Singapore Journal of Legal Studies
[1999] 531 – 551

PIERCING THE SEPARATE PERSONALITY OF THE COMPANY: A MATTER OF POLICY?

It is often said that the separate personality of a company may be ignored if the company is a mere 'sham' or 'façade'. In this article, it is submitted that the use of such metaphors masks the true issues. The separate personality of a company should be pierced if public policy makes it undesirable to recognise such separate personality, and then only to the extent of avoiding the undesirable effects.

I. INTRODUCTION

A fundamental principle of company law is that a properly incorporated company has a legal personality of its own which is separate and distinct from the individual members of the company. Thus, section 19(5) of the Singapore Companies Act[1] states:

> "On and from the date of incorporation specified in the certificate of incorporation but subject to this Act, the subscribers to the memorandum together with such other persons as may from time to time become members of the company shall be a body corporate by the name contained in the memorandum capable forthwith of exercising all the functions of an incorporated company and of suing and being sued and have perpetual succession and a common seal with power to hold land but with such liability on the part of the members to contribute to the assets of the company in the event of its being wound up as is provided by this Act."

[1] Cap 50, 1994 ed; also see s 13(3) of the UK Companies Act 1985 which states: "From the date of incorporation mentioned in the certificate, the subscribers of the memorandum, together with such other persons as may from time to time become members of the company, shall be a body corporate by the name contained in the memorandum."

This principle is referred to commonly as the rule in *Salomon* v *Salomon and Company Limited.*[2] Thus, Aron Salomon, who held virtually all the shares in Salomon and Company Limited, was not liable for the debts of the company. As Lord Macnaghten said:[3]

> "The company is at law a different person altogether from the subscribers to the memorandum; and, though it may be that after incorporation the business is precisely the same as it was before, and the same persons are managers, and the same hands receive the profits the company is not in law the agent of the subscribers or trustee for them. Nor are the subscribers as members liable, in any shape or form, except to the extent and in the manner provided by the Act. That is, I think, the declared intention of the enactment."

A striking illustration of the principle can be seen in the case of *Lee* v *Lee's Air Farming Ltd*[4] where the appellant's husband was the controlling shareholder of the company, its governing director as well as its chief pilot. While piloting an aircraft of the company, the aircraft crashed and he was killed. The question was whether he was a "worker" employed by the company for the purposes of the workmen's compensation legislation. The Privy Council held that as he and the company were separate legal persons, it was possible for him in his capacity as governing director of the company to cause the company to enter into a contract of employment with him as the chief pilot of the company. He was therefore a "worker" within the meaning of the legislation.

A more recent application of the principle in England may be found in the case of *Acatos & Hutcheson plc* v *Watson.*[5] In that case, it was held that a company (the acquiring company) which wanted to acquire the shares

[2] [1897] AC 22; also see *John Foster & Sons* v *IRC* [1894] 1 QB 516; *Gramophone and Typewriter Limited* v *Stanley* [1908] 2 KB 89; *R* v *Grubb* [1915] 2 KB 683; *IRC* v *Sansom* [1921] 2 AC 465; *Lee* v *Lee's Air Farming Limited* [1961] AC 12; *Hong Kong Vegetable Oil Company Limited* v *Malin Srinaga Wicker* [1978] 2 MLJ 13; *Acatos & Hutcheson plc* v *Watson* [1995] 1 BCLC 218.

[3] *Ibid*, at 51; also see the speech of Lord Halsbury LC at 30 where he said: "it seems to me impossible to dispute that once the company is legally incorporated it must be treated like any other independent person with its rights and liabilities appropriate to itself, and that the motives of those who took part in the promotion of the company are absolutely irrelevant in discussing what those rights and liabilities are."

[4] [1961] AC 12; also see *Nico*l v *Allyacht Spars Pty Ltd* (1987) 163 CLR 611.

[5] [1995] 1 BCLC 218.

of another company did not contravene the rule in *Trevor* v *Whitworth*[6] even though the sole asset of the other company was shares in the acquiring company. The acquiring company and the company being acquired were separate legal persons and by acquiring the shares of the company being acquired, the acquiring company was not acquiring its assets.

II. Piercing the Veil of Incorporation[7]

While the courts have recognised the separate legal personality of the company, they have on occasion chosen not to give effect to this principle.[8] The courts' power to ignore the separate legal personality of the company was evident from the case of *Salomon* v *Salomon and Company Limited* itself where Lord Watson said that he was prepared to assume that "proceedings which are permitted by the Act may be so used by the members of a limited company as to constitute a fraud upon others, to whom they in consequence incur personal liability."[9] When the courts do not give effect to the separate legal personality of a company, it is said that the courts 'pierce'[10] or 'lift'[11] the corporate veil. This means that "although whenever each individual company is formed a separate legal personality is created

6 (1887) 12 App Cas 409. The rule prohibits companies from purchasing their own shares. This rule has now been modified in many Commonwealth countries such as Australia, New Zealand, Singapore and England. Companies in these jurisdiction may, subject to certain safeguards, purchase their own shares. A discussion of share buy-backs is outside the scope of this article; for an outline of the Singapore position, see Tan CH, "Reflections on the Companies (Amendment) Bill No 36/98" (1998) 10 SAcLJ 287.

7 Useful reference may be made to the following articles: Schmitthoff, "Salomon in the Shadow" [1976] JBL 305; M Whincup, "'Inequitable Incorporation' – the Abuse of Privilege" (1981) 2 Co Law 158; P Carteaux, "Louisiana Adopts a Balancing Test for Piercing the Corporate Veil" (1984) 58 Tulane L Rev 1089; A Domanski, "Piercing the Corporate Veil – A New Direction?" (1986) 103 SALJ 224; S Ottolenghi, "From Peeping Behind the Veil, to Ignoring it Completely" (1990) 53 MLR 338.

8 This article is only concerned with the circumstances under which the courts will ignore the separate personality of the company. Parliament may of course pass legislation which limits the separate personality of a company, see *Adams* v *Cape Industries PLC* [1990] 2 WLR 657, at 752 and 755. In such cases, the extent of the limitation, if it exists, is a matter of construction of the language used in the statutory provisions.

