SALOMON'S CASE DETERS ATTEMPTS TO LIFT THE VEIL

Lee v. *Lee's Air Farming Ltd.*

The well embedded concept that a corporation is a legal entity separate from its members has resulted in obvious attempts for a long time to "lift the corporate veil" of the company. In fact circumstances which present such an opportunity have been few compared with instances of the application of the corporate entity principle itself, so that although *Salomon* v. *Salomon & Co.*[1] has been labelled[2] as a "calamitous decision," it can still be said that it is authoritative both in theory and in everyday litigation. To attribute to a company a separate *persona,* and yet in the same breath to argue that in substance the person holding the shares is the company is obviously an attempt to have it both ways. But, as is well known, to the legislature nothing is impossible or impracticable and as Devlin J. has said,[3] "No doubt the legislature can forge a sledgehammer capable of cracking open the corporate shell; and it can, if it chooses, demand that the courts ignore all the conceptions and principles which are at the root of company law." But under judicial interpretation, in instances where the "sledgehammer" has not been provided by

7. L. A. Sheridan: "Federation of Malaya Constitution." (1960) 2 *U.M.L.R.* 319.
8. *Cf. Chia Khin Sze* v. *Mentri* Besar *of Selangor* [1958] M.L.J. 105, where a detainee under the Restricted Residence Enactment (Selangor) passed prior to Merdeka sought to enforce his right to be represented by counsel under Article 5(3) in an inquiry instituted by the Mentri Besar. It was held *inter alia* that Article 5(3) is merely declaratory of existing law and hence no right of counsel existed. This ruling was provoked by Article 4(1) which after stating that the Constitution is the supreme law of the Federation, provided that any law passed after Merdeka which is inconsistent with the Constitution shall be void to the extent of the inconsistency, the implication of which being that any inconsistency between existing law and the Constitution were nonetheless valid. However this takes no notice of Art. 162(6) and it is submitted that not only was it proper for the Court to modify the law, it was in fact under a duty so to act, a matter which is now confirmed by the Court of Appeal.

1. [1897] A.C. 22.
2. O. Kahn-Freund in "Some Reflections on Company Law Reform": (1944) 7 M.L.R. 54.
3. *Bank Voor Handel en Scheepvaart N.V.* v. *Slatford* [1963] 1 Q.B. 248 at 278.

legislation, such "conceptions and principles which are at the root of company law" are still rigidly adhered to: this is exemplified very recently in a Privy Council decision on appeal from New Zealand: *Lee* v. *Lee's Air Farming Ltd.* [4]

The problem in this case was simply whether an employee of a company, who was simultaneously the sole managing director and a majority shareholder, could be regarded as a "worker" to benefit under Workers' Compensation legislation.

Geoffrey Woodhouse Lee in 1954 had formed Lee's Air Farming Ltd. for the purpose of conducting an aerial top-dressing business. The company's 3,000 shares were taken up by G. W. Lee who was allotted 2,999 shares, the remaining share having been allotted to a solicitor. By section 32 of the articles of association he was appointed the sole governing director "and full government and control of the company" was vested in him. Section 33 employed him as the chief pilot for the company at a salary of £1,500 per annum providing that "in respect of such employment the rules of law applicable to the relationship of master and servant shall apply as between the company and the said Geoffrey Woodhouse Lee." [5] The status of governing director and controlling shareholder conferred on Lee full and unrestricted control of the affairs of the company and he made all decisions relating to contracts for aerial top-dressing. Personal accident policies covered all the employees including G. W. Lee. In 1956, while piloting an aircraft owned by the company equipped for top-dressing, he was killed in an accident. The appellant, Lee's widow, claimed £2,430 as compensation under the Workers' Compensation Act, 1922 as amended by later statutes, resting her claim on the allegation that at the time of his death her husband was a "worker" in that he was employed by the company within the meaning of section 3(i) of the said Act which defined the term as "any person who has entered into or works under a contract of service or apprenticeship with an employer, whether by way of manual labour, clerical work, or otherwise, and whether remunerated by wages, salary or otherwise." The Judge of the Compensation Court stated a case to the Court of Appeal which decided that the deceased could not hold office of governing director of the company and also be a servant of the company. Lee's widow appealed to the Privy Council. In allowing the appeal the Privy Council (Viscount Simonds, Lord Reid, Lord Tucker, Lord Denning and Lord Morris of Borth-y-Gest) held that Lee was a worker within the statutory definition and was consequently entitled to compensation.

Their Lordships[6] in a very clear and vivid advice can be said to have laid down the following propositions:

I. From the concept of the "legal entity" of the company (which was neither a sham nor a simulacrum) follows the validity of all contractual obligations created between the company and an employee who at the same time is also the sole governing director and the majority shareholder.

