KEY FACTS
COMPANY LAW

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Corporate personality

Separate legal personality:

- *Salomon v Salomon & Co Ltd* (1897)
- A company is not an agent of its members
- The doctrine applies to groups – a subsidiary is not an agent of its holding company

- A company can make contracts
- A company can sue and be sued
- A company can own property
- A company has 'perpetual succession'
- Shareholders can delegate management to directors

CORPORATE PERSONALITY

A company is an association of its members and a person separate from its members

Judicial approaches to lifting the veil of incorporation:

- Evasion of liability, fraud, façade
- National security
- Agency
- Groups of companies – 'single economic unit'
- To achieve justice
- But note lack of any clear principle

The current position – *Adams v Cape Industries* (1990)

The veil will be lifted:

- when a statute, contract or other document requires it
- when the court is satisfied that the company is a mere façade
- when it is clear that the company is an agent of its members

Corporate liability:

- Liability in contract – s 39 CA 2006
- Liability in tort – liability of directors
- Criminal liability – strict liability
- Crimes requiring *mens rea*
- Corporate manslaughter

3.1 Introduction

1. A company is both a separate legal person and an association of its members. This is an underpinning feature of company law. This chapter will describe the principles and the limitations of separate legal personality.
2. Issue of the certificate of incorporation is conclusive evidence that all the requirements of the Companies Act 2006 in relation to incorporation have been complied with (s 15(4) CA 2006).
3. Section 16(2) CA 2006 provides that 'The subscribers to the memorandum, together with such other persons as may from time to time become members of the company, are a body corporate by the name stated in the certificate of incorporation'.
4. By incorporation, the company acquires separate legal personality; that is, the company is recognised as a person separate from its members, a principle established in *Salomon v Salomon & Co Ltd* (1897).
5. It was further established in this case that the company is not the agent of its members.
6. A registered company created under foreign law is also recognised as a separate legal person in the United Kingdom (*Arab Monetary Fund v Hashim (No 3)* (1991)).

3.2 Consequences of incorporation

1. The company is an association of its members and a person separate from its members. It is the company, not its members, that conducts the business of the company.
2. The company can make contracts.
3. The company can sue and be sued.
4. The company can own property.
5. The company continues in existence despite changes of membership. In other words, a company enjoys 'perpetual succession'.
6. The members can delegate management to directors.

3.3 The *Salomon* principle

1. The principle of separate legal personality is a powerful device, allowing incorporators to manage commercial risk, but in certain situations it can be used unfairly or fraudulently.
2. The concept of separate personality also extends to groups of companies, with each subsidiary in a group having a separate identity.
3. Furthermore, as a company is not an agent of its members, it follows that, unless there is specific evidence of an agency arrangement, a subsidiary is not an agent of its parent company (see further at section 3.4.2).
4. The following cases are examples of affirmation of the *Salomon* principle by the courts.
   - *Macaura v Northern Assurance* (1925): a shareholder had no insurable interest in property owned by the company. Note that in this case the principle was applied to the disadvantage of the shareholder.
   - *Lee v Lee's Air Farming* (1961): a company can employ one of its members who will have all statutory and other rights against the company.
   - *Secretary of State for Trade and Industry v Bottrill* (1999): a sole shareholder can be employed by the company and will have rights under the Employment Rights Act 1996.
   - *Secretary of State for Business, Enterprise and Regulatory Reform v Neurfeld* (2009): the Court of Appeal reviewed the law and held that a director of a company can be an employee as long as he is employed under a genuine contract of employment and not a contract for services.
   - *R v Philippou* (1989): the sole directors and shareholders withdrew funds from the company's account in London and bought themselves a property in Spain. The company went into liquidation leaving very large debts. They were charged with stealing from the company and argued that as they were the only directors, the withdrawal had the consent of the company. The Court of Appeal refused to accept this argument.
   - *Foss v Harbottle* (1843): since a company is a legal person separate from its members, a member cannot bring an action to redress a wrong done to the company, but note the statutory provisions in Part 11 CA 2006 considered in chapter 14.

3.4 Lifting the corporate veil

1. The notion that a company is recognised as a person separate from its members is often described as the 'veil of incorporation'.
2. In certain circumstances the veil of incorporation has been lifted to avoid the consequences of separate legal personality. Furthermore, there are a number of statutory exceptions to the principle.
3. Limited liability is not a direct consequence of the corporate entity principle (it is possible to form an unlimited company), but the vast majority of companies are limited and the concept goes hand-in-hand with the principle of separate personality. If the veil is lifted this right to limited liability may be lost.
4. The courts have been very reluctant to lift the veil in order to impose personal liability for the company's debts on a shareholder or director.
5. Note that in groups of companies each company has the benefit of separate legal personality, but there are a number of statutory exceptions in relation to group accounts.

