



“Lifting of the corporate veil in UK and Cyprus under common law - Overall dimensions of the topic.”

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Abstract

This dissertation was written as part of the LLM in Transnational and European Commercial, Arbitration, Mediation and Energy Law at the International Hellenic University.

This study focuses on the lifting of the corporate veil in UK and in Cyprus, as the latter has been applied as an exception to the principle of the separate legal personality of the companies in Common Law countries. The principle of the "veil of incorporation" was introduced in 1897 in *Salomon v. Salomon & Co Ltd* case in which the House of Lords brought into English law the twin concepts of corporate entity and limited liability. More specifically, the Court laid down the principle that a company is a distinct legal person entirely different from its members. However, the human intelligence and ingenuity started using the veil of corporate personality unlimitedly as a mean for fraud or improper conduct. As a result it became necessary for the Courts to lift the corporate veil in order to have the ability to look at the persons behind the company who are the real beneficiaries of the company. In regard with the above and pursuant to the need to ensure the proper use of the concept of the corporate veil, the doctrine of the lifting of the corporate veil was born. Further to the courts' approach when lifting the corporate veil, the same appears in the legislation of the two countries too, as one can notice that beside the judicial grounds there are existing legal grounds for the lifting of the corporate veil.

If we want to give an explanation of the "**Lifting of the corporate veil**" it is crucial to mention that according to the lifting of corporate veil there is a possibility to disregard the corporate personality and look behind the real person who are in the control of the company. In other words, where a fraudulent and dishonest use is made of the legal entity, the individuals concerned will not be allowed to take shelter behind the corporate personality. In this respect the court will break through the corporate shell and apply the principle of what is known as "lifting or piercing through the corporate veil."

Keywords: Separate legal personality, Lifting, Corporate veil, UK, Cyprus

Mina Sokratous
31. 01. 2017

Preface

First of all, I would like to express my sincere gratitude to my supervisor, Professor Thomas Papadopoulos, for the patient guidance and advice he has provided throughout my time as his supervising student. I have been extremely lucky to have a supervisor who responded promptly to my questions and queries. His guidance has been valuable and helped me in all the time of writing of this thesis.

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Introduction

This study deals with the “piercing” or “lifting” of the corporate veil in legal systems based on common law, namely in UK and in Cyprus. The lifting of the corporate veil is one of the most debated issues as well as the most litigated one in corporate law. Talking about the lifting of the corporate veil, we must admit that, there is numerous literature and case law dealing with the issue but from my place, in this study, I will try to give my perspective of the topic adding my personal touch to the already given analysis by the literature. In this direction, dealing with the lifting of the corporate veil would be pointless if we do not approach the general principle of corporate veil as being introduced in the UK. According to the latter, the corporation is such an autonomous legal subject and corporate entities with limited liability are separate from their shareholders meaning that the shareholders and directors are covered by the veil of corporation and they cannot be held liable for their corporations' debts or any other obligations. Thus, the corporate veil can be characterized as the cornerstone of corporate law in common law jurisdictions as it enhances the limited liability character of the companies and gives actually a significant motivation¹ for anyone who wants to incorporate a new company. As a consequence, Chapter I of this paper will focus on surveying the concept of company as a separate legal entity, as being established in the landmark decision in **Salomon v Salomon & Co Ltd**. Additionally Chapter I will also include an analysis of the limited liability of the companies and the consequences of the latter to the development of the corporate law.

