LIFTING THE CORPORATE VEIL

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INTRODUCTION

1. Frequently, when a creditor discovers that a debtor company is insolvent, the creditor will want to recover the debt from a shareholder, director or associate of the insolvent company[1]. There exist various statutory and common law mechanisms by which the corporate veil can be lifted. This lecture sets outs and discusses those mechanisms in the light of recent authorities.

PRINCIPLES OF CORPORATE PERSONALITY

2. One of the fundamental principles of company law is that a company has personality that is distinct from that of its shareholders. This rule was laid down by the House of Lords in *Salomon v. Salomon & Co*[2], in which it was held that even if one individual held almost all the shares and debentures in a company, and if the remaining shares were held on trust for him, the company is not to be regarded as a mere shadow of that individual. Lord MacNaughten stated[3]:

> *"The company is at law a different person altogether from the subscribers to the Memorandum and, although it may be that after incorporation the business is precisely the same as it was before, and the same persons are managers, and the same hands receive the profits, the company is not in law the agent of the subscribers or the trustee for them. Nor are subscribers as members liable, in any shape or form, except to the extent and in the manner provided by the Act[4]."*

3. The rule in *Salomon* lies at the heart of corporate personality, and is the principal difference between companies and partnerships. The rule applies to groups of companies just as it does to the individuals behind companies. For example, in the recent case *Tallington Lakes v Grantham Magistrates Court*[5] a number of companies all owned by

[1] Attempts by shareholders to lift the veil so as to claim reflective losses will not usually succeed – see *Johnson v Gore Wood* [2002] 2 AC 1
[2] [1897] A.C. 22
[3] *Ibid*, at p. 51
[4] i.e. Companies Act 1862
[5] LTL 25/11/2010

the same individual operated businesses from separate parts of a caravan site. The High Court held that it was not open to the magistrates court when considering liability for business rates to cross attribute acts of occupation between the different companies and to treat a single company as being in occupation of the whole.

4. In 2010 the Supreme Court has ruled in the case of *Holland v HMRC*[6]. Mr and Mrs Holland ran a business administering the business and tax affairs of contractors who did not want the trouble of running their own companies. They set up 42 trading companies (one for each contractor) and two further companies "*Paycheck (Directors Services) Ltd*" and "*Paycheck Secretarial Services Ltd*" to act as the sole director and secretary of each of the trading companies. Mr and Mrs Holland were the directors of Paycheck Directors and Paycheck Secretarial Services and owned each of those companies via another company. The business model was intended to allow each trading company to be subject to the small companies' corporation tax rate but the structure failed as the companies were treated as associated for tax purposes. The trading companies became insolvent and HMRC pursued Mr Holland as a de facto director. The Supreme Court (by a 3 to 2 majority) rejected HMRC's appeal. Lord Hope considered that the question of whether Mr Holland was acting as a de facto director of the composite companies must be approached on the basis that Paycheck Directors (the sole corporate director of each of the composite companies) and Mr Holland were in law separate persons, each with their own separate legal personality: The mere fact of acting as a director of a corporate director will not be enough for an individual to become a de facto director of the subject company. One must look at what a person actually did to see whether he assumed the responsibilities of the office of director. Everything Mr Holland did was under the umbrella of being the director of a sole corporate director. Until Parliament provides otherwise, if acts are entirely within the ambit of the duties and responsibilities of a director of the corporate director, it is to that capacity that acts are attributed.

5. It should be noted that notwithstanding the doctrine of the corporate veil a corporate body can only have knowledge by the attribution of the knowledge of a natural person. The question of whose knowledge counts as the knowledge of the company depends on the interpretation and purpose of the particular substantive rule that requires the knowledge of an individual to be treated as the knowledge in possession of the company[7].

6. There are situations in which the courts look beyond that personality to the members or directors of the company: in doing so they are said to lift or pierce the corporate veil. There is no single basis on which the veil may be lifted, rather the cases fall into several loose categories, which are examined below.

STATUTORY EXCEPTIONS

7. There are certain statutory exceptions to the rule in *Salomon* which involve a director being made liable for debts of the company because of breach of the companies or insolvency legislation. Eg:

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[6] [2010] UKSC 51
[7] See *Guy Lebon v Aqua Salt Co Ltd* [2009] UKPC 2 and *Jafari-Fini v Skillglass Ltd* [2007] EWCA Civ 261

(a) Failure to obtain a trading certificate

8. Where a public company fails to obtain a trading certificate in addition to its certificate of incorporation before trading, the directors will be liable to the other parties in any transactions entered into by the company to indemnify them against any loss or damage suffered as a result of the company's failure to comply with its obligations. See Companies Act 2006 s767(3).

(b) Failure to use Company's name

9. Section 349(4) of the CA 1985 provided that if an officer of a company or a person acting on its behalf signs a bill of exchange, cheque or similar instrument on behalf of the company, in which the company's name is not mentioned[8], that person will be personally liable to the holder of the instrument in question for the amount of it (unless it is duly paid by the company). However, although CA2006 s.84 imposes criminal penalties for failure to use the company name on relevant documents, there is currently no equivalent provision in the 2006 Act imposing such a personal liability.

