Corporate personality assignment

Law

Module Title: Company Law Company Law Assignment – Question A In this assignment, I will identify the theory of a corporate personality, demonstrate why companies exist autonomously from their promoters or owners, introduce the concept of a company having a corporate veil, and finally to identify why there is such controversy around the notion of a court lifting the corporate veil, with a focus on ‘ sham’ companies. The theory of a company having a separate legal personality comes from the introduction of incorporation.

Incorporation of a company is established when the company submits all of the relevant documents to the registrar, which, if approved; will result in the issue of an incorporation certificate, acting as conclusive evidence of its incorporation. The requirement for a company to have a separate legal entity is forever scrutinized by certain legal professionals, however this is an essential factor to ensure all of the legal liability a company can create is not directly connected to its members or shareholders. As a result, companies can own property, employ people to work in a desired role, incur their own debts and initiate contracts.

Incorporated companies exist independently autonomous from its original promoters and the people who are in directorship. The independent legal status associated with incorporated companies is said to have created the idea of casting a veil between the company and its’ members/owners/share holders, which is known amongst the legal profession as the corporate veil. As a result, this has caused various arguments against whether this separation should exist and if the so called corporate veil should be permanently lifted or just lifted at the courts discretion.

The function of preventing all legal liability falling on its' owners/members was a required characteristic and the fundamental reason why Parliament wanted to find a way of rectifying the problem and stop owners/members being subject to high amounts of liability. The landmark case that began the concept of a company becoming a separate entity and having a separate corporate personality; came from the case of Salomon v Salomon; this case laid the foundations for what has become the principle in which a court will follow, in times where a company's separate legal personality is questioned.

The first case that began the eventual principle was held in the High Court with the case of Broderip v Salomon (1893). The facts were not of vital significance, however it led to the eventual House of Lords outcome that laid the foundations on what to adopt when an incorporated company's rights are questioned. The case involved Aron Salomon who began as a solvent leather merchant who desired incorporation of his small business, to negate any liability from himself, if the company experienced financial difficulties. To achieve this, A.

Salomon forwarded the necessary documents to the registrar and incorporated his business, including himself and his family as the other members within the memorandum of association (acting as proof). The facts became complicated from this point, with the involvement of the claimant Mr Broderip, by a loan that he gave to the company to help with the financial trouble that it was under. In return, A. Salomon promised a return with interest to Mr Broderip, which was not carried through and so the company due to economic trouble was forced into liquidation and A.

Salomon taken to court by Mr Broderip, on the ground that the company was only incorporated as a way of getting around all of the debts that he had incurred while trading. The case was heard within the High court where Vaughan, Williams J. came to the decision that the Defendant A. Salomon did in fact create the business as a mere agent or facade in negating his liabilities, which he believed was contrary to the intentional meaning of the Companies Act, 1862, he stated: (see appendix 1) for judgement. This judgement was again controversial as incorporated companies negate all liability from its owners/members.

As a consequence it led to A. Salomon appealing to the Court of Appeal, where Lindley LJ, along with Lord Justice's Lopes and Kay, observed the case facts and confirmed the previous decision of the High Court and stated that the incorporated company was a trustee of A. Salomon, on the basis that A. Salomon incorporated the company as a mere nominus umbra; a facade or scheme to enable him to continue with limited liability, which LJ Lindley believed was not what Queen Elizabeth and parliament intended when the statute was formed.

Even with Lindley LJ's decision, the details of this case were of such legal controversy and questioning that there was only one real outcome that could answer the questions that arose within the case. Consequently, it was appealed to the House of Lords, to achieve a final justification on what the correct principle is, on incorporation of companies and owners/members rights of negating all liability that they previously had onto a new registered company. The case as heard by Lord's Halsbury, Herschell and MacNaghten; who came to a unanimous decision to overrule previous judgements, with

the fundamental conclusion, that the previous decisions were incorrect and that Judges should not interpret and manifest the meaning of statutes to what they believe is the correct outcome. They all stated that A. Salomon's incorporated company was not an agent or a facade to enable fraud, but in fact was a clearly registered company that was formed correctly to the requirements of the statute.

Lord MacNaghten clearly stated the decision in obiter (see appendix 2) for judgement. The Salomon case was a fundamental stage in ensuring that companies maintained a separate legal personality; the establishment of a company as a separate entity does however still have many imperfections, which arise mainly through the various instances where the courts have gone against the Salomon principle and have justified ' lifting the corporate veil' to prevent wrongful acts occurring.

