PIERCING THE CORPORATE VEIL: AN INCURSION INTO THE JUDICIAL CONUNDRUM

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Abstract

Once a company is incorporated, it enjoys, by the power of the law, a personality which is distinct from those of the incorporators. This invariably implies that those running the affairs of the company do not incur personal liability in the course of doing so. The same legal might which forms the basis for corporate existence also regulates its purpose to afford protection to those dealing with the company by ensuring that the controllers of those corporations do not use them to pursue improper personal agenda. The courts have shown the willingness to disregard the corporate entity and impose personal liabilities on the controllers when such improprieties occur. The paper examines the judicial authorities especially in South Africa and the United Kingdom. They reveal a significant level of inconsistencies in the exercise of this equitable power of the court. The paper further examines the recent legislative intervention in South Africa and argues that unless specific guidelines are provided by parliament on when the corporate veil could be pierced, the courts will continue to address this issue as a matter of judicial discretion and which is at the root of the inconsistent and conflicting judicial pronouncements in this vital area of corporate governance.

Keywords: Company, Juristic Person, Veil of Incorporation, Common Law, Statute, South Africa, United Kingdom

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1 Introduction

Since the House of Lords affirmation of the distinct legal personality of the company at the twilight of the 19th century in that famous case of *Salomon v A Salomon Co Ltd*,[191] company directors and shareholders have enjoyed almost unassailable immunity from company's transactions at common law. The basis is not far-fetched as the company being a fiction, must act through its human agency. Maintaining a distinction between the personal affairs of the agent and that of the principal ensures that liability is placed where it rightly belongs for conducts executed by one on behalf of the other. But where this principle is interpolated into the relationship between a natural person and a fictitious entity, it would only take the strong arm of the law to preserve that distinction. It is only through the legal mirror that an entity besides a natural person is visualized. The importance of the corporate entity as a medium for investment opportunity for both the small and large income earners provides one of the strongest reasons for preserving the distinction between the corporate entity and the controllers. The directors as such are mere custodians of other persons' investments as expressed in the corporate entity.

The propensity for abuses attendant to such custodial role has been one of the challenges that the law has to contend with in preserving the distinct personality of the company. The law has significantly addressed some of those challenges by laying down rules of conduct expressed as the duties of directors to guide the controllers in the conduct of the companies' affairs. Those duties, including those requiring the directors to act in good faith and in the best interests of the company, avoid conflict of interests, not to make secret profits, and to exercise due care and skill in the management of the company's affairs are fairly well articulated both by the common law and the statute.[192] Their significance in ensuring good corporate governance are not in question. But those rules are simply inadequate to address all circumstances of abuse of power by the controllers as they understandably focus mainly on the relationships between the directors and the company. They do not seem to be of any significance in dealing with those situations where the controllers are hiding behind the veil of the corporate entity to defraud third parties.

[191] [1897] AC 22.
[192] See s 76 of the SA Companies Act 71 of 2008, ss 171-177 of the UK Companies Act 2006.

Over the years, the courts have been at pains in defining the circumstances under which personal liability could be attributed to the controllers where issues of abuse of the legal personality of the company are brought to light. This difficulty is explicable from judicial expressions which reflect the primary roles of the court as the preservation of the distinct entity of the company.[193] But the imperatives of justice as demands by the peculiarities of individual cases, could compel, even in limited cases, judicial denial of the separate identity of the company to ensure a fair protection of all affected interests. The difficulty in arriving at such points of departure from the corporate juristic personality has led to a discombobulated judicial decisions.

The legislature in South Africa has, propelled by the need to streamline the common law bases for disregarding the distinct entity of the company, enacted in the Companies Act of 2008[194] that the only acceptable condition for holding directors personally liable for corporate transactions is on ground of 'unconscionable abuse' of the corporate entity. The Act, which contains a copious definitions of various terms and phrases of similar nature in section 1, inexplicably failed to define the term 'unconscionable abuse'. This failure by the parliament to assign a definite meaning to that term could be construed as an acceptance by the law makers of the absence of any generally acceptable conditions for disregarding the corporate personality of the company. By so doing, the parliament have learnt statutory force rather than resolving the existing judicial conundrum as would be revealed in the proceeding discourse.

2 Corporate Legal Personality Doctrine

Since the enactment of the Companies Act of 1862 in the United Kingdom which broadened the window of opportunities for corporations to run as distinct persons with the shareholders enjoying immunity from the business debts,[195] the courts have continued to uphold the separate personality of the company from the shareholders and the controllers. This approach to the corporate business was epitomized by the House of Lords decision in *Salomon v A Salomon and Co Ltd*,[196] a seminal case which has elicited as much academic criticism as judicial support. The facts of that case which need not be recounted here as they are available in all leading company law textbooks and reports[197] are instructive in the sense of using legal instrumentality to transform what is seemingly a personal business of one man into a corporate body simply by the inclusion of a few members of the man's family in the business and having it registered as required by law. This act of registration alone was all that was needed to place the business on a different platform and confer on it the status of a distinct person, even when the same person still runs the business and takes all the benefits accruing from the business. The statement of Lord Macnaghten in that case unequivocally depicts the judicial attitude towards the corporate device. He said:

> The company is at law a different person altogether from the subscribers to the memorandum; and, though it may be that after incorporation the business is precisely the same as it was before, and the same persons are managers, and the same hands receive the profits, the company is not in law the agent of the subscribers or trustee for them. Nor are the subscribers as members liable, in any shape or form, except to the extent and in the manner provided by the Act.[198]

It was on that basis that the House of Lords declined to hold the person running the business of the company liable for the debts incurred by the company. Perhaps if the decision of the House of Lords had stopped at that point, it would have attracted less criticism, but it went further to hold, and by doing so overruled both the first instance court and the Court of Appeal,[199] that the interest of the secured creditor of the company who was the owner and controller of the company was superior to those of the unsecured creditors who were outsiders to the company. It did not really matter, as stated by Lord Macnaghten, that "the same persons are managers, and the same hands receive the profits". The essential consideration is that the company is now a different person, and that even the controllers must now be seen from the same lance as every other person having dealings with the company. Not even the size of the company is of material essence as the courts have not seen any reason why small, one or two members, company should not enjoy the same benefits of juristic personality as large

[193] See, for instance, *Re Securitibank Ltd (No2)* [1978] 2 NZLR 136 at 159 where Richmond P stated that any suggested departure from the doctrine laid down in *Salomon v A Salomon and Co Ltd* should be watched very carefully.
[194] S 20(9).
[195] The earlier enactments were highly restrictive in their operations. See Joint Stock Companies Act 1844 and Limited Liability Act 1855.
[196] [1897] AC 22.
[197] See for instance, Stephen Girvin, Sandra Frisby and Alastair Hudson, *Charlesworth's Company law 18th ed* (London: Sweet & Maxwell, 2010) at 31.
[198] Supra at 51. Lord Halbury LC said at 30-31 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 promotion of the company are absolutely irrelevant in discussing what those rights and liabilities are.
[199] See *Broderip v Salomon* [1895] 2 Ch 323.

companies merely because there is generally and necessarily a greater degree of direct and personal involvement in management by the shareholders and directors in such small companies.[200]

One of the judicially recognized consequences of the separation of the company from the owner/controller is that the company is deemed to have its own property. This has the effect that even when the owner stands to lose by the destruction of such property, the owner is by law precluded from having insurable interest in that property. Lord Buckmaster set down the parameters for this distinction in *Macuara v Northern Assurance Co Ltd*[201] where he said:

> [N]o shareholder has any right to any item of property owned by the company, for he has no legal or equitable interest therein. He is entitled to a share in the profits while the company continues to carry on business and a share in the distribution of the surplus assets when the company is wound up.

This judicial stance could seem harsh on the owner/controller, but it is also of essence in the furtherance of the concept of limited liability of the company as it seeks to insulate the property of the members from that of the company and puts them beyond the reach of the creditors in times of insolvency.

The principle of separate personality of the company is extended by the courts to group of companies. In *The Albazero*[202] Roskill LJ stated that each company in a group of companies is a separate entity possessed of separate legal rights and liabilities so that the rights of one company in a group cannot be exercised by another company in that group. In *Lonrho v Shell Petroleum Co Ltd*[203] the House of Lords, in preserving the distinct personality of the corporate group, held that the documents of a subsidiary were not in the power of its holding company for the purpose of disclosure in litigation, even when the latter has full ownership and control of the former. The courts were not oblivious of the artificiality embedded in upholding such distinction as shown in *Adams v Cape Industries Plc*[204] where the Court of Appeal, though not persuaded by the argument of counsel, expressed some sympathy with the opinion of counsel as follows:

> We have some sympathy with the submissions of Mr Morison 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.

