

Company Law Essay

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‘Salomon v Salomon is an outdated case with little
relevance to modern company law.’

Discuss.

*Salomon v Salomon*¹ served to establish the principle of corporate personality that ‘forms the cornerstone of company law.’² It is my contention that despite various attempts by both the legislature and the judiciary to circumvent the principle, this ‘cornerstone’ has not been eroded, rather, it forms the very foundations of modern company law.

Salomon v Salomon was and still is a landmark case. By confirming the legitimacy of Mr Salomon’s company the House of Lords put forward the concept of separate corporate personality and limited liability. Inextricably linked with this *ratio* is an acknowledgement of the importance of certainty within the law, thus separate corporate personality becomes a concrete principle to which the law must adhere.

Salomon v Salomon is followed in subsequent cases, notably *Macaura v Northern Assurance Co.*³ and *Lee v Lee’s Air Farming Ltd*⁴. These cases highlight the reality of the separate corporate identity and take it a step further in stressing the distinction between a company’s identity and that of its shareholders. In effect Salomon’s principle as confirmed by *Macaura v Northern Assurance Co.* and *Lee v Lee’s Air Farming Ltd.* helps form an image of a corporation as a ‘depersonalised conception’⁵, an object that is ‘cleansed and emptied of its shareholders.’⁶

Yet the concept of an incorporated company as a separate legal person causes some difficulties, for surely all ‘legal personality is in a sense fiction’.⁷ Questions soon arise as to the exact nature of this legal personality, and consequently measures are taken to

¹ [1897] AC 22

² Sealy (1996) p54

³ [1925] AC 619

⁴ [1961] AC 12

⁵ P. Ireland et al (1987) 14 JLS 149

⁶ P.Ireland supra.

⁷ Farrar (1998) chap. 7

mitigate its effects. Although a corporation is, as per Lord Halsbury, to ‘be treated like any other person with its rights and liabilities appropriate to itself’¹ this is surely impossible. The idea of a separate legal person has been pushed to its limits, and despite a corporation being capable of some crime - whereby the mental state of a person who is ‘the directing mind and will’ of a corporation is attached to the corporation itself² - it cannot logically be capable of committing personal offences such as rape nor can it be imprisoned. Thus there remain notable differences between corporate personality and independent personality in the human sense of the word as we know it. The difference forms one of the main reasons why exceptions to the separate entity principle exist. For instance in order to establish the nationality of a company the courts look to its directors and members not merely where the company was incorporated.³ This in fact serves two differing purposes: for the ascribing of a nationality to a corporation serves to highlight its independent personality, yet simultaneously a nationality cannot be ascribed without looking to outside factors such as the nationality of directors and as such it becomes apparent that this identity is not purely independent. The other main reason as according to Pickering⁴ is that to do with potential abuse of the corporate form.

The fact that Mr Salomon paid off existing creditors before incorporating his business is of imperative importance. Due to this it was accepted that his intentions for incorporation were neither fraudulent nor intended to avoid existing legal obligations. Yet inherent within the separate entity and limited liability principles is potential for abuse by shrewd entrepreneurs. It becomes possible to use the corporate vehicle as a means for avoiding liabilities and duties. In a modern age whereby the corporate group is in existence, it also

¹ *Salomon v Salomon*

² *Lennards Carrying Co Ltd v Asiatic Petroleum Co.* [1915] AC 153

³ As occurred in *Daimler v Continental Tyres* [1915] 1 KB 893.

⁴ As quoted by F. Moghadam in QMWLJ 1 p36.

becomes possible for a parent company to set up a subsidiary company in order to transfer its liabilities, and then declare the subsidiary company bankrupt thereby leaving creditors out in the cold. It is this potential for injustice and abuse of the corporate form that has led to the mitigation of the Salomon principle by what has become known as ‘lifting the corporate veil.’

A flood of case law permeates this area of company law. Academics such as Farrar argue that lifting the veil of incorporation has not been done in any sort of systematic way; and that despite there being broad policy reasons for refusing to recognise some companies as separate entities there is no one unifying principle underlying all of this. Whereas Gallagher and Zeigler (1990) argue that all interventionist judgements that lift the corporate veil are in actual fact based on the courts perception of justice and its refusal to allow injustice occur by adoption of the corporate form. The Salomon principle was (as mentioned earlier) based on good faith, and thus it is not logically possible that the House of Lords intended to establish a means for legal fraud. Thereby it is of no surprise that the veil has been lifted in circumstances where recognition of the separate entity principle would be used as an engine of fraud.¹ This has further been consolidated by legislation in the form of the fraudulent² and wrongful³ trading provisions of the Insolvency Act 1986.