The idea of lifting the corporate veil are circumstances when the courts ' disregard the autonomous legal personality' of an incorporated company. The English Courts strongly support the principles laid down in Salomon and choose to oppose the idea of any exceptions that may occur.

However, the opinion of many legal professions is that the courts have adopted a ' laissez-faire' approach towards establishing that an incorporated company was in fact created to be a mere facade to enable illegal activities; Marc Moore (Professional legal writer) within the Journal of Business law, in his journal " A temple built on faulty foundations": piercing the corporate veil and the legacy of Salomon v Salomon", he provides a statement that clearly provides what many people think of how the courts lift the veil (see appendix

3); The statement identifies how there is a need for the so called corporate veil to sometimes be lifted.

On the other hand, it is of Marc Moore’s as well as many other people’s view that it is the way in which the veil is lifted or pierced, that causes so much uncertainty and criticism. The lifting of the veil prevents opportunists taking advantage of the Salomon principle and carrying out illegal activities. Consequently, the courts established key areas of what amounted to exceptions to the rule, by classifying illegal companies as a ‘ sham’; to enable incorporators to take advantage of the separate legal personality of a company to disguise legal impropriety’s that may be used to fraud creditors and suppliers while trading.

One of the first identifiable and significant case law that introduced the idea of ‘ piercing’ or ‘ lifting’ the corporate veil was the case of Jones v Lipman (see appendix 3), where the facts of the case introduced a clear company incorporated to be a clear ‘ facade’ or ‘ scheme’ to enable the promoter/owner to avoid a pre-existing obligation. The case facts are that the defendant, Mr Lipman was contracted to sell a property to the Claimant, Mr Jones for the sum of ? 5, 250.

When Mr Jones attempted to complete this contractual agreement, Mr Lipman changed his mind and devised a plan to negate his pre-contractual obligation to sell the property. As a result, the property was conveyed to an incorporated company that he had created and formed simply for the purpose to prevent the specific performance order within his contracted obligation with Mr Jones. This case was held in the High Court, with Russell, J,

who decided that the defendant had created the company specifically for the purpose of avoiding his pre-contractual obligation with Mr Jones.

He stated that the company was a mere “ cloak or sham” to avoid the specific performance which he had previously contracted and agreed to do. The facts of the case clearly showed a piercing of the veil and illustrated how if a company is created as a device to conceal facts and avoid pre-contractual obligations, the strict application of the Salomon principle should be ‘ pierced’ or ‘ lifted’. However, in this case Russell, J. id not achieve this justification, as he refused to recognise the existence of the corporate veil and instead made an order for specific performance against the defendant and the company he had created. The Lipman v Jones case was one of the first examples of a company being created as a clear ‘ facade’. Even though, the judge did not use the legal terms of lifting the corporate veil the idea of it was still present throughout, and it wasn’t until a later case that clear principles were created to justify lifting or piercing of the veil.

This came in the leading judgement of Lord Justice Slade, in Adams. The facts of this case were of high complexity. However, the basic facts don’t hold as much importance as the principles and outcomes that arose from the judgement. With this in mind, the basic facts involved Cape Industries PLC (the main defendants who were an English registered company) that acted as a parent company with subsidiary companies-whose business operations involved mining in South Africa, as well as the marketing of Asbestos (a lethal material that if inherited can cause serious illnesses, uch as malignant cancer). The marketing of this lethal substance, caused the company to come under legal action in the United States of America, where the

claimants (plaintiffs at that time) obtained a judgement against the English company in the American courts. However, the company had no assets left within the U. S jurisdiction and so to retrieve the required compensation they believed they deserved, they decided to enforce the judgement against the principle and head English company within the English Courts.

When the case was applied within the English Courts Lord Justice Slade came to the decision and stressed the importance on the fact that under UK Company/corporate law Cape industries were perfectly in their right to organise and conduct the business operations that they did and still maintain legal liability of such actions. He stated; “ Whether or not this is desirable, the right to use a corporate structure in this manner is inherent in our corporate law”.

In LJ Slade’s judgement he was asked to make special consideration that Cape industries gained a practical benefit from the subsidiary company trading asbestos in the US without the risks of legal liability falling upon them, this was said to most likely be a true reflection. However, the judge made it clear that in English law, Cape was entitled to organise the affairs in this manner and to expect the courts to follow the established principle of the Salomon case and show in relation to the principles of the idea of the single economic unit.

In coming to the decision within the Adams case, Lord Justice Slade identified two main areas; (‘ sham’ companies and the agency principle) where a court could ‘ pierce’ the corporate veil. The most significant in current law is if a company is incorporated as a mere ‘ facade’ or ‘ scheme’ to conceal the true

function or facts as stated earlier. The specifics of this is where a trader, like Mr Lipman (Contractual obligation to sell a property), creates and incorporates a company for the purpose of nothing more than a device to avoid pre-contractual obligation that they may be held to, by a previous contract.