(c) Disqualified Directors

10. Under s.15 of the Company Directors Disqualification Act 1986, if a person who has been disqualified from being a director of, or involved in the management of a company acts in contravention of his disqualification he will be liable for all those debts of the company which were incurred when he was so acting. The same applies to a person who knowingly acts on the instructions of a disqualified person or an undischarged bankrupt.

(d) Just and Equitable Winding Up

11. Under s.122(1)(g) of the Insolvency Act 1986 a petition may be presented to wind up a company on the grounds that it would be just and equitable to do so. This may involve lifting the veil of incorporation, for example to examine the basis on which the company was formed[9].

(e) Fraudulent Trading

12. Section 213 of the Insolvency Act 1986 deals with fraudulent trading. Under that section, if it appears to the court that *"any business of the company has been carried on with intent to defraud creditors of the company or of any other person, or for any fraudulent purpose",* it may order that *"any persons who were knowingly parties to the carrying on of the business in the manner above-mentioned are to be liable to make contributions (if any) to the company's assets as the court thinks proper".*

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[8] Thus contravening s.349 (1)(c) of CA 1985

[9] E.g. *Ebrahimi v. Westbourne Galleries* [1973] AC 360.

(f) Wrongful Trading

13. Section 214 of the Insolvency Act 1986 concerns wrongful trading, and enables the court to make a declaration, when a company has become gone into insolvent liquidation, that a former director is liable to make a contribution to the company's assets. Such a declaration can be made where the director in question knew or ought to have concluded, at some point before the commencement of the company's liquidation, that there was no reasonable prospect that the company would avoid going into insolvent litigation. By s.214(7), the provisions of s.214 also apply to shadow directors.

(g) Phoenix Companies

14. The Insolvency Act 1986 also allows the court to lift the corporate veil in cases of so-called *"Phoenix Companies",* in which a new company is created with the same or a similar name to an insolvent company. S. 216 of the Act makes it an offence for anyone who was a director of the insolvent company during the 12 months before liquidation to be associated with a company with the same name as the insolvent company or a name so similar as to suggest an association[10]. S.217 provides that where a person is involved in the management of a company in contravention of s.216, or where he acts, or is willing to act, on instructions given by a person whom he knows to be in contravention of that section, he is himself jointly and severally liable with the company for all the relevant debts of that company.

(h) Unfair Prejudice

15. The Courts' powers under s.994 of the Companies Act 2006 (duplicating those in s.459 of the 1985 Act) apply *where "the company's affairs are being or have been conducted in a manner which is unfairly prejudicial to the interests of its members generally or of some part of its members (including at least himself)."* The general proposition that the conduct of a parent company in control of a subsidiary can be relevant where a petition is presented by shareholders of a subsidiary is unsurprising[11]. It has also been held by the Court of Appeal[12] that directors' unfairly prejudicial conduct of a subsidiary may be actionable by shareholders of the parent if the parent and subsidiary have directors in common.

(i) Third Party Costs Orders

16. The court has jurisdiction to make a costs order against a party to the proceedings in favour of a non-party (including the directors or shareholders of a litigant company) by virtue of s.51 Supreme Court Act 1981 and CPR 48.2. This has been applied by the Court of Appeal in the case *of Alan Phillips Associates Ltd v Terence Edward Dowling*[13]. A contract was accepted by a company on headed paper almost identical to that of a

[10] Unless that person is given leave by the court so to act: s.216 (3)
[11] see *Nicholas v Soundcraft* [1993] BCLC 360
[12] *Citybranch Ltd v Rackind* [2004] EWCA Civ 815
[13] [2007] EWCA Civ 64

business run by Mr Phillips prior to incorporation. Mr Phillips wrongly issued proceedings in his own name and the company was then substituted as Claimant. The company's claim was dismissed and a third party costs order was made against Mr Phillips.

17. More typical circumstances for a third party costs order arose *in Goodwood Recoveries Ltd v Breen*[14] which held that where a non-party director could be described as *the "real party"* seeking his own benefit and controlling and/or funding the litigation, then even where he had acted in good faith or without any impropriety justice might demand that he be liable in costs.

18. Similarly in *CIBC Mellon Trust Co v Stolzenberg*[15] when the court held that there was no reason in principle why, if a shareholder (not being a director or other person duly authorised, appointed and legally obliged to act in the best interests of the company) funded, controlled and directed litigation by the company in order to promote or protect his own financial interest, the court should not make a costs order against him.

19. In *Lingfield Properties (Darlington) Ltd v Padgett Lavender Associates*[16] after a judgment in its favour a defendant applied for a non party costs order against a former director of the claimant who remained as company secretary. The claimant company was wholly owned by a trust in favour of the children of the company secretary. The claim had depended upon the evidence of the company secretary and he had arranged the funding of the company's litigation costs but had not funded them personally. There was evidence that the company's decisions had been made independently by its directors and that the company secretary would not have benefited personally had the claim succeeded. It was held that the company secretary was not liable as he was not the *"real party"* to the claim.

20. Recently in *Raleigh UK Ltd v Mail Order Cycles Ltd* [17] the court granted an application for a non party costs order against directors of a company. The basis of the application was that the directors, who had conducted the defence on the part of the company had funded the litigation, had known that the company would not be able to meet any adverse costs order, and were the only beneficiaries of the company and so should be regarded as being the real parties to the proceedings. The court held that granting the application was just in all the circumstances.

