3

Lifting the veil

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Introduction

3.1 You may not unnaturally wonder at this point what the phrase 'lifting the veil' is about. It refers to the situations where the judiciary or the legislature have decided that the separation of the personality of the company and the members is not to be maintained. The veil of incorporation is thus said to be lifted. The judiciary in particular seem to love using unhelpful metaphors to describe this process. In the course of reading cases in this area you will find the process variously described as 'lifting', 'peeping', 'penetrating', 'piercing' or 'parting' the veil of incorporation. In a nutshell, having spent the whole of the last chapter emphasising the separateness of corporate personality, we now turn to those situations where for various reasons that separateness is not maintained.

3.2 While some of the examples of veil lifting involve straightforward shareholder limitation of liability issues many of the examples involve corporate group structures. As businesses became more adept at using the corporate form, group structures began to emerge. For example Z Ltd (the parent or holding company) owns all the issued share capital in three other companies—A Ltd, B Ltd and C Ltd. These companies are known as wholly owned subsidiaries (see CA 2006, s 1159(2)). Z Ltd controls all three subsidiaries. In economic reality there is just one business but it is organised through four separate legal personalities. In effect this structure allows the legal personality of the parent company to avail itself of the advantages of limited liability. Thus if the parent conducts its more risky or liability-prone activities through A Ltd and things go wrong the assets of Z Ltd as a shareholder of A Ltd with limited liability in theory cannot be touched. In certain situations the legislature and the courts will not allow this to happen.

Statutory examples

3.3 The taxation authorities in the UK have been acutely aware of the potential for group structures to avoid taxation by moving assets and liabilities around the group. Thus, there are numerous examples of taxation legislation directed at ignoring the separate entities in the group. The Companies Act also recognises that group structures need to be treated differently for disclosure and financial reporting purposes in order to get a proper overview of the group financial position. The CA 2006, s 399 therefore provides that parent companies have a duty to produce group accounts. Section 409 also requires the parent to provide details of the subsidiaries' names, country of activity and the shares it holds in the subsidiary.

3.4 The Employment Rights Act 1986 also protects employees' statutory rights when transferred from one company to another within a group, treating it as a continuous period of employment. Additionally, many of the situations where lifting the veil' is at issue involve corporate insolvency, the Insolvency Act 1986 has some key veil lifting provisions. While we deal with these provisions in detail in Chapter 17, we briefly consider them here.

3.5 The Companies Acts have long recognised that the corporate form could be used for fraudulent purposes. Indeed, one of the reactions of Parliament to the *Salamon* decision was to introduce an offence of 'fraudulent trading'. This offence was continued in the 1948 Companies Act which contained both civil and criminal sanctions for fraudulent trading. While the CA 2006 still contains a criminal offence in s 993 for fraudulent trading the civil provisions are now contained in ss 213–215 of

the Insolvency Act 1986. It is these civil sanctions that operate to lift the corporate veil. Section 213 states:

> (1) If in the course of the winding up of a company it appears that any business of the company has been carried on with intent to defraud creditors of the company or creditors of any other person, or for any fraudulent purpose, the following has effect.
>
> (2) The court, on the application of the liquidator may declare that any persons who were knowingly parties to the carrying on of the business in the manner abovementioned are to be liable to make such contributions (if any) to the company's assets as the court thinks proper.

3.6 This section and its predecessor in the 1948 Act consistently proved difficult to operate in practice. The main difficulty was that there was the possibility of a criminal charge also arising. The courts therefore set the standard for intent fairly high. As the court explained in *Re Patrick and Lyon Ltd* (1933), this involved proving 'actual dishonesty, involving, according to current notions of fair trading among commercial men, real moral blame'. Reaching this standard was difficult and eventually a new provision was introduced in s 214 of the Insolvency Act 1986 to deal with what is known as 'wrongful trading'.

3.7 Section 214 was introduced to deal with situations where negligence rather than fraud is combined with a misuse of corporate personality and limited liability. In other words there was no need to prove dishonesty. This is known as wrongful trading'. Section 214 states:

> (1) . . . if in the course of the winding up of a company it appears that subsection (2) of this section applies in relation to a person who is or has been a director of the company, the court, on the application of the liquidator, may declare that that person is to be liable to make such contribution (if any) to the company's assets as the court thinks proper.
>
> (2) This subsection applies in relation to a person if—
>
> (a) the company has gone into insolvent liquidation,
>
> (b) at some time before the commencement of the winding up of the company, that person knew or ought to have concluded that there was no reasonable prospect that the company would avoid going into insolvent liquidation, and
>
> (c) that person was a director of the company at that time.

3.8 The idea behind the operation of the section is that at some time towards the end of the company's trading history there will be a point of no return. That is, things are so bad the company can no longer trade out of the situation. A reasonable

director would stop trading at this point. If a director continues to trade after this point he will risk having to contribute to the debts of the company. The case of *Re Produce Marketing Consortium Ltd (No 2)* (1989) is a good example of the way the section operates. Over a period of seven years the company had slowly drifted into insolvency. There was no suggestion of wrongdoing on the part of the two directors involved; it was just that they did not put the company into liquidation in time and thus they had to contribute £75,000 to the debts of the company.

