

From Peeping Behind the Corporate Veil, to Ignoring it Completely

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Preamble

The subject of 'Lifting the veil' is well known in the literature on company law. The problem which authors face is how to explain the judgments which deviate from the strict rule of the separate legal entity of the company. Notwithstanding much endeavour, no conclusive answer has yet been given to the question of when the courts will lift the veil. Indeed, the plea is often made, both by judges¹ and jurists,² that the legislature should lay down definite rules.³

In the absence of such statutory directions, it has remained the task of jurists to propose suggestions for some inroads into this jungle of judgments.⁴ Let me outline a few of them.

Gower's is a very common dictum, namely, that the courts would lift the veil 'when corporate personality is being blatantly used as a cloak for fraud or improper conduct.'⁵ Pennington⁶ enumerates four inroads which have been made by the law on the principle of the separate legal personality of companies: the first two are statutory ones,⁷ followed by 'judicial disregard of the principle where the protection of public interests is of paramount importance, or where the company has been formed to evade obligations imposed by the law.'⁸ Schmitthoff divides the authorities under two headings: 'the cases in which the courts applied the principal and agent construction, and the cases in which the courts lifted the corporate veil because a clear abuse of the corporate form occurred.'⁹ Another definition of lifting the veil is that it is 'a tactic used by the judiciary in a flexible way to counter fraud, sharp practice, oppression and illegality.'¹⁰ Friedman says that courts would disregard the concept of juristic personality in the frustration of tax evasion, the

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- 1 As, for example, Lord Parker: 'The legislature might, but no Court could possibly, lay down a hard and fast rule . . .'. *Daimler v Continental Tyre & Rubber Co.* [1916] 2 AC 307, 346.
- 2 See Wedderburn, 'Multinationals and the Antiquities of Company Law' (1984) 47 MLR 87, 90.
- 3 Sealy, however, does not wish a full intervention of the legislator, when he points out the benefits of 'retaining the flexibility of the present approach, especially where it enables the court to counter fraud, oppression or sharp practice or to condone some informality in the affairs of small companies' — L.S. Sealy, *Cases and Materials in Company Law* (1985), p.44.
- 4 Refraining from classification, Lord Palmer simply enumerates special cases in which the veil has been lifted, by the legislator as well as by the courts: Palmer's *Company Law*, (24th ed., 1987), Ch 18–23.
- 5 Gower, *Modern Company Law* (4th ed. 1979), p.137.
- 6 Pennington, *Company Law*, (5th ed. 1985), p.53.
- 7 The first to be mentioned, and 'by far the most extensive' is the tax legislation, followed by two sections of the Companies Act 1985 — s 24 and s 630 (now s 213 Insolvency Act 1986). With regard to these sections, see *infra*.
- 8 Pennington, *ibid.* And see also Samuels, 'Lifting the Veil', [1964] JBL 107.
- 9 Schmitthoff, 'Salomon in the Shadow' [1976] JBL 305, at 307. The first heading describes *what* the courts does, whereas the latter *when*.
- 10 Smith & Keenan, *Company Law* (7th ed 1987), p.19. They do not mention that lifting the veil is practised also in less dramatic situations, and by the legislature as well. And see also Northey & Leigh, *Introduction to Company Law* (4th ed 1987), p.20, enumerating 4 instances in which the veil would be lifted: in time of war, to determine the enemy character of the company; in cases where the company was formed for a fraudulent purpose; as between a holding company and its subsidiaries; and in revenue cases.

consideration of the real purpose of a transaction as against its legal form, and the disguise of the controlling hand through subsidiary companies.¹¹

The concept of 'piercing the veil' in the United States¹² is much more developed than in the UK.¹³ The motto, which was laid down by Sanborn, J. and cited since then as the law, is that '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.'¹⁴ The same can be seen in various European jurisdictions.¹⁵

The general nomenclature of the subject in England is 'lifting the veil', although 'veil' is but one of the metaphors selected by the court. Other labels include 'cloak', 'alias', 'alter ego', 'agent', 'fiction', 'instrumentality', 'puppet', and 'sham'.¹⁶ Can such labels help us, or do they divert our attention from the real substance?¹⁷ Cardozo, J. once said that 'Metaphors in law are to be narrowly watched, for starting as devices to liberate thought, they end often by enslaving it.'¹⁸

The courts use 'veil' as a metaphor in various circumstances, however different their approach to the veil be in each case. Part of the confusion in this area is due to the fact that the courts do not differentiate between the various attitudes with which they address the company when lifting its veil. Thus they can in the same case both ignore the veil completely and issue injunctions against the company as a separate legal entity. Again, two incompatible terms for the company may be used side by side in a judgment — a 'puppet' and 'an agent'¹⁹ — the first totally negating the possibility of an independent legal entity, the latter recognising its existence as a separate legal body and attributing to it the power to negotiate and finalise a contract on behalf of its principal.²⁰ Which of these two should prevail?

This confusion can be seen in the literature as well. We often find considerations side by side with justifications, both forming part of the definition of 'lifting the veil';²¹ or

11 Friedman, *Legal Theory*. (5th ed. 1967), p.523.

12 As 'lifting the veil' is called there.

13 The 'Deep Rock' doctrine (which emerged from *Taylor v Standard Gas & Electric Co.* (1939) 306 US 307), for example, has no parallel in the UK judiciary. See Gower, *ibid.*, at p.137, especially n 80. And see also Wedderburn's remark that 'experience in the United States ought surely to encourage us . . . to experiment with the removal of the corporate mask in cases of under-capitalisation'. And 'our courts ought surely not to be more afraid of this foray into 'abuse of rights' doctrines than are the US Courts' (K.W. Wedderburn, 'A Corporation Ombudsman?' (1960) 23 MLR 663, 667). In Israel we tend to follow the UK trend rather than that of the USA.

14 *US v Milwaukee Refrigerator Transit Co.* 142 Fed. 242, 247. And see also Wormser, 'Piercing the Veil of Corporate Entity' (1912) 12 *Col LR* 496; and Wormser, *The Disregard of the Corporate Fiction and Allied Corporate Problems* (1927). Another classification is by Aronofsky, who divides the veil-piercing responses into three distinct groups: veil-piercing by statute, by alter ego or instrumentality analysis, and under an enterprise or unitary business theory. See Aronofsky, 'Piercing the Transnational Corporate Veil: Trends, Developments and the Need for Widespread Adoption of Enterprise Analysis' (1985) 10 *NCJ IL & Com. Reg.* 31, 37.

15 e.g. Machen, 'Corporate Personality' (1910) 23 *Harv. LR* 253; Cohn and Simitis, "'Lifting the Veil" in the Company Law of the European Continent' (1963) 12 *ICLQ* 189.

16 See Henn and Alexander, *Laws of Corporations*, (3rd ed. 1983), p.347. See also a long list assembled by Pickering, 'The Company as a Separate Entity' (1968) 31 *MLR* 481.

17 Mayson, French & Ryan on *Company Law* (1988-89) s 5.2.2, p.100 point out that 'The use of this vague metaphorical language makes it very difficult to discover what the true issues are'. See also Stone, J. in *Re Clark's Will* 204 *Minn.* 574, 578: 'The method of decision known as "piercing the corporate veil" or "disregarding the corporate entity" unnecessarily complicates decision.' It is dialectically ornate and correctly guides understanding, but over a circuitous and unrealistic trail. And see (1982) 95 *Harv. LR* 853.

18 *Berkey v Third Avenue Ry.* 244 N.Y. 84, 94, 155 N.E. 58, 61, (1926) 50 *ALR* 599, 604.

19 By Lord Denning MR in *Wallersteiner v Moir (No.1)* [1974] 3 *All ER* 217 (CA).

20 See Henn & Alexander: 'The term "instrumentality" as applied to a subsidiary is ambiguous, connoting either identity or separateness' (*op cit* p356, end of n 8).