Having said so, the court preferred to stand by the law even when it may seem absurd to the 'layman' as it proceeded to hold:

> 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.[205]

If indeed the distinction can in reality be said to be a 'slender one' that would be sufficiently assuaging as the distinction actually exists though from a very narrow confine. But the reality is that such a distinction exists only in the imagination of the person making it. However, that is what the law permits.[206] Robert Goff LJ in *Bank of Tokyo Ltd v Karoon*[207] gave credence to this judicial stance by drawing yet another distinction, though a more plausible one, between law and economics where he said:

> Counsel suggested beguilingly that it would be technical for us to distinguish between parent and subsidiary company 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 here be bridged.

Even as fictitious as this distinction may seem, it remains the basis of the English company and insolvency law[208] and has been widely accepted in various jurisdictions including South Africa.[209] Preserving of the distinct

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[200] See *Petrillo v Allmax Nutrition Inc*. 2006 FC 1199 (CanLII) para 33, *Mentmore Manufacturing Co Ltd v National Merchandising Manufacturing Co Inc* (1978) 89 DLR (3d) 195, 22 NR 161 para 25, *Society of Composers, Authors and Music Publishers of Canada v 1007442 Ontario Ltd* 2002 FCT 657 (CanLII) at 9.

[201] [1925] AC 619 at 626-627.

[202] [1977] AC 774 at 807.

[203] [1980] 1 WLR 627

[204] [1991] 1 All ER 929 at 1019.

[205] Ibid.

[206] See *Continental Tyre & Rubber Co (Great Britain) Ltd v Daimler Co Ltd* [1915] 1 KB 813 CA at 916 where Buckley LJ observed that the artificial legal person called the corporation has no physical existence. It exists only in the contemplation of law.

[207] [1986] 3 All ER 468 at 485.

[208] See *Prest v Petrodel Resources Ltd* [2013] UKSC 34 para 8 per Sumption LJ.

personality of the company obviously has some commercial values to the investors. The guarantee of none exposure to future risks and liabilities attendant to corporate operations is one of the most important factors that attracts investors to the corporate entity. The way these companies are run, in some cases by persons other than the investors themselves, makes it inevitable that their attractiveness can only be guaranteed by insulating the investors from business risks attendant to such operations. The more the investors are assured of the security of their personal assets, the greater the prospect of their acceptance of the company as a medium of investment for all levels of income earners.

The courts are, however, alert to the propensity to abuse which the status of the company as a juristic person could be subjected. Those dealing with the company need to be protected against such abuses and improprieties on the part of the controllers and owners of the company to guarantee a fair business climate. The demands for the protection of those dealing with the company compels that at some point the strong arm of the law should project beyond the corporate entity itself to strike at those who control its affairs. However, identifying the circumstances under which this could occur has remained unsettled in the judicial circle.

3 Piercing the Corporate Veil

Upon incorporation of a company, an imaginary veil is placed by the law between the company and its owners and controllers which separates the company's identity from those of the owners and controllers. The real essence of doing so is to insulate or shield the owners and controllers from liabilities for company's debts.[210] But the veil is not an immutable metaphor. There is always room for the courts to circumvent it either in the exercise of judicial discretion or as empowered by statute. Lord Denning MR in *Littlewoods Mail Order Stores Ltd v Inland Revenue Commissioners*[211] alluded to the judicial power to lift the corporate veil where he stated that "[t]he courts can, and often do, pull off the mask. They look to see what really lies behind."

There is no question that the courts can lift the corporate veil, but to suggest that they do so 'often' seems to be an over statement of the exercise of this judicial power. A preponderance of the authorities suggests that the courts are overwhelmingly more inclined to upholding the legal personality of the company than disregarding it. A glimpse of this judicial approach is reflected in the statement of Lord Diplock in *Dimbleby and Sons Ltd v National Union of Journalists*[212] while referring to the statutory power to pierce the corporate veil as follows:

> The 'corporate veil' in the case of companies incorporated under the Companies Act is drawn by statute and it can be pierced by some other statute if such other statute so provides; but in view of its *raison d'etre* and its consistent recognition by the courts since [*Salomon]*, one would expect that any parliamentary intention to pierce the corporate veil would be expressed in clear and unequivocal language.

Understanding that the corporate veil could be lifted is one, but what that exercise actually entails is yet another. Dignam and Lowry[213] referred to different categorisations offered by Ottolenghi[214] such as 'peeping' where the veil is lifted to get member information; 'penetrating' where the veil is disregarded and liability is attributed to the members; 'extending' where a group of companies is treated as one legal entity and; 'ignoring' where the company is not recognized at all. The authors did not find these distinctions or categorisations useful in determining how the courts would deal with this subject matter in the future.

A similar distinction was made by the court in *Atlas Maritime Co SA v Avalon Maritime Ltd, The Coral Rose No 1*[215] where Staughton LJ said:

> To *pierce* the corporate veil is an expression that I would reserve for treating the rights or liabilities or activities of a company as the rights or liabilities or activities of its shareholders. To *lift* the corporate veil or *look behind it*, on the other hand, should mean to have regard to the shareholding in a company [its controllers] for some legal purpose.

In *Pioneer Concrete Services Ltd v Yelnah Pty Ltd*[216] Young J of the Supreme Court of New South Wales considered 'lifting of veil' to mean the act of looking behind the legal personality by the court to the real controllers. In *Ex parte Gore NO and others NNO*[217] Binns-Ward J of the South African High Court, having

209 See *Ex parte Gore NO and others NNO* [2013] 2 All SA 437 (WCC).
210 See *Charlesworth's Company law 18th ed* above note 197 at 31.
211 [1969] 1 WLR 1241 at 1254, [1969] 3 All ER 855 at 861.
212 [1984] 1 WLR 427 at 435.
213 Alan Dignam & John Lowry, *Company Law 8th ed* (Oxford: Oxford University Press, 2012) at 33.
214 S Ottolenghi, "From Peeping Behind the Corporate Veil to Ignoring it Completely" [1990] *Modern Law Review* 338.
215 [1991] 4 All ER 769 CA at 776.
216 [1986] 5 NSWLR 254 (SCNSW) at 264.
217 [2013] 2 All SA 437 (WCC) at 440-441.

reviewed some of the existing authorities, preferred a more pragmatic approach to recourse to metaphor where he stated that "[w]hat is entailed on any approach, whether it be called a "piercing" or a "lifting", is a facts-based determination by the courts in certain cases to disregard some or all of the characteristics of separate legal personality that statute law ordinarily attributes to a duly incorporated company". This approach is in tandem with the position of the UK Supreme Court in *Prest v Petrodel Resources Ltd*[218] where Lord Sumption observed that piercing the veil, properly speaking, means disregarding the separate personality of the company.

It seems that it does not really matter which metaphor is employed by the court in describing a particular judicial act, so long as it is realized that what is being done is to disregard the separate entity of the company and to get at the real persons whose conducts are the subject matter of judicial inquiry. Disregarding the separate entity of the company, however, does not invariably entail the non-recognition of the legal personality of the company. Indeed, a number of cases where the separate entity of the company is said to have been disregarded and the controller held jointly liable with the company could be construed as an actual recognition by the courts of the separate existence of the company rather than ignoring it. The cases do not reveal much difference in judicial approach between those where the piercing of veil was granted and those where it was refused[219] except that perhaps, in the former, the controllers are held jointly liable with the company. For instance, in *Stenhouse Australia Ltd v Philips*[220] the challenge by an employee of a contract in restraint of trade which the employee entered with the holding company and extended to the subsidiaries on the ground that the holding company and its subsidiaries are different companies was rejected by the Privy Council. Lord Wilberforce said:

> The evidence is clear that the business of the Stenhouse Group was controlled and coordinated by the appellant company, and all funds generated by each of the companies were received by the appellant. The subsidiaries were merely agencies or instrumentalities through which the appellant company directed its business.