3.9 While s 213 covers anyone involved in the carrying on of the business, thus qualifying the limitation of liability of members, s 214 is aimed specifically at directors. In small companies directors are often also the members of the company and so their limitation of liability is indirectly affected. Parent companies may also have their limited liability affected if they have acted as a shadow director. A shadow director is anyone other than a professional adviser in accordance with whose directions or instructions the directors of the company are accustomed to act (CA 2006, s 251, see Chapter 13). A parent company might be in this position if it was exerting direct control over the board of its subsidiaries.

Veil lifting by the courts

3.10 Since the *Salomon* decision the courts have often been called upon to apply the principle of separate legal personality in what might be called difficult situations. In some cases they have upheld the principle and in others they did not. Over this time various attempts have been made at providing explanations for when the courts will lift the veil of incorporation; none however are really satisfactory. Some texts attempt to explain veil lifting by categories: where the company is an agent of another, where there is fraud, or tax issues, or employment issues or a group of companies exists the courts will lift the veil. While it is possible to find examples of veil lifting in all these categories it is also possible to find examples of the courts upholding the separateness of companies in these categories. Others have attempted to categorise veil lifting by analysing the ways the judiciary have lifted the veil. Thus Ottolenghi (1990) offers categorisations such as: 'peeping', where the veil is lifted to get member information; 'penetrating', where the veil is disregarded and liability is attributed to the members; 'extending', where a group of companies is treated as one legal entity and; 'ignoring', where the company is not recognised at all. While these categorisations are interesting and useful for understanding how veil lifting has sometimes operated in the past they in no way offer a guide to how the courts will behave in a given situation in the future. The most accurate statement about this that can be made is that sometimes the courts lift the veil and sometimes they

refuse to. It may be frustrating and unsatisfactory but that is the reality. Having said that, there have been periods where the courts were more inclined to uphold the veil of incorporation than not. By way of our own explanation we offer the following time line which is intended as a general guide.

Classical veil lifting, 1897–1966

3.11 During this period the House of Lords decision in *Salomon* dominated. As we explained in Chapter 2, the House of Lords could not overrule itself during this period and this operated as a restraint on veil lifting. However, veil lifting did occur in exceptional circumstances during this period. The court for example in *Daimler Co Ltd v Continental Tyre and Rubber Co* (*Great Britain*) *Ltd* (1916) lifted the veil to determine whether the company was an 'enemy' during the First World War. As the shareholders were German, the court determined that the company was indeed an 'enemy'.

3.12 In *Gilford Motor Co Ltd v Horne* (1933) a former employee who was bound by a covenant not to solicit customers from his former employers set up a company to do so. The court found that the company was but a front for Mr Horne and issued an injunction. In *Jones v Lipman* (1962) Mr Lipman had entered into a contract with Mr Jones for the sale of land. Mr Lipman then changed his mind and did not want to complete the sale. He formed a company in order to avoid the transaction and conveyed the land to it instead. He then claimed he no longer owned the land and could not comply with the contract. The judge again found the company was but a facade and granted an order for specific performance. In *Re Bugle Press* (1961) majority shareholders in a company set up a second company in order to force a compulsory purchase of a minority shareholder's shares. The second company then made an offer for the shares in the first company and the majority shareholders accepted. As this meant that over 90 per cent of the shareholders had accepted it therefore triggered a compulsory purchase of the minority shareholder's shares under the Companies Acts (see Chapter 5). The minority shareholder objected and the court prevented the transaction again as the second company was but a mere facade for the majority shareholders.

The interventionist years, 1966–1989

3.13 By the 1960s the courts were increasingly demonstrating a tendency to free themselves from old precedence they saw as increasingly unjust. In 1966 this tendency led the House of Lords to change the rules under which it had operated and allow

it to change its mind and overrule itself. By 1969 Lord Denning seemed to be on a crusade to encourage veil lifting. In *Littlewoods Mail Order Stores v IRC* (1969) he stated:

> [t]he doctrine laid down in Salomon's case has to be watched very carefully. It has often been supposed to cast a veil over the personality of a limited company through which the courts cannot see. But that is not true. The courts can, and often do, pull off the mask. They look to see what really lies behind. The legislature has shown the way with group accounts and the rest. And the courts should follow suit.

3.14 In *DHN Food Distributors Ltd v Tower Hamlets* (1976) Denning argued that a group of companies was in reality a single economic entity and should be treated as one. Two years later the House of Lords in *Woolfson v Strathclyde Regional Council* (1978) specifically disapproved of Denning's views on group structures in finding that the veil of incorporation would be upheld unless it was a facade. However, Denning's views on the lifting of the corporate veil still had considerable effect. In *Re a Company* (1985) the Court of Appeal stated:

> [i]n our view the cases before and after *Wallersteiner v Moir* [1974] 1 WLR 991 [another Lord Denning case] show that the court will use its power to pierce the corporate veil if it is necessary to achieve justice irrespective of the legal efficacy of the corporate structure under consideration.

This represented probably the high point of the interventionist period where the courts seemed to treat the separate personality of the company as an initial negotiating position which could be overturned in the interests of justice.

3.15 There was however a growing disquiet about the uncertainty this brought to the concept of corporate personality and limited liability. As Lowry (1993) concluded:

> [t]he problem that can naturally arise from this approach is the uncertainty which it casts over the safety of incorporation. The use of the policy to erode established legal principle is not necessarily to be welcomed.