COMMON LAW AND THE MERE FAÇADE TEST

Engine of Fraud

[14] [2005] EWCA Civ 414
[15] [2005] EWCA Civ 628
[16] [2008] EWHC 2795 (QB)
[17] [2011] EWHC 883 (Ch)

21. It has long been established that the Courts will not allow the *Salomon* principle to be used as an engine of fraud, or to avoid pre existing legal obligations. Probably the best-known example of this rule is *Gilford Motor Company Ltd v. Horne*[18], in which the Defendant had been managing director of a the Claimant company, and had entered into a covenant not to solicit customers from his employers when he ceased to be employed by them. On leaving the company's employment, Horne formed a company to carry on a competing business, the shares in which were held by his wife and a friend, and he thereby solicited the Claimant's customers. The Court of Appeal held that this company was a mere façade or sham to cloak his breach, and granted an injunction to enforce the covenant against both Horne and the company.

22. Similarly, in *Jones v. Lipman*[19] the Defendant had entered into a contract to sell property, but then sought to avoid the sale by transferring the property to a company which he controlled. Russell J held that specific performance could be ordered against the company, which he described as *"the creature of the First Defendant, a device and a sham, a mask which he holds before his face in an attempt to avoid recognition by the eye of equity"*[20] .

23. An alternative way to achieve to have achieved the result in *Gilford Motor Company Ltd v. Horne* (as suggested by Toulson J. in *Yukong v Rendsberg (The Rialto)*[21]) but avoiding the need to lift the corporate veil would have been to argue that the company was knowingly assisting a breach of contract and therefore ought to be subject to the injunction.

24. Similarly, Toulson J in *Yukong* criticised the reasoning in *Jones v Lipman* and he quoted from a lecture by Lord Cooke:

> *"Since the company was in the vendor's control, there was no difficulty in granting a decree of specific performance against him. Describing the company as a creation of the vendor, a device, sham and mask, the judge also decreed specific performance directly against it. Those epithets, however, do not appear to have been needed to justify the remedy. No particular difficulty should arise in holding that a company or any other purchaser acquiring property with actual notice that the transaction is a fraud on a prior purchaser takes subject to the latter's equity. In truth the very granting of the remedy against the company brings out that it was not a sham."*

25. In *Standard Chartered Bank v Pakistan National Shipping Corp*[22] a company director presented bills of lading to Standard Chartered, knowing full well that the documents had been antedated and intending that Standard Chartered should suffer loss by paying the

[18] [1933] Ch. 935
[19] [1962] 1 WLR 832
[20] *ibid*, p. 836
[21] [1998] 1 WLR 294
[22] [2002] UKHL 43

company in reliance on the documents. Overturning the decision of the Court of Appeal, Lord Hoffman stated:

> *"No one can escape liability for his fraud by saying: 'I wish to make it clear that I am committing this fraud on behalf of someone else and I am not to be personally liable.'"*

If the director had been a mere employee of the company and had done the same things and written the same letters on behalf of the company in that capacity, it could never have been suggested that he was not personally liable for his fraudulent acts. His status as a director when he executed the fraud therefore could not invest him with immunity. It is a key part of this decision that the cause of action was deceit, as in cases of fraud and deceit (unlike cases of negligent misstatement under *Hedley Byrne* principles) there is no need to prove any special relationship or assumption of responsibility between the tortfeasor and the claimant. Accordingly there was no obstacle to personal liability.

26. A further example of the application of the principle that the corporate veil cannot be used to further fraud is *Kensington International Ltd v Congo*[23]. The Claimant had obtained various judgments against the Republic of Congo which it sought to enforce by way of third party debt order against money payable to a company called "*Sphynx*" who had sold a cargo of oil. Sphynx had bought the oil from Africa Oil. Africa Oil had bought the oil from the Congolese state owned oil company ("*SNPC*"). Sphynx and Africa Oil were both controlled by the president and director general of SNPC. The court held that the various transactions and company structures were a sham or façade and had no legal substance, and were set up with a view to defeating existing claims of creditors against the Congo. SNPC and Sphynx were simply part of the Congolese state and had no existence separate from the state. It was not necessary for there to be a divestment of assets at an undervalue to justify the court piercing the corporate veil in relation to the particular transactions.

27. It should be noted that the mere fact that there is fraudulent activity does not necessarily justify the piercing of the corporate veil. In *Dadourian Group v Simms*[24] individuals who had fraudulently misrepresented that one of them was a mere intermediary when in fact he was a co-owner and controller of a contracting company were liable for deceit but the veil was not lifted so the individuals were not found liable for the company's breach of contract to buy equipment. In this case there was no conspiracy to injure the Claimant and there had been a genuine intention that the company would buy the equipment.

28. The House of Lords in *Stone & Rolls v Moore Stephens* [25] lifted the corporate veil in a case where a director, who was both the sole controlling mind of a company and its ultimate beneficial owner, had been fraudulent. The company subsequently went into liquidation and a claim was made by the company (at the instigation of the liquidator and for the benefit of creditors) against the company's auditors who were said to have

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[23] [2005] EWHC 2684 (Comm)
[24] [2006] EWHC 2973 (Ch)
[25] [2009]UKHL 39

negligently failed to detect the director's fraud. The majority of the Lords held that the conduct and knowledge of the director was to be treated as the conduct and knowledge of the company. A "*sole actor*" exception applied to the general principle that the knowledge of a director was not to be taken as knowledge of a company. The company was considered to be a fraudster and not merely vicariously liable for the fraud of its director. The principle of *ex turpi causa* (a wrongdoer not being able to benefit from the wrongdoing) was therefore held to prevent the company arguing that the auditors should have detected the fraud which the company had been trying to hide. The outcome of the case would probably have been different if the company had been partly owned by an innocent third party.