3.4.1 Judicial approaches

In certain circumstances, the *Salomon* principle can be used in ways that appear to be unjust to third parties, creditors or even the shareholders themselves. The development of the law shows how the courts have sometimes taken the view that the veil of incorporation should be lifted to avoid abuse of separate personality. The approach has not always been consistent and it is difficult to identify clear principles to determine when the courts may be prepared to lift the veil and when they would decline to do so.

1. The Companies Act 2006 itself contains provisions that have the effect of lifting the veil in certain circumstances (see section 3.4.3) and the courts have also interpreted provisions in other statutes so as to require that the veil should be lifted. However, in *Dimbleby & Sons Ltd v National Union of Journalists* (1984) it was held that any parliamentary intention that the veil should be lifted must be expressed in 'clear and unambiguous language'.
2. The courts have lifted the veil in cases involving national security, particularly in times of war.

3. The veil has been lifted in cases where it has been shown that the corporate form was being used as a façade in order to avoid liability or to gain an illegitimate benefit for the shareholders. Examples include:
   (a) evasion of liability to pay tax (*Commissioners of Inland Revenue v Land Securities Investment Trust Ltd* (1969); *Littlewoods Mail Order Stores Ltd v Inland Revenue Commissioners* (1969));
   (b) evasion of a restraint of trade clause in a contract of employment (*Gilford Motor Co Ltd v Horne* (1933); *Dadourian Group International Inc v Simms* (2006));
   (c) attempt to avoid an order of specific performance (*Jones v Lipman* (1962)).
4. In the cases above, those in control of the company used the corporate form to commit a wrong. The veil will not be lifted when the company is controlled by others who have had no part in the wrongdoing (*Hashem v Shayif* (2008)) or where there has been no impropriety or attempt to hide the facts (*Ord v Belhaven Pubs Ltd* (1998)).

3.4.2 Groups

A number of cases have involved groups of companies and several different approaches have been employed by the courts.

1. **Agency**: it was held in *Salomon v Salomon* (1895) that a company is not an agent of its shareholders. However, the agency argument has been used in a number of cases involving groups of companies. Every company in a group is recognised as a separate legal person and it has been argued that a subsidiary is in certain circumstances an agent of the holding company. If on the facts of the case there is actual evidence of an agency existing, this is consistent with the principle of separate legal personality, but the issue is usually whether an agency can be inferred.
   (a) In *FG Films Ltd* (1953) the court inferred agency in a case where a United Kingdom company was set up in order to acquire film distribution rights in the United Kingdom for an American holding company.
   (b) In *Smith, Stone & Knight Ltd v Birmingham Corporation* (1939) the court laid down guidelines to establish whether an agency could be implied between a holding company and its subsidiaries. However, this case has been criticised and has not been followed.
   (c) In *JH Rayner (Mincing Lane) Ltd v Department of Trade and Industry* (1989) it was held that an agency cannot be inferred from the mere fact that the company is controlled by its shareholders.

2. **Single economic unit:** the high water mark of the courts' willingness to lift veils was *DHN Food Distributors Ltd v Tower Hamlets LBC* (1975), in which it was held that a group of companies was a single economic unit, thus enabling the group to claim compensation on the compulsory purchase of land even though the land from which the business operated was owned by a subsidiary and the business was operated by the parent company.
3. This case was disapproved by the House of Lords in *Woolfson v Strathclyde Regional Council* (1978) and the argument was not accepted in subsequent cases, including *Re Southard & Co Ltd* (1979) and *Adams v Cape Industries* (1990).
4. **Justice:** in some cases the courts have been willing to accept that the veil can be lifted where this is necessary in order to achieve justice, for example *Creasey v Breachwood Motors Ltd* (1992). However, this view has not been accepted in recent cases, and *Creasey* was overruled by the Court of Appeal in *Ord v Belhaven Pubs Ltd* (1998).
5. In the important case of *Adams v Cape Industries* (1990) the Court of Appeal reviewed the arguments for lifting the veil discussed above, in particular the agency argument, the single economic unit argument and the 'façade' argument, and held that none of these applied on the facts.
6. The case signalled a shift towards the view that in the absence of fraud, incorporators can rely on the principle of separate corporate personality. This view has been affirmed in *Ord v Belhaven Pubs Ltd* (1998), where it was held that the court may not lift the veil in situations where there is no attempt to hide the true facts, no ulterior motive and no impropriety.
7. On the other hand where impropriety can be shown the façade argument may be accepted so that the court is willing to lift the veil, as in *Trustor AB v Smallbone (No 2)* (2001) where a company was used as a device for the receipt of misappropriated funds. In circumstances where a company may be seen as a 'sham' or an abuse of the corporate form so as to evade liability or gain an unjust benefit, the veil may be lifted. The motive behind the establishment of a company may be relevant, for example if it was used as a device to conceal the true facts and to avoid limitations on a shareholder's conduct (as in *Gilford Motors v Horne*) or to avoid pre-existing liabilities.