21 See Pennington, *op cit*, who after enumerating the 'inroads' continues by saying that it has also been done 'by the courts implying in certain cases that a company is an agent or trustee for its members'. As for the first observation I would suggest that this is already *what* the courts are doing and not *when* they should do it and secondly, this is only *one* of the ways in which the courts lift the veil.

the definition of the whole subject-matter by addressing only a part of it.²²

My proposition is that before asking *when* the veil is lifted, we should analyse *what* is actually meant by this term or better still what is actually done, by the courts and the legislature. The function of lifting the veil is not always detrimental to the company or its shareholders. Sometimes it results in their benefit as well. It is suggested that in 'lifting the veil' we can detect four different attitudes towards the company, each one used in different circumstances and for different reasons.

As the metaphor of the veil is of such long standing, it is incorporated in the names of categories which reflect the differences of attitude towards the company. These categories, in a progressive order, are 'Peeping behind the Veil', 'Penetrating the Veil', 'Extending the Veil' and 'Ignoring the Veil'.²³

The Four Categories

1. *Peeping Behind the Veil*

The first category is the least offensive with respect to the separate entity theory. We can regard this attitude as an act of curiosity: the veil is lifted only to get information involving the persons who control the company, such as who are the shareholders, what is the proportion of their holdings, and what is their inter-relationship with regard to the control of the company? Having gathered this information, the veil is then pulled down and once more the company is treated as a separate legal personality, to which special characteristics are now attributed in consequence of that 'curiosity'.

The definitions of a 'holding company',²⁴ a 'wholly owned subsidiary'²⁵ or an 'associated company',²⁶ furnish good examples of a statutory 'peeping behind the veil.' The veil is lifted and the shareholders and their relationship investigated, in order to ascertain how to classify the company, to what type it belongs.²⁷ The same act of peeping behind the veil takes place whenever a statute refers to 'control' of a company.²⁸

The courts too peep behind the veil and conclude from the shareholders, or from the people in control of the company, something about the nature of the company. The most famous example is the *Daimler* case.²⁹ The question there was whether the defendant,

22 See for example Gore-Browne on *Companies* (ed. Boyle and Sykes, 44th ed., 1986, supp. 1987), 1.3.1.: "lifting the veil of incorporation", that is to ignore or set aside the separate legal personality of a company ... the courts will not allow the corporate form to be used for the purposes of fraud, or as a device to evade a contractual or other legal obligation," and see also Boyle & Birds *Company Law* (2nd ed. 1987), p.17.

23 The more common expressions for 'Lifting the Veil' are 'Piercing the Veil' or 'Disregarding the Veil'. I have deliberately decided to choose other names for the proposed categories so as to differentiate from the common nomenclature, which is generally used synonymously with the whole subject-matter.

24 As one which holds more than half of the equity share capital of another (its 'subsidiary'), controls the composition of the latter's board of directors or is a holding company of another holding company — s 736(1) of the Company Act 1985. The definition is altered by s 144 of the Companies Act 1989, by which a new s 736 is substituted for the old. See also s 21 of the Companies Act 1989 which introduces a new definition of parent and subsidiary undertakings for accountancy purposes.

25 As a company of which all the shares, voting and non-voting, are vested in the holding company or its nominees — s 736(5) of the Companies Act 1985. This definition, too, is now changed; see n 24.

26 Section 13(4) of the Income and Corporation Taxes Act 1988.

27 And see also a 'close company' and 'close investment-holding company' in ss 414(2C) and 13A of the Income and Corporation Taxes Act 1988.

28 As, for example, ss 416 and 840 of the Income and Corporation Taxes Act 1988, or s 346(5) of the Companies Act 1985.

29 *Daimler v Continental Tyre Co.* [1916] 2 AC 307 (HL). It is cited as such not only in the UK literature but also in the US. See, for example, Smyth, Soberman, Easson, *The Law and Business Administration in Canada* (5th ed., 1987) 674; and also Fink, 'That Pierced Veil — Friendly Stockholders and Enemy Corporations' (1953) 51 *Mich. LR* 651.

a British company, should pay the plaintiff, a British registered company, even though all the latter's directors and shareholders were German residents. The lower courts ruled in favour of the plaintiff as the Proclamation against Trading with the Enemy Act 1914 stipulated that 'in the case of incorporated bodies, enemy character attaches only to those incorporated in an enemy country.' The House of Lords, however, allowed the appeal on a point of fact.³⁰ It is clear, therefore, that the part of the judgment which lifts the veil of the plaintiff company is *obiter dictum*.³¹ Nevertheless, the case is recognised by many jurists as *the* reference for lifting the veil to determine the character of a company. In his judgment, Lord Shaw stressed that 'when the law prescribes the place of registration as the decisive factor delineating a company as enemy or alien — no recourse is to be made to other resources.'³² However other law lords considered that the plaintiff was an enemy. Lord Parker, to whose judgment the lifting of the veil is attributed,³³ said

a company may assume an enemy character . . . if its agents or the persons in *de facto* control of its affairs . . . are resident in an enemy country . . . The character of individual shareholders cannot of itself affect the character of the company . . . [it] may, however, be very material on the question whether the company's agents, or the persons in *de facto* control of its affairs, are in fact adhering to, taking instructions from, or acting under the control of enemies. This materiality will vary with the number of shareholders who are enemies and the value of their holdings.³⁴

Lord Parker himself was not happy with this conclusion, and pointed out the difficulties which it evokes.³⁵

In fact only his final words really constitute lifting the veil. The directors stand *in front* of the veil so that there is no need to unveil them. Not only have their actions been regarded as those of the company, but also their mind has been regarded as the company's, in cases where knowledge or will are required, as for assessing the negligence³⁶ or criminality of the company.³⁷ There is no reason why this should not be so for the purpose of establishing the character of the company.³⁸

The same applies to the tendency to consider the directors' meeting place as determining the company's place of residence for fiscal matters, especially when a company is registered in one country and makes its profits in another.³⁹ It has been held that the place of control and supervision is the governing factor for such questions and that this place is determined by the state where control is exercised, e.g. the place where the directors' meetings are

30 All the Lords agreed that because of the war the company secretary lacked authority to start legal proceedings in the company's name.

31 Lord Atkinson refused to go any further as he did not think 'that the legal entity, the company, can be so completely identified with its shareholders or the majority of them, as to make their nationality its nationality or their status its status, or it an enemy character because they are alien enemies, or to give it an enemy character because they have that character' (p327).

32 *ibid*, p333.

33 Lord Paramoor in his judgement, as well as Viscount Mersey and Lord Kinnear agreed with him.

34 *op cit* p345. Such was also the opinion of Lord Paramoor (p354).

35 *op cit* p346.

36 *Lennard's Carrying Co. v Asiatic Petroleum Co.* [1915] AC 705, HL.

37 *Cornford v Carlton Bank* [1900] 1 QB 22. Even though the court has pointed out that to attribute malice or intent to a company is to bring metaphysical subtleties to the law.

38 Indeed, in a later case. Lord Cozens-Hardy MR limited the examination to the character of the directors alone, the character of the shareholders being, in his opinion, irrelevant: *Re Hilches, ex p Muchesa Rubber Plantation Ltd.* [1917] 1 KB 48. Gore-Browne also expresses the opinion that 'for certain purposes, the courts, while respecting the separate legal personality of a company, have treated the conduct or characteristics of its directors, managers or members as attributable to the company itself. This attribution does not in the true sense involve "lifting the veil of incorporation".' (*op cit* p1005). I concur with what is said with regard to the directors or managers. As to the members, it seems to me that this is an example of lifting of the veil of the first category.

