The corporate personality and the possibility to lift the veil

publié le **18/02/2009**, vu **65273 fois**, Auteur : Corentin Kerhuel

Coursework in English Company law, about the legal personality of companies and the possibility for the courts to lift the veil under certain circumstances

PDF version HERE (with references)

‘The principle of separate corporate personality as confirmed by Salomon\'s case and reasserted in later cases... forms the corner-stone of company law. The authority of these cases is unshakeable; and yet exceptionally in some instances the law is prepared to disregard or look behind the corporate personality and (it is claimed) have regard to the realities of the situation.\'

L Sealy and S Worthington Cases and Materials in Company Law, 8th edn OUP

Discuss the accuracy of this statement with reference to decided cases. Has the courts\' attitude to lifting the veil changed in recent years?

I - Introduction

According to the Salomon case, by incorporation, the company acquires **separate legal personality**; that is, the company is recognised as a legal person separate from its members. As a consequence, the company can make contracts, can sue and be sued, can own property, the company continues in existence despite changes of membership, and the shareholders can delegate management to directors.

\"*The Salomon case was a struggle between form and substance; whether to interpret the law literally or whether to consider more its presumed spirit and intention. Was a genuine association of seven proprietors really necessary to form a company, or would six nominees holding shares for the seventh suffice? Could a paper company really transact with the beneficial owner of all its shares? The lords accepted that if the form of the company was within the letter of the law they would not look behind it to the substance*

\".

II - The principle of separate corporate personality in the Salomon Case

According to the Salomon case, a company has a dual nature as both an association of its members and a person separate from its members: \"*a company\'s property is owned by the company as a separate person, not by the members; the company\'s business is conducted by the company as a separate person, not by the members; it is the company as a separate person that enters into contracts in relation to the company\'s business and property*

\" .

In this case, Mr Salomon sold his shoe business to a company which he had set up for the purpose under the Companies Act 1982. The formalities under the Act were completed and the members of the company were Salomon, Mrs S and their five children (a minimum of seven members being required at that time). As part of the consideration for the sale of business, Mr Salomon received fully paid up shares and debentures to the value of £10,000 which he subsequently assigned to another party. Business declined and the company went into insolvent liquidation. The liquidator attempted to hold Mr Salomon liable for the debts of the company notably on the ground that the whole transaction was a fraud on the company\'s creditors from which Salomon should not be allowed to benefit and that the company was simply his agent and he should therefore indemnify the company (and its creditors) with respect to the debts incurred by the company. The House of Lords held that \"a company is not, per se, the agent of its shareholders, even if control is concentrated in only one shareholder. The mere fact that a person owns all the shares in a company does not make the business carried on by that company his business. Once the company is legally incorporated, it must be treated like any other independent person with rights and liabilities of its own\" . The decision legitimated the one-man company and rejected the lower courts\' views that such a structure was contrary to the legislation.

III - A principle reasserted in former cases

The Salomon case has been reasserted in former cases, even in cases in which the principle wasn\'t in favour of the person creating the company, as in ***Macaura v Northern Assurance Co*** (1925) . This principle also applied in the case where a principal shareholder also being the governing director of a company was held under this principle, able to make an employment contract between his company and himself. This solution was the one of the case L***ee v Lee\'s Air Farming Ltd*** (1961) where a company was held to be able to employ one of its members under a contract of service. Again, the principle applied in the case ***Secretary of State for Trade and Industry v Bottrill*** (1999) where it was decided that a sole shareholder can be employed by the company and will have rights under the Employment Rights Act 1996. This principle also applied in the well-known case ***Foss v Harbottle*** (1843), where since the company is a legal person separate from its members, a member cannot generally bring an action to redress a wrong done to the company.

IV - The possibility of disregarding this principle until the Adams case

It should be remembered that the Salomon case remains the general principle. If many textbooks deal with the question of \"*Lifting the veil*\", these cases remain exceptional. The principle dealt with in the Salomon case is extremely strong and almost without exception.

\"*Avoiding consequences of the separate personality of a company is often described in metaphorical terms as removing a ‘veil of incorporation*\'\" . Most of the cases where the courts have lifted the veil concern \"*instances where the shareholders are using the company, deliberately or otherwise, as a device to achieve certain benefits or to avoid obligations. Where there is possibly an abuse of the corporate form, the courts may regard the company for this purpose only as a mere cloak or sham and lift the veil*\" . In such cases, the justification generally used is either the interpretation of different statute laws, or the agency argument (the subsidiary is merely the agent of the principal).