The two main cases's where the corporate veil was lifted or pierced was the Lipman case (as explained earlier) and Gilford Motor Co, which had similar facts to the Lipman case, but was the first instance where the courts were forced to pierce the veil. The case was in relation to an agreed covenant, detailing that the defendant was bound by the contract not to solicit any of its previous employer's clients. The defendant attempted o avoid this covenant by incorporating a rival company designed to solicit its previous employer's clients and enable him to continue to breach the covenant and continue his profession as he was before, albeit as a rival company. The decision was unanimous that a piercing of the veil was necessary to ensure that the defendants could not breach his covenant, by awarding his previous employer (The claimants) an injunction preventing him from soliciting clients and using the incorporate company as a mere " cloak or sham" to continue with no restrictions as laid down in his covenant.

The introduction of a ' sham' company derived from the above two cases, imposed upon the courts to extend this focus by creating a test that could be applied, with the purpose of limiting the amount of cases that could apply the ' sham' or ' facade' test (sometimes referred to as preventing the opening of the floodgates). This test was created in only one significant case; Trustor AB. Trustor AB was an investment company specialising in steel,

engineering and automotive industries, Lord Moyne and Mr Smallbone were appointed to the board of directors, and Mr Smallbone, named as managing director.

It was resolved that Trustor's bank accounts could be operated by having 2 director signatures. This resulted in Lord Moyne and Mr Smallbone transferring Trustor's accounts to a Barclays Bank account, where the recipients (Lord Moyne and Mr Smallbone) distributed the money among various companies and people, to basically obtain the money for themselves. The judgement in this case came from the High Court Vice Chancellor Sir Andrew Morritt, where he granted a summary judgement against the managing director (Mr Smallbone) because he received funds from the claimants company fraudulently.

Mr Smallbone's breach of fiduciary duty and distribution of Trustor's money into devices or ' sham' companies to retrieve the money for his own purpose was something that the courts felt, was inexcusable and something that the Salomon principle could not justify, and as a result, the veil pierced. This judgement created the fundamental facade test; where if a company is created for the purpose of being a ' sham' or facade then the courts can set aside a company's separate existence and use this test to pierce the corporate veil.

The second identifiable basis for piercing the corporate veil in Lord Justice Slade's decision was referred to as the ' Agency' principle. This principle has limited applicability and is generally opposed by the courts. The agency principle can only disregard the separate corporate identity of a company

and be applied in exceptional cases, where it is clear that a subsidiary company is ‘ totally and utterly under the control’ of the parent company, to the extent where the subsidiary loses its autonomy and becomes dependent, upon the parent company for direction.

It is only when this lack of autonomy within a subsidiary is proved, can the agency principle be applied. The agency principle only has limited circumstances when it can be applied. For this reason I will not discuss it in detail, but simply highlight that it exists within the legal system, and has been utilised in cases like Smith, Stone ; Knight Ltd, where the veil was lifted to establish if a subsidiary was an agent of a parent company.

In addition, there are other interpretations of lifting the veil; known as extending the veil, as seen in DHN Food Distributors Ltd where the veil is lifted with the purpose of drawing it back over a larger amount of companies, and a minor form known as peeping behind the veil seen in the case Atlas Maritime, where the veil is lifted to simply retrieve information on who directs or controls the company. Both interpretations are valid within the English courts, however still have limited applicability and are rarely used and discussed.

To conclude, the indications within the English legal system is that courts, at their own discretion can decide to lift or pierce the corporate veil, depending on the basis that the facts of the case coincide with previous case law, (with a requirement to identify the true nature of a company) and identifies that a company is created as a sham or an agent, to enable illegal activities being continued under limited liability.

Journal articles and various legal practitioner articles identify that courts have the power to distinguish and interpret the law to their own interpretation through the use of the so called lifting of the ‘ Corporate veil’, which has many discrepancies. However, it is evident that without these exceptions where the veil can be lifted, it would allow opportunists to take advantage of incorporated companies, having a separate legal entity and use the legal principles to their own advantage.

