Table 1.2

	Small	*Medium-sized*
Aggregate turnover	£5.6 m (net) or less *or* £6.72 m (gross) or less	£22.8 m (net) or less *or* £27.36 m (gross) or less
Aggregate balance sheet total	£2.8 m (net) or less *or* £3.36 m (gross) or less	£11.4 m (net) or less *or* £13.68 m (gross) or less
Number of employees	50 (average) or less	250 (average) or less

In the case of a small or medium-sized group, the average number of persons that the company employs can now be calculated on a monthly average basis instead of a weekly average as before.

Where a parent company is not exempt and, therefore, is required to prepare group accounts, it is not required to file a profit and loss account with the annual accounts. However, where a small or medium-sized company is exempt but chooses voluntarily to prepare group accounts, it must file a profit and loss account. It is not able to take advantage of the exemption because it is not 'required' to prepare group accounts.

Exemptions inapplicable

A group is ineligible if any of the companies in it is a plc (listed or unlisted) or a company carrying on an insurance market activity or an authorised person under the Financial Services and Markets Act 2000 (though see earlier comment on this point for small groups). A special auditors' report is required for accounts delivered to the Registrar when small and medium-sized companies and groups take advantage of the exemptions referred to above. The purpose of the report is to say that the company concerned is entitled to them. This report is not required where the company has taken advantage of the audit exemption referred to below.

Criteria for exemption

Under s 477, the following conditions must apply in respect of the financial year:

- The company must qualify as a small company though even where it does it need not take advantage of the exemption and can have an audit.
- For these companies:
  (a) turnover must not be more than £5.6 million, and
  (b) the balance sheet total (assets) must not be more than £2.8 million.
- The company must not at any time during the financial year have been an ineligible company, for example:
  (a) a public company (listed or unlisted);
  (b) a parent or a subsidiary undertaking unless a member of a small group (see below) or where the subsidiary is dormant (s 249A(1A), (1B) and (1C));
  (c) a company carrying on an insurance market activity;
  (d) an authorised person or appointed representative under the Financial Services and Markets Act 2000 (subject to exceptions considered above in regard to accounting exemptions);

(e) a trade union special registered body under the Trade Union and Labour Relations (Consolidation) Act 1992, s 117(1), which are treated as corporate entities.

Members holding 10 per cent or more of the issued share capital (or any class thereof) may require the company to have an audit for the financial year by depositing a written notice at the company's registered office not later than one month before the year end.

Audit exemption and small groups

A parent or non-dormant subsidiary company can claim exemption from audit if the group of which it is a member satisfies all of the following conditions throughout the financial year into which the period of group membership falls (s 479):

- the group qualifies as a small group for the purposes of s 479 and is not at the time of preparing accounts or at any time in the financial year an ineligible group (see above);
- the group's aggregate turnover in that year is not more than £5.6 million net (or £6.72 million gross);
- the group's aggregate balance sheet total for that year is not more than £2.8 million net (or £3.36 million gross).

Effect on dormant companies

Exemption from audit is available to small dormant companies that are not ineligible under the dormant company provisions (see below) or the audit exemption procedure. Dormant companies automatically qualify by being dormant and so long as 10 per cent of the members do not request an audit (s 480).

Disclosure in annual report and accounts

The balance sheet of a company taking advantage of the relevant audit exemptions must include a statement to the effect that:

- the company is eligible to claim the exemption;
- no notice has been deposited at the company's registered office by members holding 10 per cent or more of the issued capital (or a class thereof) requiring that the company shall have an audit for the financial year; and
- the directors acknowledge their responsibilities for:
  (a) ensuring that the company keeps proper accounting records; and
  (b) preparing accounts which give a true and fair view.

The statement must appear on the face of the balance sheet above the signature required by s 414 (i.e. by a director of the company on behalf of the board). The name of the signatory must also be stated.

Format of accounts

Even if the accounts are not audited they should comply with the provisions of the Companies Act 2006. The format should follow the relevant regulations as issued by the Secretary of State.

References to audit in the articles

Companies with articles based on the 1985 version of *Table A* are unlikely to have problems in dispensing with the audit requirement since the 1985 version does not impose an obligation to appoint auditors. Article 130 of *Table A* to the 1948 Act does and companies with that or a similar article should review the contents of their articles to see that they are not precluded from implementing the audit exemption. Furthermore, Article 127 which requires that the accounts be sent to members accompanied by an auditor's report will also require amendment.

No such problems arise with companies adopting their relevant Model Articles for the Companies Act 2006.

Dormant companies

When is a company dormant? Under s 480 a company is dormant if:

- it has been dormant since its formation; or
- it has been dormant since the end of the previous financial year; and
- it is a small company; and
- it is not required to prepare group accounts;
- during the dormant period there have been no significant accounting transactions that, by s 386, are required to be entered in the company's accounting records.

Transactions that are exempt from the above and do not prevent dormant status are transactions arising from the taking of shares in the company by a subscriber to the memorandum as a result of an undertaking in the memorandum, a fee to the Registrar of Companies on a change of name under s 78, a fee to the Registrar on the re-registration of a company under the Companies Act 2006 (e.g. limited to unlimited), a penalty under s 453 for failure to deliver accounts, or a fee for the registration of the annual return under Part 24 of the Companies Act 2006.

Ineligible companies

A company cannot be regarded as dormant if it is ineligible in terms already considered for audit and accounting exemptions. However, a public company can qualify as a dormant company if it meets the basic s 249AA requirements and is a small company but cannot prepare small company accounts because of its public company status (see s 249AA(2)(a)) or because it is a member of an ineligible group. This means that free-standing public limited companies may have dormant status. If they are members of an ineligible group because the group contains one or more plcs, they may become dormant only if they are subsidiaries. Parent companies cannot be dormant because no company can be dormant under the general definition (see above) if it is required to prepare group accounts. Examples of transactions which could prevent dormant status are as follows:

- bank charges even where the account is inactive;
- payment of audit fee for the audit of the last period during which the company traded.

The problem can be solved by, say, a holding company or an individual paying the relevant fees.

Loss of exemption

The directors, or failing them the members, must appoint auditors if the company ceases to be dormant or otherwise becomes ineligible. Details of the method of appointment appear in s 388A, which should be referred to.

Form of dormant accounts

The accounts must include:

- A profit and loss account but only if the company traded in the previous period, the comparative figures being put in.
- A directors' report to include a statement that the company has not traded during the financial year. It should also state, if relevant, that a profit and loss account has not been prepared for the year.
- In place of the previous requirement on directors to make a statement on the balance sheet that the company has been dormant throughout the year, they must now make the following statements which bring them into line with the requirements on other trading audit exempt companies:
  1. For the year ended . . . the company was entitled to exemption under s 480 of the Companies Act 2006.
  2. Members have not required the company to obtain an audit of its accounts for the year in question in accordance with s 476.
  3. The directors acknowledge their responsibility for:
     (a) ensuring that the company keeps accounting records which comply with s 386; and
     (b) preparing accounts which give a true and fair view of the state of the affairs of the company as at the end of its financial year in accordance.

Standard format for accounts

Provided the company has been dormant since it was incorporated, it may use Companies House Form DCA to file its accounts. The form which is available free is only suitable for dormant companies where the only transaction has been the issue of subscribers' shares and the company is not a subsidiary.

