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Mendelsohn, James

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Wisdom of Salomon

Courts rarely lift the veil between a company and its owners and directors, whatever the justice of the case. **James Mendelsohn** outlines when limited exceptions to the rule are made

A COMPANY IS a separate legal entity, distinct from its shareholders and directors. Shareholders are not liable for a company's debts, only for unpaid amounts on their shares.

In *Salomon v A Salomon & Co Ltd* [1897] AC 22 (HL), Aaron Salomon held 20,001 of 20,007 shares in the company and was the sole director. Nevertheless, the court refused to 'lift the veil' between the company and Salomon – he was not personally liable to the insolvent company's creditors. Similarly, holding companies are not liable for the debts of subsidiaries, nor are companies within the same group liable for each others' debts (*The Albazero* [1977] AC 774).

This principle sometimes appears perverse. In *Creasey v Breachwood Motors* [1992] BCC 638, two companies had identical directors and shareholders. Company A's assets were deliberately transferred to company B, leaving Creasey with a worthless judgment against company A, his former employer.

The judge substituted company B as defendant. Although seemingly fair and practical, *Creasey* was overruled in *Ord v Belhaven Pubs* [1998] 2 BCLC 447 (CA), a case with similar facts. Statute and the courts only lift the veil in exceptional circumstances, not merely because 'justice so requires'.

Enemy state

The Trading with the Enemy Act 1939 criminalises wartime trade with the 'enemy'. The definition of 'enemy' includes an English-registered company controlled by citizens of an enemy state. This erodes the usual distinction between a company and its members or directors. Such statutory exceptions are rare. So too are cases where the courts lift the veil. These are categorised in *Adams v Cape Industries plc* [1990] Ch 433 (CA).

Cape Industries plc was an English-registered holding company, with Texan subsidiaries. Adams won judgments in Texas against one of Cape's subsidiaries, and sought to enforce these judgments against Cape, the holding company, in England. Affirming *Salomon*, the court distinguished the holding company from its subsidiaries.



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Lifting the veil: courts will be reluctant to look behind a company

The court said that the judgments would only be enforced in England if Adams could show that Cape (as opposed to its subsidiaries) was 'present' in Texas, and that Cape's business (as opposed to the business of its subsidiaries) was conducted there. Adams advanced three arguments which, although unsuccessful in *Cape* itself, nevertheless usefully group the cases where the courts have lifted the veil.

Adams argued, unsuccessfully, that the Texan companies were agents for Cape, which should therefore be made liable for their debts. In contrast, in *Smith Stone & Knight Ltd v Birmingham Corporation* [1939] 4 All ER 116, the parent company and its directors held all the shares in the subsidiary. The subsidiary's profits were treated as the parent's profits; the subsidiary had no real independent existence. The court found an agency relationship between parent and subsidiary and lifted the veil. The particular facts in each case will determine whether such a relationship exists.

Adams also argued, unsuccessfully, that Cape and its subsidiaries were really one economic unit. This argument derived from *DHN Food Distributors Ltd v London Borough of Tower Hamlets* [1976] 1 WLR 852 (CA). A parent company operated from premises owned by its subsidiary. Following compulsory purchase of these premises by the council, the parent's business folded.

In order to claim compensation, the parent company had to show that it (as opposed to its subsidiary) owned the premises. The court held that the parent and subsidiary should be

treated as one, and therefore the parent should receive compensation.

However, *DHN* was questioned in the similar case of *Woolfsion v Strathclyde Regional Council* [1978] SLT 159 (HL), and also in *Ord*. Although *DHN* has never been formally overruled, only brave lawyers will now cite it.

Sham exception

This was the third argument used, unsuccessfully, by Adams. Elsewhere, however, the courts have lifted the veil where the company has been used as a 'sham' to evade prior obligations.

In *Gilford Motor Co Ltd v Horne* [1933] Ch 935 (CA), Horne was employed by Gilford. He covenanted not to solicit Gilford's customers upon leaving. He left Gilford and set up a limited company which operated a similar business. The new company solicited Gilford's customers. Gilford sued for breach of covenant.

The court awarded an injunction against both Horne and his company, which was described as 'a device, a stratagem... a cloak or a sham, to engage in business... in respect of which... the plaintiffs might object'. In *Trustor AB v Smallbone (No2)* [2001] All ER 987, judgment was made both against a director who had misappropriated Trustor's funds, and against the separate company – the 'façade' – to which he had made unauthorised payments.

Elsewhere, the usual rule prevails, even if the court is vaguely sympathetic. In *Re Lewis's Will Trusts* [1984] 3 All ER 930, Lewis transferred his farm to a company in which he held a 75% shareholding. In his will he purported to leave the farm to his son. The will failed, as at his death the farm was not his to bequeath.

Salomon outlines that there is a 'veil' between a company and its members. This veil will only be lifted (i) where statute so requires; or (ii) where one of the categories in *Cape* applies, particularly where the court considers the company to be a 'sham'. Otherwise, the general rule will prevail.

James Mendelsohn teaches company law at the University of Huddersfield