39 See for example Goldstein, 'The Residence and Domicile of Corporations with Special Reference to Income Tax' (1935) 51 LQR 684.

held, the place where the policy of the company is decided etc.⁴⁰ In my view, however, as long as these cases refer to the place of the official meetings of the company they do not constitute a lifting of the veil: both the meetings of the board of directors and those of the general assembly are functions of the organs of the company. These acts are *overt*, and no lifting of the veil is required to unveil them. Peeping behind the veil takes place only when the courts or the legislature desire to unveil those who really govern these bodies and give them instructions.⁴¹

Therefore it is suggested that there is no lifting of the veil when recourse is made to the directors: they are either regarded as an organ of the company, its *alter ego*, or as its agents. Similarly, that part of section 213 of the Insolvency Act 1986⁴² which deals with fraudulent trading by the director, cannot be an example of lifting the veil.⁴³ Nor can section 349(4) of the Companies Act, which in case of a misdescription of the company's name imputes a personal liability to any officer of the company or a person acting on its behalf.⁴⁴ The mere fact that both sections inflict personal liability upon private persons for acts done by a company does not mean that *ipso facto* they constitute a lifting of the veil.⁴⁵ They are better regarded as 'punitive' measures, a sort of statutory *caveat* directed at those who purport to act in the name of the company, knowing that the company would not honour their acts.⁴⁶

Peeping behind the veil at the incorporators, however, enables the Court to satisfy itself as to the true legal situation of the case,⁴⁷ to make an order against the company itself,⁴⁸

40 *De Beers Consolidated Mines Ltd v Howe* [1906] AC 455. And see Young, 'The Legal Personality of a Foreign Corporation' (1906) 22 *LQR* 178.

41 As in the case of *Wallersteiner v Moir (No. 1)* [1974] 3 All ER 217: 'It is plain that Dr Wallersteiner used many companies, trusts or other legal entities as if they belonged to him. He was in control of them as much as any "one-man company" is under the control of the man who owns all the shares and is the chairman and managing director' (the description of Lord Denning MR at p237). The peeping behind the veil gave this information. It is up to the court to decide what it is going to do with it.

42 Replacing s 630 of the Companies Act 1985 mentioned in some of the literature as an example of lifting the veil.

43 Whereas as far as the members would be looked at, as the persons who were knowingly parties to the carrying on of the business for fraudulent purposes, it would undoubtedly be considered as penetrating the veil. See Mayson, French & Ryan, *op cit* p110 (s 5.3.2).

44 Mayson, French & Ryan abstain from considering this section of the Companies Act 1985 as an example of lifting the veil, as the personal liability arises only if the debt is not paid by the company itself. Although I agree that it is not an example of lifting the veil, I do not agree with their reasoning: lifting the veil is not always 'a denial of or encroachment on corporate personality' (*op cit* s 5.2.2.2, p101). It can be manifested also in penetrating the veil, when the responsibility of the members is *added* to that of the company.

45 Indeed, the latter is not included by Pennington in his chapter titled 'exceptions to the rule of separate legal personality'. However he does include the former (at p54). Only one author does not mention any of these sections in the chapter on lifting the veil — Cane, *Guide to Company Law* (2nd ed., 1987), p10.

46 Farrar cites the case of *Winkworth v Edward Baron Development Co. Ltd.* [1987] 1 All ER 114 (HL), as 'a recent case where the House of Lords seemed willing to pierce the corporate veil or use the alter ego approach in equity' (*op cit* p64). However, this case deals with the 'duty owed by the directors to the company and to the creditors of the company to ensure that the affairs of the company are properly administered and that its property is not dissipated or exploited for the benefit of the directors themselves to the prejudice of the creditors' (per Lord Templeman, p118). With all respect, it seems to me that imposing upon the directors the personal responsibility for their own actions when they breach this basic duty, has nothing to do with lifting the veil.

47 As, for example, in *Simpson v Norwest Holst Southern Ltd.* [1980] 2 All ER 471, when due to peeping behind the veil the court was ready to accept the explanations of the plaintiff's solicitors as to why it was so difficult for them to discover who was the real defendant in their claim for damages. In consequence, it allowed the claim, even though it was filed after the limitation period of 3 years. And see, as another example, the cases of *Re Express Engineering Works* [1920] 1 Ch 466, CA, and *Parker & Cooper Ltd. v Reading* [1926] Ch 975, where the courts were satisfied that the same persons were both the only directors and shareholders of the company so that their decisions taken in one configuration could be regarded as taken by the other.

48 As in *B v B* [1979] 1 All ER 801, when peeping behind the veil disclosed that the husband of the plaintiff was one of the major shareholders (and the director) of a company. This information was sufficient for the court to issue an order of disclosure against the company itself.

or to refrain from making the required order.⁴⁹ As mentioned, peeping behind the veil can also result in an advantage to the company. Such was the case, for example, of a company whose shareholders were trustees of a charitable trust. Danckwerts, J.⁵⁰ held that the company could claim to be exempt from paying a development charge because of this charitable status.⁵¹

It is evident, therefore, that peeping behind the veil is not the step which leads to personal liability of the shareholder for the debts of the company. It is only the first — but essential — step by which the courts examine certain features of the company: its composition, control, type (holding, subsidiary, etc.), character (alien), residence (for tax purposes) etc. After collecting this information, the courts decide what to do with it — whether to be satisfied with it and adjudicate on the company alone, or to move up the ladder of lifting the veil, to more serious repercussions.

2. Penetrating the Veil

A second category of lifting the veil is more operative with regard to the shareholders. The courts reach through the veil and grasp the controlling shareholders personally. The purpose of penetrating the veil is to impose upon the shareholders responsibility for the company's acts⁵² or to establish their direct interest in the company's assets.

The most prominent example is section 24 of the Companies Act 1985, by which a personal, unlimited liability for the company's obligations is imposed upon every shareholder if the company continues to trade for 6 months with fewer than the minimum number of members, and the remaining members are cognisant of the fact.⁵³ It may be noted that there the stipulation is addressed to every remaining shareholder not only to the controlling shareholder as is usually the case. However this is now immaterial in view of the reduction of the minimum number of members to two.⁵⁴

49 As in *Lonrho Ltd. v Shell Petroleum Co. Ltd.* [1980] 1 WLR 627. Having specified the complex shareholdings of the various companies, Lord Diplock reached the conclusion that no order for disclosure of documents could be given against the defendant, as this subsidiary company was not completely controlled by its holding company. And compare *Multinational Gas v Multinational Gas Services* [1983] 2 Ch 258 (CA).

50 This judge was proclaimed by K.W. Wedderburn as 'the leading modern judicial exponent of "piercing the corporate veil" in modern cases' (see 'Corporate Personality and Social Policy: The Problem of the Quasi-Corporation' (1965) 28 MLR 62, 70. This compliment was given to him for his judgement in *Re Greater London Properties Ltd.* [1959] 1 WLR 503, in which peeping behind the veil resulted in favour of the applicant, a subsidiary company).

51 *The Abbey Malvern Wells Ltd. v Ministry of Local Government and Planning* [1951] Ch 728.

52 See the proposal for the 9th EEC Directive, which contemplates that in certain circumstances, holding companies will have liability for the debts of their subsidiaries.

53 Mayson, French & Ryan are the only writers who maintain that this section of the Companies Act 1985 does not constitute lifting of the veil: 'This can hardly be regarded as a denial of a corporate personality when the company itself remains liable for its debts, and it may be best to regard this provision as nothing more than a denial of limited liability' (*op cit* s 5.2.2.2, p101). It seems to me that this passage is a good illustration of the importance of defining *what* is lifting the veil as a separate issue from the circumstances which would *justify* it. 'Denial of a corporate personality' is only one of the four categories; the others are not so drastic! In penetrating the veil the company neither loses its separate personality, nor is it exonerated from paying its own debts. The result of the penetration in this case is an additional obligation of its members.