It is clear, that case law and various articles for and against courts lifting the veil still have the overriding basis that parliament would not have intended to create an opportunity for fraud and various wrongful acts to be allowed due to a statute they created. As a result, the courts allow; in exceptional circumstances, the corporate veil to be lifted. Table of Cases – Adams v Cape Industries plc [1990] Ch 433 Atlas Maritime Co SA v Avalon Maritime Ltd (No 1) [1991] 4 All ER 769 Broderip v Salomon [1895] 2 Ch 323 (High Court, CoA)

DHN Food Distributors Ltd v London Borough of Tower Hamlets [1976] 3 All ER 852 Gilford Motor Co v Horne [1933] Ch 935 Jones v Lipman [1962] 1 WLR 832 Salomon v Salomon ; Co [1897] AC 22 Smith, Stone ; Knight Ltd v Birmingham Corporation (1939) 4 All ER 116 Trustor AB v Smallbone [2001] 2 BCLC 436 Legislation – The Companies Act 1985 [CA85] – (Mentioned within assignment) The Companies Act 2006 [CA06] – (Not specifically mentioned within assignment, but holds importance within the subject) The Insolvency Act 1986 [IA86] – Mentioned within footnote) Bibliography –

An Encyclopaedia Brittanica Company, ‘ Merriam-Webster’, ; http://www. merriam-webster. com/dictionary/magni%20nominis%20umbra; Accessed 20

November 2010 Arthur W. Machen, Jr. , ‘ Corporate Personality’, [1911], Harvard Law Review Association, Vol. 24, No. 5, page. 347-365, ; http://www. jstor. org/stable/1324691; Accessed 14 November 2010 Anglia Ruskin Univeristy Library, ‘ Harvard system of referencing’, ; http://libweb. anglia. ac. uk/referencing/harvard. htm;, Accessed 20 November 2010 ©2010 William S.

Hein ; Co. , Inc, ‘ Hein Online’, ; http://home. heinonline. org;, Accessed 15 November 2010 C. S, Krendl and J. R, Krendl, ‘ Piercing the corporate veil: Focusing the Inquiry’, [1978], Volume 55, Number 1, Denver Law Journal, ; http://heinonline. org/HOL/LandingPage? collection= journals; handle= hein. journals/denlr55; div= 7; id=; page=; Accessed 15 November 2010 D. H, Barber, ‘ Piercing the Corporate Veil’, [1980-81], 17 Willamette L. Rev. 371, ; http://heinonline. org/HOL/LandingPage? ollection= journals; handle= hein. journals/willr17; div= 35; id=; page=; Accessed 15 November 2010 © Docstoc 2010, ‘. docstoc’ ; http://www. docstoc. com/docs/24538342/LIFTING-THE-CORPORATE-VEIL; Accessed 13 November 2010 2010 Google, ‘ Google Scholar’, ; www. scholar. google. co. uk;, Accessed 12 November 2010 Lisa Linklater, 2006, “ Piercing the corporate veil” – The never ending story? , Editorial Journal Article, Company Lawyer, Available at: ; Comp. Law. 2006, 27(3), 65-66;, Accessed 15 November 2010

Marc Moore, 2006, ‘ A temple built on faulty foundations’: Piercing the corporate veil and the legacy of Salomon v Salomon, Journal of Business Law, Available at: www. login. westlaw. co. uk , Accessed: 10 November 2010 Max, Radin, ‘ The endless problem of corporate personality’,[1932], Columbia Law Review Association, Vol. 32, No. 4, Pages. 643-647, ; http://www. jstor.

org/pss/1114707; Accessed 14 November 2010 UWE Library Services, ‘ Westlaw’, ; www. login. weslaw. co. uk;, Atlas Maritime Co SA v Avalon Maritime Ltd (No 1) [1991] 4 All ER 769, Accessed; 10 November 2010 UWE Library Services, ‘ Westlaw’, ; www. ogin. weslaw. co. uk;, Adams v Cape Industries plc [1990] Ch 433, Accessed 11 November 2010 UWE Library Services, ‘ Westlaw’, ; www. login. weslaw. co. uk;, Broderip v Salomon [1895] 2 Ch 323 (High Court, CoA), Accessed 10 November 2010 UWE Library Services, ‘ Westlaw’, ; www. login. weslaw. co. uk;, DHN Food Distributors Ltd v London Borough of Tower Hamlets [1976] 3 All ER 852, Accessed 12 November 2010 UWE Library Services, ‘ Westlaw’, ; www. login. weslaw. co. uk;, Gilford Motor Co v Horne [1933] Ch 35, Accessed 11 November 2010 UWE Library Services, ‘ Westlaw’, ; www. login. weslaw. co. uk;, Jones v Lipman [1962] 1 WLR 832, Accessed 11 November 2010 UWE Library Services, ‘ Westlaw’, ; www. login. weslaw. co. uk;, Salomon v Salomon ; Co [1897] AC 22, Accessed 10 November 2010 UWE Library Services, ‘ Westlaw’, ; www. login. weslaw. co. uk;, Smith, Stone ; Knight Ltd v Birmingham Corporation (1939) 4 All ER 116, Accessed 13 November 2010 UWE Library Services, ‘ Westlaw’, ; www. login. weslaw. co. k;, Trustor AB v Smallbone [2001] 2 BCLC 436, Accessed 12 November 2010 Appendices – 1. “ That the company was the mere nominee of A. Salomon; that if his nominee had been an individual the nominee could have called on the defendant as his principal, to indemnify him from the business liabilities; the fact of the nominee being a company made no difference; and that A. Salomon must indemnify the company against the debts which its assets were insufficient to pay”. (Vaughan, Williams J. Judgement in Broderip v Salomon [1895] 2 Ch 323, [High Court, CoA]) 2. The company is at law a