9 [1897] AC 22, at 39; also see the speeches of Lords Halsbury LC and Macnaghten at 33 and 53 respectively.

10 For example, see *Re a Company* [1985] BCLC 333, at 337-338; *Alex Lobb (Garages) Ltd* v *Total Oil GB* [1985] 1 WLR 173, at 178.

11 For example, see *Pioneer Concrete Services Ltd* v *Yelnah Pty Ltd* (1986) 5 NSWLR 254, at 264; *Creasey* v *Breachwood Motors Ltd* [1993] BCLC 480, at 491.

courts will on occasions look behind the legal personality to the real controllers."[12] This will frequently lead to personal liability being imposed on the real controllers.

The difficulty arises in discerning when the courts will lift the corporate veil. This difficulty arises in large part because this area is overladen by the use of metaphors. The courts have, for example, said that the veil will be pierced where the company is "a mere cloak or sham",[13] "a mere device",[14] "a mere channel",[15] "a mask",[16] or "a facade concealing the real facts".[17] Many more metaphors abound.[18] The courts' pre-disposition with metaphors makes it very difficult to understand the principles which underlie the courts' occasional decisions to look beyond the personality of the company. Thus, in *Briggs* v *James Hardie & Co Pty Ltd,*[19] Rogers AJA said:[20]

> "The threshold problem arises from the fact that there is no common, unifying principle, which underlies the occasional decision of courts to pierce the corporate veil. Although an *ad hoc* explanation may be offered by a court which so decides, there is no principled approach to be derived from the authorities".[21]

In *Adams* v *Cape Industries PLC,* the English Court of Appeal said that they would not attempt a comprehensive definition of the principles which should guide the court in determining whether or not the arrangements of

[12] *Pioneer Concrete Services Ltd* v *Yelnah Pty Ltd* (1986) 5 NSWLR 254, at 264. *In Gower's Principles of Company Law* (6th ed), at 148, it is stated that "where the veil is lifted, the law either goes behind the corporate personality to the individual members or directors, or ignores the separate personality of each company in favour of the economic entity constituted by a group of associated companies. The latter situation is often merely an example of the former".

[13] *Gilford Motor Company Limited* v *Horne* [1933] 1 Ch 935, at 961, 965, 969.

[14] *Ibid,* at 961; *Jones* v *Lipman* [1962] 1 WLR 832, at 836.

[15] *Gilford Motor Company Limited* v *Horne, ibid*, at 965.

[16] *Jones* v *Lipman* [1962] 1 WLR 832, at 836.

[17] *Tunstall* v *Steigmann* [1962] 2 QB 593, at 602; *Woolfson* v *Strathclyde Regional Council* 1978 SC (HL) 90, at 96. This appears at present to be the preferred means of expressing the test which the courts will apply when considering whether to lift the corporate veil, see *Adams* v *Cape Industries PLC* [1990] 2 WLR 657, at 759.

[18] For a more comprehensive list, see Pickering, "The Company as a Separate Entity" (1968) 31 MLR 481.

[19] (1989) 16 NSWLR 549.

[20] *Ibid,* at 567; also see *Inland Revenue Commissioners* v *Sansom* [1921] 2 KB 492, at 514, where Younger LJ deprecated what he considered the "too indiscriminate use of such words as simulacrum, sham or cloak" which had "led to results which were unfortunate and unjust".

[21] Also see *Yukong Lines Ltd of Korea* v *Rendsburg Investments Corporation of Liberia (No 2)* [1998] 4 All ER 82, at 93.

a corporate group involved a façade which concealed the true facts.[22] The absence of any clear underlying principle was no doubt a reason why the judge in *Creasey* v *Breachwood Motors Ltd*[23] said that while the power of the court to lift the corporate veil existed, "[t]he problem for a judge of first instance is to decide whether the particular case before the court is one in which that power should be exercised" since the authorities provided limited guidance as to the circumstances in which the power was to be exercised.[24]

Academic commentators have also bemoaned the failure of the courts to articulate a coherent principle. It has been said that "[t]he use of this vague metaphorical language makes it very difficult to discover what the true issues are."[25] The authors of *Gore-Browne on Companies* state that "[i]t is not possible to formulate any single principle as the basis for these decisions, nor are all the decisions, as to when the separate legal entity of the company must be respected or when it may be disregarded, entirely consistent with one another."[26] In the context of Australia, it has been said that "it is still impossible to discern any broad principle of company law indicating the circumstances in which the court should lift the corporate veil."[27]

III. The Commercial Advantages of Limited Liability

It follows from the fact that a corporation is a separate person that its members are not as such liable for its debts.[28] This concept of limited liability is widely accepted to have done much to facilitate the growth of commerce. Holdsworth, writing about the joint stock company in the seventeenth century, in which it was possible to limit the liability of the members of the company by a contract between the members and the company, said that this and other advantages which followed from the corporate form meant that the promoters were able to secure the supreme advantage of attracting capital more easily to finance their undertaking. The investor could be attracted by the advantages of transferable shares and a limited liability.[29] It made available capital which would not otherwise have been employed in trade.[30]

22 [1990] 2 WLR 657, at 759.
23 [1993] BCLC 480.
24 *Ibid,* at 491.
25 Mayson, French & Ryan on *Company Law* (12th ed), at 124.
26 Boyle and Sykes (eds), (44th ed), at para 1.3.1.
27 *Ford's Principles of Corporations Law* (8th ed), at para 4.400.
28 *Gower's Principles of Modern Company Law, supra,* at 80; *Rayner (Mincing Lane) Ltd* v *Dept of Trade* [1989] Ch 72, at 176.
29 Holdsworth, *A History of English Law,* Vol VIII, at 202-205.
30 *Ibid,* at 213.