8. The current situation can be summarised as follows:
   (a) Although agency cannot usually be inferred, effect will be given to an express agency agreement between a company and its members or between companies in a group. An express agency affirms the principle of separate personality.
   (b) Following *Adams v Cape Industries*, it seems that the only circumstances in which the courts are likely to lift the veil are now:
      - when the court is construing a statute, contract or other document which requires the veil to be lifted;
      - when the court is satisfied that the company is a 'mere façade', so that there is an abuse of the corporate form;
      - when it can be established that the company is an authorised agent of its controllers or its members, corporate or human.
9. However, each case is considered on its facts and there are suggestions in some recent cases that the Court of Appeal may be more willing than in Adams to treat a group of companies as a single concern: see *Beckett Investment Management Group Ltd v Hall* (2007).

3.4.3 Statutory exceptions

1. There are a number of statutory provisions in the Companies Act 2006 that have the effect of lifting the veil.
2. Section 767(3) CA 2006 provides that if a public company acts before obtaining a trading certificate, all the officers and directors are liable to fines and if the company fails to comply within 21 days the directors are liable to indemnify anyone who suffered loss as a result of the transaction.
3. For groups of companies, s 399 provides that, unless subject to the small companies regime or otherwise exempt, the directors of a parent company must file group accounts.
4. Other Acts also provide examples: ss 213 and 214 Insolvency Act 1986, which provide that in cases of fraudulent trading and wrongful trading a director may be liable to make a contribution to the company's assets, and s 15 Company Directors Disqualification Act 1986 which provides that a person involved in the management of a company in contravention of a disqualification order is liable for the debts of the company.

3.5 Corporate liability

The fact that a company is an artificial person raises interesting questions as to the limits of a company's liability for wrongful acts.

3.5.1 Liability in contract

1. A company is a legal person separate from its members. One of the most important consequences of incorporation is that a company can enter into contracts and other commercial transactions and is fully liable for the debts it incurs.
2. A company can only act through its agents and the usual principles of agency, together with the provisions in s 40 CA 2006, will be applied in deciding whether a company is liable on any contract (see further chapter 5). Note that the agent is not a party to the contract, so it is the company and not its agents that will be liable for breach of contract.
3. A company must act in accordance with its constitution. The CA 2006 s 31 provides that a company has unlimited capacity unless it chooses to restrict its capacity by inserting an objects clause, which may then limit its capacity to make certain contracts. Section 39 CA 2006 is designed to provide security of contract to persons dealing with a company and this is discussed further in chapter 5.

3.5.2 Liability in tort: vicarious liability

1. In tort, a company may be held vicariously liable for the wrongful acts of its officers and employees as long as they were acting in the course of their employment. The employee who commits the act will also be liable as the primary tortfeasor.
2. Vicarious liability has been described as 'a loss distribution device based on grounds of social and economic policy' (Lord Millett in *Dubai Aluminium Co Ltd v Salaam* (2002)). The company may be held liable for a tort of someone else, for example its employee or agent.

3.5.3 When are directors liable in tort?

1. If a director, acting for a company, causes the company to commit a tort it is the company not the director who becomes liable. However, if a director is acting in a personal capacity or assumes personal responsibility he or she will be liable for the tort. Difficult questions

arise as it is not always easy to establish whether the director has acted in a personal capacity and each case depends on its own facts: see *Fairline Shipping Corporation v Adamson* (1975); *Mancetter Developments Ltd v Garmanson Ltd* (1986); and *MCA Records Inc v Charly Records Ltd* (2003).

2. Similar issues arise in cases involving the tort of negligent misrepresentation if a director provides advice on behalf of the company. In *Williams v Natural Health Foods Ltd* (1998) advice was given by a company to the claimant. The advice, which had been produced by the managing director (who was also the main shareholder) and was acted upon by the claimant, turned out to be inaccurate. By the time the action was brought the company had ceased to exist and the question arose whether the managing director could be liable. The issue was whether this was a personal act of the director rather than one carried out for the business purposes of the company. It was held that the managing director had not assumed personal responsibility and was not liable.

3. If a director were held to be personally liable for the tort, this would effectively remove the protection of incorporation and, in the case of a limited company, of limited liability. In *Williams* Lord Steyn said: '[In] order to establish personal liability under the principle of Hedley Byrne [*Hedley Byrne v Heller* (1964)], which requires the existence of a special relationship between plaintiff and tortfeasor, it is not sufficient that there should have been a special relationship with the principal. There must have been an assumption of responsibility such as to create a special relationship with the director or employee himself'. In this case it had not been possible to show that such a relationship existed.