However, although corporate veil constitutes the general rule protecting the shareholders and directors in the event of that company's financial or legal misconduct, it is not impenetrable as a concept meaning that the corporate veil can be under specific circumstances “lifted” or “pierced”. “Piercing” or “lifting” of corporate veil is undoubtedly the most commonly used doctrine to decide whether a shareholder or shareholders will be held liable for obligations of the company or not and as a consequence, this exception to the general rule of corporate veil, continues to be one of the most debatable doctrines in all of corporate law due to its complexity as a doctrine. More specifically, the lifting of the corporate veil is actually a legal decision with which the corporate veil is lifted or pierced and in such a case the shareholders are personally liable for the company's obligations. Thus, it is quite clear that the piercing of corporate veil as a doctrine is only exceptionally applicable under specific circumstances and when is needed. To this direction, courts in various cases have established some criteria under which the lifting of corporate veil doctrine is necessary. The above-mentioned criteria for using the lifting of corporate veil doctrine as well as an analysis of the doctrine, as the latter has been expressed by case law in Cyprus

¹Easterbrook & Fischel, *supra* note 5, at 97

and in UK, will be the main content of chapter II of this dissertation. Chapter II will also include a comparative analysis of the approach of the examining countries regarding the corporate veil. Finally, Chapter III gives an overall assessment of the paper where the reader can understand my perspective of the whole topic.

Chapter I

“The veil of incorporation” - The company as a separate legal entity

As mentioned above in the introduction, this chapter will focus on the principle of the veil of incorporation as it was specifically expressed in the so called **Salomon v A Salomon & Co Ltd decision**. The veil of incorporation is the cornerstone of the corporate law in Common law countries so it is undoubtedly an issue of significant importance in order to proceed with the analysis of the “lifting” of corporate veil in Cyprus and in UK later in this paper.

1.1 THE SEPARATE LEGAL PERSONALITY

Legal personality refers to the general and abstract capacity of a certain entity to operate as a legal subject.² In regard to the above definition of legal personality, the courts in the so called decision **Salomon v. A Salomon & Co Ltd** introduced the general principle of the separate legal personality of the companies meaning that the corporation is an autonomous legal entity itself and it has its own rights and liabilities which are distinct from the rights and liabilities of its shareholders. This means that the company is “a body of bodies”; technically, an artificial person composed of natural persons.³ The right to incorporate and acquire a legal personality distinct from that of the shareholders was a first step in separating the legal spheres of the enterprise owners or investors and that of the enterprise itself.⁴ Historically speaking the concept under which an artificial person has its own rights and obligations was firstly introduced by Roman law. However, although we can say that this concept was not an invention of English law, it is absolutely clear that a more noticeable development of the principle of separability of the legal personality of corporations was firstly reported in the

²J.E. Antunes, liability of Corporate Groups. Autonomy and Control in Parent-subsidiary Relationships in US, Gennan and EU law. An International and Comparative Perspective, (Deventer/ Boston, MA Kluwer Law and Taxation Publishers, 1994), 57.

³ Harry G Henn and J A Alexander, Laws of Corporations (3rd edn, 1983), p145. However, it is important to note here that sometimes the members of a company are themselves companies but in any case there will be natural person at the end of the chain.

⁴ J.E. Antunes, above Liability of Corporate Groups

seventeenth century when the English judges tried to formulate a law of corporations for municipal corporations and church institutions.⁵And interestingly, the separate corporate personality doctrine remains the foundation for corporate law which governs a lot of multinational corporations today.⁶Thus, it is understood that the doctrine of separate personality of corporations remains until today under the spotlight due to its significance.