The *Economist,* in its 18 December 1926 issue, remarked that the "economic historian of the future may assign to the nameless inventor of the principle of limited liability, as applied to trading corporations, a place of honor with Watt and Stephenson, and other pioneers of the industrial revolution. The genius of these men produced the means by which man's command of natural resources was multiplied many times over; the limited liability company the means by which huge aggregations of capital required to give effect to their discoveries were collected, organized and efficiently administered."[31] In similar vein, it was said:

> "In truth, all joint-stock companies seem to partake of the nature, and in some degree to come under the description of joint adventures, associations for a purpose which is not a big one to those engaged in them; each individual member having his own separate pursuit or profession which engrosses the chief part of his time and attention; and therefore are they, besides their public usefulness, suitable to the convenience of private persons as absorbing their spare and superfluous capital."[32]

While such statements today have a familiar ring, limited liability was not easily arrived at in England. For example, a majority of the members of a Royal Commission appointed to consider the issue opposed the extension of limited liability to joint stock companies.[33] Nor were all members of the commercial community in favour of limited liability. The Manchester Chamber of Commerce thought limited liability to be subversive of the high moral responsibility which was the hallmark of the Partnership Laws.[34] A Manchester manufacturer said that limited liability "would become the refuge of the trading skulk; and, as a mask cover the degradation and moral guilt of having recklessly gambled with the interests of traders; and then the stain which now attaches to bankruptcy would cease to exist".[35] These views did not prevail. According to Hunt,[36] the middle of the 19th century marked the high tide of *laissez-faire,* and at its crest, limited liability was sought and granted in the name of perfect freedom. Limited liability had

[31] Quoted in Hunt, *The Development of the Business Corporation in England 1800-1867* (1936), at 116.

[32] Corbet, *An Inquiry into the Causes and Modes of the Wealth of Individuals, or the Principles of Trade and Speculation Explained* (1841), at 99; quoted in Cooke, *Corporation, Trust and Company* (1950), at 132.

[33] *Gower's Principles of Modern Company Law, supra,* at 42.

[34] Cooke, *supra*, at 156-157.

[35] Quoted in Hunt, *supra,* at 118.

[36] *Ibid*, at 116-117.

become the subject of repeated and voluminous legislative inquiry, and reinforced by the pressure of rapidly accumulating capital, more and more widely diffused and seeking investment, dogged persistence in Parliament combined with the spirit of the age to secure full liberty of incorporation and limited liability. Typical of the views expressed by proponents of limited liability were the following words of a director of the Bank of England:[37]

> "The permission to all men, to employ their capital and industry in that manner which they think most suitable to their own interest, unshackled by hostile enactments on the part of the legislature, is found on the whole to be most conducive to the general prosperity. It is the principle upon which the doctrine of free trade is based – upon which the strict law of apprenticeship has been abolished, the guilds and license companies of former times have gradually disappeared, and been replaced by a state of things based on open competition."

IV. A Matter of Policy

From the foregoing, it seems clear that limited liability was ultimately preferred for the freedom it gave individuals to employ their excess capital, and the advantages which that would have for commerce. These policy considerations have been recognised by the courts. In *Rainham Chemical Works Limited* v *Belvedere Fish Guano Company,*[38] Lord Buckmaster said that "the Companies Acts expressly contemplate that people may substitute the limited liability of a company for the unlimited liability of the individual, with the object that by this means enterprise and adventure may be encouraged."[39] As the principle of the company's separate personality and the concept of limited liability are closely bound up, any discussion of the circumstances in which the courts will ignore the company's separate personality should take into account these policy considerations. Accordingly, while it is possible to attempt a description of the main categories of cases in which the courts may pierce the corporate veil,[40] it is submitted that in the ultimate analysis, piercing takes place where judges conclude that the

[37] GW Norman, quoted in Hunt, *ibid,* at 118.

[38] [1921] 2 AC 465.

[39] *Ibid,* at 475; also see *British Thomson-Houston Company Limited* v *Sterling Accessories Limited* [1924] 2 Ch 33, at 39.

[40] For example, see *Farrar's Company Law* (3rd ed), at 74, where nine categories were identified, namely agency, fraud, group enterprises, trusts, tort, enemy, tax, the companies legislation, and other legislation. In *Pioneer Concrete Services Ltd* v *Yelnah Pty Ltd* (1986) 5 NSWLR 254, at 264, Young J said that this was as good an attempt to summarise the cases as he had ever seen.

recognition of a company's separate personality would lead to undesirable consequences which outweigh the commercial benefits that society perceives are obtained by recognizing corporate bodies as separate personalities, or would undermine the value of the corporate form itself.[41]

For example, the courts have had no hesitation lifting the veil where the corporate form has been used to commit fraud.[42] Thus, in *Re Darby,*[43] Phillimore J found that two of the signatories to the memorandum of association of the City of London Investment Corporation, namely Messrs Darby and Gyde, had used the company as an instrument to perpetrate a fraud on investors who subscribed for debentures issued by another company that was promoted by the City of London Investment Corporation. As such, the learned Judge treated the City of London Investment Corporation as an alias of Darby and Gyde and allowed the liquidator of the other company to prove in their bankruptcy.[44] In *Gilford Motor Company Limited* v *Horne,*[45] the defendant, a managing director of the plaintiff company, entered into a covenant in a service agreement not to solicit customers of the plaintiff. After leaving the employment of the plaintiff, the defendant formed a company which solicited the plaintiff's customers. The English Court of Appeal held that the company was a mere sham for the purpose of enabling the defendant to commit a breach of the covenant he had entered into. As such, an injunction was issued against the defendant and the company.

Similarly, in *Re a Company*,[46] the plaintiff companies had brought a claim against the defendant alleging deceit and breach of fiduciary duty. The defendant organised his personal assets through a network of interlocking companies and trusts with the aim of preventing the plaintiffs from realising

41 Schmitthoff, "Salomon in the Shadow" [1976] JBL 305, at 309, states that aside from agency, the English courts will lift the corporate veil in situations where the form of corporateness has been abused for an unlawful or improper use.

42 In his First Hamlyn Lecture, Lord Cooke of Thorndon opinioned that there is only one broad class of cases where the process of piercing the corporate veil is truly consistent with the Salomon reasoning. This is where "under enactments such as those against fraudulent or wrongful trading, or on the permissible interpretation of an enactment or contract, or for the purposes of common law or equitable principles against fraud of oppression or relating to agency, it is necessary to look at what has happened in fact rather than form", *Turning Points of the Common Law,* The Hamlyn Lectures, Forty-Seventh Series (Sweet & Maxwell, 1997), at 13.