Similarly Gallagher and Ziegler (1990) in an examination of when the courts will at common law lift the veil of incorporation concluded that the lifting of the veil can have negative impacts on other aspects of the law such as directors' duty to the company as a whole, individual taxation principles and the rule in *Foss v Harbottle* (1843). However, by the late 1980s the Court of Appeal in *National Dock Labour Board v Pinn and Wheeler Ltd* (1989) had moved firmly against a more interventionist approach at least where group structures were concerned. This was a foretaste of what was to come in the following decade.

Back to basics, 1989–present

3.16 In *Adams v Cape Industries Plc* (1990) the Court of Appeal took the opportunity to examine at great length the way the courts have lifted the veil of incorporation in the past and narrowed significantly the way in which the courts could do so in the future. The facts of the case were extremely complex and what follows is but a very simple version. The case concerned the enforcement of a foreign judgment in England. The key issue for the Court was whether Cape Industries could be regarded as falling under the jurisdiction of a US court and therefore be subject to its judgment. This could only occur if Cape was present within the US jurisdiction or had submitted to such jurisdiction.

3.17 Until 1979, Cape, an English company, mined and marketed asbestos. Its worldwide marketing subsidiary was another English company, named Capasco. It also had a US marketing subsidiary incorporated in Illinois, named NAAC. In 1974, some 462 people sued Cape, Capasco, NAAC and others in Texas, for personal injuries arising from the installation of asbestos in a factory. Cape protested at the time that the Texas court had no jurisdiction over it but in the end it settled the action. In 1978, NAAC was closed down by Cape and other subsidiaries were formed with the express purpose of reorganising the business in the USA to minimise Cape's presence there for taxation and other liability issues.

3.18 Between 1978 and 1979, a further 206 similar actions were commenced and default judgments were entered against Cape and Capasco (who again denied they were subject to the jurisdiction of the court but this time did not settle). In 1979 Cape sold its asbestos mining and marketing business and therefore had no assets in the USA. The claimants thus sought to enforce the judgments in England where Cape had most of its assets. At issue in the case was whether Cape was present in the US jurisdiction by virtue of its US subsidiaries. The only way that could be the case in the court's view was if it lifted the veil of incorporation, either treating the Cape group as one single entity, or finding the subsidiaries were a mere facade or that the subsidiaries were agents for Cape. The court exhaustively examined each possibility.

3.19 The court first examined the major 'single economic unit' cases where group structures were treated as being a single entity. It found that the cases all involved the interpretation of a statute or a document. They reached this conclusion even though the Denning judgment (which the Court of Appeal examined) in *DHN Food Distributors Ltd v Tower Hamlets* (1976) is clearly not based upon interpreting

a statute or document. The court therefore rejected the argument that the Cape group should be treated as one, stating:

> 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 A 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 legal entities with all the rights and liabilities which would normally attach to separate legal entities.

3.20 The court then turned to what they termed the 'corporate veil' point. This category of veil lifting is exemplified by the case of *Jones v Lipman* (1962, above) and was, in the court's view, a well-recognised veil lifting category. The Court of Appeal quoted with approval the words of Lord Keith in *Woolfson v Strathclyde Regional Council* (1978) where he described this exception as 'the principle that it is appropriate to pierce the corporate veil only where special circumstances exist indicating that it is a mere facade concealing the true facts'. In these special circumstances the motives of those behind the alleged facade could be very important. The court looked at the motives of Cape in structuring its US business through its various subsidiaries. It found that although Cape's motive was to try to minimise its presence in the USA for tax and other liabilities there was nothing wrong with this. The court concluded:

> [w]hether or not such a course deserves moral approval, there was nothing illegal as such in Cape arranging its affairs (whether by the use of subsidiaries or otherwise) so as to attract the minimum publicity to its involvement in the sale of Cape asbestos in the United States of America . . . we do not accept as a matter of law that the court is entitled to lift the corporate veil as against a defendant company which is the member of a corporate group merely because the corporate structure has been used so as to ensure that the legal liability (if any) in respect of particular future activities of the group (and correspondingly the risk of enforcement of that liability) will fall on another member of the group rather than the defendant company. Whether or not this is desirable, the right to use a corporate structure in this manner is inherent in our corporate law.

3.21 The court then considered the 'agency' argument. This was a straightforward application of agency principle. If it could be established that the subsidiary was Cape's agent and acting within its actual or apparent authority then the actions of the subsidiary would bind the parent. However, if there is no express agency agreement between the subsidiary and the parent, establishing such an agency from their conduct is very hard to achieve. The court found that the subsidiaries were independent businesses free from the day-to-day control of the parent with no general power to

bind the parent. Thus as none of the three veil-lifting categories applied Cape was not present in the USA through its subsidiaries.

3.22 The judgment of the Court of Appeal in *Adams* leaves only three circumstances in which the veil of incorporation can be lifted. The first is if the court is interpreting a statute or document. This exception to maintaining corporate personality is qualified by the fact that there has first to be some lack of clarity about a statute or document which would allow the court to treat a group as a single entity. Some judges will be more enthusiastic about finding such lack of clarity than others. Although the Court is somewhat vague in *Adams* on what they mean by this exception, the Court of Appeal in *Samengo-Turner v J&H Marsh & McLennan (Services) Ltd* (2008) treated a group of companies as a single legal entity on the basis of their single economic interest in interpreting the application of an EU Regulation. Similarly in *Beckett Investment Management Group Ltd v Hall* (2007) in interpreting a clause in an employment contract in the context of a group of companies that formed a single economic entity the Court of Appeal considered that it was inappropriate to be inhibited by considerations of corporate personality.

