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The English Judicial Trends in Lifting the Corporate Veil

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Abstract

The "separate legal personality" and "limited liability" are two main and fundamental principles of corporate law. The concept of a separate legal personality of the company originated from the case Salomon v Salomon & Co Ltd. The landmark case decided that when a company is registered, it attains a separate legal identity. A corporate veil is a concept that recognizes the separate corporate personality of the company from the shareholders' personalities. In many circumstances, it happens that the corporate personality of the company commits fraud or any other illegal acts. It becomes impossible to believe that an artificial personality like a company commits any illegal act or fraud. In such cases, for the identification of the original wrongdoer, the veil of the corporation is pierced which is also called lifting the corporate veil. To highlight the English Courts' trends in lifting the corporate veil, this article unearths the canons of English courts' judgments to pinpoint the inconsistencies in their decisions. The paper inspects the exceptions to the Saloman rule that have been focused on and meticulously analysed in this research paper to highlight the evolution of these recognised exceptions including "Single Economic Entity, Fraud, and Facade, Sake of justice, and Agency."

Keywords: Lifting the Corporate Veil; Separate Legal Personality; Limited Liability; Single Economic Unit; Fraud and Facade; Sake of Justice; Agency

1. Introduction

Lifting the corporate veil is a situation in which the courts have the power to ignore the distinction between the company's personality and its members. Hence, the "veil of incorporation" is said to be lifted. Usually, the English courts use various terms for this process like "peeping, penetrating, piercing, lifting, or parting the veil of incorporation." There are various circumstances in which the courts lift the corporate veil more specific among other circumstances is straightforward involvement of the shareholders' limitation of liability matters. Moreover, several of the circumstances involve corporate group structures. After the perusal of English courts' jurisprudence, this piece is an endeavor to describe the concept and scope of lifting the corporate veil and highlights the aftermaths of the landmark *Salomon v Salomon.* Moreover, separate legal personality and limited liability principles have been critically scrutinised in order to pinpoint how the doctrine of lifting the corporate veil has been loosely, broadly, and inconsistently applied by English courts. Many issues related to misuse and exploitation of the companies to defraud the creditors have demanded the establishment of certain exceptions to the (Salomon, 1897) rule. Consequently, the English courts recognised this concern and delineated circumstances in which it became easy to lift the corporate veil to hold the exact culprits of fraud liable. To this end, this piece scrutinises the exceptions to lifting the corporate veil doctrine and provides a brief critical account of exceptions like "Single Economic Entity, Fraud, and Facade, Sake of justice, and Agency."

2. Lifting the Corporate Veil Doctrine

Aftermaths of the *Salomon v Salomon* made it clear that the inflexible application of

separate legal personality doctrine in all the cases might promote injustice to the company's shareholders and creditors. That is why; the English courts endeavored to draw some exceptions to the doctrine of separate legal personality. The main purpose of seeking these exceptions was to lessen the effect of the strict application of the separate legal personality rule and to abrogate the rigid nature of the veil of incorporation. However, it is unbelievable after such a struggle of the English courts, there is still the existence of confusion in deciding under what circumstances the veil of a corporation can be pierced by the courts. The main issue that can be observed is that the English courts used to use divergent approaches while dealing with veil-lifting cases. It can also be observed that the English courts' jurisprudence on lifting the corporate veil is highly inconsistent. Veil-lifting seems to occur freakishly. Moreover, it is rare and unprincipled. This segment will critically scrutinise the English courts' jurisprudence evolved on lifting the corporate veil.

There is a need to inspect whether lifting the corporate veil is "peeping or looking behind the veil" and "ignoring or piercing it." The earlier phrase clearly infers about the examination of the shareholders' position and identity for the lawful purpose. On the contrary, the latter expression is "reserved for treating the rights and liabilities or activities of a company as the rights or liabilities or activities of its shareholders." Consequently, it was decided by the court that it is acceptable to "peep behind the veil" with a purpose. The purpose should be the determination of the company's legal character. This examination of such legal character will help determine and look at the individuals that are controlling and directing the company and hiding them behind the corporate veil. *Atlas Maritime v Avalon Maritime* can be cited in this regard. (Daimler, 1916)was instituted during the era of the First World War. In this case, the court determined the legal character of the company based on whether or not it was run by an enemy, which means the determination of the company's enemy character was based on the shareholders' nationality. In the views of the court, the company is incompetent of being loyal or hostile.