29. A recent example of the relevant principles being applied is the case of *Antonio Gramsci Shipping Corporation v Stepanovs* [26]. Burton J. held that where companies had entered into charterparties as part of a scheme to divert corporate opportunities there was a good arguable case, for the purposes of the jurisdiction of the English court, that the veil of incorporation should be pierced in order to permit the claimants to seek to enforce the charterparties against the individual defendant as one of the controlling minds of the companies.

The now defunct "Interests of Justice Test"

30. In *Creasey v. Breachwood Motors Ltd*[27] the facts were slightly different from those of *Gilford v. Horne* and *Jones v. Lipman*. Creasey had been the manager of a garage owned by Breachwood Welwyn Ltd ("*Welwyn*"), but was dismissed from his post and intended to sue for wrongful dismissal. In anticipation of his claim, and wanting to avoid having to pay him damages, the proprietors of Welwyn formed another company, named Breachwood Motors Ltd ("*Motors*"), and transferred the entire business of the old company to it. Creasey obtained judgment in default against Welwyn, which was then struck off of the register of companies. Creasey obtained an order substituting Motors as defendants, against which Motors appealed. Richard Southwell Q.C., sitting as a judge of the Queen's Bench Division, held that Motors could be substituted as defendants, and that the veil could be lifted because Welwyn's assets had been deliberately transferred to Motors in full knowledge of Creasey's claim[28]. Richard Southwell Q.C. specifically decided that it was right to allow the veil to be lifted as regards Motors, rather than force Creasey to apply to have Welwyn restored to the register and apply for an order that its assets be restored to it under s.423 of the Insolvency Act 1986 (an alternative which the judge described as a "*procedural minefield*").

31. In *Ord & Anor v. Belhaven Pubs Ltd*[29] the Court of Appeal has however decided that the decision in *Creasey* was wrong. In *Ord* the defendant company had made various misrepresentations to the claimant. By the time these came to light, the company had all but ceased trading, and had negligible assets. The claimant sought to substitute the

[26] [2011] EWHC 333 (Comm)
[27] [1992] BCC 638
[28] *Ibid*, p. 648 B
[29] [1998] BCC 607

defendant company's holding company, and the judge at first instance followed *Creasey* and allowed the substitution. The Court of Appeal decided that this was incorrect, as the original company had not been a mere façade for the holding company, nor vice versa. Unlike the new company in *Creasey*, neither company had been created as a sham to avoid some liability, there had been no element of asset stripping and so the veil should not be lifted. Hobhouse LJ, giving the judgment of the court, stated:

> *"There may have been elements in that case* [i.e. Creasey] *of asset stripping. I do not so read the report of [Richard Southwell QC's] judgment… But it seems to me to be inescapable that the case in* Creasey v. Breachwood *as it appears to the court cannot be sustained. It represents a wrong adoption of the principle of piercing the corporate veil and an issue of the power granted by the rules to substitute one party for the other following death or succession. Therefore in my judgment the case of Creasey v. Breachwood should no longer be treated as authoritative."*[30]

The Matrimonial Cases

32. It often arises in matrimonial proceedings that a wife asserts that assets owned by a company should be treated as the assets of her husband and that the corporate veil ought therefore to be lifted.

33. In *Murbarak v Murbarak*[31] the question arose of whether or not the wife could seize and sell company assets by way of enforcement of her lump sum ancillary relief award and whether the court could ignore the company and trust structure in which the assets were held by lifting the corporate veil. It was held that the Family Division could make orders directly or indirectly regarding a company's assets where (a) the husband was the owner and controller of the company concerned; and (b) where there were no third parties who were likely to be prejudiced by such an order. The lifting of the veil was most likely to be acceptable where the assets concerned was the parties' former matrimonial home, or some other asset which the company did not use for its day to day trading. The husband had conceded that he was the ultimate owner of the company and its assets. However, that concession was not binding on the company because he was not at the material time a director and he had no authority to bind the company to meet his personal liabilities. As there were genuine third party interests (eg of creditors) the court refused to lift the veil.

34. In *Faiza Ben Hashem v Abdulhadi Ali Shayif* [32] the court refused to lift the corporate veil in ancillary relief proceedings where the company was alleged to be the husband's *alter ego*. The court was satisfied that some of the shares in the company were genuinely owned by persons other than the husband and that the company had been established to own certain properties both legally and beneficially. Neither the other shareholders nor the directors were the husbands stooges. The husband was legitimately taking advantage of the corporate structure. There was therefore no *façade* and the veil would not be lifted.

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[30] *Ibid*, p.616 B
[31] [2001] 1 FLR 673
[32] [2008] EWHC 2380 (Fam)

The Court of Appeal in *Petrodel & Others v Prest*[33] has recently held that the family courts must follow apply company law so that the shareholders of a company have no interest in, let alone entitlement to, a company's assets and that a company's assets belonged beneficially to the company itself not to its shareholders. The decision may soon be reviewed by the Supreme Court.

