



# A Parent Company and its Subsidiary

## Liability and Corporate Separateness–Piercing the corporate veil

A parent company is a corporation that owns and controls another company, referred to as its subsidiary. This relationship arises in one or more of the following ways:

- By acquiring a majority of the voting shares in the subsidiary (usually more than 50%);
- By forming the subsidiary as a new company, incorporating it for specific purposes;
- By acquiring a controlling interest in the assets or operations of the subsidiary.

Ownership of shares gives the parent company the right to control the subsidiary's decisions through voting power, appointment of directors, and influence over corporate policies.

However, despite this ownership and control, both entities are considered separate legal persons, each with its own rights, duties, assets, and liabilities.

This principle of corporate separateness is deeply rooted in the doctrine laid out in **Salomon v A Salomon & Co Ltd [1897] AC 22**, and it underpins much of modern company law globally.

Simply put, the members of a company are legally separate from the company itself as they are treated as separate legal entities.

## What Is the Corporate Veil?

The corporate veil is a legal metaphor that refers to the separation between a company and its shareholders, including its parent company if it is a subsidiary. It arises from the doctrine of separate legal personality, which holds that once a company is incorporated, it becomes a distinct legal entity – capable of owning property, incurring debts, suing, and being sued in its own name.

The separate personality doctrine therefore implies that a parent company is not automatically liable for the debts, obligations, or wrongful acts of its subsidiary. Even if the parent wholly owns the subsidiary and exercises substantial control over it, the subsidiary remains a distinct legal entity.

Although the general rule is that a parent company is not liable for the actions of its subsidiary due to their distinct legal personalities, the law recognises limited circumstances under which this corporate separateness may be disregarded, or liability directly attached to the parent.

## Piercing the Corporate Veil: Lessons from legal jurisprudence

The decision in ***Adams v Cape Industries plc [1990] Ch 433*** is arguably the most authoritative and frequently cited case on the issue of whether and when a parent company may be held liable for the actions of its subsidiary, particularly through the mechanism of piercing the corporate veil.

## Factual Background

Cape Industries plc was a UK-based parent company involved in the mining and marketing of asbestos.

It operated in the United States through a network of wholly-owned subsidiaries, including Capasco and other US-based entities.

Several employees in the United States were exposed to asbestos and suffered severe health consequences.

These employees successfully obtained a judgment in a Texas court against the Cape Group companies.

The plaintiffs then sought to enforce the US judgment in England, against the parent company, Cape Industries plc, arguing that:

- The group of companies operated as a single economic unit;
- The subsidiaries were mere facades;
- Cape was present in the United States through its subsidiaries and should therefore be amenable to US jurisdiction;
- The corporate veil should be pierced to hold Cape liable for the subsidiaries' conduct.

The Court in *Adams* set out a restrictive test that the veil may be pierced only where a company is a "mere façade concealing the true facts", and where the corporate structure is being used to evade existing legal obligations.

Mere ownership and control are not sufficient grounds for piercing the veil.

## **The test for piercing the Corporate veil**

This test has remained the standard position in common law.

Courts will pierce the corporate veil — and hold the parent company liable for the acts of the subsidiary — only in exceptional circumstances. These circumstances may include one or more of the following tests or indicators:

### **1. Functional Unity / Economic Integration Test**

Is the subsidiary so interwoven with the parent company that the two function as one entity, such that the subsidiary has no independent will or purpose?

This test asks whether:

- The parent exercises complete control over the subsidiary's operations;
- The subsidiary lacks substantive independence (i.e. no real board meetings, no business judgment of its own);
- The two companies share employees, finances, offices, and decision-making processes;
- The subsidiary is a mere conduit through which the parent acts.

### **2. Agency Test**

Was the subsidiary acting as an agent — or authorised representative — of the parent company in carrying out the wrongful act?

To establish an agency relationship, courts will examine:

- Whether the parent directed or authorised the conduct in question;

- Whether the parent company held out the subsidiary as its agent or representative;

### **3. Façade or Sham Test**

Was the subsidiary deliberately created or used to mask the identity of the true actor (usually the parent), or to avoid liability?

Courts will pierce the veil if:

- The subsidiary is a “mere façade” or shell company with no legitimate business purpose;
- The parent is using the subsidiary to evade existing legal obligations;
- There is evidence of dishonesty, concealment, or improper conduct behind the formation or operation of the subsidiary.

### **4. Fraud / Improper Motive Test**

Was the corporate structure used to commit or conceal fraud or illegality?

A court will pierce the veil where:

- The corporate form is being abused to perpetrate fraud or mislead creditors;
- The company is insolvent by design, or set up to frustrate legal claims;
- The corporate form is used in bad faith to defeat public interest or statutory duties.

## **Conclusion**

In sum, while a parent company is generally not liable for the actions of its subsidiary due to the principle of separate legal personality, courts may pierce the corporate veil in exceptional circumstances.