A dormant company can file abbreviated accounts in which case there is no need to file the directors' report or the comparative profit and loss account if applicable.

Articles of association

The company's articles should be referred to. Articles 127 and 130 of *Table A* to the Companies Act 1948 require the appointment of auditors unless altered by special (or written) resolution. There is no similar provision in *Table A* to the Companies Act 1985 or in the Companies Act 2006 Model Articles.

Provisions of company law applicable to dormant companies

These are as follows:

(a) rights to receive or demand copies of accounts and reports under ss 423 and 431 continue but there is obviously no need for an auditors' report if there is no audit;
(b) it is not necessary to lay or circulate a copy of the auditors' report if there is one nor deliver a copy to the Registrar.

Dormant companies: agency arrangements

It is common in a wide variety of businesses to operate under agency arrangements where the agent company has no economic interest in the transactions but merely brings together the principal company and the third party into a contractual arrangement. Where the agency is disclosed to the third party, no entries need to be made in the agent company's accounting records and it may submit dormant company accounts. If the agency is not disclosed, the agent company should record the transactions in its records and, therefore, cannot submit dormant company accounts. Where the agency is disclosed, the agent company will have to submit memorandum accounts to the principal and will therefore need to record transactions but this does not give rise to entries in its own records and so it can be regarded as dormant.

Dormant companies that act as agents must disclose this in their annual accounts. This applies also to the abbreviated accounts.

Distinctions between a public and a private company

(a) As we have seen, a private company need have only one director and need not have a secretary; a public company must have at least two directors and a secretary. The secretary of a private company, if one is appointed, need not be qualified in the terms required of a secretary of a public company (see s 273).
(b) In a private company two or more directors may be appointed by a single resolution. In a public limited company they must be voted on as individuals (see s 160).
(c) *As regards registration*. The name of a public company must include 'public limited company' or 'plc'. A private limited company's name must only include 'limited' or 'Ltd'. Furthermore, a public company can only commence business and borrow on the issue of a s 761 certificate by the Registrar of Companies, whereas a private company can commence business and borrow on incorporation.
(d) *As regards share capital*. The minimum allotted share capital of a public company is £50,000, whereas there is no minimum capital requirement for a private company. A public company has an unrestricted right to offer shares or debentures to the public, whereas this is prohibited in the case of a private company. The pre-emption rights of the 2006 Act apply to public companies which must offer equity share capital first to existing shareholders. These provisions apply also to a private company though they may be excluded by the articles. Under s 656 where a public company has lost half or more of its share capital it must call a general meeting, whereas this provision is not applicable to private companies. Finally, as regards a lien or charge on its own shares, this is restricted in the case of public companies by s 670 (see Chapter 11). The provisions are not applicable to private companies which may take a lien or charge on their shares.

See p. 226

(e) *As regards payment for shares*. In the case of public companies, any agreement under which shares are to be allotted by an undertaking to carry out work or perform services is prohibited (s 585) but is allowed in the case of private companies. The subscribers to the memorandum of a public company must pay for their shares in cash, whereas in a

private company payment may be in cash or some other consideration. In public companies there is a minimum payment for shares whenever issued (i.e. at least one-quarter of the nominal value plus the whole of any share premium must be paid up), but in private companies there is no minimum payment requirement. Where shares are to be paid for by a non-cash asset, public companies are required to ensure that the asset is to be transferred by contract within five years of the allotment, whereas there is no special requirement for private companies. Furthermore, public companies must have an independent accountant's report on the value of the non-cash asset used as consideration for an issue of shares. This requirement does not apply to private companies.

(f) *Acquisition of non-cash assets*. A public company cannot validly acquire non-cash assets valued at one-tenth or more of the company's issued share capital from subscribers to the memorandum in the first two years of its existence as such unless an independent accountant's report is received and the members approve by ordinary resolution. These restrictions do not apply to private companies.

(g) *As regards distribution of profits and assets*. Where interim accounts are used to support a proposed distribution these accounts must, in the case of a public company, be filed with the Registrar of Companies, whereas there is no filing requirement for private companies. Private companies need only fulfil the basic requirement of profits available for distribution. Public companies must also comply with the capital maintenance rule whereas private companies need not (see further Chapters 8 and 9).

See p. 162

(h) *As regards loans to directors, etc*. Quasi-loans and credit transactions, etc. for directors and the directors of the company's holding company are prohibited with certain exceptions in the case of public companies, as are loans, etc. to persons connected with the directors and the directors of any holding company. Quasi-loans and credit are not so restricted in private companies nor are, in general, such dealings with connected persons (see further Chapter 17).

See p. 334

(i) An essential feature of more recent company legislation has been the move towards the deregulation of private companies. In particular, company legislation now provides for written resolutions of private companies which can be passed by members without the need to call or hold a meeting. Private companies may also opt out of the audit requirement. These matters are considered in more detail in appropriate parts of the text.

Limited and unlimited companies

A registered company may be:

(a) Limited by shares

First it should be noted that limitation of liability refers to the members and not to the company itself. The liability of the company is always unlimited in the sense that it must discharge its liabilities so long as it has assets to do so.

Limitation of liability by shares may occur on formation, i.e. the company is registered as such. Where this is so the liability of each member to contribute to the capital of the company is limited to the nominal value of the shares that he has agreed to take up or, if he has agreed to take up such shares at a premium (i.e. at more than their nominal value), to the total amount agreed to be paid for such shares. Once the member has paid the company for his shares, his liability is discharged completely and he cannot be made responsible for making up the deficiencies of the company or of other shareholders. Furthermore, he has no liability

whatever in respect of unissued shares. Indeed, in ***Re Baglan Hall Colliery Co*** (1870) LR 5 Ch App 346, Giffard LJ stated that it 'is the policy of the Companies Act to enable business people to incorporate their businesses and so avoid incurring further personal liability'.

However, in the case of a small private company, the advantages of limited liability tend to be illusory, since those who give the company a significant amount of credit and bank overdraft facilities will in practice require personal guarantees from its directors and major shareholders.

(b) Limited by guarantee

Formerly, companies limited by guarantee could be registered with or without a share capital. Companies limited by guarantee with a share capital may now not be registered, though, of course, companies which had registered with a share capital before the 1985 Act forbade this remain in existence. Since they cannot now have a share capital, they must of necessity be formed as private companies because the presence of a share capital is fundamental to the definition of a public company. Where there is no share capital the members have no liability unless and until the company goes into liquidation. When this happens those who are members at the time are required if necessary to contribute towards the payment of the company's debts and liabilities and the costs of winding-up in accordance with the guarantee. The amount guaranteed will be whatever sum is stated in the statement of guarantee on formation and it is frequently a small sum such as £100, although in some cases the agreed liability may be substantial and much depends upon the type of company.

The guarantee is not an asset of the company but a mere contingent liability of its members until winding-up. Consequently it cannot be charged by the company as a security nor can it be increased or reduced by an alteration of the memorandum or by agreement with the members or by any procedure equivalent to the increase or reduction of share capital (***Hennessy*** v ***National Agricultural and Industrial Development Association*** [1947] IR 159).

If those who are members at the date of winding-up cannot meet their obligations under the guarantee or the debts exceed what they are liable to contribute, then the liquidator may have access to those who were members during the year prior to the commencement of the winding-up but only in respect of debts and liabilities incurred while they were members.