1.2 SALOMON v. SALOMON & CO LTD - FULL ANALYSIS

As mentioned above, the separate legal personality of an entity was established by the House of Lords in the landmark decision in **Salomon v A Salomon & Co Ltd (1897)**. The facts of Salomon v A Salomon & Co Ltd were as follows: Aron Salomon was a boot and shoe manufacturer and he was trading his products as a successful sole trader in the East End of London for 30 years. In Aron's family there was a family pressure to give them a share in the business. Aron wished to extend the business, so consequently he decided to form a company to which he sold his own business. By the time Aron formed the company, the existing legislation required from every company to have a minimum number of seven members. Thus, the A Salomon and Co Ltd had as members Aron Salomon himself as well as six members of his family, his wife and his five children. That six members, who were referred as subscribers in the memorandum of A Salomon & Co Ltd, interestingly, held one share each as nominees. The core idea behind the above allocation of shares was of course that the company in reality was a 'one man company'. The purchase price was £38,782 and Salomon took 20,001 shares and the six other family members took one share each. According to Lord Macnaghten the purchasing price is "a sum which represented the sanguine expectations of a fond owner rather than anything that can be called a businesslike or a reasonable estimate of value"⁷ The purchase price, as being analyzed in Farrar's company Law Book in Chapter 7, was to be paid as to 30.000 pounds out of money as it came in, which Salomon immediately returned to the company in exchange for fully paid shares 10.000 Pounds in debentures. What was the consequence, was that Salomon at the end of the day received only an amount of 1.000 Pounds in cash, 10.000 in debentures and half of the nominal capital of the company in issued shares. Aron Salomon made a lot of efforts to get the company back to its feet. Such efforts, were the loan he and his wife lent the company and of course the fact that he mortgaged his debentures to obtained the necessary funds and then loan them to the company. However, none of these efforts was enough in order to get back the company

⁵ Karen Vanderkerckhove - Piercing the Corporate Veil_ A Transnational Approach- (2007) (1). p .25

⁶ 8.Ph. I. Blumberg, (Hastings Int'l & Comp. L. Rev. 2001), 301. See also A. Dignam and J. Lowry, Company Law, (Oxford, Oxford University Press, 2006), 15 et seq.

⁷ 1897. AC 22 at 49, HL.

to its feet and the business subsequently collapsed. Therefore, the business went into liquidation and consequently, the assets of the company were forced into sale. The amount resulting from the sale of company's assets was enough for paying the mortgagee but it was not enough in order to fully repay the debentures. As a result, Aron Salomon brought a claim against the company on the basis of the debentures held, as a secured creditor. The liquidator argued that Salomon could not rank ahead of other creditors. The liquidator's argument was based in the fact that there was an identification between the company, A Salomon & Co Ltd and Mr. Salomon himself as the company carried on business on behalf of Mr. Salomon. Both the first instance judge and Court of Appeal held that the one-man company was an abuse of the Companies Act and Salomon appealed to the House of Lords⁸. More specifically, in the first instance court Mr. Vaughan Williams J. took the view that the company was 'a mere nominee and agent' of Mr. Salomon⁹ and the Court of Appeal followed with another misconceived decision by stating that 'the formation of a company and issue of debentures...were a mere scheme' to enable Mr. Salomon to 'carry on business in the name of the company with limited liability contrary to the true intent of the Companies Act 1862.'¹⁰ The House of Lords totally rejected the rulings held above by the courts and held that Mr. Salomon could not be liable for the debts of the corporation because the debts of the corporation were not personal debts of Mr. Salomon as they were two separate legal entities; and that once the artificial person has been created, "it must be treated like any other independent person with its rights and liabilities appropriate to itself."¹¹

Lord Macnaghten expressed a legal classic speech and observed quite firmly that:¹²

"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 subscribers as members liable, in any shape or form, except to the extent and in the manner provided by the Act. That is, I think, the declared intention of enactment."

Thus, it is quite clear that Salomon's case as been analyzed above has significant importance to the development of company law in common law jurisdictions that it is

⁸ J.H Farrar & B.M Hannigan, Farrar's Company Law, 4th edition, 1998, p. 67.

⁹Salomon v Salomon & Co Ltd [1897] AC 22, at 25.

¹⁰Ibid., at 9.

¹¹Salomon v. Salomon & Co. Ltd. [1897] A.C. 22.

¹²Ibid. at p. 51.

actually the law that this paper is concentrated on. It is therefore, widely accepted and recognized as the decision that establishes one of the most important principles of British company law¹³, indeed of company law of all common law systems, that a company is a legal person independent and distinct from its shareholders and its managers. Moreover, the latter principle as we can notice from latest decisions has been consistently applied and it serves as a general guideline for every judge dealing with such cases in common law jurisdictions.

