listed companies with very large numbers of controlled entities. In the case of Diversified Resources, where the average figure of 105 was substantially higher than the median figure of just 20, the skewing of the average was attributable largely to one company – BHP – which had 379 controlled entities at the time of the study. Likewise, in the case of Media (average: 67; median: 20), the skewing of the average was attributable mostly to News Corporation Ltd – which had 778 controlled entities. And, in the case of Transport (average: 59; median: 25), the higher average figure was due largely to Brambles Industries Ltd – which had 171 controlled entities.

Figure 2 reveals that the typical size of corporate groups (in terms of number of group entities) in the Banking & Finance and Insurance sectors is much larger than in the Investment & Financial Services sector. The explanation probably lies in the fact that most of the companies in the Investment & Financial Services sector are portfolio investment companies – which have diversified investments in a range of (mostly listed) companies but only very rarely are these investments large enough to confer control. On the other hand, the companies making up the Banking & Finance and Insurance sectors have operating businesses that are run through a (relatively large) number of group entities.

The sample companies were divided into quartiles based on their market capitalisation. Table 3 demonstrates that, as the size of the companies decreased, the number of controlled entities also decreased. Companies in the first quartile (those with the largest market capitalisation: between $467 million and $27,788 million) had, on average, 72 controlled entities. Companies in the second quartile ($156 million to $452 million) had, on average, 20 controlled entities; those in the third quartile ($59 million to $151 million) had, on average, 12 controlled entities; and those in the fourth quartile ($10 million to $59 million) had, on average, 9 controlled entities.[6]

TABLE 3 SIZE OF HOLDING COMPANY AND NUMBER OF CONTROLLED ENTITIES

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[5] Table B1 on pages 31-33 contains more detailed information about controlled entities according to industry type.

[6] Table B2 on page 34 contains more detailed information about controlled entities according to the size of the holding company.

		1st Quartile	2nd Quartile	3rd Quartile	4th Quartile
Market Capitalisation ($m)	Total	339,064.5	27,653.7	9,947.5	4,189.8
	Average (mean)	3,260.2	265.9	95.6	40.7
	Median	1,230.0	241.8	85.4	42.0
Controlled Entities	Total	7,533	2,115	1,243	888
	Average (mean)	72.4	20.3	12.0	8.6
	Median	48	12	9	6

International comparisons are difficult to make because different countries use different definitions of what constitutes a corporate group. However, a 1980s study by Tricker (1994) indicates a similar relationship in the UK between the size of the listed holding company and the number of group entities. The study of 144 listed UK companies found that the surveyed companies had, on average, 112 subsidiaries. The 44 largest companies had, on average, 230 subsidiaries. In contrast, the 26 smallest companies had, on average, only 26 subsidiaries.[7]

The reported data shows that a pyramid group structure – a listed company as the ultimate holding company and then a chain of subsidiaries going down several levels – is common. In some instances variations are built into the basic pyramid. Figure 3 is an example of a basic pyramid structure, and Figure 4 is an example of a pyramid with a variation. Of course, group structures can be extremely complex, especially where there are cross-shareholdings: that is, where entities in the same group hold shares in one another.[8]

FIGURE 3 A BASIC PYRAMID GROUP STRUCTURE

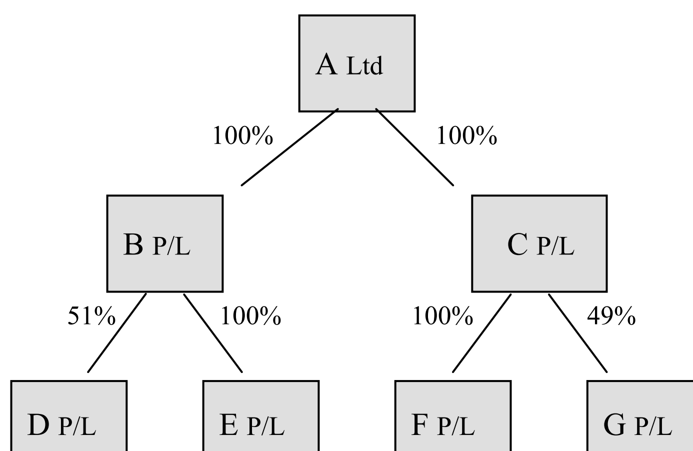

FIGURE 4 A PYRAMID STRUCTURE WITH A VARIATION

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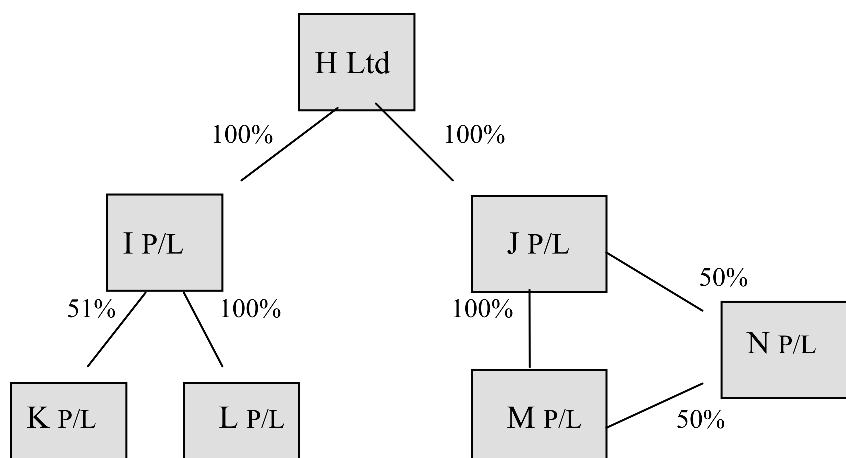
7 Tricker (1994) p 332.

8 Corporations Law, Part 2J.2 prohibits an entity from holding shares in a company which controls it: see page 21 below.



One measure of the complexity of a corporate group is the number of levels of controlled entities in the group. The group in Figure 3, for example, has two levels of controlled entities: B and C are 1st level controlled entities, while D, E, F and G are 2nd level controlled entities.

Almost half of the sample companies (201 out of 415) disclosed information about levels. Several companies had only one level of controlled entities, but the highest number reported was 11 levels. Table 4 provides information about the number of controlled entities at each level. It shows that the average sample company had 11 1st level controlled entities. The average number of 2nd level controlled entities was 10.4; the average at the 3rd level was 5.5, and then the numbers fell away quite sharply.

TABLE 4 CONTROLLED ENTITIES AT EACH LEVEL

Level of Controlled Entity	Total CE	Average (mean)	Median
1st	2,202	11.0	6
2nd	2,093	10.4	5
3rd	1,111	5.5	1
4th	568	2.8	0
5th	349	1.7	0
6th	184	0.9	0
7th	53	0.3	0
8th	57	0.3	0
9th	19	0.1	0
10th	8	0.04	0
11th	2	0.01	0

The figures in Table 5 demonstrate that on average, the larger the listed holding company (in terms of market capitalisation), the more complex the corporate group is likely to be – in terms of the number of levels of controlled entities.