If a company limited by guarantee has a share capital, its members have two liabilities. They must pay the issue price of their shares, and must honour their guarantee in the event of the company being liquidated (Insolvency Act 1986, s 74(3)). There is no benefit to the company in having such a dual liability and in practice companies limited by guarantee with a share capital were not formed. The device of the guarantee company is only used where no share capital is to be issued but the members of the company wish to limit their liability to contribute towards the company's debts and liabilities. Obviously, the members are not shareholders (except in some of the earlier companies) and membership will often be acquired by application. Provision is usually made in the articles for a member to resign. These companies provide a suitable organisation for professional bodies and trade associations which have not received a Royal Charter, particularly since under certain circumstances there is no need to show the word 'limited' – which denotes commerciality – as part of the name (see further Chapter 3).

See p. 79

Once incorporated as a guarantee company, there is no provision in company legislation for re-registration as a company limited by shares or vice versa.

It is worth noting that each member has one vote at general meetings (s 284) and is entitled to appoint a proxy to represent him (see s 324).

As regards accounts and audit, accounts must be prepared and audited, and filed at Companies House. The audit report is similar to that required for other companies but is addressed to the members, not the shareholders. The audit exemption is available as for other companies on the turnover, etc., basis.

(c) Unlimited

The personal liability of members of this type of company is the reason why not many of them exist. They are sometimes formed by those who wish to keep the company's accounts away from the public gaze (see below). In addition, there are advantages in having separate corporate status and perpetual succession even though these are not accompanied by limited liability.

Unlimited companies must be private companies since a public company is by definition a company limited by shares (or by guarantee with a share capital).

Unlimited companies may be formed as such, either with or without a share capital. A share capital may be used, for example, if the company is trading and making profits, since the shares are a basis for the distribution of that profit. As regards liability, where there is a share capital, the members must, even while the company is a going concern, pay for their shares in full, and if on a liquidation this is not adequate to satisfy all the debts and liabilities of the company together with the costs of winding-up, the members must contribute rateably according to the nominal value of their shareholding. Where there is no share capital, the members contribute equally until all the debts and liabilities of the company plus the costs of winding-up are paid. In the event of any members defaulting the others are liable to make good the deficiency as much as is necessary to pay the whole of the company's liabilities and the costs of liquidation.

If the members at the time of commencement of the winding-up cannot collectively contribute enough to pay off the debts and liabilities, the liquidator can go to those who were members during the 12 months prior to winding-up, but only in respect of debts incurred while they were members.

Special features of unlimited companies

There are certain special features relating to unlimited companies. For example, an unlimited company may reduce its capital by extinguishing liability on partly paid shares or even repaying capital to the members by passing a special resolution to that effect and the permission of the court is not required. In addition, although an unlimited company cannot issue redeemable shares it may, if its articles permit, reduce its capital by buying back the shares of its members even from out of its capital.

These practices, in theory at least, do not reduce the funds available to creditors on a winding-up because the members are liable to pay the debts and liabilities of the company in full on winding-up. However, as regards reduction of capital by purchase of shares, if the company knew at the time of purchase that the members would not be able to meet their liabilities on winding-up, the purchase would be set aside as a fraud on the creditors (***Mitchell* v *City of Glasgow Bank*** (1879) 4 App Cas 624).

See p. 162

It will be noted in Chapter 8 that the difference between the unlimited company and the private limited company are not now so marked in terms of reduction of share capital, and purchase by the company of its own shares, because of de-regulation features in the

Companies Act 2006. For example, under a new procedure in s 641, private companies may pass a special resolution to reduce capital without an application to the court.

In addition, an unlimited company enjoys privacy in regard to its financial affairs because it need not deliver copies of its annual accounts and the relevant reports to the Registrar (s 448), not even abridged or modified ones, though it must, under s 431, prepare audited accounts for its members unless it has taken the audit exemption when unaudited accounts will suffice.

However, the price of privacy is the unlimited liability of its members. The provision in regard to the annual accounts does not apply if the company concerned is a subsidiary or holding company of a limited company or is potentially under the control of two or more limited companies, including a foreign company, because of share or voting rights which they hold even though these have not been exercised in concert for the purposes of control.

European company

The EU Council (formerly the Council of Ministers) reached agreement on 20 December 2000 on the legislative framework necessary to establish a European Company Statute. The legislation came into force on 8 October 2004. Under the statute, a European Company, called a *Societas Europaea* (SE), will operate on a Europe-wide basis governed by Community law directly applicable in all member states. The statute provides for the creation of European companies in one of four ways:

1 by merging two or more existing public companies from at least two different member states;
2 by forming a holding company promoted by public or private limited companies from at least two different member states;
3 by forming a subsidiary of companies from at least two member states;
4 by the conversion of a public limited company which for at least two years had a subsidiary in another member state.

Each SE will be registered on the same register as national companies. Registration will be in the member state in which the SE has its administrative head office. SEs do not have to have a public quotation. The minimum capital requirement is 120,000 ECUs to enable medium-sized companies from different member states to create a SE.

The creation of a SE requires negotiations on worker involvement. If it is not possible to negotiate a satisfactory arrangement with worker representatives, a set of standard principles laid down in an annexe to the legislation will apply. Employment contracts and pensions are subject to national law in the member states where headquarters operate. The European Public Limited-Liability Company Regulations 2004 (SI 2004/2326) implement the above materials in the UK from 8 October 2004.

The idea is not new but has been held up for some 25 years because of the question of no worker participation in business decisions in the UK. However, this was changed from 6 April 2005 when employers with at least 150 employees became obliged to inform and consult with employees on certain of these matters under the Information and Consultation of Employees Regulations 2004 (SI 2004/3462). This was extended to employers with at least 100 employees from 6 April 2007 and to those with at least 50 from 6 April 2008. The application form for registration of an SE requires confirmation to be given that employee participation procedures are in place.

Lifting the corporate veil

The principle set out in ***Salomon*** v ***Salomon & Co Ltd*** (1897) (i.e. that a body corporate is a separate entity, separate that is from its members), led to the use of the phrase 'the veil of incorporation', which is said to hang between the company and its members and, in law at least, act as a screen between them.

However, the principle can cause difficulty and in a number of cases is lifted by the law so that the human and commercial reality behind the corporate personality can be taken account of. The veil may be lifted by the judiciary or by statute.

The judiciary

It is difficult to be precise about the circumstances in which a judge will lift the corporate veil. However, what is clear is that on occasions the ***Salomon*** decision has caused problems and the courts have had to remove the veil of incorporation to enable them to see the commercial reality behind the corporate personality. But, it is important to bear in mind that there are only a few examples of the courts removing the veil of incorporation. The overriding concern is to protect the corporate form; there is a great reluctance by the courts to depart from the ***Salomon*** principle.

Yet, it is clear that the courts will remove the veil of incorporation in cases where the incorporator is trying to avoid an obligation or achieve an unfair advantage. In other words, where there is an abuse of the corporate form. There are some occasions where it is clear that the courts will 'remove' the veil, yet the important thing to remember is that any list, including the one that follows, is not exhaustive and it is not known where the boundary lies between a court lifting/removing a veil of incorporation and leaving it intact. One of, if not *the* important case, in this area is that of ***Adams*** v ***Cape Industries***.