43 [1911] 1 KB 95.

44 Counsel for the liquidator had argued that *Salomon* v *Salomon & Co, supra,* was distinguishable as that was a case which involved "an honest company and an honest transaction", *ibid,* at 100.

45 [1933] 1 Ch 935.

46 [1985] BCLC 333.

the fruits of the claim which had been brought. The court granted injunctions restraining the defendant from disposing of shares in foreign companies, or interests under trusts or shares in English or foreign companies entitled to English assets, and also restraining the defendant from procuring the disposition of English assets by such trusts or companies. This order was substantially upheld by the English Court of Appeal which held that the circumstances justified a piercing of the corporate veil in order to achieve justice.

It is suggested that these cases show that the courts will, as a matter of policy, limit the company's separate personality where the corporate vehicle has been used for an improper purpose and not for a *bona fide* and honest transaction. Where a company has been used for an improper purpose, the underlying policies justifying the recognition of the company's separate personality[47] are not present. Indeed, if the separate personality of the company was given full effect to in such cases, this would undermine the corporation's viability and value as a vehicle for commercial transactions.

Admittedly, judicial statements to such effect are sparse. Such statements as do exist are often made tangentially. Thus, in *Saloman* v *Salomon and Company Limited,* Lord Macnaghten said that he could not see that 'one man companies' were against public policy.[48] Similarly, in *Pioneer Concrete Services Ltd* v *Yelnah Pty Ltd,*[49] Young J referred to the case of *DHN Food Distributors Ltd* v *Tower Hamlets London Borough Council*[50] as "one of those 'too hard' cases in which judges have for policy reasons justified the lifting of the corporate veil in that particular case".[51] In *Re Securitibank Ltd (No 2)*,[52] Richmond P, after referring to Lord Denning's statement in *Littlewoods Mail Order Stores Ltd* v *McGregor*[53] to the effect that the doctrine in Salomon's case should be watched very carefully, said that that would only be so "if a strict application of the principle of corporate entity would lead to a result so unsatisfactory as to warrant some departure from the normal rule."[54] It is apprehended that such policy considerations underlie what the judges mean when they say that the veil should be lifted to "achieve

47 Namely as a means for people to safely invest their excess capital without the fear of being regarded as a partner with unlimited liability, and the consequent advantages which this has on the ability to pool capital for commercial ventures.

48 [1897] AC 22, at 53.

49 (1986) 5 NSWLR 254.

50 [1975] 1 WLR 852.

51 (1986) 5 NSWLR 254, at 266.

52 [1978] 2 NSLR 136.

53 [1969] 1 WLR 1241, at 1254.

54 *Supra,* note 52, at 158.

justice where its exercise is necessary for that purpose"[55] or "where an injustice may result."[56]

In weighing the competing policies, the purpose for which the company was incorporated may be relevant. If a company was incorporated for the purpose of being engaged honestly in commercial transactions, the separate personality of the company will generally be respected.[57] If, on the other hand, it has been incorporated to facilitate a fraudulent purpose, the separate personality of the company should not prevent liability being fixed to the controllers of the company. Thus, in *Trade Facilities Pte Ltd* v *PP,*[58] Yong Pung How CJ said, in the context of an appeal against conviction under section 73 of the Singapore Trade Marks Act,[59] that if the evidence showed that the accused's mind and will were behind the company, the accused could not hide behind the corporate veil. To give effect to the corporate veil in these circumstances would be to allow the Act to be evaded "with impunity by the simple device of incorporating a $2 company to carry on the trading."[60] On the other hand, in *Pioneer Concrete Services Ltd* v *Yelnah Pty Ltd,* Young J said that there was a "good commercial purpose" for having separate companies in the group perform different functions.[61] Similarly, in *Inland Revenue Commissioners* v *Sansom,* Younger LJ spoke of "*bona fide* and genuine" companies as compared to "black sheep" which "deserved[d] condemnation".[62] This was echoed by Macpherson J in *National Dock Labour Board* v *Pinn & Wheeler Ltd* where he said:

> "But where the companies are kept alive as separate legal entities for good commercial or historical reasons in order to keep the company's name fully alive and in order to maintain the loyalty of employees for example, and also probably to avoid redundancy and other problems, I see no reason why the veil should be pierced."[63]

55 *Creasey* v *Breachwood Motors Ltd* [1993] BCLC 480, at 491; also see *Re a Company* [1985] BCLC 333, at 337-338.

56 *National Dock Labour Board* v *Pinn & Wheeler Ltd* [1989] BCLC 647, at 651; *cf Adams* v *Cape Industries PLC* [1990] 2 WLR 657, at 753, where Slade LJ said that the court is not free to disregard the principle in Salomon's case merely because it considers it just to do so.

57 This is not to say that the improper use of a corporate vehicle in a specific instance will not be sufficient for the courts to pierce the corporate veil in respect of that particular transaction.

58 [1995] 2 SLR 475.

59 Cap 332, 1992 ed.

60 *Supra,* note 58, at 497.

61 (1986) 5 NSWLR 254, at 267.

62 [1921] 2 KB 492, at 514.

63 [1989] BCLC 647, at 651.

This, it is submitted, is the reason why it has been said that where a façade is alleged, the motive of those behind the company may be highly material.[64]

The relevancy of the illegitimate use of the corporate structure to the courts is also demonstrated by the numerous instances where judges have said that the separate personality of the company cannot be ignored because the company has not been used to perpetrate a fraud,[65] the persons behind the company have not acted fraudulently or dishonestly,[66] there was no improper conduct,[67] nor was the company used to cover up illegal or immoral purposes or to assist in the avoidance of legal obligations entered into.[68] In *United States* v *Milwaukee Refrigerator Transit Company,* Sanborn J expressed the principle as follows:[69]

> "If any general rule can be laid down ... it is that a corporation will be looked upon as a legal entity as a general rule, and until sufficient reason to the contrary appears; but, when the notion of legal entity is used to defeat public convenience, justify wrong, protect fraud, or defend crime, the law will regard the corporation as an association of persons."

