Intra-group financing and enterprise group insolvency: problems, principles and solutions

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Part II

Enterprise Groups: Their Life and Death

2 Phenomenon and Rise of Multinational Enterprise Groups■

2.1 Introduction

This chapter introduces multinational enterprise groups – key actors explored in this book. There are various theories which try to explain the emergence and the continued dominance of corporate groups (network theory, agency theory, etc.). A group structure can be seen as a response to a negative outside environment (e.g. underdeveloped external markets) and as a facilitator of economic growth and wealth accumulation (e.g. improved risk management, lower transaction costs and efficient allocation of resources).[1] This chapter does not aim to discuss all factors that might have contributed to the rise of enterprise groups. Our inquiry is mainly legal and, to some extent, historic and economic.

Section 2.2. examines the emergence of groups of companies as a way of organising and conducting business. It is noted that what is known today as an enterprise group is a relatively recent invention. It should be distinguished from other related but separate phenomena, such as: (i) legal personhood – recognition of a legal personality, separate from its shareholders; (ii) limited liability – protection of shareholders' assets from the claims of the company's creditors; and (iii) entity shielding – protection of the company's assets from the claims of shareholders' creditors. Section 2.3. addresses the definition of an enterprise group and underlines its most common constitutive elements. Section 2.4. investigates different characteristics and types of enterprise groups. Section 2.5. analyses possible reasons why a group structure has become one of the most prevalent forms of a business organ-

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■ This chapter builds upon the following previously published work by the author:
– Kokorin, Contracting Around Insolvency Jurisdiction: Private Ordering in European Insolvency Jurisdiction Rules and Practices, in V. Lazic and S. Stuij (eds), Recasting the Insolvency Regulation: Improvements and Missed Opportunities. Short Studies in Private International Law, Asser Press, 2020, pp. 35-40.

1 For an overview of value-creation-based explanations for the existence of a group organisational form, see L. Enriques and S. Gilotta, The Case Against a Special Regime for Intragroup Transactions, ECGI Law Working Paper No. 641/2022, May 2022, pp. 11-15; G.G. Triantis, Organizations as Internal Capital Markets: The Legal Boundaries of Firms, Collateral, and Trusts in Commercial and Charitable Enterprises, Harvard Law Review, Vol. 117, 2004, p. 1112, observing that "[i]nternal capital markets play a greater role in capital reallocation when external capital markets are less developed and when significant information asymmetry impedes external finance."

isation. This inquiry will touch upon the economic rationale underpinning the existence of enterprise groups and the centrality of limited liability and entity shielding for their operation. This inquiry is important in view of the consequences that limited liability and entity shielding, underpinning asset partitioning, have on the treatment of group entities and their transactions in insolvency. Section 2.6. concludes.

2.2 History and Legal Foundations of Enterprise Groups

It is difficult, and maybe even impossible, to determine the exact date when enterprise groups have come into existence. One can find early precursors or prototypes of business groups in the way the Medici empire was set up in the 15th-16th centuries. The Medici family ruled over Florence from the 1430s to 1530s. Its businesses included banking, textile manufacturing and trade all over Europe. The Medici empire was organised as a system of partnerships, with a senior partnership based in Florence. The senior partnership held a controlling interest in junior partnerships and entered into separate agreements with junior partners who took charge of the local operations and received a share of profits. Commenting on this structure, De Roover wrote: "There are consequently two layers: a controlling partnership – the parent – and several tributary partnerships – the subsidiaries. Only this subspecies prefigures the modern holding company."[2]

However, the Medici enterprise was not a corporate group with separate group companies fully protected by the entity shields. De Roover describes a lawsuit tried before the court in Bruges in 1453.[3] It was brought against the acting manager of the Medici partnership in Bruges for defective packing of nine bales of wool purchased by the plaintiff from the London branch. The plaintiff argued that "the Medici branch in Bruges and the one in London were all one company and had the same master."[4] The court dismissed the claim on the basis that the London partnership should be the first one to take responsibility. Yet the plaintiff's right to sue the Bruges partnership was preserved. This case demonstrated what Hansmann et al. refer to as the "rule of weak entity shielding"[5] and the "location-based entity shielding."[6] Nevertheless, in many aspects (e.g. a common brand, in this case – the good name of the Medici, control from "headquarters"), the partnership-based system resembles present day multinationals.

2 R. De Roover, The rise and decline of the Medici Bank, 1397-1494, HUP, 1963, p. 77.

3 R. De Roover, The Medici Bank: Organization and Management, The Journal of Economic History, Vol. 6, 1946, p. 31.

4 Ibid.

5 H. Hansmann, R. Kraakman and R. Squire, Law and the Rise of the Firm, Harvard Law Review, Vol. 119, 2006, p. 1366.

6 Ibid., p. 1368.

Some authors trace the genesis of modern multinational enterprises to the colonial trading companies of the 17th century – the Dutch East India Company (*Vereenigde Oostindische Compagnie* or VOC) and the English East India Company (EIC).[7] Both companies engaged in long-distance oceanic trade and combined the idea of a separate legal personhood with joint-stock investment financing. Separate legal personality meant that the companies had their own distinct pools of assets and could enter into transactions on their own behalf.[8] They could own land, litigate in court and hold franchises. In addition to legal personhood, these companies manifested a feature of "shareholder lock-in", meaning that shareholders could not redeem their shares (i.e. take out their initial contribution) at any time they wanted. This laid down "the foundation for durable asset pools that could grow and produce wealth indefinitely […]."[9] Still, shareholders could sell their shares on the vibrant secondary market that ensured liquidity for the locked-in capital. The secondary markets in shares were booming.

Notably, separate legal personality and shareholder lock-in did not signal the presence of either limited liability or a group structure. It remains disputable whether early business corporations embraced the concept of limited liability. Gelderblom et al. argue that the VOC had transferable shares and limited liability for shareholders from the outset.[10] Harris challenges this view and emphasises that the Dutch East India Company had

7 A.M. Carlos and S. Nicholas, "Giants of an Earlier Capitalism": The Chartered Trading Companies as Modern Multinationals, The Business History Review, Vol. 62, 1988, pp. 398-419.

8 The corporate form was originally, up until the 16th century, employed for public and semi-public purposes (e.g. municipalities, monasteries) and only a partnership served as a viable form for organising business affairs. R. Harris, Industrializing English Law: Entrepreneurship and Business Organization, 1720–1844, CUP, 2000, p. 21. See also D. Graeber, Debt: The First 5,000 Years, Melville House Publishing, 2011, p. 304, noting that the "legal idea of a corporation as a "fictive" person […] was first established in canon law by Pope Innocent IV in 1250 AD, and one of the first kinds of entities it applied to were monasteries – as also to universities, churches, municipalities, and guilds."

9 K. Pistor, The Code of Capital: How the Law Creates Wealth and Inequality, Princeton University Press, 2019, p. 66. The lock-in capital feature was first applied in the VOC and only later in the EIC. This is believed to be one of the reasons why the VOC outperformed the EIC for a number of decades. See G. Dari-Mattiacci, O. Gelderblom, J. Jonker, E.C. Perotti, The Emergence of the Corporate Form, The Journal of Law, Economics, and Organization, Vol. 33, 2017, p. 196.