Adams v ***Cape Industries plc*** [1990] Ch 433, CA

Until 1979, Cape, an English company, mined and marketed asbestos. Its worldwide marketing subsidiary was another English company, Capasco. It also had a US marketing subsidiary incorporated in Illinois, NAAC. In 1974, some 462 plaintiffs sued Cape, Capasco, NAAC and others in Tyler, Texas, for personal injuries allegedly arising from the installation of asbestos in a factory. These actions were settled. Between 1978 and 1979, a further 206 similar actions were commenced and default judgments entered against Cape and Capasco. In 1978, NAAC ceased to carry on business and other subsidiaries replaced it. The plaintiffs sought to enforce the judgments in England. The defendants denied that the Texas court had jurisdiction over them for the purposes of English law.

Held – by the Court of Appeal – that the defendants were neither present within the USA, nor had they submitted to the jurisdiction there. The method of computing damages of the individual plaintiffs was contrary to the English law concept of natural justice. Accordingly, the actions would be dismissed. Slade LJ stated:

> **The 'single economic unit' argument**
>
> There is no general principle that all companies in a group of companies are to be regarded as one. On the contrary, the fundamental principle is that 'each company in a group of companies (a relatively

modern concept) is a separate legal entity possessed of separate legal rights and liabilities': The Albazero [1977] AC 774, 807, *per* Roskill LJ.

It is thus indisputable that each of Cape, Capasco, NAAC and CPC were in law separate legal entities. Mr Morison did not go so far as to submit that the very fact of the parent–subsidiary relationship existing between Cape and NAAC rendered Cape or Capasco present in Illinois. Nevertheless, he submitted that the court will, in appropriate circumstances, ignore the distinction in law between members of a group of companies treating them as one, and that broadly speaking, it will do so whenever it considers that justice so demands. In support of this submission, he referred us to a number of authorities . . .

Principally, in reliance on those authorities and the case next to be mentioned, Mr Morison submitted that in deciding whether a company had rendered itself subject to the jurisdiction of a foreign court it is entirely reasonable to approach the question by reference to 'commercial reality'. The risk of litigation in a foreign court, in his submission, is part of the price which those who conduct extensive business activities within the territorial jurisdiction of that court properly have to pay . . .

We have some sympathy with Mr Morison's submissions in this context. To the layman at least the distinction between the case where a company itself trades in a foreign country and the case where it trades in a foreign country through a subsidiary, whose activities it has full power to control, may seem a slender one . . . It is not surprising that in many cases such as ***Holdsworth*** [1955] 1 WLR 352, ***Scottish Co-operative*** [1959] AC 324, ***Revlon*** [1980] FSR 85 and ***Commercial Solvents*** [1974] ECR 223, the wording of a particular statute or contract has been held to justify the treatment of parent and subsidiary as one unit, at least for some purposes. The relevant parts of the judgments in the ***DHN*** case [1976] 1 WLR 852 must, we think, likewise be regarded as decisions on the relevant statutory provisions for compensation, even though these parts were somewhat broadly expressed, and the correctness of the decision was doubted by the House of Lords in ***Woolfson* v *Strathclyde Regional Council*** 1978 SLT 159 in a passage which will be quoted below.

Mr Morison described the theme of all these cases as being that where legal technicalities would produce injustice in cases involving members of a group of companies, such technicalities should not be allowed to prevail. We do not think that the cases relied on go nearly so far as this. As Sir Godfray submitted, save in cases which turn on the wording of particular statutes or contracts, the court is not free to disregard the principle of ***Salomon* v *A. Salomon & Co Ltd*** [1897] AC 22 merely because it considers that justice so requires. Our law, for better or worse, recognises the creation of subsidiary companies, which though in one sense the creatures of their parent companies, will nevertheless under the general law fall to be treated as separate legal entities with all the rights and liabilities which would normally attach to separate legal entities.

In deciding whether a company is present in a foreign country by a subsidiary, which is itself present in that country, the court is entitled, indeed bound, to investigate the relationship between the parent and the subsidiary. In particular, that relationship may be relevant in determining whether the subsidiary was acting as the parent's agent and, if so, on what terms. In ***Firestone Tyre and Rubber Co Ltd* v *Lewellin*** [1957] 1 WLR 464 (which was referred to by Scott J) the House of Lords upheld an assessment to tax on the footing that, on the facts, the business both of the parent and subsidiary were carried on by the subsidiary as agent for the parent. However, there is no presumption of any such agency. There is no presumption that the subsidiary is the parent company's alter ego. In the court below the judge, ante, p. 484B, refused an invitation to infer that there existed an agency agreement between Cape and NAAC comparable to that which had previously existed between Cape and Capasco and that refusal is not challenged on this appeal. If a company chooses to arrange the affairs of its group in such a way that the business carried on in a particular foreign country is the business of its subsidiary and not its own, it is, in our judgment, entitled to do so. Neither in this class of case nor in any other class of case is it open to this court to disregard the principle of ***Salomon* v *A Salomon & Co Ltd*** [1897] AC 22 merely because it considers it just so to do . . .

The 'corporate veil' point

Quite apart from cases where statute or contract permits a broad interpretation to be given to references to members of a group of companies, there is one well-recognised exception to the rule

prohibiting the piercing of 'the corporate veil'. Lord Keith of Kinkel referred to this principle in ***Woolfson*** v ***Strathclyde Regional Council***, 1978 SLT 159 in the course of a speech with which Lord Wilberforce, Lord Fraser of Tullybelton and Lord Russell of Killowen agreed. With reference to the ***DHN*** decision [1976] 1 ***WLR*** 852, he said, at p. 161: 'I have some doubts whether in this respect the Court of Appeal properly applied the principle that it is appropriate to pierce the corporate veil only where special circumstances exist indicating that it is a mere façade concealing the true facts'. . .

Mr Morison submitted that the court will lift the corporate veil where a defendant by the device of a corporate structure attempts to evade (i) limitations imposed on his conduct by law; (ii) such rights of relief against him as third parties already possess; and (iii) such rights of relief as third parties may in the future acquire. Assuming that the first and second of these three conditions will suffice in law to justify such a course, neither of them applies in the present case. It is not suggested that the arrangements involved any actual or potential illegality or were intended to deprive anyone of their existing rights. Whether or not such a course deserves moral approval, there was nothing illegal as such in Cape arranging its affairs (whether by the use of subsidiaries or otherwise) so as to attract the minimum publicity to its involvement in the sale of Cape asbestos in the United States of America. As to condition (iii), we do not accept as a matter of law that the court is entitled to lift the corporate veil as against a defendant company which is the member of a corporate group merely because the corporate structure has been used so as to ensure that the legal liability (if any) in respect of particular future activities of the group (and correspondingly the risk of enforcement of that liability) will fall on another member of the group rather than the defendant company. Whether or not this is desirable, the right to use a corporate structure in this manner is inherent in our corporate law. Mr Morison urged on us that the purpose of the operation was in substance that Cape would have the practical benefit of the group's asbestos trade in the United States of America without the risks of tortious liability. This may be so. However, in our judgment, Cape was in law entitled to organise the group's affairs in that manner and (save in the case of AMC to which special considerations apply) to expect that the court would apply the principle of ***Salomon*** v ***A Salomon*** in the ordinary way [. . .] We reject the 'corporate veil' argument . . .

The 'agency argument' in relation to NAAC

We now proceed to consider the agency argument in relation to NAAC on the footing, which we consider to be the correct one, that NAAC must for all relevant purposes be regarded as a legal entity separate from Cape/Capasco . . .