TABLE 5 AVERAGE NUMBER OF LEVELS IN THE GROUP

	Average Number of Levels
1st Quartile	4.16
2nd Quartile	3.12
3rd Quartile	2.84
4th Quartile	2.24
Total	3.17

The sample companies' controlled entities were incorporated in 122 countries. Not surprisingly, however, a very high proportion of them – 65 per cent – were incorporated in Australia. Table 6 lists the top 20 countries of incorporation.

The Australian Securities and Investments Commission (ASIC) has exercised its discretion to exempt certain wholly owned subsidiaries from the financial reporting and audit requirements of the Corporations Law, provided that the holding company and the subsidiaries to which the relief will apply enter into a deed of cross-guarantee. This issue is discussed at page 26 below. The number of sample companies which had taken up this opportunity is set out in Table 7. It can be seen that, in general, the larger the company the more likely it was that a deed of cross-guarantee had been entered into.

TABLE 6 TOP 20 COUNTRIES OF INCORPORATION OF CONTROLLED ENTITIES

Country	Number of CE	Proportion of Total
Australia	7,648	64.9%
United States	967	8.2%
United Kingdom	643	5.5%
New Zealand	612	5.2%
Hong Kong	183	1.6%
Singapore	164	1.4%
Malaysia	149	1.3%
Netherlands	100	0.8%
Canada	96	0.8%
Papua New Guinea	82	0.7%
Germany	80	0.7%
British Virgin Islands	79	0.7%
Indonesia	76	0.6%
Cayman Islands	64	0.5%
France	62	0.5%
China	54	0.5%
Philippines	53	0.4%
Thailand	48	0.4%
Zimbabwe	27	0.2%
Bermuda	27	0.2%

TABLE 7 GROUPS WITH A DEED OF CROSS-GUARANTEE

	Number	Percentage
1st Quartile	48	46.2%
2nd Quartile	32	30.8%
3rd Quartile	21	20.2%
4th Quartile	19	18.4%
Total	120	28.9%

III. The definition of corporate group

The expression "corporate group" is not specifically defined in the Corporations Law. However, there is a definition of "subsidiary" in section 46 of the Corporations Law. Under section 46, a company (A) is a subsidiary of another company (B) if B:

- controls the composition of A's board of directors; or
- is in a position to cast, or control the casting of, more than one-half of the maximum number of votes that might be cast at a general meeting of A; or
- holds more than one-half of the issued share capital of A (excluding any part of that issued share capital that carries no right to participate beyond a specified amount in a distribution of either profits or capital).[9]

Section 47 deems the composition of A's board to be controlled by B if B can appoint or remove all, or the majority, of A's directors.[10]

Section 50 defines what are related companies and this is generally regarded as the legal definition of a corporate group. Section 50 provides that two companies are related if:

- one is the holding company of the other; or
- each is a subsidiary of the same holding company.[11]

The narrow concept of control in the Corporations Law's definition of subsidiary can be problematic, as revealed in *Mount Edon Gold Mines (Aust) Ltd v Burmine Ltd*.[12] Burmine had two major shareholders:

- Europa – which indirectly held 38.5 per cent of Burmine's issued shares; and
- Mount Edon – which held 19.6 per cent of Burmine's issued shares.

The rest of the shareholdings in Burmine were widely held.

Justice White acknowledged that Europa effectively controlled Burmine's board of directors. No director could be appointed to the board of Burmine without the approval of Europa. The judge also stated that each of Europa and Burmine regarded Burmine as a subsidiary of Europa. Indeed, the financial statements of Europa were prepared on the basis that Burmine was a subsidiary of Europa. And Burmine had consistently stated in its annual reports and annual returns to the Australian Securities Commission[13] that Europa was its ultimate holding company.

In late 1993 Mount Edon made a takeover offer for Burmine. In early 1994, Burmine made an offer to purchase the shares of Europa. Mount Edon then commenced litigation

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[9] Under section 46, A is also a subsidiary of B if A is a subsidiary of a subsidiary of B.

[10] However, this does not limit by implication the circumstances in which the composition of A's board is taken to be controlled by B: Corporations Law, section 47.

[11] The term "holding company" is defined in section 9 of the Corporations Law in this way: in relation to a particular company (A), a holding company is another company of which A is a subsidiary. This definition relies on the definition of subsidiary in sections 46 and 47.

[12] (1994) 12 ACSR 727 (Supreme Court of Western Australia).

claiming that Burmine was a subsidiary of Europa under section 46 of the Corporations Law on the basis that Europa controlled the composition of Burmine's board. Mount Edon argued that the result of Burmine being a subsidiary of Europa was that Burmine was prohibited under (former) section 205(1)(b)(ii) of the Corporations Law from acquiring shares in Europa. At the time of the case, this section prohibited a company from acquiring shares in its holding company.[14]

Did Europa control the board of directors of Burmine so as to make Burmine a subsidiary of Europa? Justice White acknowledged that "Europa did, in practical terms, effectively control the board of Burmine".[15] However, he held that the test in section 46 is concerned with legal power and not de facto power. Although Europa effectively controlled the composition of Burmine's board of directors, it had no legally enforceable power to do so. According to White J, a legally enforceable power to control the composition of the board would exist where there was – for example – a provision in the constitution of the subsidiary or an agreement among shareholders conferring such a power on a parent company. He stated that:

> It is not sufficient, in my opinion that, as a matter of commercial practice, possession of a substantial percentage of the shares of a company, being less than 50 per cent, will ordinarily be enough to determine the result of an ordinary resolution at a general meeting of a company.[16]

White J focused on the uncertainty that might be created if Mount Edon's argument were to be accepted:

> If the plaintiff's submissions be right, the legislature must have intended the relationship of holding company and subsidiary to be something entirely uncertain and unascertainable, save at the moment a general meeting is held, whereupon an assessment can be made as to whether a certain body corporate has in fact controlled the composition of the board, at least at that meeting. The fact that at a specific meeting the majority shareholder with the power to control the composition of the board has refrained from attending will mean that, at the time of the meeting, a certain shareholder can be said to control the composition of the board because the directors it puts forward are voted into office and directors to whom it is opposed are either removed or are not voted into office.
>
> At that moment of time, the shareholder constitutes the holding company of the company which becomes its subsidiary. At the next meeting, perhaps called within a short period thereafter by the shareholder with the power to control the board, the directors appointed by the minority shareholder are removed and directors nominated by the majority shareholder are voted into office, over the opposition of the former, temporary, holding company. At that point, the company ceases to be the subsidiary of the minority shareholder. It is difficult to see what useful purpose can be served, in the context of [the definition of subsidiary in the Corporations Law] by so temporary and shifting a relationship.[17]

Burmine and Europa had both publicly acknowledged that Europa was the holding company of Burmine. Yet the court held that this did not satisfy the legal definition of

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13 As it was called at the time.

14 Section 205(1)(b)(ii) was repealed and replaced by a differently worded section as part of the 1 July 1998 changes to the Corporations Law made by the Company Law Review Act 1998. See page 21 below.

15 (1994) 12 ACSR 727 at 741.

16 (1994) 12 ACSR 727 at 748.