54 When enacted two members were required for a private company only whereas seven were the minimum for the formation of any other company. Today, for both types of company two members are required (s 1(1) of the Companies Act 1985). It is obvious, therefore, why today, when less than the minimum means one person, that one member should be held personally responsible for covering the debts of 'his' company. Indeed, one may say that this too is a stipulation with a punitive motivation: if a person wishes to obtain limited liability by acting via a company, he must adhere to all the requirements of the Companies Act, including that of a minimum number of members. This personal liability is inflicted upon him only after six months, in which he was acting alone. In fact, the holding of all the shares by one person does not bring about the automatic dissolution of the company (Article 5 of the Second EEC Directive) even though it is a cause for its request.

The other aspect of penetrating the veil is the recognition of a direct interest of the shareholder in the company's assets. An example of such an attitude on the part of the legislature is taxation.⁵⁵ There are, for instance, stipulations for the apportionment of certain income of a 'close company'⁵⁶ among its participators,⁵⁷ or requiring members of a close company to pay tax on transfers made by the company, the value being apportioned among them according to their respective interests in the company.⁵⁸ The members are regarded here as if they privately own portions of the company's property. Another example is section 6 of the Law of Property Act 1969, which regards the interest of a company in premises as the private interest of its controlling shareholder, thus enabling him to get rid of a protected tenant.⁵⁹

The courts, on the other hand, were reluctant to infer this direct relationship between the shareholder and the company's assets. Well known are the remarks in the *Macaura* case:⁶⁰ 'no shareholder has any right to any item of property owned by the company, for he has no legal or equitable interest therein';⁶¹ and further on: 'the corporator even if he holds all the shares is not the corporation and neither he nor any creditor of the company has any property rights legal or equitable in the assets of the corporation.'⁶² *Macaura's* claim was dismissed, therefore, on the ground that he had no insurable interest in the assets.⁶³

The courts were not always of this strict approach. An example of a different attitude is to be found in the illustration given by Lord Halsbury in the *Daimler* case, i.e. gold being handed over to enemies in an English manufactured bag.⁶⁴ Regarding the money paid to the company as being actually paid to the hands of its shareholders is a clear example of penetrating the veil. It should be pointed out that penetration was not necessarily the direct and only result of peeping behind the veil and thus establishing the company's character as 'an alien enemy' (due to the character of its controlling shareholders). The House of Lords could have adopted the approach that 'because of its enemy character it lost its rights during hostilities, as would a natural person who was an enemy alien.'⁶⁵ Another approach could have been to order the defendant to deposit the money in a closed account till the end of the war.⁶⁶ In both orders, the separate legal entity of the company would have been maintained, with no penetration.

55 'In this field the legislature has indeed cracked open the corporate shell', writes Gower (*op cit* p121).

56 Defined in s 414 of the Income and Corporation Taxes Act 1988 and s 104 of the Finance Act 1989 for the purposes of the Taxes Acts.

57 Section 423 of the Income and Corporation Taxes Act 1988 and see details in Sched 19 to this Act. These provisions were repealed by the Finance Act 1989, s 103 and Sched 17.

58 And see Gower's remark, criticising the application of this stipulation also to the dissenting member as well (*op cit* p257).

59 This stipulation would have helped the landlord in *Turnstall v Steigman* [1962] 2 QB 593, CA, and may have been enacted because of remarks by the judges in that case.

60 *Macaura v Northern Assurance Co.* [1925] AC 619 (HL).

61 *ibid.* p626 at Lord Buckmaster.

62 *ibid.* p633 by Lord Wrenbury. As an argument *a contrario*, Gower cites the judgment in *Lee v Sheard* [1956] 1 QB 192, CA, where the court recognised the plaintiff's interest in the company's profits. It seems, however, that a distinction can be made between the two cases on the ground that in *Lee* it was acknowledged that the plaintiff's part in the company's profits diminished as a result of the accident, whereas *Macaura* claimed the recovery of moneys under insurance policies in the name of the company, i.e. he claimed as the beneficiary of the policies as if the property was his. And compare *Malyon v Plummer* [1962] 3 All ER 884, where the court recognised the loss of income of the plaintiff as a result of interruption of the company's business due to her husband's death. And see also *Esso Petroleum Co. Ltd. v Mardon* [1976] QB 801 (CA).

63 According to Smyth, Soberman and Easson, this case is an example of carrying 'the logic of *Salomon's* case to absurd lengths . . . How it follows from *Salomon's* case that a shareholder has no insurable interest (as distinguished from ownership) in the assets of a wholly-owned corporation is beyond the writers' comprehension' (*op cit* p673).

64 *op cit* p316.

65 Smyth, Soberman and Easson, *op cit* p674.

66 See such a judgment in *Jansen v Driefontein Consolidated Mines Ltd.* [1902] AC 484 (HL).

In wartime the tendency certainly is to penetrate the veil. The case of *R v London County Council*⁶⁷ is an illustration. Here a local authority refused to renew a cinematograph licence held by a company incorporated in England, because a substantial majority of its shares were held by German nationals and three out of its six directors were Germans. The court upheld the refusal, holding that the control or at least the influence which enemy nationals might exert over the activities of the company in exhibiting films was a relevant matter during wartime. Bray, J. said that it is 'clearly permissible for the council to consider, when a company is the applicant, who are the persons who control the company. If it clearly appeared that such persons were not fit to have the licences, the licences ought not to be granted.'⁶⁸ The approach here is to consider the situation as if the shareholders were to obtain the licence in their personal capacity and then to decide whether the company ought to obtain it in its name.⁶⁹

A special mode of penetrating the veil is by way of declaring an agency relationship between the controlling shareholder and 'his' company. It was Vaughan Williams, J. who, in the *Salomon* case, based his judgment on an agency relationship, stating that the company had no personality of its own, being nothing more than the agent of Salomon the man. The House of Lords found a contradiction: if the company was an agent, it had a personality of its own. As a consequence, the House of Lords denied the existence of such a relationship.

The current wisdom is that agency is one of the cases in which the court will lift the veil.⁷⁰ But surely agency does not precede lifting the veil, it is the other way round. In consequence of peeping behind the veil, the courts reach the conclusion that an agency relationship exists between the controlling shareholder and 'his' company. Agency, therefore, is only a way by which the courts penetrate the veil: they construct the direct interest of the shareholders in their controlled company's acts and property by way of imputing agency relationship between the company and its controlling shareholder, whether a private person or a holding company.⁷¹ Agency is not the aim, but the *means* of lifting the veil.⁷² The courts thus 'impose' an agency relationship — which may be called therefore 'implied' or 'constructive agency'.⁷³ This agency must be construed on factual findings, where the holding of the shares is only one of the key factors for that decision.⁷⁴

67 *R v London County Council, ex p London & Provincial Electric Theatres Ltd.* [1915] 2 KB 466.

68 *ibid.*, at p472.

69 Compare this judgment with a refusal of the courts to penetrate the veil when a ship owned by a German company was seized. The court rejected the shareholders' claim for its release on the ground that they had no direct interest in the company's property: *The Unitas* [1948] P 205. In another case, where bank shares were held by a Hungarian citizen, the bank's property was seized and handed over to the Hungarian property administrator. The court held in favour of the bank: the administrator had no justification nor authority for holding the property of a Dutch registered company: *Bank Voor Handel en Scheepvaart NV v Slatford* [1953] 1 KB 248. On the same lines was also the judgment of the Federal Court of the US in similar circumstances: *Re International Telephone & Telegraph Corporation*, 343 US 156 (1952). And see criticism by Berger, 'Disregarding the Corporate Entity for Stockholders' Benefit' (1955) 55 *Col LR* 808, 811.

70 See, for example, Pennington, *op cit* p53; Farrar, *op cit* p60; Smyth, Soberman and Easson, *op cit* p674.

71 *Firestone Tyre & Rubber Co. v Llewellyn* [1957] 1 WLR 464, HL (a holding company having to pay taxes on the profits of its subsidiary); *Re F.G. (Films) Ltd.* [1953] 1 All ER 615 (a British company considered as agent of its American shareholder, hence negated the registration of its film as British). The last case is brought by Smyth, Soberman and Easson as 'the most striking example of how far the courts will go' in this area (*op cit* p675).