Having regard to the legal principles stated earlier in this judgment, and looking at the facts of the case overall, our conclusion is that the judge was right to hold that the business carried on by NAAC was exclusively its own business, not the business of Cape or Capasco, and that Cape and Capasco were not present within the United States of America, through NAAC at any material time. We see no sufficient grounds for disturbing this finding of fact.

Comment

For the purpose of enforcement of a foreign judgment, the defendant would only be regarded as falling under the jurisdiction of the foreign court where it was present within the jurisdiction or had submitted to such jurisdiction.

It may be said that the judiciary's power to lift the veil is a tactic used by the courts in a flexible way so as to counter fraud, sharp practice, oppression and illegality. In ***Conway* v *Ratiu*** [2006] 1 All ER 571, Auld LJ noted the 'readiness of the courts, regardless of the precise issue involved, to draw back the corporate veil to do justice when common sense and reality demand it'. However, this view must be tempered by the vast amount of case law in the area which indicates that the judiciary's focus is upon safeguarding the corporate form and preventing fraudulent practice as opposed to dispensing 'justice for all' via this avenue (see below). As noted earlier in this chapter, there is no substitute for reading the academic articles in this area which are outlined at the end of this chapter. Examples of special areas of application are as follows:

(a) Abuse of the corporate form

One of the fundamental areas where the courts appear willing to lift the corporate veil is where the corporate form is being used as a 'façade', 'sham' or as a 'mask' so as to evade existing liabilities or to defeat the law.

Here the courts have been prepared to investigate sharp practice by individuals who are trying to hide behind a company front. Thus, in ***Gilford Motor Co* v *Horne*** [1933] Ch 935 a former employee bound by a restraint of trade set up a company in order to evade its provisions, claiming that he as a person might be bound by the restraint but the company, being a separate entity, could not be. An injunction to prevent solicitation of Gilford's customers was granted against both him and his company which the court described as 'a device, a stratagem [. . .] a mere cloak or sham'. In this regard, Lord Hanworth MR observed:

> Farwell J heard the evidence about that company and had these documents before him. He says this: 'The defendant company is a company which, on the evidence before me, is obviously carried on wholly by the defendant Horne. Mrs Horne, one of the directors, is not, so far as any evidence I have had before me, taking any part in the business or the management of the business. The son, whose initials are "J M", is engaged in a subordinate position in that company, and the other director, Howard, is an employee of the company. As one of the witnesses said in the witness-box, in all dealings which he had had with the defendant company the "boss" or the "guvnor", whichever term is the appropriate one, was the defendant Horne, and I have not any doubt on the evidence I have had before me that the defendant company was the channel through which the defendant Horne was carrying on his business. Of course, in law the defendant company is a separate entity from the defendant Horne, but I cannot help feeling quite convinced that at any rate one of the reasons for the creation of that company was the fear of Mr Horne that he might commit breaches of the covenant in carrying on the business, as, for instance, in sending out circulars as he was doing, and that he might possibly avoid that liability if he did it through the defendant company. There is no doubt that the defendant company has sent out circulars to persons who were at the crucial time customers of the plaintiff company.'
>
> Now I have recalled that portion of the judgment of Farwell J, and I wish in clear terms to say that I agree with every word of it. I am quite satisfied that this company was formed as a device, a stratagem, in order to mask the effective carrying on of a business of Mr E B Horne. The purpose of it was to try to enable him, under what is a cloak or a sham, to engage in business which, on consideration of the agreement which had been sent to him just about seven days before the company was incorporated, was a business in respect of which he had a fear that the plaintiffs might intervene and object.
>
> Now this action is brought by the plaintiffs, the Gilford Motor Company Ltd, to enforce the terms of clause 9 of the agreement of 30 May 1929, on the ground that the defendant Horne, and the company, as his agent and under his direction, have committed breaches of the covenant which I have read.

Jones* v *Lipman [1962] 1 All ER 442

Lipman sold a house to Jones but ultimately refused to complete the sale. In order to ensure that he would not have to sell the house to Jones, Lipman executed a sham transfer of the house to a company controlled by him (which was in fact a shelf company he had purchased) just before completion of the sale contract to Jones. Lipman and a clerk of his solicitors were the only shareholders and directors. Jones applied under Ord 14a for specific performance against Lipman and the company.

Held – specific performance should be ordered against both. Russell J stated:

> The defendant company is the creature of the first defendant, a device and a sham, a mask which he holds before his face in an attempt to avoid recognition by the eye of equity. The case cited illustrates that an equitable remedy is rightly to be granted directly against the creature in such circumstances [. . .] The proper order to make is an order on both the defendants specifically to perform the agreement between the plaintiffs and the first defendant.

Wallersteiner* v *Moir [1974] 3 All ER 217

In 1967, the plaintiff (Dr Wallersteiner), a financier, issued a writ claiming damages from the defendant (Mr Moir) for libel contained in a circular letter sent out by the defendant, alleging a series of unlawful activities on the part of the plaintiff. The defendant served a defence whereby he also counterclaimed for breaches of the Companies Act 1948 s 54 and s 190, and claimed declarations that the plaintiff had been guilty of fraud. The plaintiff failed to deliver a reply or defence to counterclaim. Nevertheless, he used the proceedings to stop investigation into his conduct by the company at meetings, on the grounds that the matter was *sub judice*.

Held – the plaintiff's delays were 'intentional and contumelious and the proceedings could not be used as a gag to prevent discussion'. The action for libel should be struck out, and there would be judgment on the counterclaim. Lord Denning MR took the opportunity to make the following observations with respect to the corporate veil:

> Mr Browne-Wilkinson, as *amicus curiae*, suggested that all these various concerns were used by Dr Wallersteiner as a façade: so that each could be treated as his alter ego. Each was in reality Dr Wallersteiner wearing another hat. Mr Lincoln, for Dr Wallersteiner, repudiated this suggestion. It was quite wrong, he said, to pierce the corporate veil. The principle enunciated in ***Salomon* v *Salomon*** was sacrosanct. If we were to treat each of these concerns as being Dr Wallersteiner himself under another hat, we should not, he said, be lifting a corner of the corporate veil. We should be sending it up in flames.
>
> I am prepared to accept that the English concerns were distinct legal entities [. . .] 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. At any rate, it was up to him to show that anyone else had a say in their affairs and he never did so.

(b) Groups of companies: the human and commercial reality of the group

The court has, on occasion, lifted the veil of incorporation to allow a group of companies to be regarded as one, because in reality they were not independent either in human or commercial terms.

Re Hellenic and General Trust Ltd [1975] 3 All ER 382

A company called MIT was a wholly-owned subsidiary of Hambros Ltd and held 53 per cent of the ordinary shares of Hellenic. A scheme of arrangement was put forward under which Hambros was to acquire all the ordinary shares of Hellenic for a cash consideration of 48p per share. The ordinary shareholders including MIT met and over 80 per cent approved the scheme, MIT voting

in support. However, the National Bank of Greece, which was a minority shareholder, opposed the scheme because it would be liable to meet a heavy tax burden under Greek law as a result of receipt of cash for its shares. Templeman J refused to approve the scheme on a number of grounds. However, the one which interests us here is that he ruled that there should have been a separate class meeting of ordinary shareholders excluding MIT; thus, in effect, regarding the holding company, Hambros, and the subsidiary, MIT, as one economic unit in the class meeting and not two independent companies with independent interests.