The Privy Council seemed to have treated the group of companies as one economic unit for the purpose of the enforcement of the underlying contract, but in reality, the reference by the court to the subsidiaries as 'agencies' and 'instrumentalities' actually reflects a recognition rather than ignoring the separate existence of those companies.[221] In *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd and others*[222] Smalberger JA of the appellate division in South Africa held inter alia: "[o]nce therefore the sale of the Findon shares by LCI to the appellant was proved in the original action, and the corporate veils of LCI and GLI pierced in the present, effect can be given to the judgment in the original action against all three respondents". In both *Gilford Motor Ltd v Horne*[223] and *Jones v Lipman*[224] which are frequently referenced as the leading authorities on piercing of the corporate veil where the corporate entity was used to evade existing obligation,[225] the courts in both cases made an order against both the controllers and the companies even as the courts employed different metaphors to describe the companies. In *Horne*, Hanworth MR said:

> 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.[226]

Similarly, in *Lipman* Russel J said: "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."[227] The use of this 'portentous' expressions[228] or 'unnecessary mysticism'[229] by Hanworth MR and Russel J to describe the relationship between the controllers and the companies respectively did not deter either of the judges from making orders against the companies. Perhaps, it would have been expected that by identifying those companies as one with the owners,[230] the company's separate existence is naturally obliterated and the owner/controller

[218] [2013] UKSC 34 para 16.
[219] See Derek French, Stephen Mayson & Christopher Ryan, *Mayson, French & Ryan on Company Law 31st ed* (Oxford: Oxford University Press, 2014) at 132.
[220] [1974] AC 391 at 404 (PC). See also *Beckett Investment Management Group Ltd v Hall* [2007] EWCA Civ 613.
[221] See *Mayson, French & Ryan on Company Law 31st ed* above note 219 at 132.
[222] [1995] 2 All SA 543 (A) at 557.
[223] [1933] Ch 935 (CA).
[224] [1962] 1 WLR 832.
[225] See *Prest v Petrodel Resources Ltd* [2013] UKSC paras 29-30 and 33 per Lord Sumption.
[226] Supra at 956. Emphasis supplied.
[227] Supra at 836. Emphasis supplied.
[228] Per Lord Sumption *in Prest* supra para 30.
[229] As described by *Mayson, French & Ryan on Company Law 31st ed* above note 221 at 134.
[230] As Rimer J did in *Gencor ACP Ltd v Dalby* [2000] 2 BCLC 734 where he stated that the introduction into the story of such a creature company is insufficient to prevent equity's eye from identifying it with Mr Delby.

would be burdened with the obligations which were previously executed through the 'sham' company. But that is not the essence of piercing the corporate veil, the veil is pierced simply to address the particular impropriety which is the subject of judicial inquiry.[231] The company's existence is not hinged on that particular transaction. It is a statutory creation, attained through the process of registration and accorded judicial recognition upon fulfilment of the statutory prerequisites. The non-recognition of the company can only be done upon its being deregistered. This is not what the courts are asked to do or set out to do when they pierce the corporate veil. Thus the disregard of the corporate legal personality of the company by lifting the veil of incorporation does not amount to an extinction of the corporate entity.

4 When the Veil may be Pierced

There are broadly two sources of veil piercing, namely: statutory veil piercing and judicial veil piercing. The consequences in both cases are, however, substantially the same, ie to discover those in control of the company, and in most cases holding the controllers personally liable for transactions which are seemingly executed on behalf of the company.

4.1 Statutory Veil Piercing

The corporate veil is pierced by the statute where specific provision is made by the law which seeks to hold the controllers of the company personally or jointly liable with the company for transactions executed in the course of their duties to the company. This does not, however, extend to those transactions or conducts which amount to a breach of duty either at common law or under the statute for which such controllers are liable to the company. Lord Diplock in *Dimbleby and Sons Ltd v National Union of Journalists*[232] captured the basis of the statutory veil piercing and conditions for their enforcement where he said:

> The 'corporate veil' in the case of companies incorporated under the Companies Act is drawn by statute and it can be pierced by some other statute if such other statute so provides; but in view of its *raison d'etre* and its consistent recognition by the courts since [*Salomon]*, one would expect that any parliamentary intention to pierce the corporate veil would be expressed in clear and unequivocal language. I do not wholly exclude the possibility that even in the absence of express words stating that in specified circumstances one company, although separately incorporated, is to be treated as sharing the legal personality of another, a purposive construction of the statute may nevertheless lead inexorably to the conclusion that such must have been the intention of Parliament.

There are a number of such statutory provisions in South Africa.[233] But more importantly is that the courts do not wantonly lift the veil simply because the law so provides. The primary role of the court remains the upholding of the legal personality of the company and any deviation from that role must be convincingly settled both by the facts of the case and the enabling law. An illustration could be drawn from the Canadian courts approach to issues of personal liability of directors in copyright infringement cases. There is always issues of policy consideration at the heart of the application of such statutory provisions. Le Dain J in *Mentmore Manufacturing Co v National Merchandise Manufacturing Co*[234] emphasized this underlying policy issue as follows:

> What is involved here is a very difficult question of policy. On the one hand, there is the principle that an incorporated company is separate and distinct in law from its shareholders, directors and officers, and it is in the interests of the commercial purposes served by the incorporated enterprise that they should as a general rule enjoy the benefit of the limited liability afforded by incorporation. On the other hand, there is the principle that everyone should answer for his [misconduct]. It would render the offices of director or principal officer unduly hazardous if the degree of direction normally required in the management of a corporation's manufacturing and selling activity could by itself make the director or officer personally liable for infringement by his company.

The mere fact of being in control and honestly exercising the powers of a company, though against the tenor of the law, are simply not sufficient for the imputation of personal liability. There must be some conducts on the part of the directing minds that constitutes either a deliberate infringement of the law or exhibits a separate identity or interest from that of the company such as would make the conduct that of the directing minds.[235] Such

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[231] See *Dadourian Group International Ltd v Simms* [2006] EWHC 2973 para 682, Warren J observed that "if the veil is to be lifted, it is to be lifted for the purposes of the relevant transaction".

[232] [1984] 1 WLR 427 at 435.

[233] See Kathleen Van Der Linde, "The Personal Liability of Directors for Corporate Fault- An Exploration" (2008) 20 *South African Mercantile Law Journal* 439-461 for discussions of some of those provisions.

[234] (1978) 40 CPR (2d) 164 (FCA) at 171.

[235] See *Normart Management Ltd v West Hill Redevelopment Co Ltd* 1998 CanLII 2447 (NO CA), *Petrillo v Allmax Nutrition Inc*

deliberate infringement is not found where the director is merely pursuing the objects of the company unless the company was formed for an illegal purpose. There will also be personal liability where the director has actually ordered or authorized the acts complained of while fully aware of their unlawfulness, or being indifferent to the corporate infringement of the law while under their control.[236] It is, however, a question of fact where the alleged infringement arises from indifference on the part of the director. This was the judicial position in *CBS Inc v Ames Records & Tapes Ltd*[237] where the court held that indifference exhibited by acts of commission or omission may be inferred. It is a question of fact in each case what is the true inference to be drawn from the conduct of the person. Such inference is drawn from evidence as elucidated in the statement of claim. The evidence should be of such particularity that would lead to a reasonable conclusion that the purpose of the director or controller is not the direction or advancement of the company's purpose, but a deliberate, willful, and knowing pursuit of a course of conduct that constitutes an infringement or reflects an indifference to the risk of infringement.[238] It is also from facts that the court would arrive at the conclusion that certain conducts exhibit separate identity or interest from that of the company. In *Scotia McLoad Inc v Peoples Jewelers Ltd*[239] the Ontario Court of appeal held that "[t]o hold the directors of Peoples personally liable, there must be some activity on their part that takes them out of the role of directing minds of the corporation." An instance of conduct that would fall outside the role of the directing mind was illustrated by the Ontario Human Rights Tribunal in *Knibbs v Brant Artillery Gunners Club*[240] where the Adjudicator Ken Bhattacharjee said:

> The clearest example of such conduct is where an individual is accused of sexual harassment or other similar behaviour. In such a case, no plausible argument can usually be made that the harasser was acting within the scope of his or her authority. While the employer is, in such cases, still liable for the harassment engaged in, as it occurred in the course of the harasser's employment, broadly defined, the individual harasser also has a measure of individual culpability.

In a more business sense, the courts have always denounced the use of the corporate entity as an engine of fraud. The power of fraud as a vitiating factor in business transactions was stringently stressed by Lord Denning MR in *Lazarous Estates Ltd v Beasley*[241] where he said:

> No court in this land will allow a person to keep an advantage which he has obtained by fraud. No judgment of a court, no order of a Minister, can be allowed to stand if it has been obtained by fraud. Fraud unravels everything. The court is careful not to find fraud unless it is distinctly pleaded and proved; but once it is proved, it vitiates judgments, contracts and all transactions whatsoever.

Besides the general notion that no company is incorporated for an unlawful purpose, there are specific statutory provisions geared at the protection of those dealing with the company against fraudulent conducts of the controllers. Such provisions are found in section 993 of the UK Companies Act of 2006 and section 22(1) of the South African Companies Act of 2008. The former provides as follows:

> (1) If any business of a company is carried on with intent to defraud creditors of the company or creditors of any other person, or for any fraudulent purpose, every person who is knowingly a party to the carrying on of the business in that manner commits an offence.
> (2) This applies whether or not the company has been, or is in the course of being wound up.