72 It seems that Cane is of the same opinion: 'a company acting as agent for its shareholder is one method of effectively "lifting the veil", but the agency relationship would have to be proved on the facts' (*op cit* p11).

73 A la 'constructive notice'. and see Farrar: 'The courts have seemed willing to construe an express or implied agency of the company for its members' (*op cit* p61).

74 See the other considerations for agency relationship as delineated in *Smith, Stone & Knight Ltd. v Birmingham Corporation* [1939] 4 All ER 116. Indeed, one of the suggestions of Kahn-Freund with regard to the *Salomon* case (the decision of which he denominates as 'calamitous' — 'Some Reflections of Company Law Reform' (1944) 7 *MLR* 54) is that the company could be considered as *Salomon's* agent not because of the composition of its share-holdings, but because of the factual relationship: Kahn-Freund, 'Corporate Entity' (1940) 3 *MLR* 226.

It seems that these relationships are established by the courts with the sole aim of finding the principal responsible for the acts of his 'agent'. The basis for their judgment is that the principal has manipulated his agent to act according to his specific instructions, thus depriving 'the agent' of any willpower of its own.⁷⁵ Not all jurists are happy with this technique:

agency must be shown on the evidence to exist and may not be inferred merely from control of a company or ownership of its shares . . . if a judge were free to infer an agency from the mere fact of control, more or less at will, then the result would be that the veil could be lifted as often as he chose and the law would be unpredictable.⁷⁶

The technique of imposing an agency relationship is used by the courts when they are reluctant to ignore the veil completely, which is considered *real* lifting the veil.⁷⁷ The dictum of Lord Denning in *Wallersteiner* is a good illustration: after agreeing that the commercial concerns which were operated by Dr Wallersteiner were separate legal entities, he added:

Even so, I am quite clear that they were just *the puppets* of Dr Wallersteiner. He controlled their every movement. Each danced to his bidding. He pulled the strings. No one else got within reach of them. Transformed into legal language, they were his *agents* to do as he commanded. He was the *principal* behind them. I am of the opinion that the court should pull aside the corporate veil and treat these concerns as being his creatures — for whose doings he should be, and is, responsible.⁷⁸

One can notice the elegant way in which Lord Denning shifts from the statement that the companies 'were just the puppets' i.e. having no entity of their own, to the later statement that 'they were his agents.' In other words, by peeping behind the veil and discovering the true relationship between the controlling shareholder and the companies, the veil is penetrated in the form of creating an agency relationship, to make the controlling shareholder responsible for the acts of the company.

Another aspect of penetrating the veil is by making a company resemble a partnership, and by paralleling the close relationship between the partners to that of shareholders. Lord Halsbury did so in a famous passage in the *Daimler* case:

. . . what is this thing which is described as a 'corporation'? It is, in fact, a partnership in all that constitutes a partnership except the names, and in some respects the position of those who I shall call the managing partners.⁷⁹

This mode of penetration is manifest in winding-up cases. When the court is confronted with an application to wind-up a company on the ground that it would be just and equitable to do so, it examines whether a liquidation order would have been granted in the same circumstances to a partnership. The interpretation of the same term with reference to that in partnership law does not amount to a penetration of the veil. However, equating the

75 'the agency construction affords in many circumstances a convenient means to escape from the strait-jacket of the rigid interpretation of the rule in *Salomon's* case. In fact, it is probably the most convenient means from the practical point of view, to give effect in English law to the modern theory of parent and subsidiary as an economic unit,' says Schmitthoff, *op cit* at 309, and I cannot agree more.

76 L.S. Sealy, *Cases and Materials in Company Law* (1985), p51. *Smith, Stone & Knight Ltd. v Birmingham Corporation* [1939] 4 All ER 116 serves as an example for that.

77 See, for example, Lord Denning's quotation of the argument of counsel for Dr Wallersteiner, saying that 'If we were to treat each of these concerns as being Dr Wallersteiner himself under another hat, we should not be lifting a corner of the corporate veil. We should be sending it up in flames' *Wallersteiner v Moir (No. 1)* [1974] 3 All ER 217, 238 (CA).

78 *ibid* (italics added). This is a very good example of Latty's recapitulation: 'what the formula comes down to, once short of verbiage about control, instrumentality, agency and corporate entity, is that liability is imposed to reach an equitable result.' (Latty, *Subsidiaries and Affiliated Corporations* (1936), p191).

79 *op cit* at p.316.

relationship between the shareholders to that which exists between partners and adjudicating accordingly, does. The most famous case in this category is *Re Yenidje*.⁸⁰ Here the two shareholders were not on speaking terms, and one of them petitioned the court for a winding up order.⁸¹ Lord Cozens-Hardy MR said:

This is not a partnership strictly . . . But ought not precisely the same principles to apply to a case like this where in substance it is a partnership in the form or the guise of a private company?⁸²

Here, the court goes too far. Having peeped behind the veil and discovered the composition of the company, the court should have treated it as a distinct legal entity. Otherwise it may seem that whenever a company is composed of such a small number of shareholders, an automatic adherence to partnership is imperative.⁸³ Certainly in *Re Yenidje*, the court had to begin from the statutory phrase 'just and equitable'. But, as Lord Wilberforce says in the *Westbourne* case,⁸⁴ 'a company, however small, however domestic, is a company not a partnership or even a quasi-partnership and it is through the just and equitable clause that obligations, common to partnership relations, may come in.'⁸⁵ The special character of the company is emphasised by the fact that in some cases the court may find it impossible to liquidate the company, in spite of the closely held shares, because of a special stipulation in the articles of the company.⁸⁶

3. *Extending the Veil*⁸⁷

A third technique of lifting the veil is by its extension so that it embraces a bunch of companies.⁸⁸ Here, the veil of each one of the components is lifted — only to draw it again over a large number of components.⁸⁹ Such is the case when a group of legal entities is conducting a common activity, so that instead of referring to each one separately, one can regard them all as a single going concern, under one extended veil of incorporation.⁹⁰ Each corporate entity does not concern us any more: it is 'the enterprise entity' on which we focus attention.⁹¹

The technique can be used in other circumstances, as illustrated by the *Gilford* case.⁹²

80 *Re Yenidje Tobacco Co. Ltd.* [1916] 2 Ch 426 (CA).

81 Even though it was prosperous from the economic point of view. (The court explained that it was managed by the clever secretary.)

82 *ibid* at p432. Lord Warrington directed his judgment more to the relationship between the shareholders: 'It is true they are carrying on the business by means of the machinery of a limited company, but in substance they are partners' (p434); and see *Re Lundy Brothers Ltd.* [1965] 2 All ER 692.

83 Thus it seems that the court has a tendency automatically to resort to this practice, even when it is totally unnecessary in the circumstances, such as in the case of *Rayfield v Hands* [1958] 2 All ER 194. Here a shareholder based his claim on the articles of association, which obligated the directors to purchase the shares from a member wishing to sell them. Vaisey, J. mentioned that 'it is material to remember that this private company is one of that class of companies which bears a close analogy to a partnership; see the well-known passage in *Re Yenidje*.' With all respect, I can't see the relevance of such of comparison in this matter.

84 *Ebrahimi v Westbourne Galleries Ltd.* [1973] AC 360 (HL).

85 *op cit* at p380.

86 As in the case of *Re Cuthbert Cooper & Sons Ltd.* [1937] 2 All ER 466; or *In re K/9 Meat Supplies (Guilford) Ltd.* [1966] 1 WLR 1112 (Ch d).

87 Referred to as 'piercing the veil' by Prentice, 'Groups of Companies in English Law' in K. Hopt (ed), *Groups of Companies in European Laws* (1982), p99, 101.