3. Exceptions to the Lifting the Corporate Veil Doctrine

This segment of the article will critically examine the several exceptions that have been evolved by the English courts. This segment will investigate the invasive technique utilised for lifting the corporate veil. The exceptions that are discussed in this segment are enlisted as follows:

- Single Economic Entity
- Fraud
- Sake of Justice
- Agency

3.1 Single Economic Entity

The single economic entity is an expression used by the English courts for a holding company and its subsidiary or subsidiaries. Hence, this expression elucidates that the whole group of companies will be considered as a single unit and the liabilities and rights of every single company will be assigned to the whole group of companies. The English court considered that it is too technical to deliberate that the holding company and its subsidiary or subsidiaries are entirely distinct. The court further stated that the court of law must consider "the realities of this situation." (Holdsworth, 1955). can be cited. However, the court remained unsuccessful in describing when such a view of the court will be relevant or pertinent. Additionally, the scope of this verdict was limited to directors' duties.

The grounds of (Holdsworth, 1955)were sustained in the case *Littlewoods Mail v IRC*, Lord Denning stated that it is impossible to consider the holding company and its subsidiaries or subsidiaries distinct units. Lord Denning considered that the subsidiary is a puppet of the holding company. Kaminski LJ agreed with (Holdsworth, 1955) view of considering "the realities of this situation." However, the court could rely on the legal position of companies as their separate entity rather than their factual position.

Lord Denning stated that when the subsidiaries are completely owned and are economically dependent on their holding company, in such circumstances they all will be considered as a single unit. The court stated that the technical defence of separate legal personality cannot defeat it. (Distributors, 1976) can be cited in this context. However, the court superficially and unconstructively declined the "separate legal personality" as a technical defence.

The court in (Woolfson, 1978) was doubtful whether the court in *DHN Food* had reasonably followed the principle that recognized a deviation from the landmark *Salomon* but only in extraordinary situations. However, (Adams, 1990)categorically described that no court of law can entertain the power or discretion of dismissing the difference between "members of the group as a technical point." *Tokyo v Karoon* held that the court discusses and deals with the law rather than economics. Consequently, it is submitted that the court should encourage the application of law rather than the economic realities. Moreover, the concept of the single economic entity was highly criticised in (Ord, 1998), the court stated that a "single economic entity" is illogical and drastically inconsistent with *Salomon*. The single economic entity also derogates the basic concept of limited liability.

3.2 Facade and Fraud

The well-known and the most obvious ground for lifting the corporate veil is that the corporate is a fraud or facade. The veil has been ignored and there has been concealment of facts and figures. When the company has been utilised without bona fide intent and has been used for avoidance of any contractual liabilities then there are higher chances of lifting the veil of the company. (Jones, 1962) and (Motor, 1933). *Ltd v Horne.* There is no precise, concise and reasonable definition of the term facade as well as it has been sparsely defined in (Adams, 1990). The broader explanation of facade includes ways or methods of avoiding liability.

(Tunstall, 1962) describes that the veil of the company can be lifted in cases where the facade has been proven. This ruling was accepted in various other cases without giving any further explanation. (Woolfson, 1978)can be cited. The court in *Adams* stated that the existing liabilities can be avoided by using the facade. However, a facade helps in avoiding the existing obligations but it is not helpful to evade future obligations or liabilities. The subsidiary will never be facade on the ground that it is undercapitalised or entirely owned. This decision of *Re Polly Peck* is inconsistent with the verdict of *Re FG Films.*

(Trustor, 2002) has evolved more explanation about the exception of the facade. The court described that facade will not be constituted on the mere ground of impropriety. However, impropriety will constitute a facade if it is concealed by misapplication and misuse of corporate structure. This seminal verdict has drawn a difference between impropriety done by the company and impropriety done by shareholders. But in both cases, impropriety has been concealed by using the company with no bona fide intention.

Now there is a need to describe how the motive is relevant to the facade. *Adams* says it is extremely substantial in reaching a verdict. However, *Adams* remains unsuccessful in describing how it is a prerequisite for the constitution of a facade and what kind of a motive

is required for constituting a facade. This was explained in (Ord, 1998), where the court stated that a facade will not be constituted if any transaction is made or done in the ordinary course of business, lacking an intent to defraud the creditors. Though, this statement made in *Ord* is not satisfactory. As in the case of the transformation of assets within the group companies, in such circumstances, the creditors' interests are usually prejudiced. To this end, the business prudence defence must be raised to vanquish a case of the facade.
(Creasey, 1992) is highly criticised. This case deals with the transformation of the informal asset into an existing associated corporation. An issue arose whether the application of facade is only possible in case when the corporation was made with a mala fide intent and fraudulent purpose. The Court of Appeal dismissed the case due to a lack of evidence for the happening of the facade transaction. (Hashem, 2009)stated that it is necessary to discern the presence of liability concerning the fraudulent use of the corporation. Consequently, a facade might be constituted even though the existence of the subsidiary before the arising of an obligation or liability. The court had also described the essentials leading with the exception of the facade as:

