

## The Defence of the Corporate Veil - Parent Companies Beware!

Much interest has recently been shown in the potential consequences of the judgment given in *Stocznia Gdanska SA -v- Latvian Shipping Co and others*, which was substantially upheld by the Court of Appeal on 21 June 2002. Although the case related to Shipbuilding Contracts, the result has reinforced the traditional view that the Courts will not countenance any further erosion of the fundamental principle of English Company Law that a company is to be regarded as a legal entity with a separate legal personality, distinct from that of its members. However, the case has highlighted potential alternative sources of liability for parent companies establishing wholly owned single-purpose subsidiaries - in many industry sectors, including shipping, property and big-ticket asset finance.

### The basic principles

The principle of separate corporate personality has been established for over a century. In the leading case of *Salomon -v- Salomon & Co.* (1897), the House of Lords held that, regardless of the extent of a particular shareholder's interest in the company, and notwithstanding that such shareholder had sole control of the company's affairs as its governing director, the company's acts were not his acts; nor were its liabilities his liabilities. Thus, the fact that one shareholder controls all, or virtually all, the shares in a company is not a sufficient reason for ignoring the legal personality of the company; on the contrary, the "veil of incorporation" will not be lifted so as to attribute the rights or liabilities of a company to its shareholders.

The basic principle established in *Salomon* in relation to single companies was extended to groups of companies by a comparatively recent decision of the Court of Appeal in *Adams -v- Cape Industries PLC* (1990). In that case, the Court of Appeal held that, as a matter of law, it was not entitled to lift the corporate veil against a defendant company, which was a member of a corporate group, merely because the corporate structure had been used so as to ensure that the legal liability in respect of particular future activities of the group would fall on another member of the group rather than on the defendant company. In effect, the Court of Appeal rejected the argument that the corporate veil should be pierced just because a group of companies operated as a single economic entity.

### Related principles and considerations

A corollary of the basic *Salomon* principle is that a company cannot be characterised as an agent of its shareholders unless there is clear evidence to show that the company was in fact acting as an agent in a particular transaction or series of transactions. The mere fact that one company is the subsidiary of another (even a wholly-owned subsidiary) is not of itself sufficient to make that subsidiary an agent of its holding company.

However, it should be borne in mind that:-

- for the purposes of liability to U.K. taxation, the U.K. Tax Authorities will in certain circumstances seek to impose liability on a parent company on the basis that it is carrying on business in the U.K. through a subsidiary acting as its agent or constituting a "permanent establishment"<sup>1</sup> within the meaning of the relevant Double Tax Treaty;

- directors of a company can be held personally liable in certain circumstances if it can be established that there has been "fraudulent trading" 1 and/or "wrongful trading" 1 under Sections 213 and/or 214, Insolvency Act 1986;

- a parent company can in certain circumstances be categorised as a "shadow director" 1 of its subsidiary if the board of directors of the subsidiary is not free, and seen to be free, to come to its own decisions as to the conduct of the subsidiary's affairs.

Exceptions to the basic principles / further exceptions or inroads?

Notwithstanding these basic principles of separate corporate personality, there are certain situations where the English Courts have shown themselves willing to "lift the veil of incorporation" - i.e. to ignore or set aside the separate legal personality of a company.

In particular, the Courts will not allow the corporate form to be used:-

- for the purposes of fraud or dishonestly for the express purpose of depriving a claimant of the ability to exercise his lawful rights;
- as a mere device or sham to evade a contractual or other legal obligation;
- as a mere façade to conceal the true facts; or
- otherwise where it is established that there has been dishonesty or abuse of the corporate form.

Various attempts have been made to convince the Courts that the circumstances warranting the piercing of the corporate veil ought to be broadened. A clear attempt of this kind was made in *Trustor AB -v- Smallbone and Others* (2001); but, whilst holding that the corporate veil could be pierced on the grounds that one of the recognised exceptions had been established, the Court upheld the strict approach adopted in previous cases by refusing to acknowledge any further exceptions to the basic principles.