To similar effect is a statement by Lai Kew Chai J in the Singapore Court of Appeal in *The Andres Bonifacio*[70] where he said:

> "We accept counsel's submission that there must be special circumstances to exist before lifting the corporate veil, such as the presence of a façade or sham set up to deceive the appellants. One could not

64 *Jones* v *Lipman* [1962] WLR 832; *Adams* v *Cape Industries PLC* [1990] Ch 433, at 540.

65 For example, see *Salomon* v *Salomon and Company Limited* [1897] AC 22, at 39.

66 For example, see *Salomon* v *Salomon and Company Limited, ibid,* at 52.

67 For example, see *Pioneer Laundry and Dry Cleaners Limited* v *Minister of National Revenue* [1940] AC 127, at 137.

68 For example, see *Allarco Group Ltd* v *Suncor Inc Resources Group, Oil Sands Division* [1987] 5 WWR 159, at 164; *Jones* v *Lipman* [1962] 1 WLR 832; *Creasey* v *Breachwood Motors Ltd* [1993] BCLC 480, at 492.

69 142 Fed 242, at 247; in *Mesenberg* v *Cord Industrial Recruiters Pty Ltd* (1996) 19 ACSR 483, Young J said that it may be that "the rule is or should be that the court only regards a corporation which is a quasi partnership as a legal entity until sufficient reason to be contrary appears and that sufficient reason is where to continue to treat the legal entity as a separate entity would defeat public convenience, justify wrong, protect fraud or defend crime". In *Mayo* v *Pioneer Bank & Trust Company* 270 F 2d 823, at 830, the court said: "It is one thing to observe the corporate fiction as if the fiction were the truth – when the fiction is not abused. It is quite a different thing when the sole stockholder either ignores the corporation as a separate entity or uses the corporate fiction as an instrument of deceit."

70 [1993] 3 SLR 521.

> lift the corporate veil just because a company made subsidiaries in order to avoid future liabilities."[71]

Perhaps the clearest judicial pronouncement to the effect that the separate personality of the company should be disregarded where it is against public policy because of an illegitimate use of the corporate form is to be found in the judgment of the Supreme Court of Louisiana in *Glazer* v *Commission on Ethics for Public Employees*.[72] In that case, the majority said:

> "We agree ... that the problems involved are to be solved not by 'disregarding' the corporate personality, but by a study of the just and reasonable limitations upon the exercise of the privilege of separate capacity under particular circumstances in view of its proper use and functions ... The policies behind recognition of a separate corporate existence must be balanced against the policies justifying piercing ... Depending upon the various competing policies and interests involved, the same factual scenario may result in recognition of a separate corporate identity for some purposes, *ie*, insulation of shareholders from liability, and a disallowance of the separate corporate entity privilege for others. Each situation must be considered by the court on its merits. The facts presented must demonstrate some misuse of the corporate privilege in that situation or the need of limiting it in order to do justice."[73]

On the facts, the majority held that the separate corporate entity did not permit a public official such as Mr Glazer to use his wholly-owned and controlled corporation to do that which the Code of Ethics for Governmental Employees expressly commanded that he should not do. Recognition of the separate corporate identity on the facts would be "a misuse of the privilege of separate capacity and further none of its proper functions and objectives, *viz*, limited liability of shareholders; corporate capacity to hold property, enter contracts, sue and be sued, and to enjoy continued existence."[74]

The judgment of the majority in *Glazer* brings out another important point. While the courts may on occasion pierce the corporate veil, this does not mean that the company ceases to exist as a separate legal person.

71 *Ibid,* at 531; also see *The Skaw Prince* [1994] 3 SLR 379.

72 431 So 2d 752 (La 1983).

73 *Ibid*, at 757-758. For comments, see P Carteaux, "Louisiana Adopts a Balancing Test for Piercing the Corporate Veil" (1984) 58 Tulane L Rev 1089; A Domanski, "Piercing the Corporate Veil – A New Direction?" (1986) 103 SALJ 224.

74 *Ibid*, at 758.

Notwithstanding the lifting of the veil, the company continues to be a duly constituted legal entity until it is struck off from the companies register. The fact that the court "does lift the corporate veil for a specific purpose in no way destroys the recognition of the corporation as an independent and autonomous entity for all other purposes."[75] The separate legal personality of the company should generally be disregarded or limited only to the extent that the company has been used for an illegitimate purpose. A company may have been used in connection with a *bona fide* commercial enterprise for many years. The subsequent use of the company by its controllers to perpetrate a fraud may justify a lifting of the veil in that instant case but can afford no justification for ignoring the legal personality of the company in its previous transactions.

A. *Re Polly Peck International Plc (in Administration)*

Some discussion of public policy in the context of veil piercing took place in the fairly recent case of *Re Polly Peck International plc (in administration).*[76] Polly Peck International plc (PPI) set up a wholly-owned subsidiary, Polly Peck International Finance Ltd (PPIF). PPIF issued bonds to a group of foreign banks. These bonds were unsecured and guaranteed by PPI. Each bond issue contained a clause allowing PPI to be substituted for PPIF as the principal obligor. PPIF on-loaned all funds received to PPI. In practice, once PPIF had formally joined in a bond issue, its involvement in the subsequent management of the issue was minimal. It had no current account at a bank and all payments of interest, fees and costs in connection with the bonds appeared to have been made by PPI. In October 1990, PPI went into administration. A scheme of arrangement was approved in May 1995 which provided *inter alia* that no scheme creditor was to prove more than once in respect of any claim. In March 1995, PPIF was put in creditors' voluntary liquidation. The liquidators for PPIF submitted a claim to the scheme supervisors. The banks as bondholders also lodged claims against PPI as guarantor. The question was whether PPIF could maintain a claim separate from that of the bondholders. It was argued that PPIF did not have a separate personality from PPI and therefore could not maintain a claim against PPI. Robert Walker J rejected this argument. He held that PPIF was a distinct and separate legal entity from PPI. He also held at PPIF was not an agent or nominee of PPI in the bond issues.

[75] *Nedco Ltd* v *Clark* (1973) 43 DLR (3d) 714, at 721.
[76] [1996] 2 All ER 433.

