Corporate Personality — A Step Closer to Reality

Pek Seng Co. Pte. Ltd. & Ors. v. *Low Tin Kee & Ors.*[1]

Introduction

SINCE the House of Lords decision in *Salomon* v. *Salomon & Co. Ltd.*,[2] the occasions on which the courts have taken a peek behind the corporate veil have been many. Notwithstanding that, one would be hard put to find a coherent doctrine for lifting the corporate veil. This has resulted in impassioned pleas like that of Lord Wedderburn who asked "... is it not time to know just when a company *is* a 'sham' and when the veil of corporate personality *can* be 'torn aside'?"[3]

The problem is particularly acute in relation to corporate groups, which are in reality more predominant today than the company. Under what circumstances will the courts recognise the commercial reality behind a group of companies and hold them to be one economic entity?

The recent decision in *Pek Seng Co. Pte. Ltd. & Ors.* v. *Low Tin Kee & Ors.,* whilst to be welcomed as a step in the right direction, underscores the need for a coherent doctrine of corporate personality and the exceptions to it.

Facts

The issue arose out of an application by two wholly-owned subsidiaries for an order to set aside a Mareva injuction obtained against them by their parent company's judgment creditor.

Lomania Ltd. (Lomania) had obtained judgment against Pek Seng Co. Pte. Ltd. (Pek Seng). Execution on the judgment had been stayed pending trial of a counterclaim. Pei Huat Pte. Ltd. (Pei Huat) and Peck Chuan Devmt. Pte. Ltd. (Peck Chuan) were wholly-owned subsidiaries of Pek Seng. Pending execution of the judgment, Lomania obtained an *ex pane* Mareva injunction prohibiting Pek Seng from dealing with the

1 [1990] 1 M.L.J. 75.
2 [1897] A.C. 22.
3 K.W. Wedderburn, "Multinationals and the Antiquities of Company Law" (1984) 47 M.L.R. 87 at p. 90.

assets of Pei Huat and Peck Chuan. The subsidiaries applied to set aside the Mareva injunction against their assets.

It was common ground that Pek Seng was effectively controlled by one shareholder, Pek Tiong Seng, and that Pei Huat and Peck Chuan were controlled by Pek Seng. Pek Tiong Seng was also on the board of all three companies together with his nominee, who was the only other director. Pek Tiong Seng therefore had effective control of the subsidiaries whether directly as dominant director or indirectly, through Pek Seng.

Arguments

Two arguments were advanced by counsel for the subsidiaries. The first was that there was no real risk of Pek Seng dissipating its assets. Such a risk is, of course, a general pre-requisite for the granting of Mareva injunctions. However, as a general rule, a Mareva injunction can only affect assets belonging to the defendant. Hence, the second argument was that the injunction should not apply to the assets of Pei Huat and Peck Chuan as these assets did not belong to Pek Seng. They could only be treated as assets of Pek Seng if the corporate veils of the subsidiaries were lifted and in the present case, it was contended, there was no justification for doing so.

In so contending, counsel had to distinguish the case of *Re A Company*[4] where the English Court of Appeal upheld the lifting of the veil by the judge in granting a Mareva injunction. Counsel attempted to do this on the ground that in *Re A Company,* there was an element of fraud.

The case for Lomania was that because Pek Tiong Seng had absolute control of the three companies, there was a real risk of Pek Seng dissipating not only its own assets but also those of its subsidiaries. In urging the court to lift the veil in order to affect the subsidiaries' assets, he relied on the decision of the Malaysian Supreme Court in *Aspatra Sdn. Bhd. & Ors. v. Bank Bumiputra Sdn. & Anor.*,[5] where Lorraine Osman was sued for payment of M$27 million allegedly received by him as secret profit while acting as a director of the bank. The Supreme Court, after stating that "[t]he court would generally lift the corporate veil in order to do justice particularly where an element of fraud is involved", found such fraud present in the receipt of the said monies, lifted the veil of incorporation and granted a Mareva injunction not only against the assets of the defendant but also against those of the seventy-five companies owned and controlled by him.