The Salomon principle has led to a lot of debate with regards to what has become known as the single economic unit. Sometimes corporate groups with various subsidiaries that are in essence all separate legal entities will not be considered as such. Instead the court will have regard to the economic framework of the group as a whole. As per Goff LJ, as

¹ e.g. *Gilford Motor Co. v Horne* [1933] Ch.935

² S.213

³ S.214

he was then, the court will look to the ‘realities of the situation’¹ to pierce the corporate veil. Yet the decision here in *DHN Foods* to disregard the separate legal identity of all companies involved and to recognise them as one main company, based mainly on economic arguments has not been followed enthusiastically by the Courts. Indeed the Court of Appeal in the later case of *Multinational Gas and Petroleum Co v Multinational Gas and Petroleum Services Ltd*² indicates that *DHN Foods* was an aberration.³ This question was considered further in *Adams v Cape Industries*⁴ where it was decided that each company in a group is a separate legal entity unless there was some justification for the single economic unit argument in the wording of a particular statute or contract. This ‘conservative’⁵ restatement of the separate entity principle shows the courts willingness to stick by Salomon’s principle. Further cases have reasserted the importance of the separate entity principle as enunciated in *Salomon v Salomon* and reasserted in *Adams v Cape Industries*, notably the decisions in *Re Polly Peck International Plc (In Administration)*⁶, *Yukong Line Ltd of Korea v Rendsberg*⁷, and *Ord v Belhaven*⁸. Inherent within these decisions and undoubtedly linked to the question of corporate group structure is the question of justice.

In 1985 the Court of Appeal told us in *Re A Company*⁹ that the Court will pierce the corporate veil in order to achieve justice. However there seems to be a change of attitude and direction by the 1990’s, whereby *Adams v Cape Industries* seems to resist further attempts to erode the Salomon principle, promoting certainty at the expense of justice.

¹ *D.H.N Food Distributors v Tower Hamlets L.B.C* ([1976] 3 All ER 462)

² [1983] 3 WLR 492.

³ cf. Gallagher and Zeigler 1990

⁴ [1991] 1 All ER 929

⁵ Farrar

⁶ [1996] 2 All ER 433

⁷ [1998] 1 All ER 929

⁸ [1998] BCLC 447

⁹ [1985] BCLC 333 at p337.

We are informed that ‘..save in cases which turn on the wording of particular statutes or contracts, the court is not free to disregard the principle of Salomon merely because it considers that justice so requires.’¹ The judgements in *Re Polly Peck*, and *Yukong v Rendsberg* reiterate this non-interventionist stance despite scope for perceived injustice. The earlier case of *Creasey v Beachwood Motors Ltd*² that saw the corporate veil being lifted in order to prevent a company’s attempt at avoiding to settle an unfair dismissal claim, was set aside in *Ord v Belhaven*. The case of *Williams v Natural Life Health Foods*³ serves to reiterate the separate entity and limited liability principles, by highlighting the difficulty in lifting the corporate veil in order to sue the Managing Director. Thus we see a return in the 1990’s to the Salomon principle and its ardour for certainty.

Of paramount importance to this certainty is the detail of timing: timing in relation to the setting up of new corporations and timing in relation to switching assets around between these corporations. It becomes apparent that asset restructuring is of no problem whatsoever as long as it is clear that its purpose is not to evade pre existing legal duties.⁴ Thus if asset restructuring is planned and its timing does not appear cunning, then the courts will not consider the corporate group as one legal entity.

One recent anomaly must however be mentioned. The decision in *Connelly v RTZ*⁵ seems to disregard all of this and the corporate veil is lifted in favour of justice. It is my contention that following recent case law such as *Re Polly Peck* and *Yukong v Rendsberg*, the *Connelly v RTZ* decision is merely an aberration and notice must be had to the

¹ p536.

² [1993] BCLC 480

³ [1998] 1 WLR 830

⁴ Cf *Ord v Belhaven*.

⁵ [1998] AC 854

composition of the House of Lords at this time. Undoubtedly future judicial decisions will in fact clarify the situation, however I am of the belief that this case, with its departure from the commercial principle of certainty is not likely to be followed.

Thus recent case law points to the importance of the Salomon principle in that companies will be regarded as separate legal entities with their own liabilities and obligations unless there seem obvious reasons to disregard the corporate veil. When I say obvious I refer to reasoning that would allow fraud. Judicial decisions have varied with time, choosing to follow Salomon, then disregard it by lifting the corporate veil and now more recently to show their allegiance to Salomon once more. Legislative measures are in fact based on technicalities¹ or the prevention of wrongdoing i.e. fraud. Inextricably linked within this is a concern for justice; yet I feel this only extends as far as to include notions of commercial wrongdoing that strategically plan to defraud others by evading liabilities and obligations. For surely the whole notion of incorporation carries with it notions of risk taking and it would be impossible to protect against all of this. The judicial emphasis on certainty is the right one, for in a commercial world full of risky transactions the notion of justice becomes a subjective one and thus the clearer notion of certainty becomes more important. Corporations are therefore separate legal entities of their own as far as logically possible and this corporate veil will only be lifted in times of necessity to expose 'sham' companies and wrongful dealing.² Since *Salomon v Salomon* the courts and the legislature have not stood still, yet rather than eroding this cornerstone they have merely reinforced its importance for modern company law and fortified its foundations by not allowing it to be used to evade legal obligations.

¹ Cf S.24 Companies Act 1985

² cf. S213, 214 Insolvency Act 1986.

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