Judicial interpretation and application of this provision and the earlier versions reflect a deep sense of reluctance on the part of the courts to hold directors personally liable for transactions honestly executed on behalf of the company.[242] Defining fraud has never been an easy task for the courts.[243] In the civil context, the courts have been content to refer to fraud as an infraction of fair dealing, or abuse of confidence, or unconscionable conduct, or abuse of power as between a trustee and his shareholder in the management of a company.[244] A more stringent approach is however required when fraud is considered as an element of an offence. It is in that context that Maugham J in *Re Patrick and Lyon Ltd*[245] defined fraud as connoting 'real dishonesty involving, according to

2006 FC 1199 CanLII, *Bae-Newplan Group Ltd v Dalton* (2012) NLCA 21, *Steinhart v Aunali Moledina* 2005 CanLII 3380 (ON SC).

[236] *Apple Computer Inc v Mackintosh Computers Ltd* [1986] FCJ No 278 at 60-70.

[237] [1981] 2 WLR 973 (ChD). See also *Society of Composers, Wah Tat Bank Ltd v Chan Cheng Kum* [1975] AC 507 (PC).

[238] See *Dolomite Svanska Akteibiolag v Dana Douglas Medical Inc* (1994) 58 CPR (3d) 531 (FCTD) at 533.

[239] [1995] 26 OR 3d 481 (CA).

[240] 2011 HRTO 2005 (CanLII) para 36.

[241] [1956] 1 QB 702 at 712

[242] For detailed discussion, see Anthony O Nwafor, "Fraudulent Trading and the Protection of Company Creditors: the Current Trend in Company Legislation and Judicial Attitude" (2013) 42 No *4 Common Law World Review* 297-323.

[243] Keay referred to 'fraud' as 'a notoriously difficult state to prove.' See A. Keay, 'Fraudulent Trading: The Intent to Defraud Element' (2006) 35 *Common Law World Review* 121 at 124.

[244] See *Yalaju Amaya v AREC Ltd* [1990] NWLR (pt 145) 422 (SC), *Daniels v Daniels* [1978] 2 All ER 89 (ChD), *Estmanco (Kilner House) Ltd v Greater London Council* [1982] 1 All ER 437 (ChD).

[245] [1933] Ch 786 at 790. See also *R v Grantham* (1984) 79 Cr App R 86, [1984] QB 675 (CA), *Re Sobam BV* [1996] 1 BCLC 446 (ChD), *Re A Company No. 001418 of 1988* [1991] BCLC 197 (ChD), *Bernasconi v Nicholas Bennett & Co* [2000] BCC 921(ChD),

current notions of fair trading among commercial men at the present day, real moral blame.' Generally, it is not every dishonest act that is fraudulent in the commercial sense. The act of dishonesty must be such as would be reprehensible in the business community. This approach assists the courts in exerting some elements of objectivity in determining the existence of fraud beyond the subjective intentions of the wrongdoer. Thus, in *R v Allsop*[246] Shaw LJ observed that though the detriment that results to the victims of fraud could be secondary and incidental to the company's purpose, 'it is 'intended' only in the sense that it is a contemplated outcome of the fraud that is perpetrated.' Similarly, in *R v Grantham*[247] Lord Lane CJ held that:

> No distinction is to be drawn ... between the state of mind of one who does an act because he desires it to produce a particular evil consequence, and the state of mind of one who does the act knowing full well that it is likely to produce the consequence although it may not be the object he was seeking to achieve by doing the act.

The existence of dishonest intent is usually inferred from the manner in which the business of the company is conducted, especially when the company is in financial straits. The most reasonable expectation among the business community in such a difficult situation would naturally be that the operations of the company should be geared to minimising the existing debts, and certainly not the incurring of further debts. This expectation is implicit in the observation of Maugham J in *Re William C Leitch Brothers Ltd*[248] that "if a company continues to carry on business and to incur debts at a time when there is to the knowledge of the directors no reasonable prospect of the creditors ever receiving payment of those debts, it is, in general, a proper inference that the company is carrying on business with intent to defraud." The inquiry at this point is directed at what the South African Supreme Court of Appeal described in *Fourie NO and Another v Newton*[249] as commercial insolvency, as opposed to factual insolvency. This is evidenced by the statement of Goldstone JA in *Ex parte De Villiers & another NNO: In re Carbon Developments (Pty) Ltd (in liquidation)*[250] that "the mere carrying on of business by directors does not constitute an implied representation to those with whom they do business that the assets of their company exceed its liabilities [factual solvency]. The implied representation is no more than that the company will be able to pay its debts when they fall due [commercial solvency]."

In determining whether there is 'reasonable prospect' of recovery, the supposed level of objectivity is obscured by the weight of credence usually accorded by the courts to the directors' business decision. A resolute director would always hope for better days in the future in spite of the present financial difficulties. The judicial approach in such circumstances is popularly referred to as the 'sunshine test'[251] a phrase coiled from Buckley J's decision in *Re White and Osmond (Parkstone) Ltd*[252] where the judge said:

> In my judgment there is nothing wrong in the fact that directors incur credit at a time when, to their knowledge, the company is not able to meet all its liabilities as they fall due. What is manifestly wrong is if directors allow a company to incur credit at a time when the business is being carried on in such circumstances that it is clear that the company will never be able to satisfy its creditors. However, there is nothing to say that directors who genuinely believe that the clouds will roll away and the sunshine of prosperity will shine upon them again and disperse the fog of their depression are not entitled to incur credit to help them to get over the bad time.

In *Hardie v Hanson*[253] Menzies J of the Australian High Court emphasised that:

> even if the chances of payment of all creditors in full were so remote that it belonged to the realms of hope rather than belief, it seems to me that the fault, grievous though it may be, falls short of fraud unless it is coupled with something else, such as misrepresentation of the position or an intention to use goods purchased on credit for the purposes of dishonest gain, which gives it a fraudulent character.[254]

Welham v DPP [1961] AC 103 (HL), *Aktieselskabet Dansk Skibsfinansiering v Brother* [2001] 2 BCLC 324 (CFA HK). See generally, Alan Digman & John Lowry, *Company Law* 7th ed (Oxford: Oxford University Press, 2012) 478.

246 (1977) 64 Cr App R 29 at 31.

247 (1984) 79 Cr App R 86 at 90.

248 [1932] 2 Ch 71 at 77.

249 [2010] ZASCA 150; [2011] 2 All SA 265 (SCA) para 30.

250 1993 (1) SA 493 (A) at 504E-F.

251 See Derek French, Stephen Mayson & Christopher Ryan, *Mayson, French & Ryan on Company Law 29th ed* (Oxford: Oxford University Press, 2012) at 700.

252 ChD 30 June 1960 Unreported but quoted in *R v Grantham* [1984] QB 675 at 682. See also Keay, above note 53 at 127, French, Mayson & Ryan, *ibid.* at 700. See also *Hardie v Hanson* (1960)105 CLR 451(HC) at 464 where Kitto J described such conduct of the director as 'chasing of the rainbow'.

253 (1960)105 CLR 451(HC) at 467.

254 Dixon CJ had earlier observed in the same case that although the director had 'struggled on with the business after a time when in fairness to others and in wisdom' he should have wound it up, he had not been shown to be fraudulent. At 461. See also *Aktieselskabet Dansk Skibsfinansiering v Brother* [2001] 2 BCLC 324 (CFA HK).

The UK Court of Appeal in *Morphitis v Bernasconi*[255] stretched further the subjective view of the director's belief where it held that a misleading statement alone would not engage the provision, so long as there is no intention to defraud the creditor.[256] This is an extreme subjective approach to the determination of dishonesty. The focus by the court appears to be based entirely on what the director says is his motive for continuing to carry on the business of the company in such difficult circumstances. This line of decision would almost certainly destroy the potency of that provision as an instrument for the protection of creditors.

However, not all judicial decisions agree with that line of reasoning. In *Royal Brunei Airlines Sdn Bhd v Tan*[257] Lord Nicholls of Birkenhead cautioned that the

> subjective characteristics of honesty do not mean that individuals are free to set their own standards of honesty in particular circumstances. The standard of what constitutes honest conduct is not subjective. Honesty is not an optional scale, with higher or lower values according to the moral standards of each individual. If a person knowingly appropriates another's property, he will not escape a finding of dishonesty simply because he sees nothing wrong in such behaviour.

The misleading statement in *Morphitis's case* would have been inexcusable if this line of reasoning was adopted by the court. In *Re Continental Assurance Co of London Plc,*[258] Park J observed that "whenever a company is in financial trouble and the directors have a difficult decision to make whether to close down or go into liquidation, or whether instead to trade on and hope to turn the corner, they can be in a real and an unviable dilemma." This shows that decisions taken by the directors while the company is in dire financial straits shall not remain unquestionable. It is not simply enough for the directors to assert their honesty and genuine belief in reaching such decisions. The reasonability must be weighed against all the business odds as indicated by the business climate or surrounding circumstances.[259] A director who continues to carry on business in circumstances in which a reasonably prudent director with comparable skill and experience would not have done so, cannot rely on his or her honest belief on the prospect of turning the company's business around to escape liability when the creditors' funds are put in jeopardy by such conduct.[260] The fact that no prudent director would have acted in the same manner as the director whose conduct is impugned could act as a decisive factor in casting shadow of doubt on the acclaimed honesty of that director. Such inferences are easily drawn where the statute has interposed recklessness with intention to defraud as is the case under the South Africa Companies Act provision,[261] but nothing stops the court, depending on the circumstances of each case, from adopting a purposive approach to the interpretation of the provision giving it a wide reach even in the absence of an express inclusion of the word 'recklessness' as in the UK Companies Act provision. A clear evidence of dishonesty is found where the directors continue to enrich themselves from the company's assets in situations where there are unpaid debts and by so doing further diminish the chances of the creditors ever being paid.[262] The evidential

[255] [2003] EWCA Civ 289.