Decision

On the issue of the risk of dissipation, Chan Sek Keong J., in the instant case, accepted that there was a real risk that Pek Tiong Seng would take

4 [1985] B.C.L.C. 333.
5 [1988] 1 M.LJ. 97.

steps to render out of Lomania's reach the assets of Pek Seng as well as those of the subsidiaries, even though those assets did not belong to Pek Seng. This tendency to disregard the law was, it was held, evident in Pek Tiong Seng's past record of dishonesty which involved bribing a government Minister, a bank official, and falsifying company records. Thus the learned judge concluded that Pek Tiong Seng was in a position, factually as well as legally, to dissipate the assets of the subsidiaries.

As regards the lifting of the veil, the learned judge followed the English Court of Appeal's decision in *Re A Company* and found that justice required that the veil be lifted in the present case. The basis for that finding forms the basis of this note.

Commentary

The decision is significant in that the circumstances do not apparently fall within any of the more popularly accepted exceptions to the *Salomon* principle.[6] More particularly, it suggests that in every case where the court thinks that there is a real risk of the defendant dissipating his assets and those assets include shares or interests in corporate entities which are within his effective control, the corporate veil should be lifted.

Lifting the veil in corporate groups

If it is thought that searching for a coherent doctrine of corporate personality in general would be futile, then the search for one in relation to companies in a group would prove even more so.

Statutory law does in certain situations recognise that a group of companies may be one commercial entity. It thus requires the preparation of consolidated accounts for the whole group and a report on the state of affairs of the group by the holding company's directors. Case law, however, is much less certain about when a group would be recognised as one commercial entity thus setting aside the separate legal personalities of the companies within the group.

After the Court of Appeal's decision in *DHN Food Distributors* v. *Tower Hamlets London Borough Council*,[7] it was thought that it was "but a short step" to "the proposition that the courts may disregard *Salomon's* case whenever it is just and equitable to do so."[8] There, a holding company was allowed to claim compensation for compulsory acquisition of premises owned by its wholly-owned subsidiary but on which the holding company carried on its business. If the holding company and its subsidiaries had

6 The court was referred to *Farrar's Company Law* (J.H. Farrar, N. Furey and B. Hannigan eds., 2nd ed., 1988), pp. 60-66, where the author has conveniently classified the decisions where the court has lifted the veil into seven categories, *viz.*, agency, fraud, group enterprises, trusts, enemy, tax and companies legislation.

7 [1976] 1 W.L.R. 582.

8 D. Sugarman and Frank Webb, "'Three-in-One': Trusts, Licenses and Veils" (1977) 93 L.Q.R. 170 at p. 174.

not been recognised as one economic entity, it would have been treated as a bare licensee of the premises having no interest in the land and thus not entitled to compensation for disturbance of its business. Whilst the decision to allow for compensation was unanimous, the grounds for the decision were not. Goff L.J. and Shaw L.J. based their decisions on the facts of that particular case but Lord Denning's ground was more broad-based, relying as he did on a statement of Professor Gower's that "there is evidence of a general tendency to ignore the separate legal entities of various companies within a group and to look instead at the economic entity of the whole group."[9]

Any such tendency must have been thwarted by the House of Lords decision in the case of *Woolfson* v. *Strathclyde Regional Council*[10] which cast some doubt on the soundness of the Court of Appeal's decision.

Woolfson v. *Strathclyde Regional Council* is, of course, distinguishable on its facts from the *DHN* case. In the *DHN* case, the company that owned the land was the wholly-owned subsidiary of the company that carried on the business whereas in *Woolfson,* by contrast, the company that carried on the business had "no sort of control whatever over the owners of the land." The business was carried on by a company in which Woolfson held all but one of the shares whilst the land was owned by Woolfson and a company in which he held only two-thirds of the shares. However, the House of Lords was not content merely to distinguish the earlier decision of the Court of Appeal but felt constrained to admit to "some doubt whether in this respect, the Court of Appeal properly applied 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."[11]

Further doubt was cast on the existence of this "general tendency" in *Multinational Gas and Petrochemical Co.* v. *Multinational Gas and Petrochemical Services Ltd.*[12] There, an insolvent subsidiary, at the instance of its liquidator, sued three oil companies which were its shareholders, *S,* which was also a subsidiary of the three oil companies, and its own directors, alleging various breaches of duty based upon the advice of *S*, and activities and decisions of its shareholders and directors. The real plan behind the litigation was to make the three oil companies responsible for their subsidiary, the plaintiff. The problem for the plaintiff was that, except for *S*, the other proposed defendants resided abroad, thus prohibiting service of writ. The question was, could the foreign defendants, in particular the three oil companies, be served out of jurisdiction under the "necessary or proper party" exception. They could not be thus served if they had a good defence and the Court of Appeal (May L.J. dissenting) thought they did. The reasoning was that *S*, as a company, was a separate entity from its shareholders and its corporate veil could not be torn aside. Similarly, the plaintiff subsidiary too was a corporate entity and the three