The Current State of the Law

35. The courts are now increasingly reluctant to lift the veil in the absence of a sham. In particular, it is clear that the veil will not be lifted simply because it would be in the interests of justice. In *Adams v. Cape Industries plc*[34] the Court of Appeal was unequivocal on this point. Slade LJ said[35]:

> *"Save in cases which turn on the wording of particular statutes or contracts, the court is not free to disregard the principle of* Salomon v. Salomon & Co Ltd *[1897] AC 22 merely because it considers that justice so requires. Our law, for better or worse, recognises the creation of subsidiary companies, which though in one sense the creatures of their parent companies, will nevertheless under the general law fall to be treated as separate entities with all the rights and liabilities which would normally attach to separate legal entities."*

36. That the courts are now less willing to lift the corporate veil than was once the case is also indicated by the judgment of the House of Lords in *Williams v. Natural Life Health Foods Ltd*[36]. The defendant company was effectively run by one man, a Mr Mistlin, and had given negligent advice to the claimant regarding the profitability of a franchise. On the company being wound up, the claimant joined Mr Mistlin as a defendant on the basis that he had assumed personal responsibility. The House of Lords unanimously rejected the Court of Appeal's finding that Mr Mistlin had assumed responsibility to the Claimant, holding that in order for a director to be personally liable for negligent advice given by the company, it had to be shown both that the director had assumed personal responsibility for that advice and that the claimant had reasonably relied on that assumption of responsibility. As there had been no personal dealings between Mr Mistlin and the claimant, these tests were not met, and the corporate veil should remain intact.

37. The decision in *Williams* has subsequently been explained by Lord Hoffman as follows:

> *"just as an agent can contract on behalf of another without incurring personal liability, so an agent can assume responsibility on behalf of another for the purposes of the Hedley Byrne rule without assuming personal responsibility"*[37]

[33] [2012] EWCA Civ 1395
[34] [1990] Ch 433
[35] *Ibid* p. 536.
[36] [1998] 2 All ER 577
[37] *Standard Chartered Bank v. Pakistan National Shipping Corpn* [2002] UKHL 43

38. It should be noted that *Williams* was distinguished by the majority of the Court of Appeal in *Merrett v Babb*[38] where it was held that a professional surveyor employed by a company could owe a personal duty to the purchasers of a property notwithstanding the fact that the report he signed was on company headed paper. The decision has been criticised by, amongst others, the authors of *Jackson & Powell on Professional Negligence*.

39. It should also be noted that in the recent case of *Chandler v Cape*[39] the corporate veil was circumvented by a finding that a parent company owed a duty of care to an employee of a subsidiary company who developed asbestosis. The Court of Appeal unanimously held that in appropriate circumstances the law could impose on a parent company responsibility for the health and safety of its subsidiary's employees. Those circumstances included the situation case where (a) the businesses of the parent and subsidiary were in a relevant respect the same; (b) the parent had, or ought to have had, superior knowledge on some relevant aspect of health and safety in the particular industry; (c) the subsidiary's system of work was unsafe as the parent company knew, or ought to have known; (d) the parent knew, or ought to have foreseen, that the subsidiary, or its employees, would rely on it using that superior knowledge for the employees' protection although it was not necessary to show that the parent was in the practice of intervening in the health and safety policies of the subsidiary. The court had to look at the relationship between the companies more widely and could find that the element of reliance on it using superior knowledge was established where the evidence showed that the parent had a practice of intervening in the trading operations of the subsidiary

40. A court will also be justified in disregarding a company's personality so as to prevent the corporate form being used as a medium through which to lawfully carry out an activity which would otherwise be a wrongdoing. In *Trustor AB v. Smallbone*[40] the defendant Smallbone had effected the payment of considerable sums of money from Trustor AB, a company of which he was managing director, to a company called Introcom, which he controlled. Sir Andrew Morritt V-C found that Introcom was simply a vehicle for receiving the money, and that the payments were made in breach of Smallbone's duty to Trustor. Summary judgment was ordered against Smallbone and Introcom.

41. What then is the law following the decisions in *Ord* and *Williams*? Neither case, of course, involved findings that the relevant company had been a façade. *Ord* should not be thought to prevent the veil being lifted in cases where there is a sham or façade. Subsequent authorities, as well as the House of Lords decisions prior to *Ord*[41], show that the law is still that the courts will be willing to lift the veil in cases where there is a sham and that principle is still at the heart of the test to be applied.

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[38] [2001] EWCA Civ 214
[39] [2012]EWCA Civ 525
[40] [2001] 1 WLR 1177
[41] E.g. *Woolfson v. Strathclyde Regional Council* [1978] SLT 159, in which Lord Keith of Kinkel stated that it was appropriate to lift the veil *"only where the special circumstances exist indicating that [the company] is a mere façade concealing the true facts".*

42. In *Faiza Ben Hashem v Shayif* [42] Munby J applied the following principles which are a useful summary of the current state of the law:

(i) Piercing the corporate veil is appropriate only where special circumstances indicated that it is a mere façade.

(ii) Control of a company by the intended defendant is not of itself enough to justify piercing.

(iii) Piercing should not occur merely because it is thought necessary in the interests of justice: there has to be impropriety.