[256] Chadwick LJ held at para 48 that the only matter relied on is the promise, in the letter of 12 November 1993, that Ramac would be paid an installment of outstanding rent at the end of December. The promise was intended to mislead; in the sense that it was intended to persuade Ramac that its interests were best served by not taking proceedings (including the presentation of a winding up petition) to enforce the debt which it was then owed. But it has not been shown that, by carrying on of the business of the company during the period that Ramac was so misled, Mr Monti or Mr Bernasconi intended to defraud Ramac; or, indeed, that the carrying on of the business of the company did defraud Ramac – in the sense that Ramac's claim as a creditor in the liquidation was prejudiced by the carrying on of the business between 12 November 1993 (when, but for the misleading promise, Ramac might have presented a petition) and 23 December 1993 (when the promised payment was not forthcoming). Cf the decision of Lord Lane CJ in *R v Grantham* (1984) 79 Cr App R 86 at 90-91set down above on page 13which is supported by Pinto & Evans who observed that where a person intends by deceit to induce a course of conduct in another which puts that other's economic interest in jeopardy, he is guilty of fraud even though he does not intend or desire that actual loss should ultimately be suffered by that other. See Pinto & Evans, above n. 26 at 286.

[257] [1995] 2 AC 378 at 389 (PC).

[258] [2001] BPIR 733 para 281.

[259] In *The Liquidator of Marini Ltd v Dickson* [2003] EWHC 334 (Ch) para 68 Richard Seymour J suggested that the proper question should be whether, on the net basis, it is shown that the company is worse off as a result of the continuation of trading.

[260] See *Rubin v Gunner* [2004] EWHC 316 (Ch) para112 where Etherton J's decision reflects how unreasonable certain belief could be, as follows: 'In my judgment, the notion that a new company, whose business was intended to be that acquired from another company which had made consistent and substantial losses, and whose latest audited accounts were over a year out of date, could be successfully floated within a very short time on NASDAQ, without any involvement of the board of directors in the lead up to the flotation, and that, within a very short time, US$500,000 would be provided in respect of the flotation and then passed to RGO, even though there had been no independent valuation of the assets to be transferred to G & S, is fantastic. I do not accept that any reasonably competent director, in the position of the Respondents, could reasonably have believed that.'

[261] See *Philotex (Pty) Ltd and others v Snyman and others; Braitex (Pty) Ltd and others v Snyman and others* 1998 (2) SA 138 (SCA) at 145 per Howie JA, *Ozinsky NO v LIoyd and Others* 1992 (2) SA 396 (C) at 414, per Van Deventer J, *Klerk NO v SA Metal & Machinery Co (Pty) Ltd and Others* [2001] 4 All SA 27 (E) at 34 per Froneman J, *Srtut Ahead Natal (Pty) Ltd v Burns* [2007] 3 All SA 190 (D) at 196, *Fourie NO and Another v Newton* [2010] ZASCA 150; [2011] 2 All SA 265 (SCA).

[262] See *Carman v The Cronos Group SA* [2005] EWHC 2403(Ch) per Evans-Lombe J para 24(2) where the judge held that:

onus will always be on the director to explain, being in control of the company's affairs, why business is conducted in a particular manner, even in those cases where the intention to defraud is construed strictly subjectively by the court,[263] as such facts are supposedly beyond the reach or knowledge of the creditor which offers strong justification for treating the explanation by the directors with caution.[264]

4.2 Judicial Veil Piercing

The judicial power to lift the veil of incorporation in appropriate cases is fact sensitive. Lord Denning MR in *Littlewoods Mail Order Stores Ltd v Inland Revenue Commissioners*[265] alluded to this power where he said:

> The doctrine laid down in *Salomon v Salomon & Co Ltd* has to be watched very carefully. It has often been supposed to cast a veil over the personality of a limited company through which the courts cannot see. But that is not true. The courts can and often do draw aside the veil. They can, and often do, pull off the mask. They look to see what really lies behind. The legislature has shown the way with group accounts and the rest. And the courts should follow suit.

The courts have certainly followed the legislative trail, but unlike in the latter where the situations that warrant the veil piercing are usually specifically set down by the law, the exercise of this power by the courts has remained confounding. Starting with the response to Lord Denning's advice in *Littlewords* that the rule in *Salomon* has to be watched carefully, Richmond P of the New Zealand Appeal Court in *Re Securitibank Ltd No 2*[266] opined to the contrary where he said: "For myself, and with all respect, I would rather approach the question the other way round, that is to say on the basis that any suggested departure from the doctrine laid down in [*Salomon*] should be watched very carefully." In *DHN Food Distributors Ltd v Tower Hamlets London Borough*[267] the appeal court had reasoned that the element of control exercised by the holding company over its subsidiaries was sufficient to justify the piercing of the corporate veil. Lord Denning MR had observed that "[t]his 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." The sustainability of this decision was doubted by the House of Lords in *Woolfson v Strathclyde Regional Council*[268] where Lord Keith of Kinkel expressed approval with Lord Justice-Clerk's (Second Division) adoption of Ormerod LJ's position in *Tunstall v Steigman*[269] to effect that any departure from a strict observance of the principles laid down in *Salomon* has been made to deal with special circumstances when a limited company is a façade concealing the true facts.

In *Re a Company*[270] Cumming-Bruce LJ considered that "the court will use its powers to pierce the corporate veil if it is necessary to achieve justice". Such a stance was roundly rejected by a differently constituted Court of Appeal in *Adams v Cape Industries Plc*[271] where it held that the court is not free to disregard the principle of *Salomon* merely because it considers that justice so requires. This decision has attracted a significant level of judicial support,[272] but the failure by the courts in any of those cases to define when the veil could be pierced[273] has witnessed a recourse in subsequent judicial decisions to the same idea of interest of justice as justification for disregarding the separate corporate personality. In *Mubarak v Mubarak*[274] Bodey J emphasized that the corporate veil could be lifted not only when the company is a sham, but "when it is just and necessary." Auld LJ had in *Ratiu & Ors v Conway*[275] alluded to "the readiness of the courts, regardless of the precise issue involved, to draw

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'During the period of Dr Palatin's control until it was placed in liquidation, the business of T1 was carried on with intent to defraud its creditors… in that over that period Dr Palatin put into operation a plan for the removal from it of the assets of T1 and their application other than for the purposes and benefit of T1 by transferring them to individuals and companies in which Dr Palatin had an interest alternatively applying their proceeds for his own or his family's use.'

263 See *Strut Ahead Natal (Pty) Ltd v Burns* [2007] 3 All SA 190 (D) at 197-198.

264 See "Fraudulent Trading and the Protection of Company Creditors: the Current Trend in Company Legislation and Judicial Attitude" above note 242 for further discussions on this principle.

265 [1969] 3 All ER 855 at 861.

266 [1978] 2 NZLR 136 at 338.

267 [1976] 3 All ER 462, [1976] 1 WLR 852.

268 1978 SLT 159 at 161, 1978 SC (HL) 90 at 96 Lord Keith of Kinkel stated that he has 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.

269 [1962] 2 Q.B. 593 at 601.

270 [1985] BCLC 333(CA) at 337-338.

271 [1991] 1 All ER 929 at 1019.

272 See *Ben Hashem v Ali Shayif* [2008] EWHC 2380 per Munby J para 160, *Yukong Line Ltd of Korea v Rensburg Investments Corporation of Liberia (No.2)* [1998] 1 WLR 294 at 305, *Trustor AB v Smallbone (No2)* [2001] 1 WLR 1177 para 21, *Linsen International Ltd v Humpuss Sea Transport Pte Ltd* [2011] EWHC 2339 (Comm) para 15.

273 In *Adams' case* for instance, the court of appeal specifically stated that they will not attempt a comprehensive definition of those principles.