different person altogether from the subscribers to the memorandum; and, though 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 trustees for them. Nor are the subscribers as members liable, in any shape or form, except to the extent and in the manner provided by the Act" (Lord MacNaghten, Obiter Judgement within Salomon v Salomon & Co [1897] AC 22) 3. In this article, I will argue that, whilst the need to bar application of the Salomon principle in certain cases is undeniable, the particular way in which the English courts have rationalised these " exceptional" cases is both wrong and doctrinally unsustainable" (Statement made by Marc Moore, a professional legal writer, whose opinion is very clear and demonstrates what all legal writers and many judges believe is wrong within the English legal sytem. Taken from, Marc Moore, 2006, ' A temple built on faulty foundations': Piercing the corporate veil and the legacy of Salomon v Salomon, Journal of Business Law. ——————————————————– [1]. Salomon v Salomon & Co Ltd [1897] A. C. 22 (HoL) [2]. Broderip v Salomon [1895] 2 Ch 323 (High Court, CoA) [3]. The Companies Act, 1862; this act is the main act that is quoted and used in relation to incorporate companies, and their rights. Within Salomon and Salomon there are various sections used within the 1862 companies Act, however within the assignment, I haven't mentioned the Insolvency Act 1986, however it does hold high importance in relation to the lifting of the veil, for e. g. he insolvency act S. 216 mentions ' phoenix companies'. [4]. Latin term used within the decision of Broderip v Salomon [1895] 2 Ch 323 (High Court, CoA); referring to a shadow of a name, or in this case referring to a business that is seen as a

shadow. [5]. The quote ‘ disregard the autonomous legal personality’ was taken from the source; Marc Moore, 2006, ‘ A temple built on faulty foundations’: Piercing the corporate veil and the legacy of Salomon v Salomon, Journal of Business Law, Available at: login. westlaw. co. uk, Accessed: 10/11/2010 [6].

Laissez-faire approach sourced from; Marc Moore, 2006, ‘ A temple built on faulty foundations’: Piercing the corporate veil and the legacy of Salomon v Salomon, Journal of Business Law, Available at: login. westlaw. co. uk, Accessed: 10/11/2010 [7]. The quote “ cloak or sham” was quoted from the, Russell, J judgement within the case of Jones v Lipman [1962] 1 WLR 832 [8]. Adams v Cape Industries plc [1990] Ch 433 [9]. Quote taken from Adams v Cape Industries plc [1990] Ch 433 [10]. Gilford Motor Co v Horne [1933] Ch 935 [11].

Trustor AB v Smallbone [2001] 2 BCLC 436 [12]. In this section of the assignment I used the source; Lisa Linklater, 2006, “ Piercing the corporate veil” – The never ending story? , Editorial Journal Article, Company Lawyer, Available at: Comp. Law. 2006, 27(3), 65-66, Accessed at: 15/11/2010 [13]. Smith, Stone & Knight Ltd v Birmingham Corporation (1939) 4 All ER 116 [14]. DHN Food Distributors Ltd v London Borough of Tower Hamlets [1976] 3 All ER 852 [15]. Atlas Maritime Co SA v Avalon Maritime Ltd (No 1) [1991] 4 All ER 769 [16].

Due to the word count limits, I was not able to extend the description and provide detailed case law and arguments for and against, the other various forms of principles where a court decide to lift or pierce the veil. The agency

principle even with its limited applicability does still provide a basis for strong arguments as to why the courts allow the veil to be lifted and what the reasons are behind the strong arguments against the principle. The Agency principle is only one of the other suggested reasons, there are other forms of piercing of the veil that exist within our English courts, that I have mentioned but not discussed.