But lifting the veil can also be to the benefits of the members, as in example, in the case **_DHN Food Distributors Ltd v Tower Hamlets London Borough Council_** (1976) , where the Court of Appeal treated a group of companies as a single economic entity (so to enable compensation for compulsory purchase of land to be paid). Nevertheless, this case has been challenged in a number of following cases (as **_Woolfson Regional Council_** (1978)).

Following the Court of Appeal\'s decision in the case A**_dams v Cape Industries Plc_** (1990) (studied below), the courts ability to '*dislodge to the corporate veil\'* is now limited to cases involving an '*enemy corporation*\' or where the incorporation of a company is classed as a façade. A façade is identified in a situation where a company\'s incorporation was for a fraudulent or illegitimate purpose. Such a solution can be found in the cases **_Gilford Motor Co Ltd v Horne_** (1933) or **_Jones v Lipman_** (1962) , as well as in **_Trustor AB v Smallbone_** (2001) . The enemy corporation (or '*enemy character*\') is determined by looking behind the veil of incorporation as was done in the case **_Daimler Co Ltd v Continental Tyre and Rubber Co (Great Britain) Ltd_** (1916) , but is a rare situation.

V - A recent change of attitude?

The current position is given by the case **_Adams v Cape Industries Plc_** (1990) . In this case, the Court of Appeal could find no legal objection (in respect of a holding company-subsidiary relationship), \"*where the corporate structure of a group of companies had been used to ensure that any future legal liability, so attached to the group enterprise, would fall on a subsidiary of the holding company, rather than on the holding company itself*\". The courts there refused to lift the veil and on this strict application of the Salomon principle, Slade LJ held \"*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 way is inherent in our corporate law*\". This solution has been followed in cases such as **_Connelly v RTZ Corp Plc_** (1998) , **_Ord v Belhaven Pubs Ltd_** (1998) , or **_Lubbe v Cape Industries Plc_** (2001) .

This **_Adams v Cape Industries plc_** case modified the attitude of the courts on the question of lifting the veil to establish a controlling interest or an economic entity. Prior to **_Adams v Cape Industries_**, the method for establishing that a group of companies was in reality one economic entity was somewhat vague but a number of cases (such as **_Holdsworth & Co v Caddies_** (1955) or **_DHN Food Distributors Ltd v Tower Hamlets LBC_** (1976)) suggested that an economic entity could be established where the holding company exerted a substantial degree of control over the affairs of the subsidiary company, to the extent that the holding company controlled and dictated the corporate policy of its subsidiary. Since the case **_Adams v Cape Industries_**, a company\'s ability to control the overall policy structure of another company is unlikely, of itself, to be sufficient to justify the lifting of the corporate veil. To dislodge the corporate veil of the subsidiary, the courts have demanded something more: \"*namely, in addition to a holding company\'s control over the policy structure of its subsidiary, the finding of a façade is required in relation to the incorporation of the subsidiary company*\".

The courts changed their attitude and strengthened the Salomon principle with the case **_Adams v Cape Industries_**. Since this case, it seems that the only circumstances in which the courts are likely to lift the veil are: firstly when the court is construing a statute, contract or other document which requires the veil to be lifted; secondly when the court is satisfied that the company is a '
mere façade

\', so that there is an abuse of the corporate form; and thirdly when it can be established that the company is an authorised agent of its controllers or its members, corporate or human.

The changes of case ***Adams v Cape Industries*** have been more recently affirmed in cases such as ***Ord v Belhaven Pubs Ltd*** (1998) or ***Williams v Natural Health Foods Ltd*** (1998).

VI - Conclusion

To sum up, we could say that the courts will never lift the veil to impose liability on a shareholder for the company\'s debts. Nor they will lift the veil to benefit shareholders who would discover that trading as a company would be a disadvantage. In some (rare) instances, the courts will have a look at the substance rather than at the form to deny benefits of corporate status which they think should not be enjoyed. But we cannot predict when and for what reasons will this occurs. It would be left to the judges\' interpretation of statutes and their perception of fairness or policy. A court may \"lift the veil and regard the receipt of money by a company as receipt by its controlling shareholder if the company was improperly used as a device or façade in order to evade liability\" as in Trustor v Smallbone.

According to Professor Sealy which quotation we are discussing, the courts have refused to \" *violate the sacred canon of limited liability*\", which means that still today, the courts do not lift the veil to impose personal liability on the shareholders for the debts of the company. \"*The Principle of limited liability is not threatened and remains as solid as a rock*\" . And since the Adams case, this rock is even more solid.

PDF version HERE (with references)

Corentin Kerhuel
London South Bank University

\"Dernières

Image not found or type unknown