88 Referred to in Sched 4 to the Companies Act 1985 as 'group companies' and changed by the 1989 Act to 'group undertakings'.

89 Referred to in Sched 2 to the 1989 Act as 'the consolidation'.

90 Special regard must be given to the multinational companies in this respect. See Aronofsky, *op cit*, and the references cited therein.

91 And see also the definition of 'joint venture' and 'associated undertaking', defining special compositions of such groups — Sched 2, paras. 18 and 19 to the 1989 Act.

92 *Gilford Motor Co. Ltd. v Horne* [1933] Ch 935. CA.

Here, a managing director entered into a covenant not to solicit customers from his employers. He formed a company of his own and used it to solicit customers. The Court of Appeal held that his company was a mere sham to cloak his wrongdoings and an order was issued against him. However the court also issued an injunction against the company, even though the defendant was neither a member nor its director.⁹³ The order against the company is interesting: if the court is to disregard its separate entity, how can it issue an order against it? Indeed, this disregard of the company's entity is unnecessary, as is revealed by the final order of the court. This extended the veil: it did not make the artificial distinction of who may act in breach of the covenant — the defendant himself or the company. It contained the injunctions against both, considering them to be one unit — like an enlarged legal entity.⁹⁴ The question arises whether this judgment should be regarded as 'penetrating the veil.' Certainly, it is the case of a sole owner of the shares together with his company — as compared to a group of companies — sometimes it is difficult to distinguish between the two. A distinction based upon the direction of the pointer is suggested: when it is the shareholder whom we want to catch, while the company is still regarded as a separate legal entity, then we are penetrating the veil — the direction of the vector is from the company to the shareholders. However when it is the company which we want to catch by reaching it through its shareholders, then we are extending the veil to engulf the company as well — the direction of the vector is from the shareholders to the company.⁹⁵

Generally, however, the veil is extended in the case of several companies. The most notable example of legislation is provision in the Companies Act, according to which a holding company must include in its accounts the profits earned or losses suffered by its subsidiaries, together with the collective assets and liabilities — group accounts.⁹⁶ This group account is recognised also in the Corporation Tax Acts.⁹⁷ The extension of the veil can also ensue in an advantage for the company, as in the case of dividends paid by one member of the group to another⁹⁸ or in the claim for group relief.⁹⁹

The courts have started to follow suit and in some cases have taken this approach to a group of companies, without attributing too much importance to the separate entities of its various components.¹⁰⁰ This has sometimes been done when the group was identic-

93 He got his wife to form the company. Nevertheless the court regarded the company as his device to mask the effective carrying on of his business in breach of his covenant.

94 See also Farwell J in *Re London Housing Society's Trust Deeds* [1940] Ch 777: 'It is no doubt true to say that the registered society and the limited company are, in one sense of the word, separate legal entities, but . . . they are in substance and in truth exactly the same thing with a different structure and a different machinery . . . In my judgment, the only practical way of dealing with a question of this sort . . . is to treat for this purpose the two things . . . as the same thing in different costume'.

95 See, as another example, *Alec Lobb (Garages) Ltd v Total Oil (Great Britain) Ltd*. [1985] 1 WLR 173: to solve the company's financial difficulties it was agreed that its property would be leased to the defendant for a number of years and leased back to the company. The lease-back was granted to its two shareholders and only directors, rather than to the company, including a tie provision. The defendant maintained that this tie provision was not in restraint of trade because the lease-back was not to the company. Dillon, L.J. rejected this allegation: 'The court has ample power to pierce the corporate veil, recognize a continued identity of occupation and hold, as it should, that Total can be in no better position *quoad* restraints of trade by granting the lease-back to Mr and Mrs Lobb than if it had granted the lease-back to the company' (p178, referring to *Guilford* and *D.H.N.* Note that *Woolfson* (below n 111) was not mentioned).

96 Section 227 of the Companies Act 1985. And see also Sched 2 to the 1989 Act, to become Sched 4A to the 1985 Act, and Sched 3 (substituted for Sched 5 to the Companies Act 1985). The term 'group companies' is substituted there by 'group undertakings', in conformity with the 7th Directive of the European Communities (83/349/EEC).

97 As Gower states, 'the only outside creditor in whose favour the *Salomon* rule has been substantially mitigated is the Revenue' (*op cit* p120).

98 Section 247 of the Income and Corporation Taxes Act 1988.

99 See Chapter IV of the Income and Corporation Taxes Act 1988.

100 See 'Liability of a Corporation for Acts of a Subsidiary or Affiliate' (1958) 71 *Harv LR* 1122.

ally or wholly owned.¹⁰¹ When the court was satisfied, however, that the holding company did not have full control over the subsidiary, it did not regard them as one entity.¹⁰²

A good illustration is *DHN Food Distributors Ltd. v London Borough of Tower Hamlets*.¹⁰³ Here a company claimed compensation for disturbance owing to the expropriation of land. Yet the land belonged to another company, the shareholders of which were identical to those of the two others. Lord Denning agreed with Gower's dictum about the tendency to ignore the separate legal entities of the various companies within a group, having regard instead to the economic framework of the group as a whole. He emphasised that

this is especially the case when a parent company owns all the shares of the subsidiaries . . . These subsidiaries are bound hand and foot to the parent company and must do just what the parent company says . . . The three companies should, for present purposes, be treated as one.¹⁰⁴

It is interesting to analyse the court's attitude in this case having regard to our four categories. Its first step was peeping behind the veil to see the shareholdings of the three companies at stake. It revealed that the shareholders (and directors) of all three were identical.¹⁰⁵ This is actually a penetration of the veil, by recognising the direct interest of each of the components in the assets of the enterprise. Then it proceeded to penetrate the veil, by applying the partnership approach: 'the group is virtually the same as a partnership in which all the three companies are partners.'¹⁰⁶ The third step is the extension of the veil to cover the entire group, seeing it as one, comprehensive entity: 'These companies as a group are entitled to compensation not only for the value of the land but also compensation for disturbance.'¹⁰⁷

Goff, L.J., limiting himself to the specific facts, agreed that 'this is a case in which one is entitled to look at the realities of the situation and to pierce the corporate veil.'¹⁰⁸ His judgment was based upon the factual finding that one company held the premises in trust for the plaintiff.¹⁰⁹ Shaw, L.J. emphasised the fact that the companies could have acted in another manner so as to legitimately qualify for compensation. Therefore it was only just that they should benefit; 'Why then should this relationship be ignored in a situation

101 See C. Schmitthoff, 'The Wholly Owned and Controlled Subsidiary' [1978] JBL 218. And see *Re Courage Group's Pension Schemes. Ryan v Imperial Brewing and Leisure Ltd.* [1987] 1 All ER 528, Ch D: 'A pension scheme is established not for the benefit of a particular company, but for the benefit of those employed in a commercial undertaking; and provision can properly be made for the scheme to continue for their benefit if, on a reconstruction of the group, the undertaking is transferred from one company to another within the group, and remains identically the same' (at p531, per Millett, J.).

102 *Multinational Gas v Multinational Gas Services* [1983] 2 Ch 258 (CA). It also refused to extend the veil, even though the same ownership was involved, when the interpretation of the statute restricted it. Thus, when the statute applied specifically to the 'registered owner' of the vessel, it was construed as negating the possibility of its application to other vessels owned by separate companies of the same shareholder: *The Eypo Agnic* [1988] 1 WLR 1090 at p1097, per Lord Donaldson of Lynton MR.

103 [1976] 3 All ER 852.

104 *ibid* at p860. And see *Holdsworth (Harold) & Co. (Wakefield) Ltd. v Caddies* [1955] 2 WLR 352, mentioned in his judgment.

105 One company was importing and marketing groceries, a second was the owner of the business' vehicles and dealt with the transportation, and the third one, which owned the premises and lent them to the first, was later purchased by the latter. The whole transaction was complicated. 'What was in the minds of D.H.N.'s professional advisers in adopting this tortuous mode of proceeding it is difficult to fathom', remarked Shaw, L.J. (at p866).