17 (1994) 12 ACSR 727 at 747-748.

subsidiary in section 46 of the Corporations Law.[18] It is not surprising, therefore, that the Accounting Standards have been amended to move away from the legal definition of subsidiary contained in section 46. This was done because the legal test had proven too inflexible for indicating when financial statements of entities should be consolidated.[19] One of the shortcomings of the legal definition of subsidiary for the purposes of providing financial information to shareholders of a holding company was that it did not include enterprises which – although controlled by the holding company – were not corporations (such as trusts, partnerships and unincorporated joint ventures). The amended accounting standard, the wording of which is set out on page 2, is broad enough to include these entities.

The current position in Australia is, therefore, that different concepts of control are employed to regulate different aspects of corporate groups and their operations.[20] Indeed, reforms to the Corporations Law over the past six years have utilised a broad definition of control twice and the narrow legal concept of control once:

- the related party provisions, which became effective in February 1993, use the Accounting Standards definition of control;[21]
- section 588V, which deals with insolvent trading in corporate groups, and which took effect in June 1993, uses the narrow legal definition;[22] and
- the provisions restricting cross shareholdings within groups, which initially used the narrow legal definition, were amended recently (effective 1 July 1998) and now use a concept of control that is similar to the Accounting Standards concept.[23]

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[18] Although White J in *Mount Edon* emphasised legal rather than de facto or practical control when interpreting section 46 of the Corporations Law, the meaning of control will vary according to the statutory context. For example, section 57 of the Broadcasting Services Act 1992 (Cth) states that a "foreign person must not be in a position to exercise control of a commercial television broadcasting licence". It has been held that, in this context, the test is one of de facto or practical control rather than legal control: *Canwest Global Communications Corporation v Australian Broadcasting Authority* (1997) 24 ACSR 405 at 435-436 (Federal Court of Australia).

[19] See Ford, Austin and Ramsay (1997) para 4.340. AASB 1024 became effective on 31 December 1991. Before then, consolidation of financial statements was required only for subsidiaries as defined in section 46. For an empirical study of the impact of the introduction of the new regime, see Lambert and Zimmer (1995). For a critique of the effectiveness of the new regime, see Clarke and Dean (1993).

[20] See Edmundson (1997).

[21] See page 26 below.

[22] See pages 27-28 below.

[23] See page 21 below.

IV. Reasons for corporate groups

Reasons why a company expands its business must be distinguished from reasons why that company establishes one or more subsidiaries – although the two may, in some circumstances, be related. For example, when a company expands by entering a new line of business, it may do this by incorporating a subsidiary. However, this will not necessarily be the case.

There are several reasons for company expansion. There may be the possibility of economies of scale in production or distribution, or a reduction in transaction costs. Expansion might also result from the need to obtain access to new markets or supplies, or to eliminate competition. Or it may occur so that managers can increase their personal status and power.[24] Chandler (1990, p 17) observes that, whatever the motivation for expansion:

> The modern industrial enterprise has rarely continued to grow or maintain its competitive position over an extended period of time unless the addition of new [activities] (and to a lesser extent the elimination of old ones) has actually permitted its managerial hierarchy to reduce costs, to improve functional efficiency in marketing and purchasing as well as production, to improve existing products and processes and to develop new ones, and to allocate resources to meet the challenges and opportunities of ever-changing technologies and markets.

Why might a company establish one or more subsidiaries so that its business is conducted through a corporate group rather than through a single company?

First, the company can reduce the exposure of its assets by establishing a subsidiary. The principle of limited liability ensures that – subject to exceptions where the courts or Parliament lift the corporate veil[25] – the assets of the holding company will be protected from any liability incurred by the subsidiary.[26]

Second, the operation of a business through a corporate group rather than a single company can result in lower taxation.[27] One way in which this might be achieved is through entities incorporated in "tax havens". Table 6 shows that the top 20 countries of incorporation of the sample companies' controlled entities included three tax havens:

- British Virgin Islands
- Cayman Islands
- Bermuda

Third, in some countries there can be financial reporting considerations resulting from the fact that the financial statements of subsidiaries do not have to be consolidated with those of the holding company.[28]

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[24] See Chandler (1990) pp 15-17; Fligstein (1990); Strangeland, Daniels and Morck (1995) pp 224-226.
[25] This is discussed at pages 17-20 below.
[26] See LoPucki (1996) pp 20-23.
[27] See Hadden (1992) pp 65-66; Considine (1994) pp 231-232; Landers (1975).
[28] See Gilson (1986) pp 298-299. This is not a consideration in Australia: see page 13 above.

Fourth, a company may want to acquire a business in partnership with another company or an individual. A convenient way of structuring the acquisition is for the respective interests in the new business to be represented by shares. This necessitates the new business being acquired by a purchase of the shares of the company running it rather than by a purchase of the assets of the business. A related point is that it will frequently be preferable to acquire a business by purchasing the shares of the company rather than by purchasing the assets because:

- stamp duty is significantly higher for asset sales than for share sales; and
- the taxation advantage of carrying forward any losses of the acquired company would not be available to an acquirer of its assets.[29]

Fifth, a company may want outside investment in part only of its business. This can be done by incorporating that part of the business as a subsidiary and allowing outsiders to acquire a minority shareholding in the subsidiary. It allows the company to raise additional capital without forfeiting control.

Finally, the establishment of subsidiaries may allow greater flexibility in debt financing.[30]

The increasing influence of corporate groups is not without its problems. Hadden (1992, p 65) identifies six potential problems:

> (i) the techniques of group control, notably those involving interlocking shareholdings and directorships, may be used to entrench the positions of incumbent managers against any possible threat from external shareholders;
> (ii) the techniques of integrated financing, notably the freedom to pass assets and liabilities from company to company within the group, and the creation of complex group structures may be used to conceal the true financial position of individual companies or of the group as a whole from their shareholders or creditors;
> (iii) both techniques may be used to ensure that the interests of shareholders and directors of the group are preferred to those of minority shareholders in subsidiaries and to conceal that this has been done;
> (iv) the techniques of integrated financing may be used to avoid taxation by ensuring that maximum profit is generated in forms or in jurisdictions which attract low levels of tax;
> (v) the creation of separate companies for particular operations, supplemented by the techniques of integrated financing, may be used to avoid liability to external creditors by relying on the limited liability of each constituent company within the group;
> (vi) more or less complex group structures may be used to avoid the impact of regulatory measures on a wide range of matters, such as monopolies and mergers legislation, health and safety provisions, employee participation and planning requirements.[31]

Recent Australian cases have focused on two problems. First, the difficulties created for tort claimants when their injuries are caused by an undercapitalised subsidiary.[32] Second,

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29 See Ford, Austin and Ramsay (1997) para 23.020.
30 See Leebron (1991) p 1614.
31 See also Landers (1975).

the tension between the traditional legal principle that treats each company in a corporate group as a distinct legal entity with its own interests,[33] and commercial reality – which commonly involves participants within a corporate group, and creditors dealing with companies within that group, focusing on group principles rather than individual companies.[34] Should the law extend the rights and duties of a company within a group to reflect the activities of another company within that group? The leading US scholar on corporate groups, Professor Blumberg (1990, p 288), describes this issue as "one of the major problems in corporation law".