An alternative argument which was raised was that even if PPIF acted as a separate principal, the on-lending within the Polly Peck group was so much of the same composite transaction that it should not be treated as a separate debt. It was contended that the economic reality of a corporate group should not be ignored where a rule founded in public policy[77] would otherwise be frustrated. Robert Walker J said that while he found this argument most persuasive, he was not ultimately persuaded by it. He said that were he to accede to this argument, it would create a new exception unrecognised by the Court of Appeal in *Adams* v *Cape Industries PLC* and that was not open to him to do.

It is submitted respectfully that the decision is manifestly correct. The rule against double proof would have operated only if PPI and PPIF were a single entity. If they were separate entities, the rule against double proof would be inapplicable. As the learned Judge pointed out, the argument in one sense assumed what it sought to prove, since the result would only be inequitable if it was true that the group was one entity. As a general rule, each company in a group is a separate entity from others in that group and if the argument had succeeded, this principle would have been undermined. In addition, it would also mean that the separate personality of the company should yield whenever an existing rule founded in public policy, such as the rule against double proof, would otherwise be inapplicable. This goes too far. The true question is whether such rules are intended to co-exist with the principle of separate personality. The rule against double proof is not inconsistent with the separate personality of the company and there was therefore no reason to modify the principle of separate personality simply to allow the rule against double proof to operate, particularly where, as the judge said, he could not perceive "any obvious injustice in the unpredictable consequences that may follow from the unforeseen insolvency of a large international group of companies such as the Polly Peck group."[78]

V. Groups of Companies and Tortious Acts

It has been suggested that the corporate veil is lifted when judges are of the view that policy considerations should limit the separate personality of the company in a particular case. It is submitted that most of the cases can be rationalised consistently with this underlying principle. The paradigm example is where a corporate vehicle has been used as an instrument of fraud. Similarly, the courts may be prepared to look behind the corporate entity to see who are the controlling shareholders of the company for the

[77] In this case, the rule against double proof.
[78] [1996] 2 All ER 433, at 448.

purpose of ascertaining if the company is to be regarded as an enemy alien.[79] If the law prevents trade with enemy aliens, the policy behind this would be severely undermined if any enemy alien could incorporate a company and use the company to do what he could not do himself.[80]

Such a principle also explains why the courts should not lift the veil more readily for group enterprises notwithstanding *DHN Food Distributors Ltd* v *Tower Hamlets LBC*.[81] In that case DHN had two wholly-owned subsidiaries. The landed property was vested in one of the subsidiaries and this was its only function. DHN carried on the business of the group and occupied the land as a licensee. On the acquisition of the property, the Lands Tribunal held that only negligible compensation was payable since DHN did not own the land and the subsidiary did not carry on any business on the land. The English Court of Appeal reversed the decision on various grounds. On the ground relevant here, Lord Denning MR said that the group was virtually the same as a partnership in which all the three companies were partners.[82] As such, they should not be treated separately so as to be defeated by a technical point. Goff LJ said that while he would not at that juncture accept that in every case where there was a group of companies, the veil should be lifted, in the present case, both subsidiaries were wholly owned and they had no separate business operations.[83] As such, the veil should be pierced.

The above ground for arriving at the decision that substantial compensation should be payable is questionable. If a company is a distinct legal person, it seems wrong in the absence of some policy reason to treat groups of companies differently from cases where a company is effectively wholly-owned by a human person.[84] Accordingly, the *DHN* case has been doubted by the House of Lords in *Woolfson* v *Strathclyde Regional Council*.[85] In *Adams* v *Cape Industries PLC*,[86] the English Court of Appeal stated that

[79] *Daimler Company Limited* v *Continental Tyre and Rubber Company (Great Britain) Limited* [1916] 2 AC 307.

[80] In his First Hamlyn Lecture, Lord Cooke of Thorndon expressed the view that public policy may require that a company in alien ownership and control be itself treated as an alien, *supra*, note 42, at 15, fn 38.

[81] [1976] 1 WLR 852.

[82] *Ibid*, at 860.

[83] *Ibid*, at 861.

[84] Also see Schmitthoff, "The Wholly Owned and the Controlled Subsidiary" [1978] JBL 218; M Whincup, "Inequitable Incorporation – The Abuse of a Privilege" (1981) 2 Co Law 158; H Collins, "Ascription of Legal Responsibility to Groups in Complex Patterns of Economic Integration" (1990) 53 MLR 731.

[85] 1978 SC (HL) 90.

[86] [1990] 2 WLR 657.

there was no general principle that all companies in a group are to be treated as one. On the contrary, they are separate legal entities. English law for better or worse recognised the creation of subsidiary companies which, though in one sense the creatures of their parent companies, nevertheless fell to be treated as separate entities with all the rights and liabilities which would normally attach to such separate entities. Australia,[87] New Zealand[88] and Singapore[89] authorities are to similar effect.

"Similarly, the courts do not treat tortious acts for which the company may be liable for differently from contractual breaches by a company. In *British Thomson-Houston Company Limited* v *Sterling Accessories Limited,* Tomlin J said:

> "It has been made plain by the House of Lords that for the purpose of establishing contractual liability it is not possible, even in the case of so-called one man companies, to go behind the legal corporate entity of the company and treat the creator and controller of the company as the real contractor merely because he is the creator and controller ... Nor does the matter stand otherwise in regard to liability for tortious acts."[90]

Thus, in *Adams* v *Cape Industries PLC,*[91] it was argued by counsel that the corporate structure had been devised to ensure that Cape Industries PLC would have the benefit of the group's asbestos business in the United States of America without the risks of tortious liability. The English Court of Appeal said that while that might be so, this was inherent in English company law. Cape Industries PLC was entitled to organise the group's affairs in that manner and to expect that the courts would apply the *Salomon* principle.

However, it is arguable that a distinction should be drawn. In cases of contract, the party that contracts with the company knows who he or she is contracting with and ought also to know that the company is a separate entity from its shareholders. If this party wishes to protect himself or herself from the consequences of the company's insolvency, he or she should arrange for the company to provide adequate security or obtain guarantees from

87 *Walker* v *Wimborne* (1976) 137 CLR 1; *Industrial Equity Ltd* v *Blackburn* (1977) 137 CLR 567; *Pioneer Concrete Services Ltd* v *Yelnah Pty Ltd* [1986] 5 NSWLR 254; *Briggs* v J*ames Hardie & Co Pty Ltd* (1989) 16 NSWLR 549.