Such cases in which the court followed the same approach¹⁴ as in **Salomon v A Salomon & Co Ltd.** was in **Macaura v Northern Assurance Co. Ltd.**¹⁵ Likewise, the principle of separate legal personality of companies has been widely used by the Courts in Cyprus too, as Cyprus belongs to the common law system countries. Thus, in Cyprus, there has been similar judicial support for the separate entity concept which is quite understood in cases like **MATERO LTD v. REPUBLIC, (1986)** by the High court of Cyprus which explicitly refers to Salomon principle.¹⁶

¹³P. Davies in Palmer's Company law (1992), 2228/1, no.2. 1 523. Salomon v. A Salomon & Co Ltd concerned a cornerstone of English company law in general

¹⁴In the Canadian Supreme court case of Wadlyn Motels Ltd v Commerce General Insurance Co (1970) 12 DLR (3d)605, the court held that a company has no insurable interest in the assets of the principal shareholder.

¹⁵Macaura v. Northern Assurance Co. Ltd. [1925] A.C. 619. In this case Lord Sumner concurred and said the following:
"My Lords, this appeal relates to an insurance on goods against loss by fire. It is clear that the appellant had no insurable interest in the timber described. It was not his. It belonged to the Irish Canadian Sawmills Ltd, of Skibbereen, co Cork. He had no lien or security over it and, though it lay on his land by his permission, he had no responsibility to its owner for its safety, nor was it there under any contract that enabled him to hold it for his debt. He owned almost all the shares in the company, and the company owed him a good deal of money, but, neither as creditor nor as shareholder, could he insure the company's assets. The debt was not exposed to fire nor were the shares, and the fact that he was virtually the company's only creditor, while the timber was its only asset, seems to me to make no difference. He stood in no "legal or equitable relation to" the timber at all. He had no "concern in" the subject insured. His relation was to the company, not to its goods, and after the fire he was directly prejudiced by the paucity of the company's assets, not by the fire."

¹⁶More specifically, the court in the aforementioned decision held that:

"One of the cornerstones of modern company law is the notion of separate corporate personality. This principle has been rigorously applied by the Courts since the case of Salomon v Salomon and Co Ltd [1897] A.C. 22."

1.3 CONSEQUENCES OF SEPARATE CORPORATE PERSONALITY

In the preceding subchapters of this paper, I emphasized on the doctrine of separate corporate personality of the companies, starting from the definition of the latter and then continued with the analysis of the landmark case of Salomon and A Salomon & Co Ltd. Thus, I believe it is quite important to devote the next subchapter in quoting the consequences of the separate legal personality. As a result, one should consider the following traditional and modern corporate attributes of any corporation under common law: The first characteristic of companies which is also a consequence of the doctrine of separate corporate personality of the companies is that the company itself has perpetual succession. By the aforementioned term what we mean is that the company continues to exist even in the case in which its directors and shareholders die. "This unbroken personality, this beautiful combination of the legal characters of the finite with essentials of infinity appears to have been primary object of the invention of corporations"¹⁷ as Grant wrote in 1850.

Moving on the next consequence of separate legal personality, a company owns its own property meaning that the legal owner of the assets of the company is not its shareholder but the company itself. The shareholders have an interest in the assets of the company indirectly through the medium of their shares. No other proprietary rights belong to the shareholders and consequently, the creditors of the company are not creditors of the shareholders meaning that in principle the creditors must go against the company. The above-mentioned consequence led us to the next conclusion which is that the company itself (in its own name) can freely sue or be sued which is in my opinion one of the most important consequences of the doctrine of separate corporate personality of the companies. Moreover, the company as an independent legal entity with separate corporate personality should be in compliance with the formalities of the Companies Act in UK as well as with the corresponding Companies Act in Cyprus. As a result, the Companies shall pay registration fees but also fees of the regular filing of documents and accounts with the registrar.