274 [2001] 1 FLR 673 at 682C

275 [2005] EWCA Civ 1302 para 75. Emphasis supplied. Laws LJ emphasised his "emphatic agreement [with Auld LJ]… that

back the corporate veil to do *justice when common sense and reality demand it*." Sedley LJ in a concurring decision stated that "I recognise that there is an asymmetry between the law's longstanding insistence on the discrete legal personality of limited liability companies and its willingness to lift the veil, as the expression is, in a case like the present. But it is the latter, not the former, which accords with common sense and justice."[276]

The South Africa courts are not left out of these controversies. In *Ex parte Gore NO and others NNO*[277] Binns-Ward J of the Western Cape High Court observed that "[a] consideration of the South African authorities shows that despite the repeated affirmation that the courts enjoy no general discretion to do so merely because it would be just and equitable, courts will ignore or look behind the separate legal personality of a company where justice requires it, and not only when there is no alternative remedy." In *Hülse-Reutter and others v Gödde*[278] Scott JA observed that the circumstances in which a court will disregard the distinction between a corporate entity and those who control it are far from settled. Much will depend on a close analysis of the facts of each case, considerations of policy and judicial judgment.

The reference to 'common sense' and the demands of 'reality' by Auld LJ in *Ratiu* is a reflection of the open-endedness of the idea of the interest of justice as a ground for piercing the corporate veil. Relying on such principle as the demands of justice to disregard the separate personality of the company would open too wide a window of opportunities for the exercise of the judicial discretion in such cases. Both the company and the investors would be hurt by such an approach as it creates a state of uncertainty with the attendant apprehension by the investors, and which is by no means unreasonable, of the prospect of being held personally accountable for company's transactions. This is the very mischief that the *Salomon's case* seeks to prevent, being a disincentive for investing in the corporate entity. It is assuaging that the more recent decisions by the English superior courts of record have not accepted the idea of interest of justice as justification for piercing the corporate veil.[279] The Courts in South Africa could find these decisions more persuasive than the open-ended ones that seem to open a flood gate for circumventing of the distinct entity of the company. .

In those cases in which the corporate veil was lifted, the courts have used a number of metaphors such as stratagem, cloak, sham and façade to describe the company without offering any clear meaning of those terms. In *Adams v Cape Industries Plc*[280] the Court of Appeal declined to proffer any definition and explicitly stated as follows:

> From the authorities cited to us we are left with rather sparse guidance as to the principles which should guide the court in determining whether or not the arrangements of a corporate group involve a façade within the meaning of that word as used by the House of Lords in *Woolfson v Strathclyde Regional Council* 1978 SLT 159. We will not attempt a comprehensive definition of those principles.

However, in *Ben Hashem v Ali Shayif*[281] Munby J explained the word 'façade' as a deceptive front, and stated that a company could be a façade even though it was not originally incorporated with any deceptive intent, provided that it is being used for the purpose of deception at the time of the relevant transaction. The word 'sham' was explained by Lord Diplock in *Snook v London & West Riding Investments Ltd*[282] where he stated as follows:

> As regards the contention of the plaintiff that the transactions between himself,... and the defendants were a "sham", it is, I think, necessary to consider what, if any, legal concept is involved in the use of this popular and pejorative word. I apprehend that, if it has any meaning in law, it means acts done or documents executed by the parties to the "sham" which are intended by them to give to third parties or to the court the appearance of creating between the parties legal rights and obligations different from the actual legal rights and obligations (if any) which the parties intend to create. One thing I think, however, is clear in legal principle, morality and the authorities… for acts or documents to be a "sham", with whatever legal consequences follow from this, all the parties thereto

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there is a powerful argument of principle for lifting the corporate veil where the facts require it to include those in or behind the company."

276 See generally Derek French, Stephen Mayson & Christopher Ryan, *Mayson, French & Ryan on Company Law 29th ed* (Oxford: Oxford University Press, 2012) at 150-151 for some reflections on some of these cases.

277 [2013] 2 All SA 437 (WCC) para 28.

278 [2002] 2 All SA 211 (A) para 20.

279 See *VTB Capital Plc v Nutritek* [2013] UKSC 5, *Prest v Petrodel Resources Ltd* [2013] UKSC 34, *Antonio Gramsci v Lembergs* [2013] 4 All ER 154.

280 [1991] 1 All ER 929 at 1025.

281 [2009] 1 FLR 115 at 164-165.

282 [1967] 2 QB 786 at 802. See also *Stone v Hitch* [2001] EWCA Civ 63 para1, *Ker v Optima Community Association* [2013] EWCA Civ 578 para 21, *Pankhania v Chandegra* [2012] EWCA Civ 1438 para 20, *Wagstaff v Colls* [2003] EWCA Civ 469 para 64 which all analysed and applied that decision.

> must have a common intention that the acts or documents are not to create the legal rights and obligations which they give the appearance of creating.

What this statement reveals as simplified by Bingham LJ in *Antoniades v Villiers & Anor*[283] is that "a sham exists where parties say one thing while really intending another". In other words, the word 'sham' refers to the transaction and not to the parties as such. This invariably implies that a company which is duly incorporated cannot be a sham in the ordinary sense of that word.[284]

In *Antoniades' case*[285] Lord Bingham stated that the role of the court where a transaction is a sham is to identify and give effect to the true bargain between the parties which the written agreement was intended to conceal. Thus the court does not disregard a transaction or even the parties to the transaction merely because an agreement is described as a sham. But does this imply that the word sham is restricted to concealment and does not extend to evasion of obligation. The UK Supreme Court's decision in *Prest v Petrodel Resources Ltd*[286] does not seem to agree with this. Lord Sumption while drawing a distinction between façade and sham said:

> The difficulty is to identify what is a relevant wrongdoing. References to a "facade" or "sham" beg too many questions to provide a satisfactory answer. It seems to me that two distinct principles lie behind these protean terms, and that much confusion has been caused by failing to distinguish between them. They can conveniently be called the concealment principle and the evasion principle. The concealment principle is legally banal and does not involve piercing the corporate veil at all. It is that the interposition of a company or perhaps several companies so as to conceal the identity of the real actors will not deter the courts from identifying them, assuming that their identity is legally relevant. In these cases the court is not disregarding the "facade", but only looking behind it to discover the facts which the corporate structure is concealing. The evasion principle is different. It is that the court may disregard the corporate veil if there is a legal right against the person in control of it which exists independently of the company's involvement, and a company is interposed so that the separate legal personality of the company will defeat the right or frustrate its enforcement. Many cases will fall into both categories, but in some circumstances the difference between them may be critical.

The statement suggests that while 'façade' refers to concealment of identity, 'sham' refers to evasion of obligation. But the explanation offered by Lord Diplock in *Snook* and that line of cases had aligned the word 'sham' with concealment and not evasion of obligation as such. It seems that no clear distinction can be draw between both terms. This is buttressed by the statement of Lord Neuberger in *VTB Capital Plc v Nutritek International Corp & Ors*[287] where he observed that the difficulty expressed by Lord Diplock in *Snook's case* as to the precise meaning of the word 'sham' in connection with contracts, may equally be applicable to an expression such as 'façade'. Both terms could imply the same or nothing at all in the context of piercing of the corporate veil. The preferred course would be to avoid them entirely in dealing with the issues of piercing of the corporate veil as enjoined by Lord Neuberger in *VTB* as follows:

> Words such as "façade", and other expressions found in the cases, such as "the true facts", "sham", "mask", "cloak", "device", or "puppet" may be useful metaphors. However, such pejorative expressions are often dangerous, as they risk assisting moral indignation to triumph over legal principle, and, while they may enable the court to arrive at a result which seems fair in the case in question, they can also risk causing confusion and uncertainty in the law.[288]

The legislature in South Africa has taken a step towards the avoidance of these metaphors. Section 20(9) of the Companies Act of 2008 now recaptures all those metaphors concisely as 'unconscionable abuse'. The section provides as follows:

> If, on application by an interested person or in any proceedings in which a company is involved, a court finds that the incorporation of the company, any use of the company, or any act by or on behalf of the company, constitutes an *unconscionable abuse* of the juristic personality of the company as a separate entity, the court may -
> (a) declare that the company is *to be deemed not to be a juristic person* in respect of any right, obligation or liability of the company or of a shareholder of the company or, in the case of a non-profit company, a member of the company, or of another person specified in the declaration.[289]

283 [1988] EWCA Civ 3 para 18.
284 See *Mayson, French & Ryan on Company Law 31st ed* above note 229 at 137.
285 Supra para 13.
286 [2013] UKSC 34 para 28.
287 [2013] UKSC 5 para 124.
288 Ibid.
289 Emphasis supplied.

The Act does not define 'unconscionable abuse'. The only case so far that has applied this provision is the High Court decision in *Ex parte Gore NO and Others NNO*[290] where Binns-Ward J considered that:

> The term "unconscionable abuse of the juristic personality of a company" postulates conduct in relation to the formation and use of companies diverse enough to cover all the descriptive terms like "sham", "device", "stratagem" and the like used in that connection in the earlier cases, and – as the current case illustrates – conceivably much more. The provision brings about that a remedy can be provided whenever the illegitimate use of the concept of juristic personality adversely affects a third party in a way that reasonably should not be countenanced.