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32 *Briggs v James Hardie & Co Pty Ltd* (1989) 7 ACLC 841 (New South Wales Court of Appeal).

33 *Salomon v A Salomon & Co Ltd* [1897] AC 22 (House of Lords); *Walker v Wimborne* (1976) 137 CLR 1 (High Court of Australia).

34 *Qintex Australia Finance Ltd v Schroders Australia Ltd* (1990) 3 ACSR 267 (Supreme Court of New South Wales).

V. Regulatory approaches to corporate groups in Australia

As just highlighted, corporate groups present a number of regulatory challenges. A variety of approaches have been adopted in Australia to the regulation of corporate groups. There has been no systematic reform in this area. Rather, the regulatory approaches must be regarded as piecemeal. The approaches include:

- tightening of financial reporting rules;
- lifting of the corporate veil by courts;
- statutory prohibition of certain cross shareholdings in corporate groups;
- imposition of statutory directors' duties on "shadow directors";
- recognition by the courts of the possibility of a parent company being vicariously liable for wrongs committed by its nominee directors on a subsidiary company's board;
- acknowledgment by the courts and Parliament of the need for a degree of flexibility in the content of directors' duties in a group context;
- use of the oppression provision to remedy abuses in corporate groups;
- increased statutory regulation of financial benefits flowing from public companies to their related parties (including other companies in the corporate group);
- encouragement by the regulator of the use of cross-guarantees; and
- introduction of specific laws dealing with insolvent trading in corporate groups.

The first item on the list – tightening of financial reporting rules – refers to the 1991 change to the Accounting Standards, when a broad definition of control was adopted for the purpose of disclosure of controlled entities and consolidation of financial statements. This was discussed earlier. The remainder of the Report gives an overview of each of the other items on the above list.

A. Lifting of the corporate veil by courts

One way in which limited liability may be denied to the shareholders of a company in a corporate group is when courts decide to lift the corporate veil. The Centre for Corporate Law and Securities Regulation has been conducting a study of Australian cases where an argument has been put to the court that it should lift the corporate veil. A key aim of the study is to see whether any trends can be detected in these cases.[35] Preliminary results are contained in Tables 8 to 12. In total, 55 cases were found in which an argument had been made that the corporate veil should be lifted.[36]

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[35] For a major United States study, see Thompson (1991).

[36] The study involved a search of all Australian state and federal court reported and unreported judgments available on CD Rom using the search terms "corporate veil" and "*Salomon v Salomon*". *Salomon v A Salomon & Co Ltd* [1897] AC 22 (House of Lords) is widely regarded as the leading Anglo-Australian case endorsing the principle of the company as a separate legal entity, with shareholders having limited liability. Cases involving insolvent trading under the statutory provisions of the Corporations Law were excluded from the analysis. Section 588G of the Corporations Law imposes personal liability on a director of a company where:

Table 8 shows that there has been a substantial increase in recent years in the number of cases involving arguments about lifting of the corporate veil. In fact, 31 of the 55 cases have been brought in the 1990s. However, no trend over time is apparent as to whether or not courts are prepared to lift the corporate veil. Tables 9 and 10 indicate that most of the companies in relation to which an argument has been made about lifting the corporate veil have been small proprietary companies.

TABLE 8 AUSTRALIAN COURTS' WILLINGNESS TO LIFT THE CORPORATE VEIL

Time Period	Total No of Cases	Lifted	Not Lifted	Percentage Lifted
Pre 1960s	2	0	2	0
1960s	3	1	2	33.3
1970s	4	1	3	25.0
1980s	15	6	9	40.0
1990s	31	5	26	16.1
Total	55	13	42	23.6

TABLE 9 NATURE OF THE COMPANY SOUGHT TO BE LIFTED: PROPRIETARY VS PUBLIC

Category	Total No of Cases	Lifted	Not Lifted	Percentage Lifted
Proprietary	47	11	36	23.4
Public	8	2	6	25.0

- the company is insolvent when it incurs a debt or becomes insolvent by incurring that debt; and
- at the time there are reasonable grounds for suspecting that the company is insolvent or would become insolvent; and
- the director is aware that at that time there are such grounds for so suspecting or a reasonable person in a like position in a company in the company's circumstances would be so aware.

The reason the insolvent trading cases were excluded from the analysis is that it is clear why the court is lifting the corporate veil in these cases. From 1989 to the end of 1997, there were 63 reported judgments in the *Australian Corporations and Securities Reports* involving section 588G or its predecessor.

TABLE 10 NATURE OF THE COMPANY SOUGHT TO BE LIFTED: NUMBER OF SHAREHOLDERS

Category	Total No of Cases	Lifted	Not Lifted	Percentage Lifted
1 s/h	7	4	3	57.1
2-3 s/h	24	4	20	16.7
>3 s/h, but closely held	4	1	3	25.0
public; *not* closely held	8	2	6	25.0
proprietary; s/h unclear	12	2	10	16.7

TABLE 11 CONTEXT IN WHICH LIFTING ARGUMENT MADE[37]

Context	Total No of Cases	Lifted	Not Lifted	Percentage Lifted
Contract	18	5	13	27.8
Tort	5	2	3	40.0
Criminal	3	0	3	0
Statute	26	6	20	23.1
Procedural/discovery	3	1	2	33.3
Solicitor/client	1	0	1	0

TABLE 12 GROUNDS ADVANCED FOR LIFTING THE VEIL[38]

Grounds	Total No of Cases	Lifted	Not Lifted	Percentage Lifted
Agency	34	8	26	23.5
Fraud	11	2	9	18.2
Group enterprises	18	2	16	11.1
Trust	3	0	3	0
Unfairness/justice	10	5	5	50.0

Table 11 shows that the most common context in which the lifting of the corporate veil argument has been made is a statutory context (26 cases) followed by a contract context (18 cases) and a tort context (5 cases).

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[37] The sum of the total number of cases is 56 because in one case the argument about lifting the corporate veil was made in both a contract and a tort context.

[38] The sum of the total number of cases is more than 55 because in some cases more than one argument was advanced to justify the lifting of the corporate veil.

Table 12 indicates that the most common ground argued in support of lifting the corporate veil was agency (34 cases). The agency ground is of particular relevance to corporate groups. As Ford, Austin and Ramsay (1997, para 4.370) explain, the agency ground is more likely to be made out where the controller of a company is a parent company, and the controlled company is a wholly owned subsidiary, than where the controller is a human.

> [W]here a parent company withholds from the subsidiary company the normal consequences of being a separate legal entity, there is a possibility that the courts will identify it with the controller. This may happen where a parent company forms or acquires a subsidiary ostensibly to do something for which the subsidiary needs a minimum level of resources but the parent does not give it adequate proprietors' capital or loan money, or equip it to run its own business by loan of personnel or other resources or give it a reasonable chance of independently obtaining credit or resources from third persons. In such a case a court may hold that the dominated subsidiary is an agent of the parent or a partner with it.[39]

In *Briggs v James Hardie & Co Pty Ltd*,[40] Justice Rogers suggested that different considerations should apply in deciding whether to lift the corporate veil in tort actions compared to other actions such as contract:

> Generally speaking, a person suffering injury as a result of the tortious act of a corporation has no choice in the selection of the tortfeasor. The victim of the negligent act has no choice as to the corporation which will do him harm. In contrast, a contracting party may readily choose not to enter into a contract with a subsidiary of a wealthy parent. The contracting entity may enquire as to the amount of paid up capital and, generally speaking, as to the capacity of the other party to pay the proposed contract debt and may guard against the possibility that the subsidiary may be unable to pay.[41]

Are Australian courts more willing to lift the veil in actions in negligence? The study showed that in 40 per cent of the tort cases the court was prepared to lift the corporate veil (see Table 11). This was the highest percentage of all categories. However, because there were only five tort cases, the sample is too small to make any meaningful conclusions.