3.23 Second, where 'special circumstances exist indicating that it is a mere facade concealing the true facts' the courts may lift the veil of incorporation. In general, one can describe these cases as the 'you know it when you see it' cases. These are decisions where there is some injustice involved in maintaining the veil of incorporation, which was placed there deliberately to facilitate the injustice complained of. *Jones v Lipman* (1962) is the classic example. There Mr Lipman's sole motive in creating the company was to avoid the transaction. We all know it would be morally wrong to maintain the separate personality of Mr Lipman and the company. The judiciary have thus constructed the exception as 'a mere facade concealing the true facts'. In determining that exception the motives of those behind the alleged facade may be relevant. Cape however is confusing in the way the court applied this exception. The court, although giving the example of *Jones v Lipman* (1962) when examining Cape's motives, seems to recognise the moral culpability of Cape's motive in creating the subsidiaries to minimise its liability in the USA when they state, '[w]hether or not such a course deserves moral approval, there was nothing illegal as such in Cape arranging its affairs'. This seems a strange and confusing point for the court to make as Mr Lipman also did nothing illegal yet the exception applied there. Unfortunately the Court of Appeal offered no other guidance as to when this exception might apply.

3.24 The third exception is not really an exception to the Salomon principle but rather a straightforward application of agency principle. Therefore the question is just the same as it would be for two human beings—'have they entered into an express

agency agreement or could an agency be implied from their conduct?' Parent companies and their subsidiaries are unlikely to have express agency agreements. They are even less likely to have express agreements if avoidance of liability was the reason for setting the subsidiary up in the first place, as it was in *Adams*. Proving an implied agency will also be very difficult as *Adams* sets the bar very high. An implied agency would need evidence that day-to-day control was being exercised over the subsidiary by the parent. Again, this is unlikely to be the case where liability limitation was one of the motives for forming the subsidiary. (For an interesting example of where a high level of control did attribute liability to a parent company see *Millam v The Print Factory (London) 1991 Ltd* (2008)).

3.25 As you can see from the above, *Adams* has significantly narrowed the ability of the courts to lift the veil of incorporation. Gone are the wild and crazy days when the Court of Appeal would lift the veil 'to achieve justice irrespective of the legal efficacy of the corporate structure' as it did in *Re a Company* (1985). The rest of the 1990s was largely dominated by the restrictive approach of *Adams* (for example see *Yukong Lines Ltd of Korea v Rensburg Investments Corpn of Liberia* (1998)) apart from one interesting aberration which we now turn to examine.

Creasey v Breachwood Motors Ltd (1993)

3.26 The case concerned two companies Breachwood Welwyn Ltd and Breachwood Motors Ltd. The two companies had directors and shareholders in common. Mr Creasy had been dismissed from his post of general manager by Breachwood Welwyn Ltd and had issued a writ against Welwyn alleging wrongful dismissal. Shortly after this happened Welwyn ceased trading and its assets were transferred to Breachwood Motors Ltd. Breachwood Motors Ltd then took over and carried on the business of Breachwood Welwyn Ltd. In doing this they paid off Breachwood Welwyn Ltd's creditors but did not maintain or return assets to Breachwood Welwyn Ltd to enable it to meet its judgment debt to Mr Creasy. The wrongful dismissal action was not defended by Breachwood Welwyn Ltd and judgment was entered in default in favour of Mr Creasy and an order for £53,835 made against Breachwood Welwyn Ltd. A year later the company was struck off the companies register and dissolved. Mr Creasy successfully applied to have Breachwood Motors Ltd substituted as the defendant in order to enforce the judgment. Breachwood Motors Ltd appealed.

3.27 The judge in the case, Mr Richard Southwell QC, ignored the restrictive approach in *Adams* in finding that the central issue was that, with the benefit of solicitors' advice, the directors of Breachwood Motors Ltd (who were also directors

of Welwyn) had deliberately ignored the separate legal personalities of the two companies. They had transferred Breachwood Welwyn Ltd's assets and business to Breachwood Motors Ltd without regard to their duties as directors and shareholders. The court was justified therefore in lifting the corporate veil and treating Breachwood Motors Ltd as liable for Breachwood Welwyn Ltd's liability to Mr Creasy.

3.28 The case has caused considerable comment because of its maverick status and the confused nature of the rationale. The judge seems to suggest that when determining the facade exception it is not only the motives of those behind the alleged facade that may be relevant but also whether they have breached their duties as directors. Indeed, from the judgment it seems that the motives of the directors were irrelevant and that just the fact of a breach of duty was sufficient to justify lifting the veil. However, the Court of Appeal soon took the opportunity to overrule it.

Ord v Belhaven Pubs Ltd (1998)

3.29 Ord and Belhaven Pubs Ltd were engaged in a legal action about a lease. During the course of the action the group structure of which Belhaven Pubs Ltd was a part was reorganised because of a financial crisis within the group. As a result of the reorganisation Belhaven Pubs Ltd had no assets or liabilities and would therefore have nothing with which to pay any judgment against it. As the litigation regarding the lease was still continuing Ord applied to have the parent company of Belhaven Pubs Ltd substituted. The High Court judge who first heard the case allowed the substitution. The Court of Appeal however took the view that the reorganisation of the group was legitimate and not merely a facade to conceal the true facts. The assets were transferred at full value and the motive appeared to be the group's financial crisis rather than any ulterior motive. The court also took the opportunity to specifically overrule the judgment in *Creasey v Breachwood Motors Ltd* (1993).