(iv) The impropriety has to be linked to the use of the company structure.

Identification of Shams and Facades

43. Some shams or facades may be obvious, but many others will not. The courts are reluctant to provide precise guidelines so as to define what constitutes a sham preferring the flexibility of a case by case approach. Useful tests to be employed when trying to identify a sham are:

(i) Are the relevant entities in common ownership?

(ii) Are the relevant entities in common control?

(iii) Was the company structure was put in place before or after a particular liability (or serious risk) arose, and if the latter then to what extent was the liability or risk a motivating factor for those who set up the structure?

(iv) Was the company structure put in place in an attempt to allow an activity which would be unlawful if carried out personally?

AGENCY AND GROUPS

44. In the absence of a sham, the doctrine of agency has sometimes been relied on in an attempt to lift the veil. Although *Salomon* made it clear that a company is not automatically the agent of its shareholders, in exceptional cases such a relationship can exist, and it will be a question of fact whether there is a relationship of agency in any particular case. Questions of agency most often arise in the context of associated or group companies, and so the two areas are here considered together.

Statute

[42] [2008] EWHC 2380 (Fam)

45. Companies Act 1985 ss. 227-231 (and CA 2006 s.399 *et seq*) provide that groups of companies must prepare group accounts, which must comprise consolidated balance sheets and profit and loss accounts for the parent company and its subsidiary undertakings. The aim of the accounts is to give a true and fair picture of the state of the undertakings included in the consolidation as a whole, which are treated for the purposes of the accounts as an economic unit. The process naturally requires that the corporate veil be lifted in order to identify which companies form the group. The courts are also sometimes willing to treat a group of companies as a unit for other purposes, and have tended to justify the decision to pierce the veil by analogy with the legislation, or by finding that one group company was the agent of another.

Case Law

46. The development of the courts' attitude to agency in a company context has tended not to produce clear rules, perhaps until recently, and so the case law is summarised below. The principles leading to a finding of agency were considered by Atkinson J in *Smith, Stone & Knight Ltd v. Birmingham Corporation*[43], in the context of whether a subsidiary company was the agent of its holding company. That was a case where agency was established and the veil lifted – the parent company had full and exclusive access to the subsidiary's books, the subsidiary had no employees other than a manager, it occupied the parent's premises for no consideration and the only evidence of its purportedly independent existence was its name on the stationery. Atkinson J said that the question of whether a company was carrying on its own business or its parent's was a question of fact, and identified six questions which he considered determinative:

(i) Were the profits of the subsidiary those of the parent company?

(ii) Were the persons conducting the business of the subsidiary appointed by the parent company?

(iii) Was the parent company the "*head and brains*" of the venture?

(iv) Did the parent company govern the venture?

(v) Were the profits made by the subsidiary company made by the skill and direction of the parent company?

(vi) Was the parent company in effective and constant control of the subsidiary?

These questions, while still relevant, can no longer be viewed as a complete statement of the law. As will be discussed below, the trend of the authorities has been away from findings of agency unless particular circumstances dictate that such a finding should be made. An exception to the trend is the unreported case *of Hyundai v Prince Jefri*

[43] [1939] 4 All ER 116

Bolkiah[44] where the Court refused to strike out a claim based on the contention that a corporate entity was at all relevant times merely the agent of its major shareholder.

47. It is relevant to consider the purpose for which the relevant company structure was created. In *Re F.G. (Films) Ltd*[45] an American holding company set up a British subsidiary to produce a film, in order that it might be classified as a British film. The Board of Trade refused to register it as such, and the matter came to court. It was held that the British company's participation in the making of the film was so small as to be practically negligible, and that it had been brought into existence for the sole purpose of being put forward as having made the film, and for thus enabling it to qualify as a British film, and that therefore there was a relationship of agency.

48. In *Littlewoods Mail Order Stores Ltd v. McGregor*[46] Lord Denning warned that the *Salomon* doctrine had to be carefully watched, and said that Parliament had shown the way as regards the scrutiny of groups of companies, and that the courts should follow suit.

49. An influential case in this area was *DHN Food Distributors Ltd v. Tower Hamlets London Borough Council*[47], which concerned compulsory purchase: one company in the group owned the freehold of premises, from which another group company traded and which it occupied as bare licensee. The Court of Appeal stressed the significance of the existence of a *"single economic unit"* and recognised the group as a single entity, allowing it to recover compensation, but the exact reasons behind the decision are unclear, as the members of the court were each apparently influenced by different factors. Lord Denning MR noted that the subsidiaries were wholly owned, Shaw LJ pointed out that the companies had common directors, shareholdings and interests, and Goff LJ referred to ownership and the fact that the companies had no business operations outside the group. Goff LJ also stated that not all groups would be treated in this way, and there have been cases since *DHN Food Distributors* in which wholly owned subsidiaries have not been identified as a unit with their holding companies[48].