The trial judge had deployed these explanatory terms to justify his earlier findings that:

> The relevant improprieties involved in the current case involved the controllers of the companies treating the group in a way that drew no proper distinction between the separate personalities of the constituent members and in using the investors' funds in a manner inconsistent with what had been represented. The first mentioned category of impropriety, in my view, constituted an unconscionable abuse by the controllers of the juristic personalities of the relevant subsidiary companies as separate entities and brought the case within the ambit of the statutory provision.[291]

But the English courts decisions[292] where those metaphors were used to portray the negative aspect of the relationship between the company and the controllers/owners did not accept that the mere conduct of the business of group of companies by the controllers in such a manner as failed to maintain the separate identities of the companies in the group was sufficient for the court to also disregard the distinct identities of those companies. In *Adams v Cape Industries Ltd*[293] the Court of Appeal unanimously pronounced that:

> 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.[294]

The failure by the controllers to observe the separate identities of the companies in the group is at best an abuse of the corporate structure which, as was held by Lord Neuberger in *VTB Capital Plc*,[295] is insufficient to justify the piercing of the corporate veil. The approach adopted by the South Africa court in *Gore*, would amount to, as Lord Sumption denounced in *Prest*,[296] the court disregarding the legal personality of the companies with the same insouciance as the controller did.

The provision refers to 'unconscionable abuse' and not just 'abuse'. The adjective 'unconscionable' in that context depicts some level of impropriety bordering on the motive of the wrongdoer,[297] and not merely the perpetration of the wrongful act. It elicits a moral burden demanding the exercise by the court of its equitable powers to reverse the injurious conduct by providing relief to the injured party. This was reflected in the analysis by Lord Sumption in *Prest* of the decision in *Gilford Motor Co Ltd v Horne*[298] where the director had used the company to evade an existing obligation. Lord Sumption said:

> It is also true that the court in *Gilford Motor Co* might have justified the injunction against the company on the ground that Mr Horne's knowledge was to be imputed to the company so as to make the latter's conduct *unconscionable or tortious*, thereby justifying the grant of an equitable remedy against it.[299]

This analysis suggests that an abuse of corporate structure only becomes unconscionable where there is a benefit derivable by the abuser and which adversely affects the existing interest of the third party. The mere misuse of the corporate structure is simply not sufficient to constitute unconscionable abuse within the context of section 20(9) of the Companies Act. It is instructive that prior to the enactment contained in section 20(9), the South African Supreme Court of Appeal had provided a lead on when the veil could be pierced which is highly reminiscent of what section 20(9) portends. Scott JA in *Hülse-Reutter and others v Gödde*[300] said: "[W]hat, I think, is clear is that as a matter of principle in a case such as the present there must at least be some misuse or

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[290] [2013] 2 All SA 437 (WCC) para 34.
[291] Ibid para 33.
[292] With the exception of perhaps *DHN Foods Distributors Ltd v Tower Hamlets London Borough Council* [1976] 1 WLR 852.
[293] [1991] 1 All ER 929 at 1019.
[294] See also *Woolfson v Strathclyde Regional Council* [1978] UKHL 5 which disapproved of Lord Denning's position in *DHN*.
[295] [2013] UKSC 5 para 143.
[296] [2013] UKSC 34 para 36.
[297] See *Adams v Cape Industries* [1991] 1 All ER 929.
[298] [1933] Ch 935.
[299] *Prest v Petrodel Resources Ltd* supra para 29. Emphasis supplied.
[300] [2002] 2 All SA 211 (A) para 20. Only a passing reference was made to this case by Binns-Ward J at 449 para 27.

abuse of the distinction between the corporate entity and those who control it which results in an unfair advantage being afforded to the latter". Present in this decision are the two elements as earlier identified that should compel judicial intervention, namely: the misuse or abuse of the corporate structure, and an unfair advantage conferred on the abuser. It is the latter that invokes the equitable powers of the court and should be so applied in the context of section 20(9) of the Act.

Section 20(9)(a) requires that once unconscionable abuse is established, the court could declare the company not to be a juristic person in relation to that particular transaction. The implication of this provision is that no order should be made against the company and that only the controller will be liable for the wrongdoing. This seems to be a true reflection of what the piercing of the corporate veil entails. As earlier argued, it does not make much sense to suggest that the veil is pierced while the company is jointly held liable with the controller. That would amount to recognition, rather than a disregard, of the separate corporate personality.

Another appellate court decision which reflects the confounding jurisprudence established by the South African courts in this area of law is *Cape Pacific Ltd v Lubner Controlling Investments Pty Ltd*,[301] a case decided well before the Companies Act of 2008 was enacted. This was a case where one company (LCI sued as the first respondent), had transferred property to another (GLI the second respondent) apparently to evade obligation incurred by the first respondent to the appellant. The third respondent (Lubner)'s involvement was simply on account of being in control of both companies but certainly not a party to the transaction. The appellate court considered that this act of control by Lubner, and perhaps his beneficial interest in the property in question, were sufficient to warrant the piercing of the corporate veil and to make the second and third respondents parties to the contract between the first respondent and the appellant. Smalberger JA had, while lending credence to piercing of the corporate veil in that circumstances stated as follows:

> The evidence, coupled with Lubner's failure to testify, goes way beyond the concession that Lubner was the moving spirit behind LCI. It establishes on the requisite balance of probabilities that notwithstanding LCI's corporate identify (sic), Lubner at all material times personally exercised control over the Findon shares (and hence the Clifton flat) as effectively and completely as if they belonged to him personally. In relation to its dealings with the Findon shares LCI was more than just Lubner's puppet; it was essentially none other than Lubner personally, albeit in a different guise…. Lubner effectively controlled the affairs of GLI at the relevant time. In 1979 when the sale of the Findon shares to the appellant, and the subsequent transfer of those shares from LCI to GLI took place, Lubner was the sole shareholder of GLI. He and Swersky were the directors of GLI…. It is in fact common cause that Lubner had complete voting control at that time over GLI…. It was Lubner's idea to transfer the Findon shares from LCI to GLI. This was not done to further GLI's corporate interests, but to ensure Lubner's continued personal occupation of the Clifton flat. Henceforth Lubner as LCI would no longer enjoy the benefit of the flat; but Lubner as GLI would continue to do so. It was a transfer… from Lubner's left to his right hand. When the situation is exposed for what it really is, the inevitable truth that emerges is that not only did Lubner control the affairs of GLI, but in relation to its acquisition of the Findon shares GLI *was* Lubner in one of his guises…. the transfer of the Findon shares to GLI was a device or stratagem resorted to by him in a deliberate attempt to thwart the appellant's rights to delivery of the shares. His conduct in the circumstances, if not fraudulent, was at the very least gravely improper.[302]

A long line of authorities at common law, starting from *Salomon*, have consistently held that the company is the owner of its own property and that whatever interest of the controller in the property is not material to upholding the separate personality between the company and the controller. Lord Wrenbury emphasised this in *Macuara v Northern Assurance Co Ltd*[303] where he said: "My Lords, this appeal may be disposed of by saying that the corporator even if he holds all the shares is not the corporation, and that neither he nor any creditor of the company has any property legal or equitable in the assets of the corporation." This judicial position has also been adopted by the South African courts. In *Dadoo Ltd v Krugersdorp Municipal Council*[304] Innes CJ of the Appellate Division said:

[301] [1995] 2 All SA 543 (A).
[302] Ibid at 548-549.
[303] [1925] AC 619 at 633. See also *Tate Access Floors Inc v Boswell* (1991) CH 512 at 531 per Brown-Wilkinson VC who observed that if people choose to conduct their affairs through the medium of corporations, they are taking advantage of the fact that in law those corporations are separate legal entities, whose property and actions are in law not property and actions of their incorporators or controlling shareholders. In *Farrar v Farrars Ltd* (1888) 40 ChD 395 at 409-410 Lindley LJ held that a sale by a person to a corporation of which he is a member is not, either in form or substance, a sale by a person to himself. To hold that it is, would be to ignore the principle which lies at the root of the legal idea of a corporate body, and that idea is that the corporate body is distinct from the persons composing it.
[304] 1920 AD 530 at 550-551. See also *Stellenbosch Farmers' Winery Ltd v Distillers Corporation (SA) Ltd* 1962 (1) SA 458(A).

> [W]hether ownership by Dadoo, Ltd., is in substance ownership by its Asiatic shareholders. Clearly in… law it is not. A registered company is a legal *persona* distinct from the members who compose it…. That result follows from the separate legal existence with which such corporations are by statute endowed, and the principle has been accepted in our practice. Nor is the position affected by the circumstance that a controlling interest in the concern may be held by a single member. This conception of the existence of a company as a separate entity distinct from its shareholders is no merely artificial and technical thing. It is a matter of substance; property vested in the company is not, and cannot be, regarded as vested in all or any of its members.