Blumberg (1986, pp 623-626) has demonstrated that a number of the economic justifications for limited liability have either limited application or no application to holding companies and their wholly owned subsidiaries. Are courts more prepared to lift the corporate veil where there is a corporate group? Although further analysis needs to be done to fully answer this question, the preliminary results indicate that the question would be answered in the negative.

B. Prohibition of certain cross shareholdings

Part 2J.2 of the Corporations Law, which became operational on 1 July 1998, effectively prohibits an entity from holding shares in a company that controls it.[42] Part 2J.2 uses a

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[39] Ford, Austin and Ramsay (1997) para 4.370.

[40] (1989) 7 ACLC 841 (New South Wales Court of Appeal).

[41] (1989) 7 ACLC 841 at 863. See also Dye (1972); Halpern, Trebilcock and Turnbull (1980) pp 145-147, 149; Easterbrook and Fischel (1985) p 112.

[42] Section 259B prohibits a company taking security over shares in a company that controls it (subject to exceptions). Under section 259C, the issue or transfer of shares of a company to an entity it controls is void

broad definition of control – similar but not identical to the Accounting Standards definition.[43] This is a significant development because before 1 July 1998 the provisions that Part 2J.2 replaced – former sections 185 and 205(1)(b)(ii) – prohibited a subsidiary from acquiring shares in its holding company. That is, the pre-1 July 1998 provisions relied on the narrow legal definition of control.

The Jenkins Committee (1962, para 151) pointed out that this type of provision serves a two-fold purpose:

> First, the section prevents the directors of a holding company from maintaining themselves indefinitely in office, against the wishes of other shareholders, with the votes of shares held by a subsidiary. Secondly, [the section] operates to prevent the capital of a holding company from being indirectly depleted as a result of the purchase of its shares by its subsidiary.

Before the 1 July 1998 changes, it was possible for a company (A) to hold shares in another company (B), where A was effectively controlled by *but* was not a subsidiary of B, because the old provisions relied on the section 46 (subsidiary/holding company) concept of control. The 1 July 1998 changes stemmed from the recommendation of the (former) Corporations Law Simplification Task Force (1994, p 10) that "the rules should address the commercial reality of control rather than legal technicalities".

C. Imposition of directors' duties on "shadow directors"

Section 60(1)(b) of the Corporations Law defines the term "director" to include a person in accordance with whose directions or instructions the directors of the company are accustomed to act. The everyday term for a person fitting this definition is a "shadow director".[44] Although a company cannot formally be appointed as a director, it is possible for it to be a shadow director. As a result, the duties applying to directors under the Corporations Law – including the officers' duties in section 232 and the duty to prevent insolvent trading in section 588G – will also apply to a company deemed to be a shadow director.

In *Standard Chartered Bank of Australia Ltd v Antico*,[45] Hodgson J had to determine whether a listed company, Pioneer, was a shadow director of another listed company, Giant. The argument that Pioneer was a shadow director of Giant was made as part of a claim by a major creditor of Giant that three actual directors of Giant, plus Pioneer as a shadow director, had allowed Giant to trade while insolvent.[46] Pioneer held, through two wholly

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unless an exception applies or ASIC has exempted the company from the operation of the section. Under section 259D, if a company obtains control, or increases its control, of an entity that holds shares in the company, then within 12 months either the entity must cease to hold shares in the company or the company must cease to control the entity (subject to exceptions).

[43] See Corporations Law, section 259E; Edmundson (1997) pp 273-276.

[44] For analysis of the law of shadow directors, see Carroll (1997); Markovic (1996); Koh (1996).

[45] (1995) 18 ACSR 1 (Supreme Court of New South Wales).

[46] At the time of the case, the duty to prevent insolvent trading was contained in section 556 of the Companies Code. It is now in section 588G of the Corporations Law, which is outlined in footnote 36 above.

owned subsidiaries, 42 per cent of the issued ordinary shares in Giant. Pioneer had 3 nominee directors on the board of Giant out of a total of 11 board members. There were several factors which led Hodgson J to conclude that Pioneer was a shadow director of Giant:

- Pioneer had effective control of Giant by virtue of its 42 per cent shareholding. The only other significant shareholders in Giant held approximately 10 per cent, 6 per cent, 6 per cent and 3 per cent, respectively, of its shares.
- Pioneer exercised management and financial control of Giant and decisions involving the assets of Giant were effectively taken by Pioneer.
- Pioneer imposed on Giant requirements for financial reporting consistent with its own financial reporting requirements.

D. Vicarious liability of parent company for wrongs of nominee directors

In a recent New Zealand case,[47] Thomas J said that in principle it should be possible for a parent company to be held vicariously liable for the wrongful acts (or omissions) of one of its employees serving as a director on the board of a subsidiary. However, Thomas J reluctantly followed a Privy Council decision[48] which denied that a parent company could be vicariously liable for the wrongs of an employee-nominee director. The point has not yet been decided in Australia. However, there are strong policy arguments in favour of allowing the doctrine of vicarious liability to apply in this area.[49]

E. Acknowledgment of need for flexibility in content of directors' duties

Directors' duties are relevant to the regulation of corporate groups.[50] It is a fundamental principle of corporate law that a director must act in good faith in the interests of the company of which he or she is a director.[51] Although each company in a corporate group must be treated as having its own interests, the courts have acknowledged that to some extent directors, when performing their functions, may properly consider the interests of other companies within the corporate group. Different tests have been expressed.

In the English case *Charterbridge Corporation Ltd v Lloyds Bank Ltd*,[52] Pennycuick J had to consider whether directors of a company (C) had acted in the interests of C when they had C guarantee payment of a debt owed to a bank by an associated company. The judge

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47 *Dairy Containers Ltd v NZI Bank Ltd* [1995] 2 NZLR 30 (High Court of New Zealand).

48 *Kuwait Asia Bank EC v National Mutual Life Nominees Ltd* [1991] AC 187 (Privy Council).

49 See Pizer (1997); Thomas (1997). And, as Pizer (1997, pp 81-82) points out, there are other ways in which a parent company may find itself indirectly liable for the wrongdoing of an employee-nominee director: (i) if the nominee director commits a criminal offence, the parent could be held criminally liable for aiding and abetting the offence; (ii) the parent could be held personally liable if it authorised the nominee to commit a tort; and (iii) the parent could also be liable under the accessorial liability rule in *Barnes v Addy* (1874) 9 Ch App 244, if it knowingly or recklessly assisted in or procured a breach of fiduciary duty by the nominee director.