> "In the first place, ownership and control of a company are not of themselves sufficient to justify piercing the veil. This is, of course, the very essence of the principle in (Salomon, 1897). Secondly, the court cannot pierce the corporate veil, even where there is no unconnected third party involved, merely because it is thought to be necessary in the interests of justice. Thirdly, the corporate veil can be pierced only if there is some 'impropriety': Fourthly, the court cannot, on the other hand, pierce the corporate veil merely because the company is involved in some impropriety. The impropriety must be linked to the use of the company structure to avoid or conceal liability. Fifthly, it follows from all this that if the court is to pierce the veil it is necessary to show both control of the company by the wrongdoer(s) and impropriety, that is, (mis)use of the company by them as a device or facade to conceal their wrongdoing. Finally, and flowing from all this, a company can be a facade even though it was not originally incorporated with any deceptive intent. The question is whether it is being used as a facade at the time of the relevant transaction(s). And the court will pierce the veil only so far as is necessary to provide a remedy for the particular wrong which those controlling the company have done. In other words, the fact that the court pierces the veil for one purpose does not mean that it will necessarily be pierced for all purposes."

This is a well-celebrated decision as it only describes the fundamentals leading to the exception of the facade but also efficiently resolves the quagmire of (Creasey, 1992). The cases that are discussed have great ramifications in the applicability of the exception of fraud, more specifically, in the group companies.

3.3 Sake of Justice

Generally, while lifting the corporate veil, an extraordinary ground is made that is in the interest of justice or for the sake of justice. This ground is criticised. It was held in (A, 1985) that the court will lift the corporate veil in the cases where justice requires the same. The court further stated that the courts will never regard the lawful effectiveness of the

structure of the corporation under consideration. Such type of grounds provides the support to unrestricted and unlimited utilisation of judicial discretion. An individual should validate the unjust situation to the court rather than encouraging that the situation is illegal. Otherwise, the legal corporate structure is presumed to be illegal when it is causing unjust results. This does not rest well and is inconsistent with (Salomon, 1897)*n*, in this case, despite the prima facie unjust result; the court held the separate legal personality of the company, as corporate form use was legal. The court in *Adams* held that the court should not deviate from the landmark ruling of *Salomon* on mere ground and consideration of justice.

There are various cases in which the justice exception was encouraged and the courts dismissed the ruling of (Adams, 1990). For example, the court in (Creasey, 1992) declined the applicability of the exception of fraud and stated that *Adams* did not restrict the scope of justice developed in the case (A, 1985). The court lifted the corporate veil on the justice exception. This verdict was inconsistent with (Jones, 1962) and (Motor, 1933) as it had factual resemblances with both of these cases.

However, (Re, 1996) validated the *Adams* principle. Moreover, this principle was also affirmed in (Line, 1998) *Investment*. Both cases criticised *Creasey* for not following the *Adams* ruling. However, the judgments of these cases were limited and they remained unsuccessful in resolving the issue between (Creasey, 1992)and (Adams, 1990). At last, the conflict between (Creasey, 1992)and (Adams, 1990)was resolved in (Ord, 1998). *Creasey's* decision was criticised and the court after comparing both points of view stated that (Creasey, 1992) wrongly pierced the corporate veil. (Tunstall, 1962)*v Smallbone* authenticated the decision of (Ord, 1998). The approach of dismissing the exception of justice was objective as it did not sit well with *Salomon's* verdict. Additionally, broadening the scope of discretion in the veil-lifting case will develop uncertainties.

3.4 Agency

Generally, for lifting the veil of corporate in cases of group companies, generally the English courts elucidate the association of the principal and agent. Jurisprudential illogicality can be generated in the circumstances when the court of law on one side considers the separate legal personality of the company as well as the court encourages the separate existence of such corporation and the court also supports the search for an agent for the company as well. While on the other hand, in the imposition of liability the court changes its attitude and considers the agent liable for the acts of the company. That is why; the agency is considered another ground or way for lifting the veil of the corporation. In contrast with the facade, the agency approach is also utilized to impose liability on the parent company for the subsidiaries' actions.