50. To further confuse the position, *DHN Food Distributors* was not followed by the House of Lords in the Scottish appeal of *Woolfson v. Strathclyde Regional Council*[49], and also runs counter to many decisions of courts in Australia and New Zealand. In *Industrial Equity Ltd v. Blackburn*[50] the High Court of Australia said that the group accounts legislation did not operate to deny the separate legal personality of the company. In *Re Securitibank Ltd (No. 2)*[51] the New Zealand Court of Appeal considered the decision in *Littlewoods Mail Order Stores* and thought that the approach in that case was the wrong way around– the court considered that the *Salomon* principal should be the starting point

[44] 9 March 2001, Ch D, per Morrit V-C
[45] [1952] 1 WLR 483
[46] [1969] 3 All ER 855
[47] [1976] 3 All ER 462
[48] E.g. *Lonrho Ltd v. Shell Petroleum Co Ltd* [1981] 2 All ER 456
[49] (1978) 38 P & CR 521
[50] (1977) 137 CLR 567
[51] [1978] 2 NZLR 136

for any examination of a group of companies, and any departure from it should be considered carefully. In the New South Wales case of *Pioneer Concrete Services v. Yelnah Pty Ltd*[52] Young J considered the authorities and held that the veil should only be lifted where there was in law or in fact a partnership between the companies, or where there was a sham or façade[53].

51. The English position was again considered by the Court of Appeal in *Adams v. Cape Industries plc*[54], in which the Claimants with default judgments obtained in Texas against a company sought to enforce those judgments against an its ultimate holding company in the United Kingdom. The Court of Appeal held that although a parent company exercised supervision and control over its subsidiary in a foreign country, the parent company was not present in that country, and did not submit to that jurisdiction, by a subsidiary which did business in its own right. In the passage quoted above, Slade LJ stated that the *Salomon* principle will not be disregarded simply because justice so requires, and that subsidiary companies should be considered as individuals unless special circumstances dictated otherwise. Members of a corporate group were perfectly entitled to use the corporate structure even if the consequence was that only lowly capitalised subsidiaries were exposed to potentially harmful asbestos claims.

52. One of the rare cases concerning group companies in which *Salomon* has been distinguished where there has been no fraud is *HIT Finance Ltd v Lewis & Tucker*[55]. There a wholly owned subsidiary was claiming against a negligent valuer damages based on the cost of borrowing money from its parent companies. The Court held that as the subsidiary would never have borrowed from anyone other than its parent, the nominal cost of its borrowing was not its real loss. Instead it awarded what it estimated was the parent companies' cost of borrowing.

53. It is suggested, therefore, that the present position is that in general the courts are likely to be unwilling to lift the veil as against groups of companies in the absence of some agreement of agency, and that *Littlewoods Mail Order Stores* and *DHN Food Distributors* cannot any longer be considered authoritative.

REPRESENTATIONS AS TO CREDITWORTHINESS

54. Only rarely will the concepts of a sham or agency assist in the process of attaching liability to a director or shareholder of an insolvent company. Proving that a company is a sham can be difficult, particularly if the company is long established, and agency will not normally be relevant. Further, the statutory remedies against directors for wrongful and fraudulent trading[56] are of very limited assistance to most creditors since:

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[52] [1986] 5 NSWLR 254

[53] This seems essentially to have been the approach taken by Registrar Baister in the Chancery Division of the High Court in the case of *Skjevesland v Geveran Trading Co Ltd* [2000] B.P.I.R. 523.

[54] [1990] Ch 433

[55] [1993] 2 EGLR 231

[56] Insolvency Act 1986 ss 213-214

(i) they depend upon the company being wound up and action being taken by the liquidator; and

(ii) any sums recovered are shared amongst all the various creditors.

In November 2007 the Court of Appeal[57] made clear that there is an alternative remedy for many of those creditors. This alternative is to claim directly against the directors for fraudulent representations as to creditworthiness, an old but often overlooked cause of action [58], albeit one that often has to overcome the hurdle of Lord Tenterden's Act (the Statute of Frauds (Amendment) Act 1828).

55. As explained in *Pakistan National Shipping*[59]:

(i) a director will not be treated as liable with a company as a joint tortfeasor if he does no more than carry out his constitutional role in the governance of the company – eg by voting at board meetings. Similarly a controlling shareholder will not be liable as joint tortfeasor for doing no more than voting at general meetings and appointing directors.

(ii) Nevertheless, there is no reason why a person who happens to be a controlling shareholder or director should not be liable with the company as a joint tortfeasor if he is not exercising control through the constitutional organs of the company and the circumstances are such that he would be so liable if he were not a director or controlling shareholder.

56. In the context of intellectual property the potential for joint tortious liability of individuals who have responsibility for the control of a company, alongside the company, is of long standing.[60] In *Contex Drouzhba v Wiseman* Irwin J[61] and the Court of Appeal applied this principle to the tort of deceitful misrepresentations as to creditworthiness.

57. In *Contex Drouzhba* the defendant was a director of a company which he knew was in a weak financial position. So as to obtain goods for the Company, the director signed a document which was given to the Claimant suppliers stating:

> *"6.Payments: Bank Transfer made the account of the performer [Claimant] made not later than 30/thirty/ days after the shipment"*

(i) This document clearly containing a promise by the company to pay for goods to be ordered in the future;

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[57] *Contex Drouzhba v Wiseman* [2007] EWCA Civ 1201
[58] see *Pasley v Freeman* (1789) 3 TR 51
[59] *Standard Chartered Bank v Pakistan National Shipping Corp (No 2)* [2000] 1 Lloyds Rep 218, 235
[60] *Rainham Chemical Works Ltd v Belvedere Fish Guano Co Ltd* [1921] 2 AC 465, and *MCA v Charly Records* [2001] EWCA Civ 1441
[61] [2006] EWHC 2708 (QB),

(ii) The director by signing the document impliedly represented that the company had the capacity to meet its obligations to pay for goods to be ordered thereafter; and

(iii) The representation was fraudulent as the director knew the company did not have that capacity and had no chance of gaining it.