9 L.C.B. Gower, *Modern Company Law* (3rd ed.) p. 216.
10 1978 S.C. (H.L.) 90.
11 1978 S.C. (H.L.) 90 *per* Lord Keith at p. 96.
12 [1983] Ch. 258.

oil companies as its shareholders did not owe it fiduciary duties. Also, applying the *Salomon* principle, the court held that any claim the company might have had against its directors had been extinguished by the informal approval of all its shareholders. This had the effect of adopting the directors' acts as those of the company.

Five years after *Woolfson* v. *Strathclyde Regional Council,* the House of Lords again demonstrated its adherence to the *Salomon* principle. In *Lonrho Ltd.* v. *Shell Petroleum Ltd.*,[13] it rejected an attempt to compel a joint holding company to use its powers to compel a foreign subsidiary and its sub-subsidiaries to release documents in their possession to comply with an order for discovery of documents in the context of litigation against the holding company. It was held that the documents were in the control of the board of directors of the subsidiary and not of the shareholders.

The *Multinational* and *Lonrho* cases are evidence that the courts do not regard the corporate personality doctrine merely as a matter of form to be lightly cast aside as a "technical point" whenever convenient to do so. More importantly, these cases perhaps also lend support to the principle that where it is a stranger to the group that wishes to lift the veil, the courts show the greatest reluctance to do so.[14]

The two cases followed by Chan Sek Keong J., however, run against the vein of that principle. In both *Re A Company*[15] and the *Aspatra*[16] case, the corporate veil was lifted at the behest of a stranger to the group. The factor that distinguishes these two cases from the others is, it is submitted, the presence of fraud.

In *Re A Company,* not only did the cause of action involve fraud (specifically deceit and breach of trust) but it was also alleged that the defendant had created and used the network of companies to conceal his English assets and put them out of reach of the plaintiffs. It was held that the evidence filed in support of the application supported both the allegations of deceit as well as of fraud in the use of the network of companies to conceal assets:-

> "But the evidence is clear enough at this stage that the whole construction is but a facade used to place the English assets outside the reach of the first defendant's creditors, including the plaintiffs, if judgment is obtained by them...."[17]

In the case of *Aspatra,* it was admitted that there was an element of fraud in the receipt of secret profits and this the court found sufficient to justify the lifting of the corporate veil.

13 [1980] I W.L.R. 627 (HL).
14 For one reference to this principle, see, *Gore-Browne on Companies* (A.J. Boyle and R. Sykes eds., 44th ed., 1986), Vol.1, para. 1.4.
15 [1985] B.C.L.C. 333.
16 [1988] 1 M.L.J. 97.
17 [1985] B.C.L.C. 333 at p. 336.

Fraud has thus been said to open doors otherwise kept firmly closed to third parties.[18] Where was the fraudulent key in the case under review?

The judgment of Chan Sek Keong J. is vague not only as regards whether fraud was present but also as regards whether it is an essential element in the first place. On the one hand, Chan J. appeared to realise the significance of fraud in the two cases he followed and to suggest that in the case before him too, there was fraud or at least a tendency to use the subsidiaries as an instrument of fraud:-

> "In *Re A Company,* the defendant had formed a dishonest intention to dissipate assets before he was sued and in anticipation of being sued. He set out to take and took advantage of the law, that is to say the principle *of Salomon* v. *Salomon & Co. Ltd.*, to vest his assets in corporate entities and trusts in order to conceal them from his creditor. In principle, the case where the defendant forms such an intention after he has been sued should be treated in the same way. A pre-action intention is no different from a post-action or post-judgment intention, as far as the plaintiff is concerned: such a defendant is equally dishonest as the defendant in *Re A Company.*"[19]

In *Re A Company,* the evidence established that the network of companies had been used, and perhaps even created, for the disposal of the defendant's English assets. There was no such use here. All that was found was a post-judgment dishonest intention to make fraudulent use of the subsidiaries: in other words, a risk of dissipation. Is that risk of dissipation, even one involving use of the subsidiaries, sufficient to amount to fraud? It is submitted that fraud in the precedent cases involves something more - either fraud in the cause of action or fraud in the use or creation of the subsidiaries. Past dishonesty giving rise to a risk of dissipation does not amount to fraud.

