**An introduction to group companies**

This section provides an overview of group companies.

**Definition of ‘group’**

It is important to note that different definitions of ‘group’ will apply, depending on whether you are considering company law, taxation or accounts.

In addition, when looking at a contract, for example, as part of a due diligence exercise, you should always check what definitions have been used for ‘group’. The contract will often refer back to the Companies Act 2006 (‘**CA 2006’**) definitions but will sometimes make amendments to these definitions.

In this section, we will focus on the definitions applicable to groups for **company law** purposes:  the main ones can be found in ss.1159(1) and (2) CA 2006 as supplemented by Schedule 6 CA 2006 and s.1162 CA 2006. You may find it helpful to have these provisions in front of you while you are working through this section.

A group of companies will have a ‘parent’ or ‘holding’ company and one or more subsidiary companies. Depending on the size and structure of the group, subsidiaries may have subsidiaries of their own.

**Example**

Assume that A Ltd owns B Ltd and B Ltd owns C Ltd in each case the holding is of 100% of the shares.

This means:

1. A Ltd is B Ltd’s parent;
2. B Ltd is C Ltd’s direct parent company;
3. B Ltd and C Ltd are both subsidiaries of A Ltd; and
4. C Ltd is an indirect subsidiary of A Ltd.

**Section 1159(2) CA 2006**: a company is a **wholly-owned subsidiary** of another company if it has no members except that other and that other’s wholly-owned subsidiaries or persons acting on behalf of that other or its wholly owned subsidiaries.

Following the example above, then:

* B Ltd is a wholly-owned subsidiary of A Ltd as B Ltd has no other members;
* C Ltd will also be a wholly-owned subsidiary of A Ltd as it has no other members save for B Ltd, which is A Ltd’s wholly-owned subsidiary.

**Definitions of ‘subsidiary’ and ‘holding company’**

It is not necessary for one company to own the whole of another company for the group relationship to exist, however.

**S 1159(1) CA 2006:** a company is a subsidiary of another company, its holding company, if that other company

1. holds a majority of the voting rights in it; or
2. is a member of it and has the right to appoint or remove a majority of the board of directors; or
3. is a member and controls alone, pursuant to an agreement with other members, a majority of the voting rights in it.

**Read:** Access Schedule 6, paragraphs 2 and 3 CA 2006 to see what ‘voting rights’ and ‘the right to appoint or remove the majority of the board of directors’ mean.

**Structure charts and Non-UK companies**

It is important to note that references to ‘company’ in s.1159 capture ‘**any body corporate**’ which **includes entities incorporated outside of the UK**.  This is as a result of **s.1159(4) and s.1173**.  Therefore, whilst the example above includes only UK companies, it could have included non-UK entities.  You are likely to see group structures in corporate transactions that contain non-UK entities.

When working on a transaction involving a group of companies it will often be helpful to prepare a group structure chart so that the relationships between the respective companies within the group can be correctly identified. It should be possible to draw up a group structure chart of the UK companies from information which can be obtained from company searches of all the companies within a group.

If there are overseas entities input from overseas counsel will be required.

**Parent Liability**

You will remember from your study of Business Law and Practice that a key characteristic of limited companies in the United Kingdom is that the company is the concept of limited liability.

This means that parent companies are not automatically liable for the debts or other liabilities of their subsidiaries. This concept, whereby the company is separate to its owners is referred to as the corporate veil (you may have studied this if you studied Company Law).

It is worth noting that the corporate veil means that the shareholders also do not have any direct interest in the assets held by the subsidiary company as these are separate.

Liability can occasionally arise, either through commercial practice or process of law. We will now consider other examples where parent companies may incur liabilities of their subsidiaries.

**Parent liability: contract**

One of the most common ways for a parent to assume liability in respect of its subsidiaries under contract is by means of a **guarantee**.

A guarantee from a parent company may be required where the business and assets of the subsidiary are not considered to be substantial enough on their own to be sure that the subsidiary will be able to perform its obligations under a contract.

In the context of a corporate acquisition, if a subsidiary is selling its business, the buyer is quite likely to request that the selling company’s ultimate parent company joins in to the acquisition agreement in order to guarantee the subsidiary’s performance under the warranties and indemnities contained in the acquisition agreement. On the other hand, if a newly-formed company is the buyer under an acquisition agreement, the seller may request that the buyer’s parent company guarantees its liabilities in respect of the purchase price, particularly if there is any deferred consideration.

Additionally, companies in a group can be called upon to guarantee the obligations of each other. A common example of this is when each of the companies in a group guarantees the liabilities which each of the other group companies have to a bank (for example, loans and overdrafts). This is called a **cross-guarantee**.

Note, although, as you learnt in Topic 9, private equity transactions often involve newly formed companies parent company guarantees are very rarely used in the transactions, so you should always consider the wider context.

**Parent liability: tort**

In the last couple of decades there has been an increase in actions being taken, usually in tort law, to prove that a parent company has liability. These have commonly been in areas such as health and safety or environmental matters, often with an overseas subsidiary and claimants. Practically, a parent company will often have deeper pockets than a single subsidiary which is why claimants may seek to pursue that liability.

In the case of **Chandler v Cape plc** [2012] 3 All ER 640 provided that parent liability could be established where the parent has a practice of intervening in the trading operations of the subsidiary, such as production and funding issues or superior knowledge or expertise.

This has subsequently been applied and confirmed in the Supreme Court in the cases **Lungowe v Vedanta Resources plc** [2019] UKSC 20 and Okpabi v Royal Dutch Shell plc [2021] UKSC 3.

It is important to note that in these cases it was found that each of the parent company had assed responsibility for managing and/or controlling the relevant activity of the subsidiary and, therefore, had a duty of care to the claimants in each case. The parent, was not, therefore, liable for claims against the subsidiary but had its own liability. It remains very difficult to pierce the “corporate veil”.

**Parent liability: Insolvency**

Parent liability can arise under the Insolvency Act 1986 as set out below.

**Fraudulent trading**

Any person knowingly a party to carrying on the business of a company with intent to defraud creditors may be required to make such contributions to the company’s assets as the court thinks proper on the application of a liquidator or administrator.

‘Person’ includes a body corporate so that if a holding company is involved with carrying on the business of its subsidiary in a way intended to defraud creditors the holding company may be held liable.

**Wrongful trading**

Directors of a company that has gone into insolvent liquidation or administration may be held liable to make a contribution to the company’s assets if at some time before the commencement of the winding up or administration of the company such directors knew or ought to have concluded that there was no reasonable prospect of avoiding an insolvent liquidation or administration. Director includes shadow directors. This means that if the holding company effectively determines the way in which the directors of the subsidiary will act, the holding company may be found to be a shadow director of the subsidiary and incur liability accordingly.

**Summary**

* If a company owns the whole of another company, then that second company will be a **wholly-owned** subsidiary.
* A subsidiary and parent company relationship may also exist if a company owns (or is able to control) the majority of the voting rights in another company or is a shareholder and has the right to appoint or remove a majority of the board of that company.
* A parent company is a distinct entity from its subsidiaries and is not directly responsible for the liabilities of its subsidiaries.
* However, in certain circumstances a parent company may assume liability for the debts or other liabilities of their subsidiaries as a result of contractual obligations or the application of the law of tort or as a result of certain statutory provisions in the Insolvency Act 1986.