50 See generally, Austin (1993); Yeung (1997).

51 See the discussion in Ford, Austin and Ramsay (1997) paras 8.070-8.160.

52 [1970] Ch 62 (English High Court of Justice, Chancery Division).

found that the directors of C looked to the benefit of the corporate group as a whole and did not give separate consideration to the benefit of C. In this situation, the judge proposed the following test for whether directors have breached their duties:

> The proper test, I think, in the absence of actual separate consideration, must be whether an intelligent and honest [person] in the position of a director of the company concerned, could, in the whole of the existing circumstances, have reasonably believed that the transactions were for the benefit of the company.[53]

The judge held that, on the facts, this test was satisfied and therefore the directors had not breached their duties.

A stricter formulation was adopted by Mason J in the Australian High Court case, *Walker v Wimborne*.[54] Mason J stated that directors of a company which is part of a larger group must adhere to the "fundamental" principle that "each of the companies [is] a separate and independent legal entity, and that it [is] the duty of the directors … to consult its interests and its interests alone in deciding whether payments should be made to other companies".[55] Nevertheless, Mason J accepted that the payment of money by one group company (A) to a downstream group company (B) "to enable company B to carry on its business may have derivative benefits for company A as a shareholder in company B if that company is enabled to trade profitably or realise its assets to advantage".[56]

More recently, Justices Clarke and Cripps of the Court of Appeal of the Supreme Court of New South Wales also expressed "reservations" about the test proposed by Pennycuick J in *Charterbridge*. In *Equiticorp Finance Ltd (in liq) v Bank of New Zealand*,[57] Clarke and Cripps JJA preferred the following approach: Where directors have failed to consider the interests of their company and have instead considered the interests of the corporate group, they should be found to have committed a breach of duty. If, however, the transaction was – when viewed objectively – in the interests of the company, then no consequences would flow from the breach of duty.[58] Nevertheless, Clarke and Cripps JJA applied the *Charterbridge* objective test because all parties in the case advised that that test should be applied in the appeal.[59]

As part of the Federal Government's Corporate Law Economic Reform Program (CLERP), there is a proposal to amend the Corporations Law to expressly allow the directors of a wholly owned subsidiary to act in the best interests of the holding company, even

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53 [1970] Ch 62 at 74.

54 (1976) 137 CLR 1 (High Court of Australia).

55 (1976) 137 CLR 1 at 6-7.

56 (1976) 137 CLR 1 at 6.

57 (1993) 32 NSWLR 50.

58 (1993) 32 NSWLR 50 at 148.

59 (1993) 32 NSWLR 50 at 147-148. The dissenting judge, Kirby P, adopted the approach of Mason J in *Walker v Wimborne*. Hansen J of the Supreme Court of Victoria recently applied the *Charterbridge* test in *Farrow Finance Co Ltd (in liq) v Farrow Properties Pty Ltd (in liq)* (1997) 26 ACSR 544 at 580-585.

though it may not be in the best interests of the subsidiary. Under the proposal, this will be subject to these conditions:

- the constitution of the subsidiary must expressly authorise the director to act in the best interests of the holding company;
- the director must act in good faith in the best interests of the holding company; and
- the subsidiary must not be insolvent at the time the director acts and must not become insolvent because of the director's act.[60]

This draws on a New Zealand precedent.[61] Interestingly, an early CLERP proposal would have extended this provision to the directors of a partially owned subsidiary – subject to the three conditions set out above plus a requirement for prior authorisation by the shareholders of the subsidiary (with no votes being cast in favour of the resolution by the holding company or an associate) (CLERP 1998, p 107).[62]

F. Use of the oppression provision

Section 246AA of the Corporations Law – known as the oppression provision – allows a member of a company or ASIC to obtain relief from the court where:

- the affairs of a company are being conducted in a manner that is oppressive or unfairly prejudicial to, or unfairly discriminatory against, a member or members; or
- an act or omission, or a proposed act or omission, by or on behalf of a company, or a resolution, or a proposed resolution, of a class of members of a company, was or would be oppressive or unfairly prejudicial to, or unfairly discriminatory against, a member or members.

The oppression provision has proved to be the most extensively used and effective remedy available to minority shareholders in Australia. This is in the context of there being relatively little litigation commenced by shareholders in Australia.[63] The type of conduct which has been held to constitute oppression includes:

- improper exclusion from participation in management;
- improper diversion of business;
- payment of excessive remuneration to a company controller;
- failure to prosecute an action;

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60 Corporate Law Economic Reform Bill 1998, section 187.

61 Companies Act 1993 (NZ), section 131(2).

62 The New Zealand provision extends to partially owned subsidiaries in this way: Companies Act 1993 (NZ), section 131(3).

63 In a survey of judgments reported in the *Australian Corporations and Securities Reports* for the period September 1989 to March 1994, there were only 93 reported judgments in which the litigation had been commenced by a shareholder: Ramsay (1995). Of these 93 reported judgments, 25 were actions under the oppression provision. By way of comparison, for the year ending 30 June 1994, the Australian Securities Commission (as it was then called) commenced 107 major criminal prosecutions for alleged breaches of directors' duties; 184 major criminal prosecutions for alleged breaches of statutory provisions other than those dealing with directors' duties; and 79 major civil actions: Ramsay (1995).

- making a share issue with the dominant purpose of reducing a shareholder's proportional stake in the company;
- denial of access to information;
- unlawful divestiture of shares; and
- oppressive conduct of board meetings.[64]

The oppression provision is relevant to corporate groups in two ways. First, where directors of a company take actions which are not in the best interests of that company but are for the benefit of related companies, this has been held to constitute oppressive conduct. The cases involving the Independent Resources group of companies are the best-known examples in this area.[65] In these cases, the directors of group companies improperly channeled the companies' funds to the controlling shareholder in a way that was held to constitute oppression of minority shareholders.

The second way in which the oppression provision is relevant to corporate groups arises in this way: Can a shareholder in one group company claim that he or she is being oppressed because of what is occurring in another group company even though the shareholder is not a member of that other company? The starting point is the words of section 246AA, which refer to the "affairs" of the company being conducted in an oppressive manner. Does the reference to "affairs" of the company refer only to the company of which the plaintiff is a shareholder or does it also include other companies in the corporate group? There is not a clear answer to this question under Australian law. In *Re Dernacourt Investments Pty Ltd*[66] and *Re Norvabron Pty Ltd (No 2)*,[67] it was held that the affairs of a parent company include the business of a subsidiary. However, in *Morgan v 45 Flers Avenue Pty Ltd*,[68] the court was unwilling to construe conduct of a director of a subsidiary as conduct in the affairs of the parent company, despite the parent company having appointed the director.

G. Increased regulation of related party transactions

In 1991, CASAC published a report recommending increased regulation of financial benefits given by public companies to their related parties. The report (CASAC 1991, p 1) stated:

> Following the corporate collapses of the 1980s, it has become evident that some corporate controllers abused their positions of trust by arranging for the shifting of assets around and away from companies and corporate groups, and into their own hands. They achieved this by various means, including

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[64] For a review of the major oppression cases in Australia, see Ford, Austin and Ramsay (1997) para 11.460; Ramsay (1999).