106 *ibid* at p860, by Lord Denning M.R. The difficulty of establishing the real relationship between the companies is manifested here: regarding them to be partners, although having said beforehand that they were 'bound hand and foot to the parent company'.

107 *ibid*.

108 *ibid* at p861.

109 This finding of an equitable interest in the land does not evoke, however, the lifting of the veil.

in which to do so does not prevent abuse but would on the contrary result in what appears to be a denial of justice?’¹¹⁰

In the later case of *Woolfson*,¹¹¹ also concerning compensation with regard to land, the House of Lords cast some doubt on whether the Court of Appeal in the *DHN* case ‘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.’¹¹² This presumably expresses Lord Keith’s view, that the veil is lifted only *against* shareholders. However, the *DHN* case is only one of many in which the veil is also lifted in their favour.¹¹³ As Goff, L.J. said, ‘the realities of the matter should decide the case.’¹¹⁴

The practice of extending the veil is much more developed in the US.¹¹⁵ The results of extending the veil to include the general enterprise entity are numerous: holding affiliated transport companies liable in tort for damages caused by negligent conduct of one of them;¹¹⁶ treating the holding company as responsible for the acts of its subsidiary;¹¹⁷ rejecting the subsidiary’s claim because its holding company was involved in the detrimental act caused by a third party;¹¹⁸ rejecting the holding company’s claim in the bankruptcy proceedings of its subsidiary;¹¹⁹ preventing the circumvention of the Hapburn Act, known as the Commodities Clause; and many others.

In the UK, however, ‘the judicial innovations are even more timid than the legislative’, in Gower’s words.¹²⁰ The Cork Committee¹²¹ stressed the necessity for reforming legislation in the near future with regard to outside creditors’ rights in bankruptcy of a subsidiary company, but with the exception of its proposal for ‘wrongful trading’, which was included in the Insolvency Act 1986, its proposals have not been implemented.

110 *ibid* at p867. The sense of justice led to ‘lifting the veil’ in its three distinct categories, to the benefit of the companies themselves.

111 *Woolfson v Strathclyde Regional Council* 1978 SLT 159, 38 P & CR 521 (HL).

112 Per Lord Keith of Kinkell at p526. However he distinguished between the two cases on the basis of control: in the *DHN* case, the company which owned the land was the wholly owned subsidiary of the company that carried on the business, the latter being also in complete control of the situation. In the *Woolfson* case, there was not such total control of the company owning the land. Moreover, the fact that the claim was brought on the part of one of the shareholders, holding only 2/3 of the company’s shares, proves the disparity between the shareholders themselves and between the main shareholder and the company. See too *National Dock Labour Board v Pinn & Wheeler Ltd* [1989] BCLC 647, where *Woolfson* was relied on.

113 Indeed, Lord Denning MR states categorically: ‘They should not be treated separately so as to be defeated on a technical point. They should not be deprived of the compensation which should justly be payable for disturbance’ (at p860). And Shaw, L.J. stresses the point that ‘If each member of the group is regarded as a company in isolation, nobody at all could have claimed compensation in a case which plainly calls for it’ (p867).

114 Farrar is also of this view: ‘There seems to be a general reluctance to apply the [*Salomon*] principle in a pedantic way where the result will cause injustice’ (*op cit* p65).

115 See ‘“Merger” or Agency of a Subsidiary Corporation as Grounds of the Liability of the Parent Corporation for Acts of its Subsidiary’ (1927) 27 *Co LR* 702; Berle, ‘The Theory of Enterprise Entity’ (1947) 47 *Col LR* 343.

116 *Ross v Pennsylvania RR Co.*, 106 NJL 536; *Berkey v Third Avenue Ry.*, 244 NY 84.

117 *Costan v Manila Electric Co.*, 24 F (2d) 383.

118 *Rapid Transit Subway Construction Co. v City of NY*, 182 NE 145.

119 *Taylor v Standard Gas & Electric Co.* 306 US 307. For other references on this subject see Latty, above. And see also the debate between J.M. Landers, ‘A Unified Approach to Parent Subsidiary Affiliate questions in Bankruptcy’ 42 *U Ch L Rev* 589 (suggesting 3 remedies in case of bankruptcy of a subsidiary, with claims of the holding company competing with third party claims: veil piercing, enabling the creditors of the subsidiary to get their claims from the holding company; subordination of the holding company’s claims to those of third parties; and consolidation of the assets of the subsidiary and the holding companies into one pool in favour of the creditors) and R.A. Posner, ‘The Rights of Creditors of Affiliated Corporations’ 43 *U Ch L Rev* 499 (objecting to such procedure from economic point of view) and the answer of Landers, ‘Another Word on Parent Subsidiaries and Affiliates in Bankruptcy’ 43 *U Ch L Rev* 527.

120 Gower, *op cit* p133. And see the remark of Templeman, L.J. in *Re Southard & Co. Ltd.* [1979] 1 WLR 1198, 1208.

121 *Insolvency Law and Practice: Report of the Review Committee* (1982) Cmnd 8558.

4. Ignoring the Veil

The most extreme form of lifting the veil is when the courts ignore it completely.¹²² This approach is as a sanction to which the courts turn when they think that the company was not founded for commercial or other sound grounds, but only as a means to defraud or defeat creditors or to circumvent laws.

The courts have many names to describe a company which is not a genuine one. 'Cloak', 'instrumentality', 'sham', 'scheme', 'puppet' or 'bubble company' are but a few.¹²³ However, although the behaviour of the controlling shareholder is contemptible, it is suggested that this method of disregarding the company's separate entity has gone too far. Not only is it against the legal system: taken literally, it deprives the courts themselves of the possibility of issuing orders against the company as such, if and when they deem fit. Thus, for example, when the court states that the company was no more than 'a device and a sham, a mask which he holds before his face in an attempt to avoid recognition by the eye of equity,'¹²⁴ it contradicts its own order issued later on against this same company.¹²⁵

The desire of the court to ignore the company does not always do justice, especially when other parties are affected. In such cases, a remedy can be found in a more conventional way, namely to nullify the hurtful action. Thus, for instance, a transfer of land to a controlled company by its owner in order to evade execution of a personal contract of sale when its price has increased can be repudiated, without condemning or ignoring the company itself. This approach is analogous to the situations dealt with by the Insolvency Act 1986; when a transfer of assets is made with the intention to defraud creditors, the court 'shall make such an order as it thinks fit for restoring the position to what it would have been if that individual had not entered into that transaction.'¹²⁶ The same can be said of a transfer of property to — or from — a controlled company: the right remedy would be to declare as void the transfer itself. 'If a corporation conveys its assets to a shareholder in fraud of creditors, the assets may be reached on principles of fraudulent conveyance,' write Henn and Alexander.¹²⁷ If a contracting party tries to avoid the execution of the contract, maintaining that a company is the proprietor of the land, the court may order him as the controlling shareholder to have the resolutions necessary to complete the sale passed by the company's authorities.¹²⁸ If on the other hand a person transfers his assets to a company under his control so as to avoid their seizure by the creditors, the court may issue an injunction restraining him from disposing of his shares in the company, as well as restraining him from procuring the disposition of these assets. There is no need to ignore the separate existence of the company.¹²⁹

¹²² This is what is being called by the courts and the authors 'disregarding' or 'ignoring' the veil. As those names describe the entire subject I have decided to dedicate to this category an epithet of its own.

¹²³ See, for example, *In re Carl Hirth, ex p Trustee* [1899] 1 QB 612; *Gonville's Trustee v Patent Caramel Co. Ltd.* [1912] KB 599; *In re Fasey, ex p Trustees* [1923] 2 Ch 1; *Woolfson v Strathclyde Regional Council* 1979 SC (HL) 90. And see also *supra*, n 14.