DHN Food Distributors v *Tower Hamlets London Borough Council*
[1976] 3 All ER 462

DHN Food Distributors (DHN) was a holding company which ran its business through two wholly-owned subsidiaries, Bronze Investments Ltd (Bronze) and DHN Food Transport Ltd (Transport). The group collected food from the docks and distributed it to retail outlets. Bronze owned the premises in Bow from which the business was conducted and Transport ran the distribution side of the business. Tower Hamlets compulsorily acquired the premises in Bow for the purpose of building houses. This power of compulsory acquisition arose under the Housing Act 1957 and compensation was payable under the Land Compensation Act of 1961 under two headings: (*a*) the value of the land; and (*b*) disturbance of business. Tower Hamlets was prepared to pay £360,000 for the value of the land but refused to pay on the second heading because DHN and Transport had no interest in the land. This was unfortunate for the group as a whole since the loss of the premises had caused all three companies to go into liquidation, it being impossible to find other suitable premises. The practical answer would have been, of course, to have conveyed the premises from Bronze to DHN when compulsory acquisition was threatened. This had not been done, although the conveyance would have been exempt from stamp duty since it would have been a transfer between associated companies. However, Lord Denning in the Court of Appeal drew aside the corporate veil and treated DHN as owners of the property whereupon Tower Hamlets became liable to pay for disturbance of business. The basis of Lord Denning's judgment was that company legislation required group accounts and to that extent recognised a group entity which he felt the judiciary should do also. Lord Denning did not feel that it was necessary to imply an agency between the holding and subsidiary company.

Lord Denning observed 'This case might be called the "Three in one". Three companies in one. Alternatively, the "One in three", one group of three companies', going on to note:

> . . . A further very interesting point was raised by Mr Dobry on company law. We all know that in many respects a group of companies are treated together for the purpose of general accounts, balance sheet, and profit and loss account. They are treated as one concern. Professor Gower in *Modern Company Law*, 3rd edn (1969), p 216 says: 'there is evidence of a general tendency to ignore the separate legal entities of various companies within a group, and to look instead at the economic entity of the whole group.'
>
> This is especially the case when a parent company owns all the shares of the subsidiaries – so much so that it can control every movement of the subsidiaries. These subsidiaries are bound hand and foot to the parent company and must do just what the parent company says. A striking instance is the decision of the House of Lords in ***Harold Holdsworth & Co. (Wakefield) Ltd*** v ***Caddies*** [1955] 1 W.L.R. 352. So here. This group is virtually the same as a partnership in which all the three companies are partners. 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. The three companies should, for present purposes, be treated as one, and the parent company DHN should be treated as that one. So DHN are entitled to claim compensation accordingly. It was not necessary for them to go through a conveyancing device to get it.

> I realise that the President of the Lands Tribunal, in view of previous cases, felt it necessary to decide as he did. But now that the matter has been fully discussed in this court, we must decide differently from him. These companies as a group are entitled to compensation not only for the value of the land, but also compensation for disturbance. I would allow the appeal accordingly.

Comment

(i) It cannot be said from this case that there is a general principle of group entity. Much depends upon the circumstances of the case. Thus, in ***Woolfson* v *Strathclyde Regional Council*** (1978) 38 P & CR 521 the House of Lords did not follow DHN Foods in what was a similar situation because in Woolfson the subsidiaries were active trading companies and not, as in DHN Foods, mere shells. Again, in ***Multinational Gas and Petrochemical Co* v *Multinational Gas and Petrochemical Services Ltd*** [1983] 2 All ER 563 the Court of Appeal held, following ***Salomon***, that wholly owned subsidiaries in a group were separate entities and not the agents of the holding company or each other in the absence of a specific agency agreement. Furthermore, in ***Dimbleby & Sons Ltd* v *NUJ*** [1984] 1 All ER 751, a group of companies was regarded as a series of separate entities so that the picketing of one company within the group by workers employed by another company within the group was regarded as unlawful secondary picketing for the purposes of s 17 of the Employment Act 1980. (See now s 224 of the Trade Union and Labour Relations (Consolidation) Act 1992.)

(ii) Additional examples in the group situation are to be found in ***Re H and Others*** [1996] 2 All ER 391 where in an action by Customs and Excise to restrain defendants who had been charged with various offences of evading excise duty from dealing with assets pending trial the Court of Appeal was prepared to restrain subsidiary companies' assets, refusing to regard the companies as separate entities under the ***Salomon*** rule even though the evasions were alleged to have been committed by the holding company. However, in ***Re Polly Peck International plc (In Administration)*** [1996] 2 All ER 433 the High Court applied the ***Salomon*** rule in a corporate insolvency, holding that the separate legal existence of group companies was important where the companies were creditors of the holding company and each wished to make a separate claim in the holding company's insolvency and be paid what is called a dividend on that claim.

(iii) More recently, the court has drawn aside the corporate veil in order that the defence of justification to a claim for defamation could succeed. See ***Ratiu & Regent House Properties*** (below).

Ratiu & Regent House Properties* v *Conway [2006] 1 All ER 571

Regent instructed Mr Conway, a solicitor, to act in the purchase and development of a site in London and related matters. Mr Conway's retainer was with the subsidiary. Relationships deteriorated when Mr Conway made a bid for a property in competition with Regent. Following this, Regent made an allegation of misconduct in regard to his proposed property purchase in that he was in breach of his fiduciary duty to Regent. Mr Conway brought a claim for defamation against Regent, contending that his fiduciary duty was owed only to the subsidiary and not to Regent.

Regent defended the claim on the basis of justification (i.e. that the allegations they had made were true because Mr Conway owed Regent a duty of care as a fiduciary as well as the subsidiary and that duty of care had been broken as regards Regent also. That, of course, was not the contractual position and to accept that fiduciary duties were owed to Regent it was necessary for the court to draw aside the corporate veil in favour of Regent and so sustain its defence. This the Court of Appeal did. It found that throughout the relevant period, Regent had been the 'moving spirit' behind the relevant transactions. In reality, said the court, Mr Conway well knew that his client was Regent and that the subsidiary was merely a vehicle controlled by Regent. Mr Conway was in breach of a fiduciary duty to Regent. The decision of the jury in the lower court that Regent's defence of justification failed was set aside.

The current approach was set down by Robert Goff LJ in ***Bank of Tokyo Ltd*** v ***Karoon*** [1987] AC 45, stating 'Counsel suggested beguilingly that it would be technical for us to distinguish between parent company and subsidiary in this context; economically, he said, they were one. But we are concerned not with economics but with law. The distinction between the two is, in law, fundamental and cannot be abridged.'

(c) Groups of companies: the concept of agency

The concept of agency has sometimes been used by the courts under which a subsidiary is regarded as the agent of its holding company, even though there is no agency agreement as such between them in regard to the transaction concerned. The effect is that transactions entered into by a subsidiary are regarded as those of the holding company for which the holding company is liable. This doctrine has been implemented for purposes of liability to tax.