3.30 Both the *Creasey* and *Ord* cases are illustrations of a classic veil-lifting issue, that of whether the reorganisation of the company was a legitimate business transaction or the motive was to avoid liability. If the motive was to avoid liability then according to the facade exception there was the possibility of lifting the veil. If the court takes the view that the veil should be lifted (and this is by no means certain as *Adams* takes a very strict view of the types of motives needed) then liability can flow to the parent company. Indeed, in *Kensington International Ltd v Congo* (2006) the court did hold that a dishonest transaction involving transfers between related companies was designed to avoid existing liabilities and was therefore a sham. The court then went on to lift the veil of incorporation.

Trustor AB v Smallbone (No 2) (2001)

3.31 During Smallbone's period as Trustor's managing director various sums of money had been transferred in breach of fiduciary duty from Trustor to another company owned and controlled by Smallbone. Trustor applied to the court to pierce the corporate veil so as to treat receipt by the second company as receipt by Smallbone on the grounds that: the company had been a sham created to facilitate the transfer of the money in breach of duty; the company had been involved in the improper acts; and the interests of justice demanded such a result.

3.32 The court in an interesting judgment recognised the tension between some of the earlier cases and the *Adams* judgment but concluded that *Adams* was the greater authority. In deciding to lift the veil on the basis of the facade exception the Vice-Chancellor concluded:

> [c]ompanies are often involved in improprieties. Indeed there was some suggestion to that effect in *Saloman v Saloman & Co Ltd* [1897] AC 22. But it would make undue inroads into the principle of *Saloman v Saloman & Co Ltd* if an impropriety not linked to the use of the company structure to avoid or conceal liability for that impropriety was enough.
>
> In my judgment the court is entitled to 'pierce the corporate veil' and recognise the receipt of the company as that of the individual(s) in control of it if the company was used as a device or facade to conceal the true facts thereby avoiding or concealing any liability of those individual(s).

Here the Vice-Chancellor was faced with a clear case of an improper motive but in deciding to lift the veil he emphasises the connection between the impropriety and the use of the corporate structure. Just as in *Jones v Lipman* (1962) the corporation must be the 'device' through which the impropriety is conducted, impropriety alone will not suffice. (See also *R v K* (2006).)

3.33 Png (1999) makes the point that these cases offer the judiciary the possibility of an interesting development in the facade exception. While *Jones v Lipman* (1962) makes it clear that forming a company as a mere facade will engage a lifting of the veil, there may also be the possibility that a company which was formed for legitimate purposes initially, but which subsequently becomes a facade, will also engage a lifting of the veil. In *Raja v Van Hoogstraten* (2006) the court, faced with a façade claim to lift the veil, emphasised that the dishonest construction of a group of companies to conceal ownership of assets and minimise liability could give rise to a lifting of the corporate veil. Interestingly, the court in Raja explicitly moves away from what it calls a 'narrow' reading of *Adams* to adopt an expansive approach which partly encompasses Png's point in finding that the dishonest construction of

a group of companies might give rise to a the court lifting the veil of incorporation even in relation to liabilities not envisioned by the creator of the sham companies.

Tortious liability

3.34 Many of the recent developments in veil lifting have involved claims of tortious liability. Indeed, tortious liability is one of the fault lines created by limited liability. Normal trade creditors when dealing with a limited liability company have the opportunity to assess the risk of doing business. They can then opt to secure their lending, charge a premium for that risk or do both. However, employees or members of the public (involuntary creditors) who may be at risk of the company causing them personal injury have no way of effectively mitigating that risk. Therefore, limited liability in cases where tortious liability for personal injury is at issue can allow parent companies to avoid liability without providing any compensation.

3.35 This particular problem was recognised by the CLRSG in its preliminary deliberations (*Modern Company Law for a Competitive Economy: Completing the Structure*, ch 10). In that chapter the CLRSG took a very cautious and conservative view of the problem and concluded that because of the *Adams* case the UK judiciary would be unwilling to lift the veil for involuntary creditors. They concluded no reforms were needed. The matter of parent liability for personal injury torts of its subsidiaries was then dropped and does not appear anywhere in the CLRSG's *Final Report*. Given that over the course of the CLRSG review of UK company law a number of very high-profile (see below) examples of this problem passed through the UK courts, the omission is all the more bemusing. As Muchlinski (2002) concluded after reviewing the work of the CLRSG, 'the Steering Group does not appear to have been strongly influenced by concerns such as those of involuntary creditors who have suffered personal injuries at the hands of the overseas subsidiaries of United Kingdom-based Multi-National Enterprises [a corporate group with subsidiaries abroad]. Rather, it was oriented towards the traditional, shareholder-based, model of company law and towards a cost-effective, pro-business approach to regulation.'