10 O. Gelderblom, A. de Jong and J. Jonker, The Formative Years of the Modern Corporation: The Dutch East India Company VOC, 1602–1623, The Journal of Economic History, Vol. 73, 2013, p. 1051; M. Prak and J.L. van Zanden, Pioneers of Capitalism, Princeton University Press, 2022, p. 122, claiming that the VOC "exemplified the new capitalism that was taking shape around 1600. […] For the first time, we see the limited liability company emerging as a new business entity, the trading of company shares, speculation in these shares on a stock exchange, conflicts between shareholders and management over the policy of the new company – all rooted in the "modern" separation between ownership and management of a company."

two classes of shareholders – passive shareholders (*participanten*) and active shareholders (*bewindhebbers*). According to Harris, while the liability regime of the former was not defined in the charter or elsewhere, the latter assumed personal liability.[11] There is no need to take sides in this debate. What is more crucial is to point out that even though the early inter-continental trading companies had complex governance structures, they were hardly groups of companies in the modern sense. Instead, most shareholders were merchants and regular citizens.[12] The recognition of a company as a legal person with transferable shares, being the foundation of "entity law", was not necessarily the foundation of "group law".

The emergence of conglomerates of companies linked through control or significant ownership – enterprise groups – comes after the recognition of legal personhood and after the crystallisation, if not the universal acceptance, of the idea of limited liability.[13] Many historians and economists consider that modern multinational enterprises developed in the mid- to late 19th century.[14] This period was characterised by the advent of new industrial technologies, improvements in manufacturing and management

11 R. Harris, A new understanding of the history of limited liability: an invitation for theoretical reframing, Journal of Institutional Economics, Vol. 16, 2020, p. 646. Harris describes three historical periods in the formation of limited liability and states that limited liability, in the present-day sense, became a uniform attribute of corporations only in the 20th century. He attributes this development to the establishment of corporate insolvency and liquidation procedures and the proliferation of debt finance. Interestingly, Harris notes that limited liability was not a prerequisite for economic growth and the expansion of large businesses in the modern period of history.

12 P. Frentrop, The Dutch East India Company: the first corporate governance debacle, in T. Clarke, J. O'Brien and C.R.T. O'Kelley (eds), The Oxford Handbook of the Corporation, OUP, 2019, pp. 51-74.

13 For the history of limited liability, see S.M. Bainbridge, M.T. Henderson, Limited Liability: A Legal and Economic Analysis, Edward Elgar Publishing, 2016, observing that limited liability has ancient roots (the Roman legal device *peculium*), that it surfaced in the Middle Ages in the form of *commenda*, where passive investors enjoyed limited liability, and that it became more institutionalised in the 19th century (e.g. *société anonyme* under the Napoleonic *Code de Commerce* of 1807; the UK's Limited Liability Act of 1855 and the Joint Stock Companies Act of 1856; New York Act of 22 March 1811).

14 M. Wilkins, The History of the Multinational Enterprise, in A.M. Rugman (ed), The Oxford Handbook of International Business, 2nd edn, OUP, 2009, p. 16, arguing that the modern multinational firm is a "post-industrial revolution phenomenon" and that "[o]nly with steamships, railroads, and cables was it possible for managers to exercise control over business operations across borders in a meaningful manner." Also M. Wilkins, The Emergence of Multinational Enterprise: American Business Abroad from the Colonial Era to 1914, HUP, 1970; L. Franko, The European Multinationals: A Renewed Challenge to American and British Big Business, Harper and Row, 1976. For a comprehensive study of business groups in the developed economies of the West, see A.M. Colpan and T. Hikino (eds), Business Groups in the West: Origins, Evolution, and Resilience, OUP, 2018, p. 3, observing that "[b]usiness groups actually rose to function as a critical factor of industrial dynamics in the context of the Second Industrial Revolution in the late nineteenth century."

processes, and the international division of production. It was also when corporate laws of a number of jurisdictions were liberalised. One of the key characteristics of this process concerned the right of legal persons (companies) to own shares in other legal persons, without which multi-layered group structures could not have come into existence.

For contemporary lawyers, it may seem self-evident that companies can create other companies, acquire and own shares in them. However, it has not always been the case. Describing the American experience, Blumberg observes that "[i]n the absence of an express provision in the statute or charter, it was settled that acquisition by one corporation of another corporation's shares was *ultra vires*."[15] In the USA, New Jersey was one of the first states to amend its corporation laws in 1888-1893 to provide for corporate ownership of shares. Other states followed suit, although by 1910 only thirteen of them had similar laws.[16] Gradually, intercorporate stockholding became widely recognised. This gave rise to groups of companies that expanded their operations nationally and internationally.[17] Most of these groups had a pyramidal structure. The building of corporate pyramids was driven by the policy of the states, many of which required local chartering of regulated industries, including insurance, banking and utility companies. The incorporation of local subsidiaries was a pathway to circumvent the states' protectionist requirements.[18]

Corporate ownership of shares in another company was a late arrival in the UK too. Historically, it was believed that a company, being an artificial person, lacked the legal capacity to own shares. The change occurred in the mid-19th century, when the power of intercompany stock ownership was attributed to the provisions of memoranda of association, notwithstanding the omission of the express recognition of such power in incorporation statutes. English courts held in the 1860s that neither the common law nor the Companies Act of 1862 prohibited companies from acquiring and owning shares in other companies, should the memorandum of association so prescribe.[19] That being said, it was not until the 1890s that corporate groups

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15 P. Blumberg, Limited Liability and Corporate Groups, The Journal of Corporation Law, Vol. 11, 1986, p. 606. Note that such special legislative enactment or charter provision was virtually never granted to manufacturing companies.

16 F. Freedland, History of Holding Company Legislation in New York State: Some Doubts as to the "New Jersey First" Tradition, Fordham Law Review, Vol. 24, 1955, pp. 369-411.

17 M.J. Roe, Corporate Strategic Reaction to Mass Tort, Virginia Law Review, Vol. 72, 1986, p. 47, arguing that "[a]uthority to own subsidiaries was a device to facilitate molding the disparate local companies into a nationwide enterprise."

18 M. Pargendler, The Grip of Nationalism on Corporate Law, Indiana Law Journal, Vol. 95, 2020, p. 566.

19 *In re Barned's Banking Company* (1867) 3 LR Ch 105, 112-13; R*e Asiatic Banking Corporation* (1868-69) LR 4 Ch App 252 at 257; *The Gramophone and Typewriter Ltd v. Stanley* [1908] 2 KB 89, affd *The Gramophone and Typewriter Ltd v. Stanley* [1906] 2 KB 856. C. Witting, Liability of Corporate Groups and Networks, CUP, 2018, pp. 65-66.

began to take shape in the UK. This development was largely linked to the merger activity aimed at the reduction of competition and price increase. Unlike their US counterparts, these early groups were "more in the nature of loose federations than integrated corporations".[20] It was the 1920s-1930s when corporate groups entered "the conscious jurisprudence of UK company law."[21]

As to continental Europe, there seems to have been no general prohibition of intercorporate stockholding. As a result, various group structures took shape.[22] Commenting on the German experience, Van Oostrum notes that the growing economic concentration and power of group enterprises in the mid- and late 19th century prompted the crystallisation of group law.[23] A group structure was utilised by Siemens, Europe's primary producer of telegraphic equipment, which diversified its production by setting up subsidiaries for different lines of business (e.g. electro-chemicals, telephone equipment, fertilizers) and building joint ventures like Telefunken, created to develop wireless telegraphy.[24] However, the proliferation of group structures in Germany only occurred in the 1920s, during the period of the Weimar Republic. At that time, the number of stock corporations (AGs) rose explosively, indicating an increase in the number of corporate groups.[25] Kuntz confirms that corporations actively invested in shares, "building groups or at least holdings of large blocks of stock."[26] The first definition of a group in German company law appeared in 1937,[27] while the standalone regulation of groups – the well-known *Konzernrecht* – was introduced in 1965.[28]

20 P. Lipton, The Mythology of Salomon's Case and the Law Dealing with the Tort Liabilities of Corporate Groups: An Historical Perspective, Monash University Law Review, Vol. 40, 2014, p. 475.