(Salomon, 1897) held that although a corporation does its businesses and transactions in the name of shareholders, however, this proposition will never infer that the company is an agent of the shareholders. This was concluded by Lord Herschell. A query arises about whether or not a company can act as an agent of shareholders. Prima facie and logically, the company enjoys the status of a separate legal personality as well as is a "juristic person." Hence, the company is independent and there is no impediment or illegality if the company enters into any agency contract under its name. (Kodak, 1903) had authenticated this logic.
The case held that the company is competent to be an agent of its parent company. (Gramophone, 1908) can be cited in this regard. This decision also gives rise to various questions as the verdict was incomprehensive and did not give answers to various questions including what would be the factors that will assist in finding the presence of agency between the subsidiary and its parents.

(Smith & Knight, 1939) tried to resolve the question and recognised the six features that can help in determining who was actually carrying the business. The Atkinson J summarised these six points as:

> "The 6 points deemed relevant for the determination of the question: Who was really carrying on the business? In all the cases, the question was whether the company could be taxed in respect of all the profits made by some other company, a subsidiary company, being carried on elsewhere. The first point was: Were the profits treated as the profits of the company? When I say 'the company' I mean the parent company. Secondly, were the persons conducting the business appointed by the parent company? Thirdly, was the company the head and the brain of the trading venture? Fourthly, did the company govern the adventure decide what should be done and what capital should be embarked on the venture? Fifthly, did the company make the profits by its skill and direction? Sixthly, was the company in effectual and constant control?"

However, it can be observed that these six points are pinpointing the functional control of the business. It can also be seen that features four to six are overlapping each other. Moreover, these points are establishing the agency test into one as a simple control. General tests of common law such as the capability of binding the representation and the principle are relinquished. They are declined or omitted in regard to the "putative principal's control over his agent." (Tyre & Rubber, 1957) lessened the bar by inferring an agency rather than managerial independence.

In (Maritime, 1991), it held by the court that "to hold that a wholly-owned subsidiary was rendered an agent merely because it was closely controlled would be to propound a revolutionary doctrine, and refused to so." In (Adams, 1990), the court of law stated that it is impossible to attribute agency, in a case where the subsidiary is incompetent of having the authority to be bound by its parent company. Moreover, the agency would not be imputed in the case when the subsidiary remained unsuccessful in representing itself as an agent of its parent. The agency is formally more inaccessible, in cases *"where the formal corporate forms concerning the subsidiary had been observed."* These aforementioned circumstances and cases had indirectly moved away from the *"ownership and control standard"* toward the common law agency test.

(Line, 1998) had authenticated the above verdicts. (Line, 1998)stated that the canon evolved in the (Smith & Knight, 1939) case was very broad. The court in (Line, 1998) held that besides ownership and control, the compulsory prerequisite is intended to create agency. The court further stated that the intent to create an agency suggests that the subsidiary intention was basically the opposite. This verdict was a watershed in agency law that is applied to the veil of a corporate body. This verdict established an intention test. Along with it, this decision had developed an assumption against the agency, particularly in the group companies' cases. It is submitted that agency test for lifting the veil of the corporation would not regard the Smith Stone and *Knight v. Birmingham DC*, as well as much burden, will be placed on the claimant that will make it hard to prove.

4. Conclusion

The English courts' jurisprudence evinces that the lifting of the corporate veil had been continuously evolving as demonstrated by the evolution of exceptions to the separate legal personality principle originating from the (Salomon, 1897). However, this doctrine had left a

minute scope and extent for reliability, precision, and stability. It is evident from (Tunstall, 1962)and (Woolfson, 1978), that the English courts dismissed the veil-lifting although the company was asking to lift the veil. On the contrary, the courts in (DHN, 1976) and (Holdsworth, 1955) had accepted the extension of the veil to be pierced. Hence, the English courts' trends regarding lifting the corporate veil are evolving, vague, imprecise, inconsistent, and sometimes contradictory. It is necessary to note that the English courts demonstrated encouraging signs and tried to achieve a degree of certainty while dealing with the cases of two enduring propositions that are agency and facade and English courts have settled these cases reasonably. It is necessary to acknowledge the recommended test of an agency that can assist in protecting the corporate structure.

Undoubtedly the separate legal personality doctrine is fundamental. It is a check that discourages the misuse of the legal personality of the company. And this doctrine has a great significance for corporate groups. To this end, it is necessary to apply this doctrine carefully and uphold it for regulatory protection of the legal personality of the company. Due to emerging economic transactions in the world, the significance of these doctrines will also increase in the development and evolution of corporate law.

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