1.4 LIMITED LIABILITY OF COMPANIES UNDER COMMON LAW

The content of this subchapter, can be also mentioned as a consequence of the separate corporate personality of the companies. And this is because, although limited liability is not necessarily an attribute of the latter doctrine, the two concepts of limited liability and separate corporate personality are commonly connected in practice. However, in my opinion, the aforementioned concepts are separate and any effort to equate the two is wrong.

¹⁷ Grant on Corporations (1850) Butterworths, p 4.

Historically speaking, it is not easy to determine the period when limited liability emerged in the United Kingdom. However, on the legislative front, it was only in 1855 and 1856 that the English Parliament enacted the first Limited Liability Act and the Joint Stock Companies Act.¹²¹⁸ In any case, the concept of limited liability exists until today and has significant importance to the development of company law. Regarding the concept of limited liability, the shareholders of a limited liability company are not, in principle, liable for the company's debts and as a result the company itself, according to the doctrine of separate corporate personality, undertakes its own debts. The shareholders are liable to the company only on the par value of their shares; in principle, the shareholders do not risk more than their capital contribution.¹⁹ Thus, it is easily understood that the concept of limited liability as well as the concept of separate corporate personality is a great motivation to passive investors that do not participate in management to invest where they would not do if they would be exposed to the risk of unlimited liability.²⁰ Furthermore, it permits large-scale enterprises, where shareholders would not be capable of bearing the risks involved and where it is impossible to involve the thousands of investors in management.²¹ Limited liability encourages also the development of public markets for stocks and thus helps make possible the liquidity and diversification benefits that investors receive from those markets.²² So, there is no doubt that the two concepts of limited liability and separate corporate personality, as being analyzed above, are actually a vital tool to the countries belonging to the common law system and more specifically to UK and Cyprus. However, the concept of the separate corporate personality of the companies with limited liability is not absolute and as we will see precisely in the next chapter the concept has some significant exceptions.

¹⁸A. Dignam and J. Lowry, above (Company Law 2006), 17; S. Bowmer, 'To pierce or not to pierce the corporate veil - why substantive consolidation is not an issue under English law' (2000) 15(8) J. Int'l Banking L., 193.

¹⁹ Karen Vanderkerckhove - Piercing the Corporate Veil_ A Transnational Approach- Kluwer Law International (2007) (1). p.24

²⁰H.G. Manne, Our Two Corporation Systems: Law and Economics, 53 VA. L. REV, 1967, p. 262-265. It is really important to mention that the separate corporate personality of the companies as well as the limited liability increases funding availability for projects that have positive net values, but carry too much risk in terms of potential to wipe out all of the investor's capital.

²¹H.G. Manne, above (Va. L. Rev. 1967), p. 262.

²²Henry G. Manne, Our Two Corporation Systems: Law and Economics, 53 VA. L. REV., p.259, 262, 1967 (publicly held corporations with many small shareholders could not exist without limited liability).

Chapter II

“Lifting” or “Piercing” of corporate veil - Overall dimension of the concept

This chapter focuses on the “lifting” or “piercing” of the corporate veil in Cyprus and in UK which, definitely, can be characterized as the core of the thesis. The terms of “lifting” or “piercing” are the two terms that are mostly used to designate the same reality. But there are some other terms in English that describe the same situation and these are the terms of “penetrating”, “ignoring”, “extending” or “parting” the veil,^p “disregarding the corporate entity or personality”. In Greek the predominant term for the lifting of corporate veil which is repeatedly found in Cyprus cases and literature is “Άρση του εταιρικού πέπλου”.