21 I. Mevorach, Insolvency within Multinational Enterprise Groups, OUP, 2009, p. 11, referring to T. Hadden, Inside Corporate Groups, International Journal of the Sociology of Law, Vol. 12, 1984, pp. 271-286.

22 T. Hadden, Regulating Corporate Groups: An International Perspective, in J. McCahery, S. Picciotto and C. Scott (eds), Corporate Control and Accountability, Oxford: Clarendon Press, 1993, p. 343 and pp. 350-351.

23 C.H.A. van Oostrum, Regres bij concernfinanciering (Serie Van der Heijden Instituut nr. 156) (diss. Leiden), Deventer: Wolters Kluwer, 2019, p. 232.

24 A.D. Chandler, Scale and Scope: The Dynamics of Industrial Capitalism, HUP, 1994, p. 466.

25 F. Hoffmann, Konzernhandbuch, Wiesbaden: Gabler, 1993, p. 61.

26 T. Kuntz, German corporate law in the 20th century, in H. Wells (ed), Research Handbook on the History of Corporate and Company Law, Edward Elgar Publishing, 2018, p. 207.

27 *Gesetz über Aktiengesellschaften und Kommanditgesellschaften auf Aktien*, 1937, § 15(1).

28 The adoption of the Stock Corporation Act (*Aktiengesetz*), dealing with stock corporations (*Aktiengesellschaft*). A. Scheuch, *Konzernrecht*: An Overview of the German Regulation of Corporate Groups and Resulting Liability Issues, European Company Law, Vol. 13, 2016, pp. 191-198.

The industrial revolution prompted the development of enterprise groups in the Netherlands. While some business groups trace their origin to the late 19th century, at that time, the majority of companies remained small-scale and family-owned.[29] The early 20th century saw a spike in the merger activity, giving rise to famous names. For example, in 1929, Dutch Margarine Union merged with the British soap manufacturer Lever Company to form Unilever Group (Unilever). Until 2020, Unilever had a dual-parent holding company structure with Unilever PLC (the UK) and Unilever N.V. (the Netherlands).[30] In 1890, a number of Dutch entrepreneurs founded the Royal Dutch Petroleum Company, which focused on the sale of petroleum in East Asian markets. This company merged with British Shell Transport and Trading Company Limited in 1907 – a move dictated by competition with American Standard Oil. Until recently, Shell had a dual nationality and organisational structure. In 2005, its shareholders supported the unification of Shell's Dutch and UK parent companies under a single parent company, Royal Dutch Shell plc.

The history of enterprise groups is closely interwoven with economic and political history.[31] This is because group operations are often international and dependent on political processes. They are also affected by technological inventions and market developments. The rise of modern groups in Europe and the USA dates back to the late 19th and the beginning of the 20th century. This was the time of the expansion of foreign direct investment and the establishment of cross-border operations. The technological progress, including the invention of telegraph and telephone, promoted the integration and centralisation of group structures.[32] Skeel notes that America's first

29 For a study of Dutch business groups in 1903-2003, see F. De Goey and A. De Jong, The Netherlands: The Overlooked Variety of Big Businesses, in A.M. Colpan, T. Hikino (eds), Business Groups in the West: Origins, Evolution, and Resilience, OUP, 2018, pp. 165-192.

30 For background and reasons for the unification, see Form F-3 Registration Statement under the Securities Act of 1933 <https://www.sec.gov/Archives/edgar/data/110390/000110465920094571/tm2027199-1_f3asr.htm> (accessed 15 July 2023).

31 For a study of multinational enterprises, see P. Muchlinski, Multinational Enterprises and the Law, 2nd edn, OUP, 2007 and P. Muchlinski, Multinational Enterprises and the Law, 3d edn, OUP, 2021. Note that the term "multinational enterprise" as used by Muchlinski, is broad and does not entail a specific form of a corporate structure or the juridical form of an enterprise. This is why it should be distinguished from an enterprise group – a term that implies a certain pattern of ownership and control.

32 Before the 19th century, enterprises were largely organisationally decentralised. This was the case of the EIC, whose multi-divisional nature – a separation of powers between the board of directors and relatively independent overseas managers (factors), was highlighted in a number of studies. See E. Erikson, Between Monopoly and Free Trade: The English East India Company, Princeton University Press, 2014; G.M. Anderson, R.E. McCormick, R.D. Tollison, The economic organisation of the English East India Company, Journal of Economic Behavior and Organization, Vol. 4, 1983, p. 226, noting that the "Central Office was too far removed from the Indies to do much more than endorse decisions already made by its chief factors or to sanction decisions of which it disapproved."

large-scale business enterprises, the railroads, brought many units carrying on different types of economic activities under their control and adopted hierarchical business structures, "with a class of middle managers between the railroad's workers and its executive officers."[33] Hadfield describes this "old" economy as the "economy of consolidation and vertical integration, the absorption of economic activity in entire industries within the walls of a handful of, maybe even a single, corporation."[34] According to Hadfield, this is the "world of General Motors, U.S. Steel, AT&T, and, eventually, IBM."[35]

The 1990s witnessed the deepening of global production and supply chains, a shift from raw materials and manufacturing towards the service economy and liberalisation of trade and investment regimes. Interestingly, unlike the technological advancements of the 19th century, the current technological progress pulls in the opposite direction by instilling decentralisation.[36] The ease with which information is accessed and disseminated across the globe simplifies access to corporate decision-making and corporate ownership. Another "decentralising" factor arises from the operation of platform-based businesses and their asset base. Baird points out that, "[f]ew businesses today center around specialized long-lived assets. In a service-oriented economy, the assets walk out the door at 5:00 pm."[37] One might argue that "assets-light" and platform-based businesses have fewer incentives to adopt hierarchical or pyramidal corporate structures that have prevailed over the 20th century. Decentralisation is further promoted by the advent of distributed ledger technology, including blockchain, which empowers the creation of decentralised autonomous organisations (DAOs).[38] This may boost new models of industrial and legal organisation.

33 D.A. Skeel, Icarus in the Boardroom: The Fundamental Flaws in Corporate America and Where They Came From, OUP, 2005, p. 25.

34 G. Hadfield, Legal Infrastructure and the New Economy, I/S: A Journal of Law and Policy for the Information Society, Vol. 8, 2012, p. 12.

35 Ibid.

36 M.J. Roe, Three Ages of Bankruptcy, Harvard Business Law Review, Vol. 7, 2017, p. 215, suggesting that while collective bankruptcy proceedings are needed for industries comprised of big, vertically integrated firms, they may lose appeal in the case of decentralised organisational structures.

37 D.G. Baird, The New Face of Chapter 11, American Bankruptcy Institute Law Review, Vol. 12, 2004, p. 82.

38 See I. Kokorin, Contracting Around Insolvency Jurisdiction: Private Ordering in European Insolvency Jurisdiction Rules and Practices, in V. Lazic and S. Stuij (eds.), Recasting the Insolvency Regulation: Improvements and Missed Opportunities. Short Studies in Private International Law, Asser Press, 2020, pp. 35-40. For rather sceptical views on whether blockchain is capable of transforming the corporate form, see K.F.K. Low, E. Schuster and W.Y. Wan, The Company and Blockchain Technology, LSE Legal Studies Working Paper No. 18/2022, 29 October 2022 <https://ssrn.com/abstract=4258114> (accessed 15 July 2023).

2.3 Defining an Enterprise Group

Despite the proliferation of multinational enterprise groups and the significant economic power they hold nowadays, there is no universal legal definition of an enterprise group.[39]

For instance, Dutch law adopts the approach that embraces the economic reality of groups of companies. Under the Dutch Civil Code (*Burgerlijk Wetboek* or BW), a group is defined as "an economic unit in which legal persons and partnerships are organisationally interconnected."[40] It specifies that group entities are legal persons and partnerships connected to each other in one group.[41] From the definition of a group, we can conclude that two criteria are of relevance: (i) economic unity, and (ii) organisational connection.