[65] *Re Spargos Mining NL* (1990) 3 ACSR 1 (Supreme Court of Western Australia); *Re Enterprise Gold Mines NL* (1991) 3 ACSR 531 (on appeal: *Jenkins v Enterprise Gold Mines NL* (1992) 6 ACSR 539) (Supreme Court of Western Australia).

[66] (1990) 20 NSWLR 588 (Supreme Court of New South Wales).

[67] (1986) 11 ACLR 279 (Supreme Court of Queensland).

[68] (1986) 10 ACLR 692 (Supreme Court of New South Wales).

> remuneration payments, asset transfers or loan arrangements, on terms highly advantageous to themselves but to the detriment of these companies. In other instances, substantial inter-corporate loans were entered into with the apparent purpose or effect of disguising the true financial position of individual companies within a group. This was made easier by the lack of any general statutory requirement that shareholders either consent to, or be informed of, these transactions. These abuses generally involved significant losses of corporate funds, with adverse affects on investor and creditor returns and confidence. They also brought into question the integrity of Australian financial markets, with detrimental consequences for the national economy.

The reforms were enacted in 1993. Chapter 2E of the Corporations Law now prohibits a public company (or an entity which is controlled by a public company) giving a financial benefit to a related party unless the financial benefit is exempt[69] or is approved by shareholders. A related party includes companies or other entities controlled by directors of the public company. Chapter 2E employs the broad Accounting Standards concept of "control".

H. Regulatory encouragement of cross-guarantees

ASIC has exercised its discretion to exempt certain wholly owned subsidiaries from the financial reporting and audit requirements of the Corporations Law, provided that the holding company and the subsidiaries to which the relief will apply enter into a deed of cross-guarantee.[70] Each of the companies to which the deed applies guarantees payment in full of all the debts of all the companies.[71]

The attraction of not having to prepare, and have audited, separate financial statements for every wholly owned subsidiary has clearly encouraged large corporate groups to make use of cross-guarantees. The empirical study detailed earlier in this Report revealed that almost one in three of the Top 500 companies had taken up this opportunity presented by ASIC. Among the companies in the first quartile, the take-up rate was approaching 50 per cent (see Table 7).

I. Regulation of insolvent trading in groups

Under sections 588V and 588W of the Corporations Law, a liquidator of a subsidiary (as defined in section 46) has power to bring proceedings for compensation against the holding company where:

- the subsidiary was insolvent when it incurred a debt or became insolvent by incurring that debt;
- at the time, there were reasonable grounds for suspecting that the subsidiary was insolvent or would become insolvent;

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[69] Exemptions include financial benefits given to or by a wholly-owned subsidiary of a public company; reasonable remuneration for company officers; and financial benefits given on arm's length terms.

[70] See ASIC Class Order 98/1418 "Wholly-owned entities"; ASIC Pro Forma 24 "Deed of cross guarantee". The holding company must also have prepared consolidated financial statements (whether or not required to do so under the Corporations Law).

[71] For discussion of these cross-guarantees in corporate groups, see Hill (1992, 1995); Dean, Luckett and Houghton (1993); Clarke, Dean and Houghton (1995); Farrar (1998) pp 192-194.

- either:
  - ◊ the holding company (or one or more of its directors) was aware that there were these reasonable grounds for suspecting insolvency; or
  - ◊ having regard to the nature and extent of the holding company's control over the subsidiary's affairs, and to any other relevant circumstances, it is reasonable to expect that a holding company in the holding company's circumstances (or one or more of its directors) would be aware that there were reasonable grounds for suspecting insolvency;
- the person to whom the debt is owed has suffered loss or damage in relation to the debt because of the subsidiary's insolvency; and
- the debt was wholly or partly unsecured when the loss or damage was suffered.[72]

The origin of these provisions is a report of the Australian Law Reform Commission (ALRC 1988). The Commission recommended a broader provision than was eventually enacted. Under the recommendations of the Commission, liability for insolvent trading could attach not just to a holding company but to any related company (ALRC 1988, para 334). The Commission proposed that a court could order a company liable for the debts of a related (insolvent) company if the court determined this to be just. Three criteria to which the court should have regard were proposed:

- the extent to which the related company took part in the management of the insolvent company;
- the conduct of the related company towards creditors of the insolvent company; and
- the extent to which the circumstances that gave rise to the winding up of the insolvent company were attributable to the actions of the related company (ALRC 1988, para 335).

One key point to note about both the Australian Law Reform Commission's proposed provision (which focused on related companies), and the provisions that were enacted (which focus on a holding company and a subsidiary), is that they both rely on the narrow legal definition of control.[73] The opportunity to utilise the broader Accounting Standards definition of control in this area was not taken up.[74]

This Research Report began with a reference to the industrial dispute on the Australian waterfront in 1998. It is appropriate to end on the same note. In May 1998, all Senators other than those of the Liberal and National Parties supported an amendment to the Corporations Law which would have inserted a provision very similar to the one proposed by the Australian Law Reform Commission in 1988.[75] This was done in the context of the

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72 Four defences are set out in section 588X.

73 See the discussion of the terms subsidiary, holding company and related companies, at page 11 above.

74 For criticism of the narrow approach adopted, see Ramsay (1994) pp 543-545.

75 See Hansard, Senate, 22 June 1998, pp 3229-3231.

restructuring of the Patrick group and the related waterfront dispute, and some other cases where employees had suffered after having their employment terminated by an employer company that turned out to be insolvent. The House of Representatives disagreed with the proposed amendment, and in June the matter was referred to the Parliamentary Joint Committee on Corporations and Securities. The Joint Committee's terms of reference include whether corporate and industrial relations law appropriately and adequately deals with:

- "the trend to use shell companies to avoid the normal contractual obligations arising from the employer/employee relationship or with creditors"; and
- "protecting against manipulation of corporate structures to avoid employee rights and entitlements and creditors' rights and entitlements".

This final example illustrates that, despite the range of regulatory approaches already taken to corporate groups in Australia, the topic is as important and controversial as ever and further regulatory reform is likely.

Appendix A
Empirical study: Methodology

1. Sample

- The sample size is 415 companies. The sample companies were all among the Top 500 companies (ranked by market capitalisation) listed on the ASX as at 28 November 1997. The sample of 415 companies was achieved by excluding the 41 overseas-based companies (the majority of which were from New Zealand, Papua New Guinea, Bermuda and the UK) and the 44 listed property trusts that were in the Top 500 at that time, for the reasons set out below.
- The overseas-based companies were excluded because the disclosure rules in other jurisdictions, regarding subsidiaries/controlled entities, are different to the Australian rules.
- Listed property trusts were also excluded from the study. Listed property trusts are not industrial companies. They are unit trusts which own real estate, and which are listed on the ASX so that their units may be traded in the secondary market. Many listed property trusts do not have any controlled entities, and therefore it was considered inappropriate to include them in the study.

2. Date of study

- The data was obtained from 1997 annual reports. In addition to hard copy annual reports, the ASX's *Datadisc* CD-ROM and individual companies' Internet home pages were used. Australian companies have a variety of year-end dates, so it is not possible to give one particular date as the date to which the figures relate. However, a large proportion of the sample companies have a 30 June year-end, so 30 June 1997 is the date in most instances.