Parent company personal injury tortious liability

3.36 In *Connelly v RTZ Corpn Plc* (1998) Mr Connelly had been a uranium miner working in Namibia for a subsidiary of RTZ. He subsequently developed cancer and attempted to sue the parent company in London alleging that RTZ had played a part in the health and safety procedures employed by the subsidiary and that RTZ

owed a duty of care to him. RTZ applied to have the action struck out in London arguing that Connelly should sue the subsidiary in Namibia. The issue went to the House of Lords who found that the matter could not be heard in Namibia because of the complexity of the case and the cost. London was therefore the appropriate forum. The decision was not unanimous; Lord Hoffmann dissented on the basis of the implications for the *Salomon* principle, concluding:

> [t]he defendant is a multinational company, present almost everywhere and certainly present and ready to be sued in Namibia. I would therefore regard the presence of the defendants in the jurisdiction as a neutral factor. If the presence of the defendants, as parent company and local subsidiary of a multinational, can enable them to be sued here, any multinational with its parent company in England will be liable to be sued here in respect of its activities anywhere in the world.

3.37 The case went back to the High Court and the tortious issue was tried. RTZ argued that the subsidiary was Connelly's employer. Therefore any duty of care was owed by the Namibian subsidiary. RTZ also argued that the claim was time barred under the Limitation Act 1980. The court refused to strike out the action on the duty of care point finding that it was arguable that the parent company had responsibility for health and safety at the mine and this would have been such as to create a duty of care to Mr Connelly. However, the claim was time barred under the Limitation Act. Mr Connelly could have brought the case in 1989 but chose not to.

3.38 The case opened up the possibility that actions could be brought against a parent company based in London for the actions of its subsidiary based abroad and that, at least in theory, and depending on the amount of control exerted over the subsidiary, a parent company could owe a duty of care to the workers of the subsidiary.

3.39 The case of *Lubbe v Cape Industries Plc* (2000) continued the pattern of lifting the veil where tortious liability for personal injuries is at issue. The case concerned litigation brought by over 3,000 employees and nearby residents of Cape Industry's wholly owned asbestos-mining subsidiary in South Africa claiming damages from the parent company in London for death and personal injury caused by exposure to asbestos at or near the mining operation in South Africa. The issues were the same as in the *Connelly* case. The House of Lords found that South Africa was the more appropriate place to sue but that the lack of legal representation and the expert evidence required to substantiate the claims in South Africa would amount to a denial of justice. The action could therefore proceed against the parent in London. The case went back to the High Court for trial and in January 2002 Cape settled the action for £21 million.

Commercial tort

3.40 The difference in the treatment of tortious actions for personal injury and other more commercial torts such as negligent misstatement that involve, at least tangentially, veil lifting is striking. In *Williams v Natural Life Health Foods Ltd* (1998) the House of Lords emphasised the *Salomon* principle in the context of a negligent misstatement claim. The managing director of Natural Life Health Foods Ltd (NLHF) was also its majority shareholder. The company's business was selling franchises to run retail health food shops. One such franchise had been sold to the claimant on the basis of a brochure which including detailed financial projections. The managing director had provided much of the information for the brochure. The claimant had not dealt with the managing director but only with an employee of NLHF. The claimant entered into a franchise agreement with NLHF but the franchised shop ceased trading after losing a substantial amount of money. He subsequently brought an action against NLHF for losses suffered as a result of its negligent information contained in the brochure. NLHF subsequently ceased to trade and was dissolved. The claimant then continued the action against the managing director and majority shareholder alone, alleging he had assumed a personal responsibility towards the claimant.

3.41 The reality of this claim was to try to nullify the protection offered by limited liability and as Lowry and Edmunds (1998) have pointed out the House of Lords was particularly aware of this in reaching its decision. The House of Lords considered that a director or employee of a company could only be personally liable for negligent misstatement if there was reasonable reliance by the claimant on an assumption of personal responsibility by the director so as to create a special relationship between them. There was no evidence in the present case that there had been any personal dealings which could have conveyed to the claimant that the managing director was prepared to assume personal liability for the franchise agreement. However, if the tort is deceit rather than negligence the courts will allow personal liability to flow to a director or employee (see *Daido Asia Japan Co Ltd v Rothen* (2001) and *Standard Chartered Bank v Pakistan National Shipping Corpn (Nos 2 and 4)*. An officer of the company may also be personally liable for costs if they pursued an action unreasonably or for an ulterior motive (see *Gemma Ltd v Gimson* (2005)).

3.42 The *Williams* case has subsequently been particularly influential where commercial torts are at issue. For example the High Court in *Noel v Poland (2001)* dismissed a negligent misstatement/deceit action against the chairman and a director

of a liquidated insurance company for inducing Noel to become a Lloyds name (a contractual arrangement where an individual agrees (for a fee) to cover certain insurance losses made by the Lloyds insurance market). The court found that the chairman and director were acting on behalf of the company and that there had not been any assumption of personal responsibility.

3.43 The difficult issue of directors' tortious liability, however, has proved an enduring one. In *MCA Records Inc v Charly Records Ltd (No 5)* (2003) a director had authorised a number of infringing acts under the Copyright Designs and Patent Act 1988. The Court of Appeal in a very detailed consideration of the issue of directors' liability in tort, including the *Williams* case, took a more relaxed approach to the possibility of liability. The Court concluded:

> if all that a director is doing is carrying out the duties entrusted to him as such by the company under its constitution, the circumstances in which it would be right to hold him liable as a joint tortfeasor with the company would be rare indeed . . . [however] there is no reason why a person who happens to be a director or controlling shareholder of a company 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. In other words, if, in relation to the wrongful acts which are the subject of complaint, the liability of the individual as a joint tortfeasor with the company arises from his participation or involvement in ways which go beyond the exercise of constitutional control, then there is no reason why the individual should escape liability because he could have procured those same acts through the exercise of constitutional control.