"Economic unity" entails an economic bond between companies within the group. This may be observed in external communication, joint reporting, consolidated annual accounts, a common financial and economic policy, intra-group financing, a 403-statement (section 6.5.2.3.3.) and the dependence of group entities on each other. These characteristics serve as points of reference, and their absence does not necessarily mean that there is no economic unit.[42] "Organisational connection" indicates a certain degree of integration within the group structure. This integration could take various forms and degrees, and may arise from capital participation, membership rights or an agreement that makes it possible to exercise control rights.

From legislative history, the third element can be deduced, that is (iii) centralised management (*centrale leiding*).[43] In practice, there can be varying degrees of such centralised direction and autonomy of individual group companies. Yet this element suggests the existence of some central decision-making on a joint strategy and hierarchy between group members, making

39 On the problem of defining a corporate group, see S. Pepels, Defining groups of companies under the European Insolvency Regulation (recast): on the scope of EU group insolvency law, International Insolvency Review, Vol. 30, 2021, pp. 96-123.

40 Dutch Civil Code, Article 2:24b.

41 Ibid. Foreign legal entities can also form part of a group.

42 J. van der Kraan, Toepassing en rechtskarakter van de groepsvrijstelling van artikel 2:403 BW (Serie Van der Heijden Instituut nr. 171), Deventer: Wolters Kluwer 2022, 3.3.2.

43 *Kamerstukken II* 1979/80, 16 326, nr. 3, MvT, p. 42, noting that the bond between group members would usually find expression in capital participation, "in view of the control required to act as a unit, this participation will generally be a – direct or indirect – majority shareholding; 50% and minority shareholdings will only lead to group membership if the shareholding is reinforced with special rights, otherwise the participating company will not be able to continue its leadership with a decisive vote." *Kamerstukken II* 1987/88 19 813, nr. 5, MvA, punt 14, zie voorts art. 2:406, aant. 2.1. Since 2005, the concept of central management can be found in a closely related provision concerning consolidated annual accounts (Article 2:406 BW).

it possible to implement a common group strategy.[44] A necessary complement of, but not the only requirement for, central management is that it must be able to be "imposed", if necessary, against the will of the directors of subordinate companies.[45]

There is a connection between these three criteria. After all, economic unity presupposes a certain organisational connection that is established under central leadership.[46] This is why it is argued that companies connected through a franchise agreement may not constitute a group, since both central management and economic unity could be weak or absent. In most cases, the franchisor is not responsible for and does not take a share in the business of his franchisees.[47] Equally, a pure investment company that holds shares in another company may not be associated with that company in a group, because the element of central management (planning, coordination and control of the policy of subsidiaries) might be missing.[48]

The German Stock Corporation Act (*Aktiengesetz* or AktG) provides that "where a controlling enterprise and one or several controlled enterprises are combined under the common management of the controlling enterprise, they form a group."[49] The key element defining a group is therefore control, which is manifested in the ability to "directly or indirectly exert controlling influence."[50] Control exists if group members have entered into a control agreement (*Beherrschungsvertrag*) and is presumed if one legal entity holds the majority stake in another legal entity.[51] This is a situation of a vertical group, structured in a pyramidal hierarchical form. This group type is reflected in the definition of a corporate group given by Blumberg, according to which a group is an enterprise "organized in the form of a dominant

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44 Asser/Kroeze 2-I 2021/261.
45 Ibid.
46 M. Olaerts, GS Rechtspersonen, commentaar op art. 2:24b BW.
47 S. Bartman, A. Dorresteijn & M. Olaerts, Van het Concern, Wolters Kluwer, 2020, 2.2.1.
48 Asser/Maeijer, Van Solinge & Nieuwe Weme 2-II* 2009/816.
49 Stock Corporation Act of 6 September 1965 (Federal Law Gazette I, p. 1089), § 18.
50 AktG, §17(1). The Federal Court of Justice (*Bundesgerichtshof* or BGH) emphasised that "controlling influence" should at least in part be conveyed by means of company law and not solely through economic links. BGH, Urteil vom 26-03-1984 - II ZR 171/83. On the regulation of corporate groups in German law, see A. Cahn and D.C. Donald, Comparative Company Law: Text and Cases on the Laws Governing Corporations in Germany, the UK and the USA, 2nd edn, CUP, 2018, pp. 834-840. The ability to exercise the dominant influence over another undertaking characterises a parent undertaking for the purposes of prudential supervision and accounting under EU banking legislation. See e.g. Article 4(15) of the Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms.
51 AktG, §17(2). Also, A. Scheuch, Konzernrecht: An Overview of the German Regulation of Corporate Groups and Resulting Liability Issues, European Company Law, Vol. 13, 2016, pp. 191-198.

parent corporation with scores or hundreds of subservient sub-holding, subsidiary, and affiliated companies."[52] The AktG also states that if "legally separate enterprises are subject to common direction, although none of such enterprises controls the other, such enterprises shall constitute a group and the individual enterprises shall constitute members of such group."[53] This is the case of a horizontal or heterarchical group, in which legal entities could enjoy more autonomy, and the group as a whole may operate in a more decentralised way.[54]

The UK's Companies Act 2006 recognises two main types of corporate groups: (i) parent and subsidiary undertakings, relevant primarily for accounting purposes, and (ii) a holding company and its subsidiaries, used in other statutory contexts. For the first type, the law obliges parent companies, incorporated in the UK (with certain exceptions), to produce annual consolidated group accounts.[55] These group accounts should encompass subsidiary undertakings and give creditors and shareholders a clear picture of the group's performance. An undertaking is considered a parent undertaking if it holds a majority of voting rights in another undertaking (subsidiary), has a participating interest in that undertaking, and can appoint or remove the majority of its board members. Also, a parent and subsidiary undertaking relationship exists where a parent undertaking has the right to exercise dominant influence over the subsidiary, either by virtue of the provisions contained in the undertaking's articles or through a control contract (legal control),[56] or where it has the power to exercise or actually exercises dominant influence over a subsidiary (factual control).[57]

Outside the accounting context – for general purposes – the "scope" of a group may often be relevant as well. For example, under English law, a subsidiary is prohibited from holding shares in its parent (holding) company.[58] Determination of a group can also be important in calculating various types of tax liability and even for commercial contractual construction.[59] The

52 P. Blumberg, The Transformation of Modern Corporation Law: The Law of Corporate Groups, Connecticut Law Review, Vol. 37, 2005, p. 606, noting that group enterprises "typically conduct a single integrated enterprise under common control and often under a common public persona."