Firestone Tyre & Rubber Co Ltd v ***Lewellin*** [1957] 1 All ER 561

An American company formed a wholly owned subsidiary in England to manufacture and sell its brand of tyres in Europe. The American company negotiated agreements with European distributors under which the latter would place orders with the American company which the English subsidiary would carry out. In fact, the distributors sent their orders to the subsidiary direct and the orders were met without any consultation with the American company. The subsidiary received the money for the tyres sold to the distributors and, after deducting its manufacturing expenses plus 5 per cent, it forwarded the balance of the money to the American company. All the directors of the subsidiary resided in England (except one who was the president of the American company) and they managed the subsidiary's affairs free from day-to-day control by the American company.

Held – by the House of Lords – that the American company was carrying on business in England through its English subsidiary acting as its agent and it was consequently liable to pay United Kingdom tax.

Comment

(i) The principle of presumed agency, or agency in fact, of the subsidiary was used in ***Smith, Stone & Knight Ltd*** v ***Birmingham Corporation*** [1939] 4 All ER 116. Premises belonging to Smith, Stone were compulsorily acquired by the Corporation. The question to be resolved was whether the business of waste paper merchants, for which the premises were used, was carried on by Smith, Stone or by its subsidiary, Birmingham Waste Co Ltd. This was vital because an owner/occupier could get compensation, but a tenant/occupier like the waste company could not. The court decided that the waste company occupied the premises as a mere agent of Smith, Stone because, among other things, it was a wholly owned subsidiary and the directors were the same in both companies. Smith, Stone was entitled to compensation. This case can be distinguished from ***DHN Food Distributors*** because, as we have seen in the ***DHN*** case, Lord Denning did not find it necessary to imply an agency.

(ii) The theories of the economic reality of the group and the implied agency approach have not been used to control abuses in the area of holding and subsidiary companies in regard to trade creditors. If a subsidiary is insolvent, only public and stock market opinion prevents the holding company from liquidating the subsidiary leaving its creditors' claims unsatisfied even though the group as a whole is solvent. In some cases even public and market opinion and criticism do not prevent it. The EC Ninth Directive, which has yet to be implemented, does in certain situations make the dominant company within the group liable for losses incurred by a dependent company.

(d) Illegality

The courts have been prepared to draw aside the veil of incorporation in order to establish that a company was owned by nationals of an enemy country so that to do business with it would be illegal because it would be trading with the enemy.

Daimler Co Ltd* v *Continental Tyre & Rubber Co (Great Britain) Ltd
[1916] 2 AC 307

After the outbreak of war with Germany, the tyre company, which was registered in England and had its registered office there, sued the Daimler Company for money due in respect of goods supplied to Daimler before the outbreak of war. Daimler's defence was that, since the tyre company's members and officers were German, to pay the debt would be to trade with the enemy, and that, therefore, the claim by the tyre company should be struck out, i.e. not allowed to go to trial. Evidence showed that all the members of the tyre company save one were German. The secretary of the company, who held one share, lived in England and was a British subject. He brought the action in the name of, and on behalf of, the company. Lord Parker of Waddington stated:

> No one can question that a corporation is a legal person distinct from its corporators; that the relation of a shareholder to a company, which is limited by shares, is not in itself the relation of principal and agent or the reverse; that the assets of the company belong to it and the acts of its servants and agents are its acts, while its shareholders, as such, have no property in the assets and no personal responsibility for those acts. The law on the subject is clearly laid down in a passage in Lord Halsbury's judgment in ***Salomon* v *Salomon & Co*** 'I am simply here', he says, 'dealing with the provisions of the statute, and it seems to me to be essential to the artificial creation that the law should recognise only that artificial existence – quite apart from the motives or conduct of individual corporators. . . . Short of such proof' – i.e., proof in appropriate proceedings that the company had no real legal existence – 'it seems to me impossible to dispute that once the company is legally incorporated it must be treated like any other independent person with its rights and liabilities appropriate to itself, and that the motives of those who took part in the formation of the company are absolutely irrelevant in discussing what those rights and liabilities are.' I do not think, however, that it is a necessary corollary of this reasoning to say that the character of its corporators must be irrelevant to the character of the company; and this is crucial, for the rule against trading with the enemy depends upon enemy character.
>
> A natural person, though an English-born subject of His Majesty, may bear an enemy character and be under liability and disability as such by adhering to His Majesty's enemies. If he gives them active aid, he is a traitor; but he may fall far short of that and still be invested with enemy character. If he has what is known in prize law as a commercial domicil among the King's enemies, his merchandise is good prize at sea, just as if it belonged to a subject of the enemy Power. Not only actively, but passively, he may bring himself under the same disability. Voluntary residence among the enemy, however passive or pacific he may be, identifies an English subject with His Majesty's foes. I do not think it necessary to cite authority for these well-known propositions, nor do I doubt that, if they had seemed material to the Court of Appeal, they would have been accepted.
>
> How are such rules to be applied to an artificial person, incorporated by forms of law? As far as active adherence to the enemy goes, there can be no difference, except such as arises from the fact that a company's acts are those of its servants and agents acting within the scope of their authority. An illustration of the application of such rules to a company (as it happens a company of neutral incorporation, which is an a fortiori case) is to be found in ***Netherlands South African Ry Co* v *Fisher***.
>
> In the case of an artificial person what is the analogue to voluntary residence among the King's enemies? Its impersonality can hardly put it in a better position than a natural person and lead to its being unaffected by anything equivalent to residence. It is only by a figure of speech that a company can be said to have a nationality or residence at all. If the place of its incorporation under municipal

law fixes its residence, then its residence cannot be changed, which is almost a contradiction in terms, and in the case of a company residence must correspond to the birthplace and country of natural allegiance in the case of a living person, and not to residence or commercial domicil. Nevertheless, enemy character depends on these last. It would seem, therefore, logically to follow that, in transferring the application of the rule against trading with the enemy from natural to artificial persons, something more than the mere place or country of registration or incorporation must be looked at.

My Lords, I think that the analogy is to be found in control, an idea which, if not very familiar in law, is of capital importance and is very well understood in commerce and finance. The acts of a company's organs, its directors, managers, secretary, and so forth, functioning within the scope of their authority, are the company's acts and may invest it definitively with enemy character. It seems to me that similarly the character of those who can make and unmake those officers, dictate their conduct mediately or immediately, prescribe their duties and call them to account, may also be material in a question of the enemy character of the company. If not definite and conclusive, it must at least be prima facie relevant, as raising a presumption that those who are purporting to act in the name of the company are, in fact, under the control of those whom it is their interest to satisfy. Certainly I have found no authority to the contrary. Such a view reconciles the positions of natural and artificial persons in this regard, and the opposite view leads to the paradoxical result that the King's enemies, who chance during war to constitute the entire body of corporators in a company registered in England, thereby pass out of the range of legal vision, and, instead, the corporation, which in itself is incapable of loyalty, or enmity, or residence, or of anything but bare existence in contemplation of law and registration under some system of law, takes their place for almost the most important of all purposes, that of being classed among the King's friends or among his foes in time of war.

What is involved in the decision of the Court of Appeal is that, for all purposes to which the character and not merely the rights and powers of an artificial person are material, the personalities of the natural persons, who are its corporators, are to be ignored. An impassable line is drawn between the one person and the others. When the law is concerned with the artificial person, it is to know nothing of the natural persons who constitute and control it. In questions of property and capacity, of acts done and rights acquired or liabilities assumed thereby, this may be always true. Certainly it is so for the most part. But the character in which property is held, and the character in which the capacity to act is enjoyed and acts are done, are not in pari materia. The latter character is a quality of the company itself, and conditions its capacities and its acts. It is not a mere part of its energies or acquisitions, and if that character must be derivable not from the circumstances of its incorporation which arises once for all, but from qualities of enmity and amity, which are dependent on the chances of peace or war and are attributable only to human beings, I know not from what human beings that character should be derived, in cases where the active conduct of the company's officers has not already decided the matter, if resort is not to be had to the predominant character of its shareholders and corporators . . .