On the facts of this case the Court found that the director was liable as a joint tortfeasor. (See also *Koninklijke Philips Electronics NV v Princo Digital Disc GmbH* (2004) where a company director was also held personally liable.)

3.44 The difference in treatment of personal injury torts and more commercial torts such as negligent misstatement is somewhat consistent with the voluntary/involuntary nature of their transactions with the company. We say somewhat consistent, as there is an obvious inconsistency. The contrast between the outcomes in the cases of *Adams v Cape Industries Plc* (1990) and *Lubbe v Cape Industries Plc* (2000) is striking. Both these cases concern the same underlying claim for personal injury for asbestos contamination from the same company. In *Adams* the claimants were successful in the US courts and sought to enforce the action against the parent in London. The Court of Appeal did not lift the veil in that case. In *Lubbe* the same claim for personal injury was made against the same company but because there was an underdeveloped court system where the subsidiary was operating the House of Lords lifted the veil and allowed the parent to be sued in the UK for the action

of the subsidiary. The basis of the decision was that not to do so would amount to a denial of justice.

3.45 It is difficult to see how the decision in the *Adams* case where the subsidiary was operating in a jurisdiction with a developed court system and where the claimants successfully used that system but needed to enforce it against the parent in London achieved any measure of justice. Thus a personal injury caused by a UK subsidiary operating in the USA or any developed country will not give rise to any liability on the part of the parent but a personal injury caused by the subsidiary of a UK company in an underdeveloped jurisdiction will. The fact that the CLRSG declined to consider any reform of this area is even stranger given this inconsistency. The CLRSG's predictions that the UK judiciary would not lift the veil for involuntary creditors proved mistaken. The CLRSG sadly adopted a much more conservative approach to the issue than the judiciary did, which is a terrible thing to conclude about a law reform body.

The costs/benefits of limited liability

3.46 Limited liability has certain advantages. It obviously encourages investment as the members' risk is minimised. It also encourages risk taking on the part of management who can take risks sure in the knowledge that the members will not lose everything. Limited liability is also said to facilitate a public share market. If liability were unlimited then the value of shares would depend on the wealth of the individual holder. Shares would be worth less to a wealthy shareholder as that shareholder would be more likely to be sued in a liquidation than a poor one. This would hinder the development of a liquid share market as the value of the shares could not be assessed until a buyer was found and his personal assets also assessed.

3.47 For example, if we look in the *Financial Times* at the quoted share price of a company, that price is based, as we discussed in Chapter 2, on the market's perception of all the publicly available information that affects that limited liability company. It is the price at which anyone can buy the shares. If we moved to a situation where liability was unlimited then the price of a share would not be a standard price: it would vary depending on the wealth of the buyer. In other words, only the combination of the public information on the company plus the private information on the potential shareholder's wealth could determine the price of the share. This would not help the development of a liquid market in a company's shares.

3.48 Another advantage of limited liability was identified by Hansmann and Kraakman (2000) who noted that not only does limited liability protect the shareholders from

the company's creditors but it can also serve to put the business assets of an individual out of reach of that individual's personal creditors. Thus, by forming a company and placing his business assets in the company in return for shares in the company the individual no longer has any legal interest in the assets. This serves to partition the personal assets of the shareholder from his business assets. If the shareholder is insolvent the personal creditors can take the shares but cannot get at the assets of the company.

3.49 Oddly, given that limited liability seems to move the risk of doing business away from the shareholders and on to the creditors, large powerful creditors have also benefited from limited liability. As a result of the movement of risk to the creditors, creditors have been forced to monitor and protect against risk more effectively. Secured lending in the form of fixed and floating charges, risk premiums in terms of interest charged and board representation have all improved the creditors' monitoring mechanisms.

3.50 These are all undoubted advantages but limited liability does have disadvantages. Risk is moved to the creditors, not all of whom can mitigate their risk. Small trade creditors and involuntary creditors cannot secure their transaction, charge a risk premium or engage in board-level monitoring. As a result in an insolvent liquidation they have little protection. Indeed, the actions of powerful secured creditors are often detrimental to the most vulnerable creditors as they often have priority in a liquidation. This is still the case with employees as even though they have been given priority above floating charges (see Insolvency Act 1986, s 175 and s 386 and Chapter 17 fixed charges, (over the most valuable assets) still have priority. Involuntary creditors have little or no protection if limited liability is upheld.

3.51 Perhaps the most disturbing use of limited liability occurs within group structures. In group structures limited liability's facilitation of asset partitioning allows a very effective double limitation of liability for parent companies and their members. Investors in a parent company can achieve limitation of liability not only for themselves but also for the parent company by structuring its business through a number of subsidiaries. For example Fred, Nancy, Dougal and Mat are the shareholders in M Ltd, the parent company of wholly owned subsidiaries N Ltd, Y Ltd and X Ltd. M Ltd has divided its business into three between the subsidiaries. Y Ltd buys wine for storage and investment, N Ltd stores the wine Y Ltd buys and X Ltd markets the sale of the wine once it has been stored for a few years. All the profits of the subsidiaries flow back to M Ltd. Y Ltd entered into a number of complex agreements to buy French wine at a guaranteed price. The French wine harvest was a disaster and the harvest in the rest of the world was excellent. As a result of the poor quality of French wine and a glut of excellent wine from everywhere else

Y Ltd ended up with liability running into millions of pounds. It could not meet its obligations to its creditors and is eventually placed into insolvent liquidation. Some months later M Ltd forms another wholly owned subsidiary J Ltd to carry out the wine-buying function. The question remains as to whether the parent company could be liable for the debts of the failed subsidiary. The answer is—probably not.