53 AktG, §18(2).

54 I. Mevorach, Insolvency within Multinational Enterprise Groups, OUP, 2009, p. 19.

55 Companies Act 2006, sections 399-402.

56 Companies Act 2006, section 1162(1), (2), (3). A control contract functions like German *Beherrschungsvertrag*.

57 Companies Act 2006, section 1162(4).

58 Companies Act 2006, section 136.

59 *Enviroco Ltd v. Farstad Supply A/S* [2011] 1 WLR 921. The case concerned interpretation of an indemnity clause, which covered "affiliates", being defined by reference to a "subsidiary" under the Companies Act 1985.

definition applicable for non-accounting purposes is largely similar (e.g. majority of voting rights, right to appoint or remove a majority of the board of directors),[60] but seems to be narrower. This is because the tests for the existence of a corporate group based on legal and factual control do not apply with respect to the second type of corporate groups.[61]

So far, our overview of laws addressing the concept of a group has touched upon commercial, company, or accounting legislation. The definition of an enterprise group can also be found in insolvency-specific rules, even though these rules are rare. The EIR Recast defines a "group of companies" as a "parent undertaking and all its subsidiary undertakings."[62] The "parent undertaking" means "an undertaking which controls, either directly or indirectly, one or more subsidiary undertakings."[63] In a similar, inclusive manner, the BRRD and the SRMR define a group as a "parent undertaking and its subsidiaries."[64] The MLEGI refers to "two or more enterprises that are interconnected by control or significant ownership,"[65] with control being the "capacity to determine, directly or indirectly the operating and financial policies of an enterprise."[66]

In sum, a "group" does not have a single definition and may even be defined differently in the same jurisdiction, depending on the purpose and relevant area of regulation (tax, accounting, competition, company, insolvency). That said, control and share ownership often determine the existence of a corporate group. However, the degree of autonomy within an enterprise and the strength and significance of centralised direction or a group-wide strategy may vary from one group to another. Limiting the definition of an enterprise group to a particular degree of control or stock holding, whether direct or indirect, of a specified percentage of capital or votes may be counterproductive. It inevitably creates a mismatch between law and economic reality, allows some groups to avoid legal consequences, and deprives other groups of many benefits and tools, available under

60 Companies Act 2006, section 1159.
61 E. Ferran, L.C. Ho, Principles of Corporate Finance Law, 2nd edn, OUP, 2014, p. 26; R. Valsan, National Report on the United Kingdom, in R.M. Manóvil (ed), Groups of Companies: A Comparative Law Overview, Springer, 2020, p. 631.
62 EIR Recast, Article 2(13).
63 EIR Recast, Article 2(14).
64 BRRD, Article 2(26); Regulation (EU) No 806/2014 of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund (SRMR), Article 3(23).
65 MLEGI, Article 2(b).
66 MLEGI, Article 2(c). Definitions of an "enterprise group" and "control" are derived from the UNCITRAL Legislative Guide, Part three.

insolvency law.[67] A more inclusive approach is therefore appropriate. The adoption of this approach does not mean that all groups should be treated in the same way. Quite the opposite.

2.4 Characteristics and Types of Enterprise Groups

Enterprise groups are distinct from each other.[68] Group structures have different shapes and sizes, ranging from colossal worldwide-operating multinationals, such as Lehman Brothers, Nortel Network, Royal Dutch Shell and Unilever, to groups consisting of a parent company and one subsidiary, incorporated and operating in the same country. Enterprise groups diverge in terms of their corporate and operational structures, ways of group financing, management and ownership. They may consist of complex networks of wholly or partly owned subsidiaries, sub-subsidiaries and companies not linked by equity ownership but still closely related to or dependent on the business of an enterprise group (e.g. suppliers, distributors, franchisees).

Mevorach developed a comprehensive typology of multinational enterprise groups, depending on the degree of their integration/interdependence – to what extent the group operates as a single economic unity, and the level of control – how centralised or decentralised control and decision-making is.[69] In terms of integration, a distinction is made between business integration, asset integration and no integration. As for patterns of control, group entities may be centrally controlled from a single or multiple "heads" (centralised group),[70] enjoy certain autonomy but still be subject to direction or supervision by the parent company (decentralised group), or even lack a common head office (heterarchical group).

67 Mevorach points out that "narrowing the meaning of the term MEG *a priori* could be detrimental to a meaningful approach to [insolvencies within MEGs]." See I. Mevorach, Insolvency within Multinational Enterprise Groups, OUP, 2009, p. 24.

68 For the discussion of different types of groups (e.g. "hierarchy type", comprising diversified business groups and pyramidal business groups vs. "network-type" business groups, wherein individual entities maintain autonomy regarding strategic and budgetary decisions), see A.M. Colpan and T. Hikino (eds), Business Groups in the West: Origins, Evolution, and Resilience, OUP, 2018.

69 I. Mevorach, Insolvency within Multinational Enterprise Groups, OUP, 2009, pp. 135-47.

70 A good example of a corporate group with multiple parent companies was Unilever. Since its formation in 1930, Unilever was owned through two separately listed companies, Unilever PLC (UK) and Unilever NV (NL). It was agreed that the two holding companies would seek to operate as a single company, both administratively and economically. This was made possible over the years by a number of agreements entered into between the entities (Foundation Agreements) and by special provisions in their articles of association. The NV and PLC had the same directors and applied the same accounting policies. R. Abma, De mislukte unificatie van Unilever, Maandblad voor Ondernemingsrecht, n. 1-2, 2019, pp. 40-48. In 2020, Unilever unified its group legal structure under a single parent company, Unilever PLC.

Some group enterprises are notable for running a single business. It is observed that a typical group "is a single business firm organized as a collection of legal entities."[71] The degree of integration can be determined by reference to a wide variety of factors, reflecting the economic structure of the group (e.g. centralised administration of resources and intensity of intra-group transactions, handling of personnel), management of marketing (e.g. common trademarks and logos) and public image.[72] Integrated groups may have a vertical hierarchical structure, where a parent company owns, controls and directs its subsidiaries.[73] Such pyramid-like groups are typical for some European jurisdictions, such as Germany and Italy.[74] They also prevail among large US banks.[75]

Other groups consist of relatively self-sustaining, loosely connected business units, which are responsible for separate product or industry lines and can survive on their own. Some banking groups have chosen a decentralised corporate structure, organised according to a business segment, geographical presence, or functions. A good example is HSBC, the largest UK bank. It is composed of separate Operating Banks active in different geographical markets. Notably, the critical shared infrastructure, services and systems are moved into a bankruptcy-remote group of separately capitalised non-bank service companies. This division is made to reduce operational dependencies across critical functions, jurisdictions and legal entities.

The separability embedded within the structure of HSBC Group corresponds to the chosen resolution strategy, the multiple point of entry (MPOE) model, that entails "resolution of regional or national groups of affiliated companies",[76] as opposed to a resolution at a holding company level. This demonstrates how a regulatory (resolution) model affects the way a banking group is internally organised, and the other way round.

71 H. Hansmann and R. Squire, External and Internal Asset Partitioning: Corporations and Their Subsidiaries, in J.N. Gordon, W-G. Ringe (eds), The Oxford Handbook of Corporate Law and Governance, OUP, 2018, p. 262.

72 UNCITRAL Legislative Guide, Part three, Ch. I, para. 15.

73 Note that business integration and control patterns within a group do not always correlate in a specific way. Thus, centralised control does not necessarily lead to high business integration.

74 K.J. Hopt, Groups of companies: A Comparative Study of the Economics, Law, and Regulation of Corporate Groups, in J.N. Gordon, W-G. Ringe (eds), The Oxford Handbook of Corporate Law and Governance, OUP, 2018, p. 604.

75 J.N. Gordon, W-G. Ringe, Bank Resolution in the European Banking Union: A Transatlantic Perspective on What it Would Take, Columbia Law Review, Vol. 115, 2015, pp.1297-1370.

76 HSBC Holdings plc, SIFI Plan, Public Section, 17 December 2021, p. 2, noting that HSBC considered switching to a single point of entry (SPOE) model, but concluded that the MPOE is a preferred model, because it is "consistent with the decentralized financial, operational and legal entity structure of the HSBC Group."