Held – by the House of Lords – that the action must be struck out. Although the place of registration and the situation of the registered office normally governs the company's nationality and domicile for the purposes of actions at law, the court has a jurisdiction to draw aside the corporate veil in some cases to see who the persons in control of the company's affairs are. If, as here, the persons in actual control of the company were enemy aliens, the company could be so regarded for the purposes of the law relating to trading with the enemy.

(e) The personal relationship company

A breakdown in the management of the company or the complete exclusion of a member director from participation in management have been redressed by winding up the company on the just and equitable ground by regarding the company as in fact, if not in form, a partnership.

Ebrahimi* v *Westbourne Galleries [1972] 2 All ER 492

Since 1945 Mr Ebrahimi and Mr Nazar had carried on a partnership which dealt in Persian and other carpets. They shared equally the management and profits. In 1958 they formed a private company carrying on the same business and were appointed its first directors. Soon after the company's formation, Mr George Nazar, Mr Nazar's son, was made a third director. By reason of their shareholdings, Mr Nazar and George had the majority of votes at general meetings. The company made good profits, all of which were distributed as directors' remuneration and no dividend was ever paid. In 1969 Mr Ebrahimi was removed from the position of director by a resolution at a general meeting in pursuance of what is now s 168. Mr Ebrahimi presented a petition seeking an order under s 210 of the Companies Act 1948 (see now s 994, 2006 Act) that Mr Nazar and George should purchase his shares or, alternatively, an order under what is now s 122(1)(g) of the Insolvency Act 1986 that the company be wound up. At first instance Plowman J refused the order under s 210 because the oppression alleged was against Mr Ebrahimi in his capacity as director and not that as member. However, the petition for a compulsory winding-up was granted because, in the opinion of Plowman J, it was just and equitable that the company should be wound up. The Court of Appeal affirmed the decision of Plowman J under s 210 but dismissed the petition for a compulsory winding-up, regarding it as an unjustifiable innovation in the company situation. On further appeal, the House of Lords reversed the Court of Appeal and restored the decision of Plowman J that an order for winding-up should be made. The major points arising from the case are as follows:

(a) The majority shareholders, Mr Nazar and George, had made use of their undisputed right under what is now s 168, CA 2006 to remove a director, namely Mr Ebrahimi. Could such use of a statutory right be a ground for making a compulsory winding-up order under what is now s 122(1)(g) of the Insolvency Act 1986? In other words, could the exercise of a legal right be regarded as contravening the rules of equity which are the basis of what is now s 122(1)(g)?
(b) The House of Lords answered these questions in the affirmative, at least for companies founded on a personal relationship, i.e. for companies which in essence were partnerships, though in form they had assumed the character of a company: '[. . .] a limited company is more than a mere judicial entity, with a personality in law of its own: [. . .] there is room in company law for recognition of the fact that behind it, or amongst it, there are individuals, with rights, expectations and obligations *inter se* which are not necessarily submerged in the company structure. That structure is defined by the Companies Act [. . .] and by the articles of association by which shareholders agree to be bound. In most companies and in most contexts, this definition is sufficient and exhaustive, equally so whether the company is large or small. The "just and equitable" provision does not, as the respondents suggest, entitle one party to disregard the obligations he assumes by entering a company, nor the court to dispense him from it. It does, as equity always does, enable the court to subject the exercise of legal rights to equitable considerations; considerations, that is, of a personal character, arising between one individual and another, which may make it unjust, or inequitable, to insist on legal rights, or to exercise them in a particular way', said Lord Wilberforce.
(c) The decision makes an important contribution to the movement for harmonisation of European company law. The concept of the private company founded on a personal relationship has been approximated to the continental European concept. For example, it is accepted in Germany and France that the private company is a special association and not merely a variety of a general concept of companies and they are governed by different enactments.
(d) The partnership analogy is an example of the drawing aside of the corporate veil, i.e. treating a company as a partnership. Once this has been done, partnership law applies and under this each general (not salaried) partner is, in the absence of contrary agreement, entitled to a say in management (see Partnership Act 1890, s 24(5)). The same is true of a limited liability partnership under Reg 7 of the Limited Liability Partnership Regulations 2001. Furthermore, the definition

of partnership requires that the partners be in business 'in common' which they obviously are not if one or more of them is deprived of a say in management. A general partner who is deprived of a say in management is, in the absence of a contrary agreement, entitled to dissolve the firm.

However, the partnership analogy would not necessarily be applied to all private companies. The analogy is most likely to be used where, as in the ***Westbourne*** case, the proprietors (members) and the managers (directors) are one and the same, as full general partners in a partnership are.

Comment

See p. 312

(i) For the possibility, in more recent times, of using the more versatile remedy of 'unfair prejudice' under s 994, see Chapter 16.

See p. 328

(ii) It should also be noted that the Nazars did not offer to buy Mr Ebrahimi's shares. If they had done so, e.g. at a fair price to be decided by the company's auditors, the court may not have wound the company up so that Mr Ebrahimi could get his share capital back. A pretty drastic remedy, though, to wind up a solvent company just to achieve this (see also Chapter 16).

Statutory provisions

A good starting point for the discussion of such statutory provisions is Lord Diplock's statement in ***Dimbleby & Sons Ltd*** v ***National Union of Journalists*** [1984] 1 WLR 427 when he observed: 'The corporate veil in the case of companies incorporated under the Companies Acts is drawn by statute and it can be pierced by some other statute if such statute so provides; but, in view of its raison d'etre and its constant recognition by the courts since ***Salomon*** v ***A. Salomon & Co Ltd***, one would expect that any parliamentary intention to pierce the corporate veil be expressed in clear and unequivocal language.'

(a) Section 761, Companies Act 2006

It will be recalled that by reason of s 761 a plc cannot commence trading or exercise borrowing powers unless and until it has received a s 761 certificate from the Registrar. If it does so, the transactions are enforceable against the company but if the company fails to meet its obligations within 21 days of being called upon to do so the directors are, under s 767, jointly and severally liable to indemnify a person who has suffered loss or damage by reason of the company's failure to meet its obligations. This is a further example of liability in the directors to pay, e.g. the company's debts, and no proof of fraud is required.

(b) Section 405, Companies Act 2006

This provides that where there is a holding and subsidiary relationship between companies the holding company is required, subject to certain exceptions already referred to, not only to prepare its individual accounts but also group accounts. This suggests that for financial purposes the companies within a group are one.

Finally, there are a number of examples to be found in the law relating to corporate insolvency. Thus, when a company goes into liquidation and the evidence shows that the directors have negligently struggled on for too long with an insolvent company in the hope that things would get better but which has, in the end, gone into insolvent liquidation, there are provisions in the Insolvency Act 1986 under which the directors concerned may, if the company goes into liquidation, be required by the court, on the application of the liquidator, to make such contribution to the company's assets as the court thinks proper. This means in effect that the directors will be paying or helping to pay the company's debts. Further and more detailed