3. Notes on methodology

- As mentioned above, the data was obtained from annual reports. The notes to the consolidated financial statements of each Australian company listed on the ASX (and of various other types of Australian companies) must include certain information about each "controlled entity". At the time of the study, the source of this disclosure obligation was (former) section 297(1) of the Corporations Law, (former) regulation 3.6.02 of the Corporations Regulations and (former) Schedule 5, paragraph 38 of the Corporations Regulations. The source is now Accounting Standard AASB 1034 (which uses the term "subsidiary" rather than "controlled entity" – but this is a difference of terminology only because "subsidiary" in the Accounting Standards is defined using the broad control concept contained in AASB 1024). Interestingly, the amount of disclosure required about controlled entities under AASB 1034 is less than under the old regime, because the

Australian Accounting Standards Board believes some of the details to be of limited relevance to users of financial reports.

- Some of the information that was required to be disclosed about each controlled entity, at the time of the study, was:
  - ◊ its name;
  - ◊ its country of formation or incorporation; and
  - ◊ particulars of its relationship with other entities in the group, including the percentage of its shares held by other entities in the group.
- Controlled entities that were listed in the annual report, but which were stated to be in liquidation, were not counted.

Appendix B
Empirical study: Detailed tables

TABLE B1 INDUSTRY TYPE AND NUMBER OF CONTROLLED ENTITIES

Industry	Mkt Cap ($m)	Total CE	100% CE	50-99% CE	<50% CE
Alcohol & Tobacco					
Total	6,790.8	479	458	17	4
Average (mean)	754.5	53.2	50.9	1.9	0.4
Median	189.5	16	14	0	0
Banking & Finance					
Total	88,225.3	966	933	31	2
Average (mean)	5,189.7	56.8	54.9	1.8	0.1
Median	1,331.0	34	33	0	0
Building Materials					
Total	16,293.8	753	653	89	11
Average (mean)	1,163.8	53.8	46.6	6.4	0.8
Median	198.7	22.5	15	0.5	0
Chemicals					
Total	3,768.2	54	38	10	6
Average (mean)	628.0	9	6.3	1.7	1
Median	148.2	8.5	6.5	1	0
Developers & Contractors					
Total	14,485.6	633	584	45	4
Average (mean)	629.8	27.5	25.4	2.0	0.2
Median	112.3	20	20	0	0
Diversified Industrials					
Total	15,447.3	860	741	119	0
Average (mean)	1,029.8	57.3	49.4	7.9	0
Median	622.2	40	38	3	0
Diversified Resources					
Total	40,836.5	523	438	81	4
Average (mean)	8,167.3	104.6	87.6	16.2	0.8
Median	2,721.4	20	16	11	1
Energy					
Total	18,210.2	382	346	36	0
Average (mean)	650.4	13.6	12.4	1.3	0
Median	205.2	8.5	8	0	0
Engineering					
Total	2,778.7	363	306	11	46
Average (mean)	252.6	33	27.8	1	4.2
Median	82.1	16	11	0	0

Food & Household					
Total	14,613.3	468	432	35	1
Average (mean)	1,461.3	46.8	43.2	3.5	0.1
Median	288.2	29	27	0	0
Gold					
Total	7,684.8	596	523	66	7
Average (mean)	156.8	12.2	10.7	1.3	0.1
Median	59.2	4	4	0	0
Healthcare & Biotechnology					
Total	5,554.6	241	223	16	2
Average (mean)	326.7	14.2	13.1	0.9	0.1
Median	206.7	8	7	0	0
Infrastructure & Utilities					
Total	5,585.2	123	115	8	0
Average (mean)	558.5	12.3	11.5	0.8	0
Median	244.7	1.5	1	0	0
Insurance					
Total	11,114.5	386	321	52	13
Average (mean)	1,234.9	42.9	35.7	5.8	1.4
Median	601.5	28	26	2	0
Investment & Financial Services					
Total	9,752.5	421	355	46	20
Average (mean)	212.0	9.2	7.7	1	0.4
Median	82.2	1	0	0	0
Media					
Total	41,141.7	1,275	1,217	56	2
Average (mean)	2,165.4	67.1	64.1	2.9	0.1
Median	359.2	20	19	1	0
Miscellaneous Industrials					
Total	6,468.0	800	696	92	12
Average (mean)	143.7	17.8	15.5	2.0	0.3
Median	93.7	15	10	0	0
Other Metals					
Total	16,299.4	493	435	55	3
Average (mean)	626.9	19.0	16.7	2.1	0.1
Median	212.0	10	9	0	0
Paper & Packaging					
Total	4,683.9	238	193	33	12
Average (mean)	936.8	47.6	38.6	6.6	2.4
Median	139.5	18	18	0	0

Retail					
Total	17,493.4	618	579	36	3
Average (mean)	1,093.3	38.6	36.2	2.3	0.2
Median	153.2	11	9.5	1	0
Telecommunications					
Total	12,437.6	115	79	32	4
Average (mean)	1,776.8	16.4	11.3	4.6	0.6
Median	112.2	15	13	2	0
Tourism & Leisure					
Total	9,007.0	577	552	25	0
Average (mean)	428.9	27.5	26.3	1.2	0
Median	294.8	11	10	0	0
Transport					
Total	12,183.2	415	395	18	2
Average (mean)	1,740.5	59.3	56.4	2.6	0.3
Median	101.4	25	21	1	0

Legend

Mkt Cap	market capitalisation of the sample listed companies
Total CE	total number of controlled entities
100% CE	number of entities in which the listed company has a 100% interest (directly or indirectly)
50-99% CE	number of entities in which the listed company has an interest (directly or indirectly) of at least 50% but less than 100%
<50% CE	number of entities in which the listed company has a controlling interest (directly or indirectly) of less than 50%

TABLE B2 SIZE OF HOLDING COMPANY AND NUMBER OF CONTROLLED ENTITIES

Quartile	Mkt Cap ($m)	Total CE	100% CE	50-99% CE	<50% CE
1st Quartile					
Total	339,064.5	7,533	6,820	644	69
Average (mean)	3,260.2	72.4	65.6	6.2	0.7
Median	1,230.0	48	40.5	2	0
2nd Quartile					
Total	27,653.7	2,115	1,895	187	33
Average (mean)	265.9	20.3	18.2	1.8	0.3
Median	241.8	12	11	0	0
3rd Quartile					
Total	9,947.5	1,243	1,108	84	51
Average (mean)	95.6	12.0	10.7	0.8	0.5
Median	85.4	9	8	0	0
4th Quartile					
Total	4,189.8	888	789	94	5
Average (mean)	40.7	8.6	7.7	0.9	0.05
Median	42	6	6	0	0

Legend

Mkt Cap — market capitalisation of the sample listed companies

Total CE — total number of controlled entities

100% CE — number of entities in which the listed company has a 100% interest (directly or indirectly)

50-99% CE — number of entities in which the listed company has an interest (directly or indirectly) of at least 50% but less than 100%

<50% CE — number of entities in which the listed company has a controlling interest (directly or indirectly) of less than 50%

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