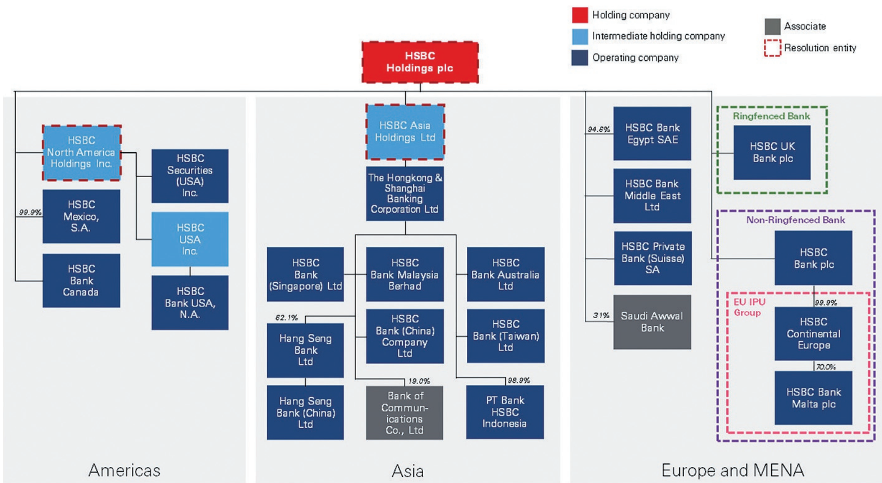

Figure 2. Simplified HSBC Group structure (as of 1 August 2023)[77]

While HSBC Group manifests a substantial degree of decentralisation, when it comes to global strategy, it is still centrally directed. Other enterprise groups may lack centralised control and hierarchical patterns and operate in a more heterarchical way, distinguished by decentralised and flatter corporate networks with largely autonomous profit centres.[78]

The diversity of corporate forms and structures complicates or makes impossible the adoption of a one-size-fits-all approach to their regulation, including regulation in a situation of financial distress and insolvency. At the same time, it is important to emphasise that closely integrated groups – groups consisting of separate legal entities but operating as a single economic unit – deserve special attention in insolvency. The reason is, first, that the interest of group members may differentiate them from any legal entity that operates "on its own" in any market. Second, and consequently, in such groups, a failure of one group member may be triggered by financial distress of other group members, while value can be preserved and maximised when a group is being taken into account (see section 1.1.2., describing the global sale of Nortel's assets). Another reason for paying special attention to

77 This figure is taken from the website of HSBC Group <https://www.hsbc.com/investors/investing-in-hsbc/group-structure> (accessed 1 August 2023). It does not include service companies and special purpose entities.

78 P. Muchlinski, Multinational Enterprises and the Law, 3d edn, OUP, 2021, p. 62, arguing that we may witness the "gradual replacement of closely held subsidiaries with free-standing companies linked to the parent by contract."

integrated groups is that the gradually appearing group-mindful insolvency law is particularly relevant to them.[79]

2.5 Enterprise Groups and the Curious Case of Limited Liability

There are multiple financial, economic, operational, fiscal and other reasons for enterprises to operate through the establishment of separate legal entities. Underpinned by the principles of entity shielding and limited liability, the separation of a single enterprise into distinct legal entities can decrease exposure to risks arising from failures related to a particular geographical market (e.g. when a group is planning to enter a new untested market) or a business segment (e.g. when a certain activity can lead to significant environmental liability or is simply riskier).[80] Thus, entity separation within groups can pursue a "protective" or risk-reduction function.

The protective function is closely related to another function that could be referred to as the "enabling" function. A layered corporate structure may enable the maximisation of financial returns. For example, a group can establish special entities responsible for raising funds on capital markets (SPVs), which can give access to foreign investors and secure better financing terms (see section 1.1.3. for Oi Brazil). The use of a group structure can also be driven by reasons of regulatory partitioning, defined as a "separation between the legal spheres of the corporation and its members beyond the attribution of property rights over assets."[81] Regulatory partitioning might be underpinned by fiscal considerations (tax allowances, tax exemp-

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79 EIR Recast, Articles 56(1), 57(1) and 58, mandating cooperation between IPs and courts in a group insolvency, but only "to the extent that such cooperation is appropriate to facilitate the effective administration of those proceedings." G. Moss, I. Fletcher, S. Isaacs (eds), Moss, Fletcher and Isaacs on the EU Regulation on Insolvency Proceedings, 3rd edn, OUP, 2016, para. 8.756, noting that "[i]n order to obtain full value of the sale of assets which span different legal entities, a co-operative approach is likely to be essential." See also the Singapore's Insolvency, Restructuring and Dissolution Act 2018 (IRDA), section 65(2), permitting the court to restrain commencement or continuation of any proceedings or enforcement actions against a related company (subsidiary or holding company), but only if such related company plays a "necessary and integral role" in debtor's restructuring. See *Re IM Skaugen SE and other matters* [2019] 3 SLR 979; [2018] SGHC 259, at [63].

80 English courts accept that corporate risk compartmentalisation constitutes a legitimate use of the group structure. See *Adams v. Cape Industries plc* [1990] Ch 433. This, however, does not insulate the parent company from liability for actions of a subsidiary on the principles of tort law. See *Lungowe v. Vedanta Resources plc* [2019] UKSC 20. On the advantages of group structures, see also K.J. Hopt and K. Pistor, Company Groups in Transition Economies: A Case for Regulatory Intervention? European Business Law Review, Vol. 2, 2001, p. 13.

81 M. Pargendler, Regulatory partitioning as a key function of corporate personality, in E. Pollman and R.B. Thompson (eds), Research Handbook on Corporate Purpose and Personhood, Edward Elgar Publishing, 2021, p. 264.

tions for intra-group dividends, group relief).[82] It could also be mandated by specific regulatory requirements, like those applicable to financial institutions.[83] Another example of the regulation that prompts the creation of group structures and intra-group financial arrangements is Article 3:2 of the Dutch Act on Financial Supervision (*Wet op het financieel toezicht* or Wft). Under this article, no banking license is required for a group finance company if, among other requirements, such finance company on-lends or invests at least 95% of its balance sheet total within its group, and its liabilities arising from bond issuance are unconditionally guaranteed or otherwise secured by the parent company.[84] This is one of the reasons why in the Lehman Brothers and Oi Brazil cases, bonds issued by Dutch SPVs were guaranteed by parent companies.

Complex group structures have also developed naturally as a result of acquisitions and joint ventures. Corporate expansions are often facilitated by the quest for monopoly gains, the search for synergies, strategies to neutralise potential competitors, and the pursuit of economies of size and scale.[85] In recent years, a prominent trend in the business world has been the surge in takeovers motivated by the pursuit of new technologies and expanded customer bases. This strategy has resulted in several high-profile tech acquisitions, including Microsoft's acquisitions of Skype (2011), LinkedIn (2016) and GitHub (2018), Google's acquisitions of YouTube (2006), Motorola (2012) and Fitbit (2021), and Facebook's acquisitions of Instagram (2012) and WhatsApp (2014).

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82 UNCITRAL Legislative Guide, Part three, Ch. I, para. 23; A.A. Berle Jr., The Theory of Enterprise Entity, Columbia Law Review, Vol. 47, 1947, p. 343; M. Sáez Lacave and M. Gutiérrez Urtiaga, Corporate Groups: Corporate Law, Private Contracting and Equal Ownership, ECGI Law Working Paper No 581, 2021, p. 8, noting that the "first reason why groups are valuable is that they offer the possibility to engage in regulatory arbitrage" and arguing that "[r]egulatory arbitrage can explain why many group structures are so complex and legally intractable."

83 For instance, the UK's banking sector structural reform of 2019 mandated that core banking services (e.g. taking deposits, making payments and providing overdrafts for UK retail customers and small businesses) was made financially, operationally and organisationally separate from investment banking and international banking activities. Therefore, retail and investment banking should be provided by separate legal entities. For discussion and criticism of this strategy, see T. Wetzer, In Two Minds: The Governance of Ring-Fenced Banks, Journal of Corporate Law Studies, Vol. 19, 2019, pp. 197-249. In response to the GFC, the USA introduced the Volcker rule (§ 619 of the Dodd-Frank Act). It imposes the group-level restrictions on banks and prohibits groups which include FDIC-insured banks from engaging in proprietary trading. The Volcker rule is of structural nature and affects the internal structure of banking groups. See J.C. Coates IV, The Volcker Rule as structural law: implications for cost-benefit analysis and administrative law, Capital Markets Law Journal, Vol. 10, 2015, pp. 447-468.