88 *Re Securitibank Ltd* (No 2) [1978] 2 NZLR 136.

89 *The Skaw Prince* [1994] 3 SLR 379.

90 [1924] 2 Ch 33, at 38; also see *Rainham Chemical Works Limited* v *Belvedere Fish Guano Company* [1921] 2 AC 465.

91 [1990] 2 WLR 657.

the company's shareholders or directors. As Lord Templeman said:[92] "Since *Salomon's* case, traders and creditors have known that they do business with a corporation at their peril if they do not require guarantees from members of the corporation or adequate security."

The victims of tortious acts, on the other hand, are usually not in a position to make adequate arrangements for the inadequate resources of a corporate tortfeasor. They have to take the corporate tortfeasor as it is.[93] Notwithstanding this, it is understandable why the law has not drawn a distinction between contract and tort cases. If such a distinction was drawn, it would significantly undermine the ease with which investors would feel able to contribute to the capital of a company as they would face the spectre of unlimited liability should the company commit a tortious act.[94]

VI. Alternatives to Piercing the Veil of Incorporation

There are several alternatives to lifting the corporate veil which may lead to the same result. For example, in *Gilford Motor Company Limited* v *Horne,*[95] the injunction against the company could possibly have been granted on the basis that the company was the agent of the defendant. It would have been unnecessary to lift the veil in these circumstances. Where the corporate entity is regarded as an agent of its shareholders, its shareholders will be liable to third parties for acts done on their behalf. In such cases, there is no lifting of the corporate veil. The shareholders are liable to the third parties because of the acts of their intermediary, namely the company. Where a company is considered to be an agent of its shareholders (or controllers), there is no disregard of the corporate personality but rather an affirmation of it.

In *Salomon* v *Salomon and Company Limited,*[96] it was held that the mere fact that a shareholder controlled virtually all the shares of a company did

92 *JH Rayner (Mincing Lane) Ltd* v *Department of Trade and Industry* [1990] 2 AC 418, at 482.

93 Also see the judgments of Rogers AJA in *Briggs* v *James Hardie & Co Pty Ltd* (1989) 16 NSWLR 549 and Goff LJ in *DHN Food Distributors Ltd* v *Tower Hamlets London Borough Council* [1976] 1 WLR 852.

94 Any unfairness in the failure to make a distinction between tortious and contractual claims is ameliorated somewhat by the principle that where a company has committed a tortious act under the express directions of those in control, those in control as well as the company are responsible for the consequences, as to which see the discussion below.

95 [1933] 1 Ch 935. In *Yukong Line Ltd of Korea* v *Rendsburg Investments Corp of Liberia* (No 2) [1998] 4 All ER 82, at 95, Toulson J said that if an injunction lay against Mr Horne, it was also proper that an injunction should lie also against the company which was knowingly assisting him to defeat his contractual obligations.

96 [1897] AC 22; also see *Kodak Limited* v *Clark* [1903] 1 KB 505.

not make the company an agent of the shareholder. Similarly, in *Adams* v *Cape Industries PLC,*[97] it was held that various companies alleged to be agents of Cape Industries PLC were not agents of it as they had no authority to enter into contracts binding Cape Industries PLC. One of the companies in question had been a wholly owned subsidiary of Cape Industries PLC. In *Dennis Wilcox Pte Ltd* v *Federal Commissioner of Taxation,* Jenkinson J said:

> "Neither the circumstance that a company is completely subject to the ownership and the direction of another person nor the circumstance that that other person exercises dictatorial control of the activities of the company in ways which minimise the manifestations of the company's separate legal identity will justify, in my opinion, a conclusion that acts in the law formally done by the company are to be regarded, for purposes of the kind here in question in relation to Australian income tax, as acts in law done by that other person."[98]

These authorities suggest that it should generally be difficult to establish an agency relationship in the absence of express agreement to such effect.[99] If an agency relationship is too easily imputed or presumed, this will have the effect of undermining the principle of the company's separate personality.

Some cases, however, appear to have approached the issue from a different perspective, namely to find an agency relationship to circumvent the principle of separate personality.[100] Thus, Woon states that the agency is implicit rather than expressly created. It is inferred by the court from the circumstances of the case.[101] There is some artificiality about such an approach. A person

[97] [1990] 2 WLR 657.

[98] (1988) 79 ALR 267, at 274.

[99] As there was in *Rainham Chemical Works Limited* v *Belvedere Fish Guano Company* [1921] 2 AC 465 and *Southern* v *Watson* [1940] 3 All ER 439; also see *Gramophone & Typewriter Ltd* v *Stanley* [1908] 2 KB 89, at 95-95; *Inland Revenue Commissioners* v *Sansom* [1921] 2 KB 492, at 503; *Dennis Wilcox Pty Ltd* v *Federal Commissioner of Taxation* (1988) 79 ALR 267; *Donnelly* v *Edelstein* (1994) 121 ALR 333.

[100] See *In re FG (Films) Ld* [1953] 1 WLR 488; *Smith, Stone and Knight Ltd* v *Birmingham Corpn* [1939] 4 All ER 116; *Hotel Terrigal Pty Ltd* v *Latec Investments Ltd (No 2)* [1969] 1 NSWR 676. In *Briggs* v *James Hardie & Co Pty Ltd* (1989) 16 NSWLR 549, at 569, Rogers AJA cited *Smith, Stone and Knight Ltd* v *Birmingham Corpn* as an outstanding instance where the court held, in a case where fairness clearly so demanded, that a company was acting as an agent for its shareholders. *Smith, Stone and Knight Ltd* was applied in *Spreag* v *Paeson Pty Ltd* (1990) 94 ALR 679 where Sheppard J found an agency relationship on the facts.