¹²⁴ *Jones v Lipman* [1962] 1 WLR 832.

¹²⁵ The court later decreed specific performance of the sale of the land against both the contracting party and his company. As the sale should have been executed by the company, being now the owner of the land, this fact in itself shows the flaw in the previous approach by the court in totally disregarding the separate legal entity of the company. Sealy summarises this case, saying that 'Ignoring the veil, Russell, J. ordered specific performance against both the defendant and his company'. It seems that the use of 'penetrating the veil' instead of 'ignoring the veil' would have removed this inner-contradiction.

¹²⁶ Section 239. And see also s 240.

¹²⁷ Henn & Alexander, *op cit* p.347. This chapter starts with 'Apart from corporate law principles'. That means that these authors too think that ignoring or rejecting the company is unnecessary; and see also their references *ibid* n 15.

¹²⁸ As in *Elliott & Elliott (Builders) Ltd. v Pierson* [1948] Ch 452.

¹²⁹ *Re a Company Ltd.* [1985] BCLC 333. Gore-Browne remarks that 'the technical form of the injunction respected the corporate form of the English and foreign companies concerned' (*op cit* 1.4.3).

Commentary

It is impossible to list the cases in which the veil will be lifted: there can be no *numerus clausus*. Indeed, the general *dictum* that the veil will be lifted when it is used to perpetrate fraud or to circumvent a statute, or when the enemy character of the company is relevant, is both insufficient and inaccurate. As for the last, it has been shown that tainting the company with an alien character is one of many examples, including statutory ones, in which the court peeps behind the veil and looks at the corporators, only to return and address itself to the company as a separate legal entity. As for the two other reasons given for ignoring the veil — perpetrating a fraud or circumventing a statute — the approach seems neither necessary nor right, as other, less rigorous remedies are at hand.

Generally, the courts are less reluctant to extend the veil when dealing with a group of companies than to penetrate it when dealing with one company.¹³⁰ When a group of companies is conducting one amalgamated business, even though the onus of proof is upon the plaintiff who is seeking the extension of the veil, it seems that the courts are satisfied with *prima facie* proof on his part of the connection between the companies. Then they tend to demand strong evidence from the defendants to prove that each of the companies was managed by its own board of directors and that it did not receive orders or instructions from the others. If the case is one of firm and intensive ties of management and decision making, and the subsidiary is wholly owned by the holding company, the courts tend to regard them as one going concern, generally by attributing to them a 'constructive' agency relationship.

Much more than that is needed for penetrating the veil when dealing with a closely held company. Here as well the *modus operandi* of the company has an important role. A strong personal involvement of the controlling shareholder — as distinct from the director — in the business of the company must be shown to justify penetration. Such circumstances may be: non-compliance with the formal requirements laid down in the Companies Acts; inadequacy of capitalisation of the company; 'milking' the company by its shareholders;¹³¹ association and intermingling of the affairs of the controlling shareholders with those of the company, etc.

However, beside a careful examination of the facts of the case, reference must be made to further matters which the courts consider. These include:

- (1) the type of company — a closely held company, subsidiary or holding company;¹³²
- (2) the motives for formation of the company — commercial ones, as opposed to fraudulent purposes, like defeating creditors, evading laws, etc;
- (3) the type of legal action — a claim in tort, contract, bankruptcy, etc;¹³³
- (4) the identity of the person seeking the lifting of the veil — an aggrieved third party or the controlling shareholder himself.¹³⁴

130 Compare *Tunstall v Steigman* [1962] 2 QB 583 (where granting a landowner's claim would have amounted to lifting the veil in her favour) with *Willis v Association of Universities of the British Commonwealth* [1964] 2 WLR 946 (similar situation, with a group of companies). In his comment on the latter case Wedderburn points out that 'the decision in the *Willis* case appears to give groups of "entities", such as holding and subsidiary companies, preferential treatment compared with the small incorporator and his one-man company' (28 MLR 62, at 70).

131 This is a consideration more in use in the US judicature than in the UK. See Henn & Alexander, *op cit* p349, references in n 21.

132 The explanation of Landers of the fact that the courts are more inclined to lift the veil with regard to a subsidiary is the notion that the corporate form protects the shareholders against personal liability; and 'since disregard of the corporate fiction in the context of related corporations does not involve additional liability for the individual stockholder, the basic policy behind limited liability remains undisturbed' (J.M. Landers, 'A Unified Approach to Parent Subsidiary affiliate Questions in Bankruptcy', 41 *U Ch L Rev* 589, 622).

133 'in matters of property and contract, the courts should surely be most hesitant to lift the veil in response to superficial considerations of "common sense" or "reality" or "fairness"', writes Sealy, *op cit* p.45.

Let us re-examine now the general description of lifting the veil in the literature, and see how it fits into our categories. Let us take the statement by Farrar,¹³⁵ about which an Australian judge says: 'This is as good an attempt to summarise the case as I've seen.'¹³⁶ Farrar lists the main legal categories under which the cases of lifting the veil may be headed as follows:

- (1) agency;
- (2) fraud;
- (3) group enterprises;
- (4) trusts;
- (5) enemy;
- (6) tax;
- (7) the companies legislation.

From our viewpoint, this list is composed of the justifications for lifting the veil, the considerations of the courts and the means by which the veil is actually lifted. To analyse the list in more detail: 'agency' and 'trusts' are but ways of penetrating the veil; 'fraud' is one of the justifications for lifting the veil; 'group enterprises' is the case in which the veil be extended; 'enemy' is one of the cases in which peeping behind the veil is necessary, with a possible penetration of the veil as a result; 'tax avoidance' is one of the considerations of the courts for lifting the veil, either by merely peeping behind it or in specific instances, mainly statutory ones, also penetrating it; and the last — 'the companies legislation' — is but one of the legislative enactments containing provisions for lifting the veil in all of the first three categories.

The description by Charlesworth is also relevant to our categorisation:

There are exceptions to the principle in *Salomon's* case, where the veil is lifted and the law disregards the corporate entity and pays regard instead to the economic realities behind the legal facade. In these exceptional cases, 'the law either goes behind the corporate personality to the individual members, or ignores the separate personality of each company in favour of the economic entity constituted by a group of associated concerns'.¹³⁷

Although this passage is generally used for describing *when* the courts will lift the veil, we can detect in it the answer to the question *how* it is done. Indeed, it covers almost all the categories of lifting the veil: the first to be mentioned is the total disregard of the veil, followed by the penetration, and the last is the extension of the veil. Each of these necessitate the peeping behind the veil as its first step, to ascertain whether the company in question merits further treatment.¹³⁸

To conclude, it is suggested that our four categories may help to provide a better insight into the statutory and judicial process of lifting the veil, bearing in mind that each category will have its own appropriate set of considerations and justifications.

134 See Henn & Alexander, *op cit* Ch. 149: 'Disregard of Corporateness for Benefit of Shareholders'. Gower suggests that 'Legislative intervention to protect an incorporator from the unforeseen disadvantageous consequences of incorporation is rare', *op cit* p136. Yet he himself mentions one such case — s 6 of the Law of Property Act 1969. And in the Israeli judicature there are cases in which the courts have lifted the veil upon the request and for the benefit of the members themselves.

135 Farrar's *Company Law* (2nd ed., 1988) p60.

136 *Pioneer Concrete Services Ltd v Velnah Pty Ltd.* (1986) SC(NSW) 11 ACLR 108, 177, by Young, J.

137 Charlesworth, *Company Law* (13th ed., 1987), p27. The citation is from Gower, *op cit* p112. And see also a similar approach by Northey and Leigh, *op cit* p20.

138 The last phrase of Gower's summing up (*op cit* p112, cited above) is 'The latter situation is often merely an example of the former.' Indeed, in both cases the court, after having individualised certain characteristics of the shareholders returns to address itself to the company; only in the latter case, the result of its interest in the shareholders is the elongation of the veil over a new, different body.