84 W.A.K. Rank and W. van Spanje, Dutch Lehman jitters? Butterworths Journal of International Banking and Financial Law, February 2009, pp. 89-92.

85 O.E. Williamson, The Modern Corporation: Origins, Evolution, Attributes, Journal of Economic Literature, Vol. 19, 1981, pp. 1537-1568.

Whether as a result of natural growth and expansion or in pursuit of a deliberate attempt to insulate risk and acquire additional regulatory benefits, modern enterprises predominantly exist as groups of companies. However, their existence would likely not have been possible or would have been materially curtailed without limited liability and entity shielding – two fundamental doctrines in company law.[86] "Limited liability" protects shareholders from the liability for debts incurred by legal entities they create or invest in, while "entity shielding" ensures that creditors of shareholders cannot have a direct recourse against the assets of their companies.

For many decades, the doctrine of limited liability has been widely praised. In the often-cited 1911 speech, the President of Columbia University and a future Nobel Peace Prize recipient, Nicholas Murray Butler, declared: "I weigh my words, when I say that in my judgment the limited liability corporation is the greatest single discovery of modern times […]. Even steam and electricity are far less important than the limited liability corporation, and they would be reduced to comparative impotence without it."[87] In 1926, The Economist proclaimed: "The economic historian of the future may assign to the nameless inventor of the principle of limited liability, as applied to trading corporations, a place of honour with Watt and Stephenson, and other pioneers of the Industrial Revolution."[88] Nearly a century later, Andenas and Wooldridge noted that "limited liability […] has become a force driving the organization of large multi-company enterprises."[89]

As noted above, limited liability does not constitute a necessary or indispensable characteristic of a legal entity or its economic prosperity. Indeed, history shows that the invention of limited liability and its entrenchment

86 Hansmann and Kraakman refer to these doctrines as "defensive asset partitioning" (protecting personal assets of shareholders from the company's creditors) and "affirmative asset partitioning" (shielding the company's assets from the creditors of its shareholders and managers). See H. Hansmann and R. Kraakman, The Essential Role of Organizational Law, The Yale Law Review, Vol. 110, 2000, pp. 387-440.

87 N.M. Butler, Politics and Economics, 143rd Annual Banquet of the Chamber of Commerce of the State of New York, 1911. The President of Harvard University, Charles W. Eliot, shared a similar view, pointing out that the "principle of limited liability is by far the most effective legal invention for business purposes made in the nineteenth century." Quoted in W. Cook, Watered Stock Commissions Blue Sky Laws Stock without Par Value, Michigan Law Review, Vol. 19, 1921, p. 583.

88 The Economist, 18 December 1926, p. 1053. Note that the attitude to limited liability has not always been positive. The 1824 editorial from *The Times of London* shared the view that "[n]othing can be so unjust as for a few persons abounding in wealth to offer a portion of their excess for the information of a company, to play with that excess – to lend the importance of their whole name and credit to the society, and then should the funds prove insufficient to answer all demands, to retire into the security of their unhazarded fortune, and leave the bait to be devoured by the poor deceived fish."

89 M. Andenas and F. Wooldridge, European Comparative Company Law, CUP, 2009, p. 829.

did not coincide with the recognition of legal personhood. It is likely that early commercial enterprises did not possess the characteristic of limited liability. In many cases, the issue of shareholder liability did not arise at all, either due to an effective state guarantee, as in the case of the VOC, or due to the late arrival of insolvency statutes applicable to companies.[90] In light of this, a few questions arise. First, what is the rationale behind and the (economic) reasons for having limited liability? Second, how do these rationale and reasons stand or play out in a group context? We will address these questions below. In doing so, our goal is not to cover all the arguments that can be made to explain the emergence of limited liability as a default rule. Instead, the focus is on the leading theories of limited liability.

One of the first attempts to theoretically substantiate limited liability was made by Manne, who wrote that "[l]imited liability is probably an essential aspect of a large corporate system with widespread public participation."[91] This argument is predicated on the assumption that unlimited liability would deter small investors from participating in large enterprises, such as railroads, canals, or long-distance sea voyages. Hundreds or even thousands of dispersed shareholders in a public company may have relatively limited economic incentives and high costs involved in monitoring or managing such an enterprise. This is why, the argument goes, a shift in the risk of failure from shareholders to creditors is defendable.[92] While this argument is appealing in a situation of widespread distribution of shares, it becomes less convincing for groups in which a parent entity exercises control and oversight over its subsidiaries. The desire to encourage investment by many small shareholders (i.e. absentee investors) who have no real decision-making power, does not easily apply to the establishment of a multi-layered group structure. Mevorach asserts (and we agree) that "[e]ncouragement of entrepreneurial risk-taking […] is less relevant when considering a group which conducts a common business."[93] It remains a mystery how and why limited liability, originally designed to encourage capital investments by many individuals, was extended to a parent-subsidiary relationship.

90 R. Harris, A new understanding of the history of limited liability: an invitation for theoretical reframing, Journal of Institutional Economics, Vol. 16, 2020, pp. 643-664; P. Wood, Corporate, Bank and Sovereign Insolvencies: Why the Difference? Business Law International, Vol. 22, 2021, p. 315, noting that "[h]istorically, the seeds of corporate bankruptcies germinated out of the bankruptcy of individuals, an area of law stretching back to the far past."

91 H.G. Manne, Our Two Corporation Systems: Law and Economics, Virginia Law Review, Vol. 53, 1967, p. 262.

92 One may wonder, however, whether this risk shifting is justified with respect to involuntary creditors, such as tort victims.

93 I. Mevorach, Insolvency within Multinational Enterprise Groups, OUP, 2009, pp. 42-43.

Reflecting on this, Blumberg writes that "[l]imited liability for corporate groups, one of the most important legal rules in modern economic society, appears to have emerged as a historic accident."[94]

Another benefit frequently assigned to limited liability relates to the efficient operation of stock markets. Halpern, Trebilcock and Turnbull argue that in the absence of limited liability, share prices will depend on the relative wealth of equity holders. This is because under the unlimited liability regime, an expected rate of return and level of risk for both creditors and shareholders correlate with the wealth level of each shareholder, or the ratio of such wealth to the maximum potential loss in the event of default.[95] As a result, the price of shares in the same company would be affected by the relative wealth of a buyer or seller of shares, ultimately having a constraining effect on their tradability. There are two problems with this statement. First, it fails to explain the early operation of capital markets with tradable shares but without limited liability. Second, it is based on the assumption that limited liability fully insulates the company from its shareholders. In the economic reality of corporate groups, this assumption loses its salience, as the share price or the price of debt securities issued by a group member often reflects the overall economic strength of the entire group. This becomes evident in situations where one or more group entities provide guarantees, or where the debtor is closely integrated with or reliant on the well-being of other group entities.[96] Therefore, the identity of a shareholder or shareholders preserves its relevance.

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94 P. Blumberg, Limited Liability and Corporate Groups, The Journal of Corporation Law, Vol. 11, 1986, p. 605.