4. However, it may be possible to show that the director is personally liable for a tort involving fraud or dishonesty, as in *Standard Chartered Bank v Pakistan National Shipping Corp (Nos 2 and 4)* (2002 and 2003), where both the director and the company were sued for the tort of deceit. See also *Contex Drouzhba Ltd v Wiseman* (2007).

3.5.4 Liability for crime

1. Companies can commit crimes of strict liability and there are a large number of regulatory offences that apply to companies. In such cases it is necessary only to show that the company committed the criminal act (*actus reus*): *Alphacell Ltd v Woodward* (1972).

2. There are certain crimes which it is impossible for a company to commit since the *actus reus* could not be committed by an artificial person, for example driving a vehicle in an unsafe condition (*Richmond-on-Thames BC v Pinn & Wheeler Ltd* (1989)).
3. There are also obvious limitations on the sanctions that can be applied to companies: notably, a company cannot be imprisoned.
4. In recent years debate has centred on whether a company, being a legal entity without a mind of its own, is able to form the necessary *mens rea* for the offence in question.
5. In three cases in 1944 companies were convicted of offences requiring *mens rea* (*DPP v Kent & Sussex Contractors*; *R v ICR Haulage Ltd*; *Moore v Bresler*).
6. The principle that in certain circumstances a company can commit a crime requiring *mens rea* was recognised by the House of Lords in *Tesco Supermarkets Ltd v Nattrass* (1972).

3.5.5 Corporate manslaughter

1. Following the capsize of the Herald of Free Enterprise, the question of whether a company could be convicted of manslaughter was considered. In *R v P&O European Ferries (Dover) Ltd* (1990) it was held that it was possible for a company to commit manslaughter, as long as it could be established that a person who could be identified as the 'mind and will of the company' could be found guilty of the offence: this became known as the identification principle. In that case, however, the company was not guilty.
2. The first successful prosecution of a company for manslaughter was *R v Kite* (1996), in which the company was fined £60,000 on conviction. The managing director of the company was convicted and was sentenced to three years imprisonment, reduced by the Court of Appeal to two years. In this case, unlike *P&O European Ferries*, the managing director could be seen as the controlling 'mind and will' of the company and the company was therefore guilty of the offence.
3. Some of the difficulties are highlighted in *Attorney General's Reference (No 2 of 1999)* in which the trial judge directed the acquittal of Great Western Trains Ltd following a rail accident which caused the deaths of seven people. It had not been possible to prove gross negligence on the part of any individual who could be identified as the directing mind and will of the company.

4. In March 1996, the Law Commission published a report *Legislating the Criminal Code: Involuntary Manslaughter* (Law Com No 237), in which the Commission made a number of recommendations, including proposals for a new offence of corporate killing, separate from the offences that can be committed by individuals. After further consultation and long delays the Corporate Manslaughter and Corporate Homicide Act 2007 was passed in July 2007.

5. The Act abolishes the common law offence of corporate manslaughter by gross negligence (s 20) and signals a shift from the identification principle to the concept of management failure. Whereas previously it had been necessary to show that death had been caused by a person or persons who could be identified as the 'mind and will' of the company, the Act now focuses on the way an organisation is managed by its 'senior management'.

6. It provides that an organisation (it includes partnerships as well as corporations) will be guilty of manslaughter if the way in which its activities are managed or organised by senior management:
   - causes the death of a person or persons, and
   - amounts to a gross breach of the relevant duty of care owed by the organisation to the victim(s) (s 1(1)).
   - It is further provided that the way the company's activities are managed or organised must be a substantial element in the breach referred to above (s 1(3)).

7. Senior management is defined in s 1(4) of the Act as those who play a significant role in:
   - making decisions about how the whole, or a substantial part, of an organisation's activities are to be managed or organised, or
   - actually managing or organising the whole or a substantial part of those activities.

8. Section 2, read with ss 3–7, defines 'relevant duty of care', which is a question of law for the judge. A breach of duty is a 'gross breach' if the alleged conduct falls far below what can reasonably be expected of the organisation in the circumstances.

9. It is up to the jury to decide whether the death was caused by a gross breach of duty and s 8 sets out the factors that the jury must consider in coming to a decision.

10. On conviction an organisation is liable to pay a fine. The Act also gives power to the court to make:

- a remedial order, requiring the organisation to take steps to remedy the breach or any deficiency relating to health and safety (s 9), and
- a publicity order, requiring the organisation to publicise the fact that it has been convicted of the offence and other details as ordered by the court is provided for in s 10, but this has not been brought into force.