It may well be, however, that no reference to or finding of fraud was intended in the above-quoted passage. This conclusion is supported by there being no further reference to fraud in Chan J.'s judgment. The key element in his judgment is, apparently, effective control rather than fraud:-

> "If the court has formed the view that a real risk exists of the defendant taking steps to remove his assets from the reach of the plaintiff, then justice to the plaintiff can only be done by making a restraining order against any assets owned by the defendant, directly and indirectly, and within his unfettered control to dispose of."[19]

The consequence of eliminating fraud and requiring only effective control as a condition for lifting the veil is significant. It would mean, as Chan J. recognises, "that *in every case* where the court thinks that there is a real risk of the defendant dissipating his assets and these assets

18 *Supra,* note 14, para. 1.4.
19 [1990] 1 M.L.J. 75 at p. 78.

include shares or interests in corporate entities which are within his effective control, the corporate veil should be lifted",[20] fraud or no fraud. That would be drawing new and wider boundaries. Or would it? Effective control as a key for lifting the veil is not a new concept. Similar boundaries have been drawn though in less explicit terms. Cumming-Bruce L.J.'s reference in *Re A Company*[21] to the puppet companies of Dr. Wallersteiner in *Wallersteiner* v. *Moir*[22] and to control elsewhere in his judgment suggests that control was equally instrumental in his decision. Unfortunately, there the decisiveness of its role was clouded by the additional factor of fraud, clearly established and constantly referred to. Lord Denning, of course, gave it a lead role in his judgment in *Wallersteiner* v. *Moir* where a loan was found to be in breach of the then section 190(1) of the Companies Act 1948 because the borrowing company "danced to Wallersteiner's bidding" and relied on it again in his judgment in *Lonrho Ltd.* v. *Shell Petroleum Ltd.*[23]

Using effective control as the yardstick for lifting the veil is a move to be commended not least because it would enable the law to distinguish between the Wallersteiner and Pek Tiong Seng type of corporate groups where the companies danced to the tune of one man and from which the corporate veil ought to be lifted and groups where the individual companies ran their own show, with little or no interference from their parent or owner. That it is an appropriate key has also been recognised by legislators in Europe, particularly in Germany, where for instance, the extent of a parent's liability for its subsidiary's debts corresponds to the extent of the parent's control over the subsidiary's affairs. Chan J.'s judgment is thus a step in the right direction.

The judgment is also significant for its recognition of common sense and reality, for what is a share save for the value of assets of the company it represents? Any wrongful disposal of those assets must result in the diminution of the value of the shares. The injunction merely recognises this reality.

Conclusion

The decision is thus laudable for placing a premium on commercial reality. However, two points must be noted.

Firstly, it emphasises the need for a coherent doctrine, the fulfilment of which cannot be left to case law; for so long as there exists both bold and timorous souls, such a doctrine is unlikely to emerge.

Secondly, it must be realised that the decision is but a small step in the right direction. The Mareva injunction does not have the effect of rendering the assets of subsidiaries liable to be taken in execution

20 [1990] 1 M.L.J. 75 at p. 78 (emphasis added).
21 [1985J B.C.L.C. 333 at p. 337.
22 [1974] 3 All E.R. 217.
23 [1980] 2 W.L.R. 367 at pp. 373-374.

for the parent's debts. It merely preserves the *status quo,* by preserving the assets. We are similarly far away from the day when a parent company will be held liable for the debts of its subsidiaries whether effectively controlled by the parent or not.

To this end, one can only repeat the call for statute to lift corporate veils and make parent corporations, in stated circumstances, liable for some, at least, of the debts and liabilities of subsidiaries, and for English law to take a lesson from its German counterpart where effective parental control is the key to recognition of the group as one economic entity, instead of relying on vague and uncertain so-called exceptions to the *Salomon* principle.

PATRICIA G. S. ONG-WEE*

* LL.B. (Hons.) (N.U.S.), LL.M. (Lond.), Lecturer, Division of Legal Studies and Taxation, School of Accountancy and Business, Nanyang Technological Institute, Singapore.