95 P. Halpern, M. Trebilcock, S. Turnbull, An Economic Analysis of Limited Liability in Corporation Law, University of Toronto Law Journal, Vol. 30, 1980, p. 130. The advantages of limited liability were summarised by Easterbrook and Fischel, who summed up that limited liability: reduces the costs of monitoring managers and other shareholders ("[l]imited liability makes the identity of other shareholders irrelevant"); promotes free transfer of shares; makes shares homogeneous commodities; allows more efficient diversification ("[d]iversification would increase rather than reduce risk under a rule of unlimited liability"); facilitates optimal investment decisions. See F.H. Easterbrook, D.R. Fischel, Limited Liability and the Corporation, University of Chicago Law Review, Vol. 52, 1985, pp. 89-117.

96 *In re Oi Brasil Holdings Coöperatief U.A.*, 578 B.R. 169, 180 (Bankr. S.D.N.Y. 2017), quoting the offering memorandum for the 2021 Notes, issued by Coop: "the ability of [Coop] to pay principal, interest and other amounts due on the Notes and other indebtedness will depend upon the financial condition and results of operations of Oi and its subsidiaries that are creditors of [Coop]." Financial position of group entities was also taken into account in *DTEK Energy BV, Re* [2021] EWHC 1551 (Ch), at 19, citing among other factors, evidence that if "the schemes are not implemented it is "highly likely" that disordered "domino" insolvencies would occur across the Group." INSOL International Special Report, Restructuring Cross-border Groups: Key Considerations Around Foreign Tax and Finance-driven SPVs, June 2020, para. 2.3., noting that in a going concern situation "[c]reditors [...] typically look at the group as a whole and do not focus particularly on the SPV that issued the debt instruments."

More than forty years ago, Posner suggested that the division of an enterprise into a bundle of formally separate but commonly owned and controlled entities should simplify risk assessment for creditors (i.e. evaluation of a borrower's creditworthiness) and thus reduce monitoring costs and bring down the cost of credit.[97] According to Posner, corporate division and limited liability aim to solve the problems of information and supervision. Instead of appraising the enterprise in its entirety, creditors only need to look into the existing and expected assets and liabilities of a separate legal entity, which should arguably be cheaper. Paraphrasing the English poet John Donne, each group company is perceived to be "an island entire of itself." However, in practice, a clear-cut division of an enterprise into isolated islands of assets and liabilities does not occur and is therefore unrealistic.[98] In fact, in many groups, the internal organisation and partition are rather complex or even messy. Therefore, the monitoring costs for creditors are not necessarily reduced, and the informational efficiency attributed to limited liability may be overstated. As will be demonstrated later in the book, various group liability arrangements exacerbate the problem by contractually perforating limited liability and building bridges – serving as the channels for interdependence and contagion – between group "islands".

The principle of limited liability and the related principle of entity shielding are deeply ingrained in legal traditions, even though the degree of their assertion may vary from one jurisdiction to another[99] and from one area of law to another.[100] It is not our purpose to question the many benefits of limited liability, particularly for public companies with distributed shareholding[101] and for highly diversified or heterarchical groups, in which

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97 R.A. Posner, The Rights of Creditors of Affiliated Corporations, University of Chicago Law Review, Vol. 43, 1975, pp. 499-526.

98 K. Ayotte, H. Hansmann, Legal Entities as Transferable Bundles of Contracts, Michigan Law Review, Vol. 111, 2013, p. 722, noting that the "ambiguity of entity boundaries, therefore, may in fact raise creditor-monitoring costs in large corporate groups, not lower them."

99 See with respect to Brazil, M. Pargendler, How Universal Is the Corporate Form? Reflections on the Dwindling of Corporate Attributes in Brazil, Columbia Journal of Transnational Law, Vol. 58, 2019, p. 4, pointing out that "Brazilian law has eroded the most fundamental elements of the corporate form – namely, "capital lock-in" (or "entity shielding") and limited liability – with the effect that there is no longer a strong separation between the assets of Brazilian business corporations and their shareholders." On the other side of the spectrum is the UK, where, since the House of Lords' decision in *Salomon v. A Salomon and Co Ltd* [1897] AC 22 (dealing with a one-man company!), the "principle of separate personality and the privilege of limited liability enjoy great force in English common law." C. Gerner-Beuerle and M. Schillig, Comparative Company Law, OUP, 2019, p. 975.

100 K.E. Sørensen, Groups of Companies in the Case Law of the Court of Justice of the European Union, European Business Law Review, Vol. 27, 2016, pp. 393-420.

101 S.M. Bainbridge and M.T. Henderson, Limited Liability: A Legal and Economic Analysis, Edward Elgar Publishing, 2016, p. 10, noting that "the idea of limiting liability of shareholders in large public companies, especially when those shareholders are individuals with modest means, is fairly uncontroversial."

business and risk compartmentalisation develops naturally. But it is worth pointing out that for those groups operating an integrated business with intra-group liability arrangements, the rationale for limited liability is weaker.[102] Given that distinguishing the two situations is not easy, the policy of limited liability applies by default. Yet the strength of this policy and the policy of preserving separateness of assets and liabilities of group entities (asset partitioning) should not prevent legal responses that recognise the group reality without contravening these policies. Entity separateness does not mean entity insulation in law.

2.6 Conclusion

This chapter introduces the phenomenon of enterprise groups. It shows that corporate groups had a relatively late arrival on the historical stage. This arrival post-dated the recognition and conceptualisation of the legal personhood attribute, or of a legal personality separate from its members. It also came after the idea of limited liability was crystallised and established in law, although not everywhere at the same time. The rapid rise of hierarchical groups coincided with the fast-paced industrial progress of the late 19th and beginning of the 20th century and the liberalisation of corporate laws in the UK and the USA. This liberalisation gave a green light to intercorporate stockholding – a prerequisite for the emergence of a parent-subsidiary structure. Over the 20th century, enterprise groups grew in size and complexity and became one of the prevalent forms for organising business.

Following a brief historical overview, the chapter observes that despite the current dominance of a corporate group structure, legal definitions of a group vary between jurisdictions and also between different contexts and regulatory domains (e.g. tax, accounting, prudential regulation, company, insolvency). Frequently, a group of companies is defined with reference to control and influence, exercised by one legal entity over another. This control may be presumed if a certain percentage of capital or votes is reached. Instead of being caught up in definitional debates and taking into account that insolvency law benefits from an inclusive definition of a group, we focus on some characteristic elements and types of groups.

Enterprise groups can be distinguished based on two factors: the extent of business integration and intra-group interdependence, and the level of control and decision-making independence within the group. Historically, groups have often taken the form of integrated pyramid-shaped enterprises.

102 H. Hansmann and R. Squire, External and Internal Asset Partitioning: Corporations and Their Subsidiaries in J.N. Gordon, W-G. Ringe (eds), The Oxford Handbook of Corporate Law and Governance, OUP, 2018, p. 252, arguing that "a corporate group's use of intra-group guarantees weighs in favor of disregarding the group's internal partitions."

However, looking ahead, we may see more decentralised group structures, in part facilitated by technological advancements and a general shift to the service and information-based economy.

Finally, the chapter discusses fundamental doctrines underpinning the existence of corporate groups today – limited liability and entity shielding. These doctrines pre-determine a separate entity treatment in company and insolvency law. It is emphasised that limited liability, called by some as the "greatest single discovery of modern times", was initially sought to safeguard the position of many small individuals investing in large enterprises like railroads and canals, but was later replicated in a group setting. This raises many questions about the (economic) rationale and benefits of limited liability for groups of companies which engage in a single business and voluntarily perforate limited liability with the help of different cross-entity liability arrangements (cross-guarantees, co-debtorship). While sharing some thoughts on this, we do not explore all possible arguments in favour or against limited liability and the corresponding principle of entity shielding. Instead, it is argued that the centrality of the doctrine of limited liability does not have to stifle the development and application of legal tools that aim to reflect the economic reality of enterprise groups without breaching entity (asset) separateness.