58. The director was a joint tortfeasor in respect of the deceitful misrepresentation.

> *"It cannot ever have been the policy of the law that a director of a company who commits acts amounting to deceit and at the same time procures acts amounting to deceit by the company of which he is a director should be able to claim exemption from tortious action because of his status as director."*[62]

> *"Since the essence of the case is representations as to the Company's credit which were almost all in fact made by [the director] himself, the analysis must be that [the Director] both made those representations personally and procured the company to make them ... Here [the director] controlled everything closely, while most of the representations were made by [the director] personally, they were necessarily made on behalf of the company. Insofar as the representations as to credit consisted of orders placed pursuant to various agreements, they were also made on occasion by other company employees under the direction of [the director]. In my judgment, this is a situation where the individual director and the company may be joint tortfeasors."*[63]

59. When *Contex Drouzhba* came before the Court of Appeal no permission to appeal was given on the general principle of the director's joint liability. The only issues which concerned the Court of Appeal were defence arguments based on section 6 of Lord Tenterden's Act (the Statute of Frauds (Amendment) Act 1828). This Act provides that:

> *"No action shall be brought whereby to charge any person upon or by reason of any representation or assurance made or given concerning or relating to the character, conduct, credit, ability, trade, or dealings of any other person to the intent or purpose that such other person may obtain credit, money, or goods upon, unless such representation or assurance be made in writing, signed by the Party to be charged therewith"*

60. This legislation, although antique, is still in force. Its meaning has long been the subject of debate and it was as recently as 2011 that the Court of Appeal held that the wording of s.6 of the Act makes no grammatical sense and that the word *"credit"* has been misplaced and should be after the word *"upon"* rather than before the word *"money"*.[64]

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[62] [2006] EWHC 2708 (QB), at [96]
[63] [2006] EWHC 2708 (QB), at [97]
[64] *Roder UK Ltd v West & Philips* [2011] EWCA Civ 1126

61. Lord Tenderden's applies only to fraudulent representations. For an action for false representation as to creditworthiness to be maintained, the representation as to the credit of another person must be signed by the person making it, and not by an agent and *"person"* for this purpose includes a company. It was contended unsuccessfully on behalf of the director that the only representations made by the director were by conduct or implied representations and therefore outside the section.

62. As Waller LJ pointed out:

> *"Certainly, if the judge is right, it appears that there may be situations in which, by the signing of contracts by directors where those directors are guilty of fraudulent trading, creditors may have a direct remedy against the director in deceit, and a remedy that avoids the consequences of sections 213 and 214. Those consequences flow from the finding of an implied representation of the type found in this case (against which there is now no appeal), together with a finding that the contract satisfies the above section of Lord Tenterden's Act."* [65]

63. The Court of Appeal held that Irwin J was right to impose liability on the director and that Lord Tenterden's Act provided no defence. Importantly, the fact that a representation can only be implied from the terms of a written document rather than being an express term was held not to assist the director. To impose personal liability there is no need for any express representations as to creditworthiness, so long as there is something in writing and it was signed by that person.

64. It should be noted that, as decided in *Roder UK Ltd v West & Philips*[66] in 2011, a potential defence under Lord Tenterden's Act does not arise where a director makes representations as to creditworthiness which result in a creditor not calling in an existing debt. In effect, there can only be a defence under the Act where the representation is made before the goods or relevant credit is provided and a director or other person who makes a misrepresention to buy extra time for repayment of a company debt is potentially liable.

CONCLUSIONS

"Genuine Ultimate Purpose"- An alternative test?

65. It has been suggested by some commentators[67] that a *"genuine ultimate purpose"* test should replace the traditional established sham or façade test. However, this novel approach may throw up as many problems as the traditional test. Further, it seems to strike at the heart of the concept of the limited liability company since a primary (and often sole) purpose of incorporation is to reduce personal exposure to trade creditors, a motive that has been held to be acceptable since the concept of the limited company first

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65 *Contex* [2007] EWCA Civ 1201 at [7]
66 [2011] EWCA Civ 1126
67 eg see Marc Moore *" A temple built on faulty foundations"* [2006] JBL 180

became part of the legislative framework. Parliament, when passing the Companies Act 2006, had ample opportunity to conduct a wholesale revision of this principle but deliberately left the topic well alone. There currently appears to be little judicial enthusiasm for such revision either.

Predicting the future

66. Most direct assaults on the principle of separate corporate personality will struggle to succeed. Except in the most blatant of cases, many judges are uncomfortable with the vague concept of shams and would prefer to make their decision without having to grapple with it. Agency arguments will also struggle to find a receptive court unless special circumstances apply.

67. Instead, Judges are likely to be attracted to forms of analysis which allow the corporate veil to remain intact even if it is side-stepped. Increasing numbers of claims for deceit can be anticipated although at the same time difficulties remain when attempting to impose liability on directors for negligence. Those advising company directors will therefore need to remind them of the fact that the Corporate Veil may be only a flimsy protection against their companies' disgruntled creditors.

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