[101] *Company Law* (2nd ed, 1997), at 63.

who intends to trade through the vehicle of a company would hardly ever do so on the basis that the company was his agent.[102] Accordingly, where the courts impute an agency relationship, they often do so by *ex post facto* rationalisation, sometimes on the basis that the company has been undercapitalised and therefore could not have conducted any business transactions for its own benefit.[103] It is submitted that this approach is unsatisfactory even if it may be attractive in individual cases to shift the loss from the creditors to the controllers of the company. If the courts desire to ignore the separate personality of the company, it behoves them to give cogent reasons why this is desirable instead of using the term "agent" as a convenient means of circumventing the principle in *Salomon's* case.

Alternative approaches could also have been adopted in other cases. In *Jones* v *Lipman,*[104] Lipman transferred land which he had contracted to sell to Jones to a company in which Lipman and a nominee were the sole shareholders and directors. Russell J ordered specific performance of the contract against Jones and the company. The order against the company was made on the basis that it was "the creature of [Lipman], a device and a sham, a mask which he holds before his face in an attempt to avoid recognition by the eye of equity."[105] It has been pointed out that there should have been no particular difficulty in holding that a company or any other purchaser acquiring property with actual notice that the transaction is a fraud on a prior purchaser takes subject to the latter's equity.[106] Specific performance against the company could have been granted on this basis.

Similarly, *Re Darby*[107] could have been decided on the basis that the persons in control of the company had procured or directed the company to commit a wrongful act. Where this is the case, the persons who have directed the act may be liable as joint tortfeasors with the company.[108] Nor

[102] Also see *Yukong Line Ltd of Korea* v *Rendsburg Investments Corp of Liberia (No 2)* [1998] 4 All ER 82, at 90-92.

[103] *In re FG (Films) Ld* [1953] 1 WLR 483; *Spreag* v *Paeson Pty Ltd* (1990) 94 ALR 679. The fact that a company is undercapitalized is not decisive since no minimum paid-up capital is stipulated in the various Companies Acts and the controllers of the company may prefer to find alternative methods of financing the company's transactions rather than subscribe for or issue shares

[104] [1962] 1 WLR 832.

[105] *Ibid*, at 836.

[106] Lord Cooke of Thorndon, *Turning Points of the Common Law, supra*, note 42.

[107] [1911] 1 KB 95.

[108] *Rainham Chemical Works Limited (in liquidation)* v *Belvedere Fish Guano Company Limited* [1921] 2 AC 465; *Wah Tat Bank Limited* v *Chan Cheng Kum* [1975 – 1977] SLR 1; *C Evans & Sons Limited* v *Spritebrand Limited* [1985] 2 All ER 415; *Gabriel Peter & Partners* v *Wee Chong Jin & Ors* [1998] 1 SLR 374.

was there a need to lift the veil in *Re a Company*[109] as there was *prima facie* evidence that the companies held assets on trust for the first defendant and were part of an elaborate scheme by which the first defendant hoped to prevent the plaintiffs from realising the fruits of the proceedings being brought against him. In these circumstances, there should have been no difficulty restraining the defendant from procuring the disposition of English assets by such companies without piercing the corporate veil.

The availability of these alternative causes of action means that there was no real need for the courts in those cases to characterise the companies in question as shams or facades to limit the effect of the companies' separate personalities. The same result could have been achieved even with the full recognition of the company as a separate entity. Indeed, while those cases demonstrate that the instinctive desire not to give effect to the separate personality of the company was eminently justifiable, the reliance on the 'sham' or 'façade' concept adds an unnecessary layer of legal analysis. It is perhaps high time for this concept to be banished in view of its inherent ambiguity and the terms 'sham' and 'façade' used only in the more traditional sense mentioned below. Should it be necessary to limit the company's separate personality, this should be on the basis that public policy requires such a limitation.[110]

VII. Conclusion

It has been submitted that the present state of the law on lifting the corporate veil is unsatisfactory because the court have, through the use of metaphors, masked the true issues. It has been suggested that while the courts have in general been unwilling to express this, issues of public policy have been at the root of those decisions where the corporate veil has been lifted and this should be recognised as the underlying principle which causes the courts to disregard the separate personality of the company. The adoption of the suggested underlying principle will mean that the courts will be required to articulate cogent reasons for their decisions and this will be to the benefit of all businessmen and lawyers. Where alternative causes of action which may lead to the same result as veil piercing are available, they should be relied upon without the need for any veil piercing.

If the terms 'facade' or 'sham' are to be used, it is suggested that they should be used only in the manner defined by Diplock LJ in *Snook* v *London and West Riding Investments Ltd.*[111] In that case, Diplock LJ said:

[109] [1985] BCLC 333.
[110] Also see Lord Cooke of Thorndon, *supra*, note 42, at 17.
[111] [1967] 2 QB 786; also see Lord Cooke of Thorndon, *ibid.*

> "I apprehend that, if [the word 'sham'] has any meaning in law, it means acts done or documents executed by the parties to the 'sham' which are intended by them to give to third parties or to the court the appearance of creating between the parties legal rights and obligations different from the actual legal rights and obligations (if any) which the parties intend to create ... that for acts or documents to be a 'sham' ... all the parties thereto must have a common intention that the acts or documents are not to create the legal rights and obligations which they give the appearance of giving."[112]

An example of such an instance may be seen in *Adams* v *Cape Industries PLC*.[113] In that case, the English Court of Appeal had found that the interposition of a company, AMC, between Cape Industries PLC and CPC was a façade because AMC was no more than a corporate name which Cape Industries PLC or its subsidiaries used on invoices.[114] Cape Industries PLC, in other words, had no real intention of engaging in transactions with its subsidiary, AMC. AMC had been interposed simply to allow Cape Industries PLC's involvement to appear more removed. Such a situation is different from the typical case where a company has been used in the manner intended but the veil is lifted as a matter of policy.

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[112] *Ibid*, at 802; also see *Hilton* v *Plustitle Ltd* [1989] 1 WLR; *Chase Manhattan Equities Ltd* v *Goodman* [1991] BCLC 897.

[113] [1990] 2 WLR 657.

[114] *Ibid*, at 699, 759.

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This article was written in connection with a research project funded by the National University of Singapore under the auspices of the Centre for Commercial Law Studies, Faculty of Law.