3.52 It is important to note here that we are not discussing Fred, Nancy, Dougal and Mat being personally liable for the debts of Y Ltd or M Ltd. The group application of the *Salomon* doctrine means we are just discussing whether the assets of the parent company can be attacked by the claimants in virtue of it being the sole shareholder in Y Ltd. The personal assets of Fred, Nancy, Dougal and Mat are safe no matter what. The question is whether the parent company gets limited liability as well. Thus just as Hansmann and Kraakman (2000) suggest that asset partitioning allows individuals to put their assets beyond their personal creditors, its most important and far-reaching consequence is that it allows a company also to put its assets beyond the reach of its creditors. The word Ltd or Plc after a parent company name now effectively means the company itself has achieved limited liability.

3.53 Despite the fact that this represents an enormous extension of the *Salomon* principle to cover corporate members, the judiciary have treated it as a straightforward application of the *Salomon* doctrine without questioning whether this is appropriate. Thus the starting point in group structure veil-lifting cases has always been that *Salomon* applies unless there are other reasons for lifting the veil, rather than recognising that allowing asset partitioning to operate for parent companies is a radical and far-reaching extension of the *Salomon* principle and taking the starting point in group veil-lifting cases as asking (as the courts do for example in Germany) whether *Salomon* is an appropriate principle to apply to group structures at all. However, sometimes the separateness of a subsidiary can be disadvantageous to a parent company. For example in *Barings Plc (in liquidation) v Coopers & Lybrand (No 4)* (2002) a loss suffered by a parent company as a result of a loss at its subsidiary was not actionable by the parent—the subsidiary was the only proper claimant. (See also *Shaker v Al-Bedrawi* (2003).)

FURTHER READING

Davies *Gower and Davies' Principles of Modern Company Law,* 8th edn (London, Sweet & Maxwell, 2008), chs 8 and 9.

Gallagher and Ziegler 'Lifting the Corporate Veil in the Pursuit of Justice' [1990] *JBL* 292.*

Hansmann and Kraakman The Essential Role of Organisational Law' [2000] *Yale LJ* 387.

Lowry and Edmunds 'Holding the Tension between Salomon and the Personal Liability of Directors' [1998] *Can Bar Rev* 467.

Lowry 'Lifting the Corporate Veil' [1993] *JBL* 41.

Mitchell, 'Lifting the Corporate Veil in the English Courts: An Empirical Study' [1999] 3 *Company Financial and Insolvency Law Review* 15.

Moore *'A temple built on faulty foundations'* [2006] *JBL* 180.

Muchlinski 'Holding Multinationals to Account: recent developments in English litigation and the Company Law Review' [2002] *Co Law* 168.

Ottolenghi 'From Peeping Behind the Corporate Veil to Ignoring it Completely' [1990] *MLR* 338.*

Png 'Lifting The Veil of Incorporation: *Creasey v Breachwood Motors:* A Right Decision with the Wrong Reasons' [1999] *Co Law* 122.

Ramsay and Noakes 'Piercing the Corporate Veil in Australia' (2002) Available at SSRN: http://ssrn.com/abstract=299488.

Rixon 'Lifting the Veil between Holding and Subsidiary Companies' [1986] *LQR* 415.

Thompson 'Piercing the Corporate Veil: An Empirical Study' [1991] 76 *Cornell Law Review* 1036.

*Note that the articles above that are marked with an asterisk were written prior to the Court to Appeal decision in *Adams v Cape Industries Plc* (1990).

SELF-TEST QUESTIONS

1 What is the difference between separate legal personality and limited liability?

2 Why has the legislature introduced statutory veil-lifting provisions?

3 When will the courts lift the veil of incorporation?

4 Ned, Orin, Dan and Matilda are the shareholders and directors of Q Ltd, the parent company of wholly owned subsidiaries W Ltd, R Ltd and X Ltd. Q Ltd has divided its business into three between the subsidiaries specifically to minimise its liability for tax and tortious actions. W Ltd buys and mixes chemicals for the paint industry, R Ltd transports the chemicals and X Ltd markets the mixed chemicals. All the profits of the subsidiaries flow back to Q Ltd. An accident occurs while R Ltd is transporting hazardous chemicals along the motorway. Fifteen people are badly burned and noxious fumes are released into the air near a town. Additionally chemicals leak into a major river contaminating the water downstream for hundreds of miles. The projected damages and fines payable by R Ltd come to millions of pounds. R Ltd is capitalised only to the extent it needed to transport chemicals in the two trucks it owns. It has some liability insurance but only to the amount of £1 million. After a few months R Ltd

is in insolvent liquidation. In the meantime Q Ltd has set up another wholly owned subsidiary to carry out the group's transport needs.

Discuss whether the parent company and/or its members could be liable for the actions of R Ltd. When you have done that critically evaluate the legal outcome.

5 Formulate a single rule (bearing in mind the advantages and disadvantages of limited liability) that would provide the courts with guidance as to when to lift the veil of incorporation.