It is part of the findings of the court in *Cape Pacific Ltd* that "the Findon shares, which guaranteed Lubner (and his family) personal occupation of the Clifton flat, were initially owned by Lubner. They were transferred to LCI by Lubner in 1976 when Lubner became a non-resident."[305] These findings reflect the divesting of legal interest in the property in question by Lubner in favour of LCI even as Lubner still enjoyed occupational right in the property. Thus, when the sale of the property by the LCI to the appellant took place in 1979, Lubner was not and could not have been a party to the transaction as he no longer had a legal title to the property. The facts of this case are not analogous to the instances of *Gilford Motor Co Ltd v Horne*[306] or *Jones v Lipman*[307] which the court seemed to have relied on.[308] In both cases, it was the controller who, after incurring personal obligation to the third party, sought to evade that obligation through the instrumentality of the respective corporate entities involved. In *Cape Pacific Ltd*, LCI which incurred the obligation is a corporate entity in its own right. It is LCI that was seeking to evade its own obligation by transferring its own property to GLI. LCI does not control GLI. There is as such no issue for the consideration of piercing of the corporate veil. This was a simple question of the court nullifying the transfer by LCI to GLI and ordering LCI to perfect its obligation to the appellant.

The question which is of relevance in a case of this nature but which the appellate court seemed to have overlooked, is the propriety or otherwise of holding a person liable in a contract in which that person is not a party. In *Hülse-Reutter and others v Gödde*[309] Scott JA specifically addressed this issue where he held:

> [W]hat the respondent seeks to do is to enforce his contractual rights arising under the Goldleaf agreement against the appellants rather than the party with whom he actually contracted, namely Goldleaf. The justification for this is said to be that because the appellants used the company as a vehicle to perpetrate a fraud, therefore the distinction between the corporate entity and those who control it should be ignored and the latter held liable on the contract. I cannot agree.

The same approach was adopted by the UK Court of Appeal in similar circumstances in *Antonio Gramsci Shipping Corp and Others v Lembergs and Other*[310] where the court considered among others, whether a party to a contract with a corporation, which is controlled by an individual who has used it as a device or façade to conceal wrongdoing, can proceed against the individual in contract, and can establish jurisdiction by virtue of a jurisdictional clause in the contract with the corporate entity. Beatson LJ held, against the compelling argument of counsel,[311] that the piercing of veil is not automatic and should not be done simply on account of the finding that an individual owns and controls the relevant company at the relevant time and has used it as a façade to conceal the true facts.[312] Referring to the Supreme Court decision in *Prest v Petrodel Resources Ltd*,[313] Beatson LJ held that it is clear that under the present state of the English law, "the court can only pierce the corporate veil when 'a person is under an existing legal obligation or liability or subject to an existing legal restriction which he deliberately evades or whose enforcement he deliberately frustrates by interposing a company under his control".[314] Lord Beatson thus concluded that the submission that it is possible to pierce the corporate veil to deem Mr Lembergs to have consented to the jurisdiction clause contained in a contract entered into by the company on account of his being in control of that company is untenable.

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305 Supra at 554.
306 [1933 All ER 109 (CA).
307 [1962] 1 All ER 442 (ChD).
308 Supra at 555.
309 [2002] 2 All SA 211 (A) para 19.
310 [2013] 4 All ER 157 para 6.
311 That Antonio Gramsci had shown a good arguable case for 'piercing' the corporate veil because there was a good arguable case that Mr Lembergs was a beneficial owner and controller of the corporate defendants which were incorporated for the purpose of diverting profits from it, he was one of the 'masterminds behind the scheme to divert profits' from it, and he 'approved the arrangements' for the scheme, including the conclusion of the charterparties. Supra para 20.
312 Supra para 46.
313 [2013] UKSC 34 paras 27, 34, 35, 60 and 98.
314 Supra para 65.

In *Cape Pacific Ltd*, Lubner (like Lembergs) did not incur any obligation to the appellant apart from being the controller of the companies found to be used as façade. Lord Neuberger had in *VTB Capital Plc v Nutritek International Corp and others*[315]observed that:

> In so far as VTB invokes the principle of piercing the veil of incorporation, its case involves what, at best for its point of view, may be characterised as an extension to the circumstances where it has traditionally been held that the corporate veil can be pierced. It is an extension because it would lead to the person controlling the company being held liable as if he had been a co-contracting party with the company concerned to a contract where the company was a party and he was not.

Lord Neuberger proceeded to give reasons why this extension of the principle should not be allowed where he said:

> In any event, it would be wrong to hold that Mr Malofeev should be treated as if he was a party to an agreement, in circumstances where (i) at the time the agreement was entered into, none of the actual parties to the agreement intended to contract with him, and he did not intend to contract with them, and (ii) thereafter, Mr Malofeev never conducted himself as if, or led any other party to believe, he was liable under the agreement.[316]

There was no suggestion in *Cape Pacific Ltd* that the appellant intended to contract with Lubner, nor did Lubner make any representation to the appellant implying that he would be liable under the contract. Indeed, the appellant's case, as in *Antonio Gramsci*,[317] is that Lubner was seeking to avoid the contract. There seems, in the light of existing authorities, to be no justification for piercing the corporate veil in the circumstances of that case and holding Lubner liable on a contract between LCI and the appellant is not sustainable in the light of the existing authorities.

5 Conclusion

It is not in dispute that the corporate veil could be pierced where there is impropriety in the running of the affairs of the company. The dispute, however, lies in identifying the nature of the impropriety and when such an impropriety should warrant the exercise by the court of the power to pierce the corporate veil.

The South African courts decisions in *Cape Pacific Ltd* and in *Gore* seem too hasty in applying the judicial power to disregard the separate existence of the companies involved. The pronouncements by the UK Supreme Court and the Court of Appeal in their recent decisions on this issue[318] evidently suggest that the South African courts pronouncements may not withstand the contemporary judicial position on the piercing of the corporate veil.

But in those UK Supreme Court decisions, especially in *Prest*, the pronouncements made by the individual judges do not seem to provide any definite route through which such matters could be addressed in the future. Beatson LJ in *Antonio Gramsci* summarised the inconsistencies embedded in their lordships pronouncements in *Prest* as follows:

> As to further development of the law, doing so by classical common law techniques may not be easy. In *Prest's* case Lord Sumption (at [28]) identified two underlying principles which he called "the concealment principle" and "the evasion principle". But Lord Neuberger was of the view (at [75] that there is a "lack of any coherent principle in the application of the doctrine of "piercing the corporate veil", and Lord Walker's view (at [106]) was that it is not a doctrine in the sense of a coherent principle or rule of law but a label. Lady Hale (at [92]) was "not sure whether it is possible to classify all of the cases in which the courts have been or should be prepared to disregard the separate legal personality of a company neatly into cases of either concealment or evasion". Absent a principle, further development of the law will be difficult for the courts because development of common law and equity is incremental and often by analogical reasoning.[319]

The alternative is to be found in statutory intervention. The legislature in South Africa has done so by synchronising all the existing metaphors used by the courts to describe the relationships between the company and the controller where the veil is lifted into what the law referred to as 'unconscionable abuse'. This is

[315] [2013] UKSC 5 para 132, a case which was similarly relied on by the appeal court in *Antonio Gramsci*.
[316] Ibid para 140.
[317] Supra, Beatson LJ observed at para 59 that "[i]n these proceedings, Antonio Gramsci's case is not that Mr Lembergs authorised the Corporate Defendants to contract on his behalf, but that he specifically sought to avoid this."
[318] *VTB Capital Plc v Nutritek International Corp and others* [2013] UKSC 5, *Prest v Petrodel Resources Ltd* [2013] UKSC 34, *Antonio Gramsci Shipping Corp and Others v Lembergs and Other* [2013] 4 All ER 157 (CA).
[319] Supra para 66.

provided for in section 20(9) of the Companies Act as the only ground upon which the corporate veil could be pierced. The Act, however, failed materially to assign specific meaning to that term and as such subjecting it to the exercise of judicial discretion as witnessed in *Gore*, and by so doing accorded statutory flavour to the very mischief which the provision is meant to redress. Unless a definite meaning is assigned by parliament to the term 'unconscionable abuse' within the context of section 20(9), that provision may not achieve its purpose.

There is, however, a positive aspect of section 20(9). This is found in paragraph (a) of the provision. It empowers the court to deem the company not to be a juristic person in relation to the particular transaction or conduct that is the subject matter of judicial inquiry once unconscionable abuse of the corporate entity is established. If this provision is duly applied by the courts, it will ensure that controllers of the company are held solely personally liable and not jointly with the company where the corporate veil is pierced, an approach which the courts seem to have erroneously adopted in most of the existing cases.

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