II. The fact that the employee is the sole governing director in whom is vested the full government and control of the company is no fetter on the capacity of the "legal entity" to contract with the employee, who in thus contracting is also the agent of the company.

III. Such contractual transactions cover a contract of service, and the dual capacity of governing director as a servant of the company cannot be validly objected to, because, "the fact that so long as the deceased continued to be governing director, with amplitude of powers, it would be for him to act as the agent of the respondent company to give the orders

4. [1960] 3 All E.R. 420.

5. Articles of Association: s.33: Referred to in [1960] 3 All E.R. at p. 422.

6. As delivered by Lord Morris of Borth-y-Gest.

does not alter the fact that the respondent company and the deceased were two separate and distinct legal persons."[7]

The authority of *Salomon's* case[1] was sufficient for the strongly constituted Board to conclude that an inroad into the corporate entity principle could not be made to deny the apparent status of the appellant's late husband. The salutary words of Lord Halsbury in *Salomon's* case[8] were most emphatically repeated, "My Lords, the learned Judges appear to me to have been absolutely certain in their own minds whether to treat the company as a real thing or not. If it was a real thing; if it had a legal existence and if consequently the law attributed to it certain rights and liabilities in its constitution as a company, it appears to me to follow as a consequence that it is impossible to deny the validity of the transactions into which it has entered." The "validity of the transactions" covered Lee's contract of service, the operation of which cannot be questioned on another quite distinct ground: the objection of the dual capacity of Lee who was in full government and control of the company's affairs as the sole governing director and the majority shareholder.

But in the application of the above *dictum* and the concomitant principle in *Salomon's* case one significant distinguishing factor, it is submitted, is important. In *Salomon's* case it is well known that the specific issue before the House of Lords was whether the company formed by Salomon and his nominees was a properly constituted one or was a mere sham was determinative of the litigated point of whether Salomon was liable to indemnify the company against its trading debts. It was this specific issue which met with the blunt, perhaps angry, reprimand of Lord Halsbury, "Either the limited company was a legal entity or it was not. If it was, the business belonged to it and not to Mr. Salomon. If it was not, there was no person and no thing to be an agent at all; and it is impossible to say at the same time that there is a company and there is not."[9] But on the facts of the present case it is clear that what was in issue was not whether Lee's Air Farming Ltd. was a properly constituted company or a mere sham: in fact as Lord Morris pointed out[10] this was neither suggested in argument nor could such talk be entertained on the facts of the case and as he remarks it is admittedly a legal one-man company being neither "a sham nor a mere simulacrum." What called for determination in the present case (as the judge of the Compensation Court clearly indicated in his statement of case) was whether the fact that Lee was a sole governing director as well as a majority shareholder of the company was a valid objection to him being at the same time a "worker" of it. Recognition and application of *Salomon's* case only concludes the issue, so far as it decides that the fact of Lee being a sole governing director with the majority of the shares allotted to him did not effect the validity of the one-man company thus formed: consequently the result of the recognition of the corporate entity of this one-man company had to be followed.[11] At this juncture it is clear that the main issue is still left open: whether the sole governing director-majority shareholder can yet be validly employed by the one-man company as a "worker." This apparently depends on whether a director can be employed under a contract in a dual capacity. This point has been decided in the affirmative in other prior English cases.[12] But it is obvious that this point does not depend on the

7. [1960] 3 All E.R. at p. 426.

8. [1897] A.C. 22 at p. 33.

9. *Ibid*. at page 31.

10. [1960] 3 All E.R. at p. 425.

11. On the facts of the present case, the resulting validity of contract-transactions between the company and the sole governing director-majority shareholder had to be recognised. Illustrations of such recognition are: *I.R.C.* v. Sansom [1921] 2 K.B. 492 and *Fowler* v. *Commercial Timber Co. Ltd.* [1930] All E.R. Rep. 224.

12. *Re Beeton & Co. Ltd.* [1913] 2 Ch. 279; *Re T. N. Farrer Ltd.* [1937] 2 All E.R. 508.

application of the principle in *Salomon's* case by itself. Whereas, on a perusal of their Lordships' advice, it is implicit in the analysis of the facts and the reasoning solely on the authority of *Salomon's* case, that the principle of corporate entity was accepted to solve the issue as a whole without resort to an independent determination of the other important factor tabulated above.

This emphatic application of the corporate entity principle in the face of a plea to "lift the veil of incorporation" is significant as a rigid adherence to the fundamental principles of company law in this novel sector of the law where inter-acting conceptions of two different branches produce the desired result which is litigated for. The corporate veil was not lifted to permit the membership and state of internal management of the company to affect the issue of whether an employee was to benefit under workmen's compensation legislation. Does this not reflect on the social acumen of the judges in compensating the widow in view of the nature of workmen's compensation legislation rather than an exclusively conscious application of the traditional principles of company law?

A. WILSON.