2.1 “LIFTING” OR “PIERCING” OF THE CORPORATE VEIL

The “lifting” or “piercing” of the corporate veil as already mentioned above, is a legal decision with which the corporate veil is lifted or pierced and in such a case the shareholders are personally liable for the company’s financial and other obligations. When the courts pierce the corporate veil, they disregard the separateness of the corporation and hold a shareholder responsible for the corporation’s action as if it were the shareholder’s own.²³ Thus, it is quite clear that the concept of the “lifting” or “piercing” of corporate veil totally opposes to the doctrine of the separate legal personality under which the company is an autonomous legal entity with independent legal personality which is the general principle of companies law in common law countries. Consequently, as the concept of the lifting of the corporate veil opposes to the general rule, the latter has exceptional application by the courts. But, when has such legal concept application by the courts? What does really lead the courts to ignore the independence of the company and concerns itself directly with the members or the directors of the company? The answers to the aforementioned questions are not strictly ascertained by the courts and the literature²⁴ as it is up to the courts discretion² to decide whether they should lift the corporate veil, meaning that the courts decide ad hoc when they should observe possible liability directly to the members of the company instead of the company itself. Such assessment is usually based in specific circumstances that justify the deviation from the basic rule of the principle of the

²³R.B. Thompson, 'Piercing the corporate veil: an empirical study' (1991) 76 Cornell L. Rev., p.1036.

²⁴Warner Fuller, *The Incorporated Individual: A Study of One-man Company*, (1938) 51 Harv LR 1373, 1377. “It is impossible to ascertain the factors which operate to break down the corporate insulation.”

²⁵Tata Engineering Locomotive Co v. State of Bihar AIR 1965 SC 40 “The matter is largely in the discretion of the courts and will depend upon “the underlying social, economic and moral factors as they operate in and through the corporation.”

independent corporate personality.²⁶ In the following subchapters I will analyze the grounds that lead to the lifting or piercing of the corporate veil as being introduced by the law of Cyprus and UK and of course as they have been introduced by the courts in several cases. In the context of the aforementioned analysis one must notice that the reasons justifying the lifting of the corporate veil are distinguished in the judicial grounds as well as in the legal grounds which will be referred also as the legal provisions.

2.2 GROUNDS UNDER WHICH THE CORPORATE VEIL IS LIFTED IN UNITED KINGDOM

The corporate veil is lifted or pierced under some specific extraordinary circumstances and to this end the courts in numerous cases has introduced some specific grounds that justify such deviation from the so called Salomon principle. These judicial grounds for the lifting of the corporate veil as well as the legal grounds for the piercing of the corporate veil in UK will be quoted in detail in the next subchapters.

2.2.1 LEGAL LIFTING OF THE CORPORATE VEIL IN UNITED KINGDOM

Undoubtedly, the locus classicus for legislation for the legal piercing of the corporate veil was expressed in the speech of the **Lord Diplock in the Dumbleby & Sons v National Union of Journalists case**²⁷. Lord Diplock 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’être* and its consistent recognition by the courts since **Salomon v A Salomon & Co Ltd**, 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 same legal personality of another, a purposive construction of the statute may nevertheless lead inexorably to the conclusion that such must have the intention of the Parliament.”

i) Less than statutory minimum members

²⁶Odyssey (London) Ltd. v. OIC Run Off Ltd. (2000) TLR 201 CA It can be said “that adherence to the Solomon principle will not be doggedly followed where this would cause an unjust result”.

²⁷ 1984, 1 WRL 427 at 435 B-G, HL.

The first legal ground under which the lifting of the corporate veil is justified in UK is established by the legislator in **Section 24 of the Companies Act ('CA') 1985**²⁸ which provides that if a company carries on business without having at least two members and does so for more than 6 months, any person who is a member after those six months is liable jointly and severally with the company for the payment of its (contractual) debts. However, the aforementioned limitations by the Section 24 of Companies Act seems to be rarely invoked especially if we take into account that the single member private companies are allowed. Consequently, this reason of lifting the corporate veil constitutes a rather theoretical exception to the general rule of limited liability²⁹ and to this end the aforementioned provision has been deleted in the new corporate legislation of UK, namely the Companies Act 2006.

ii) Fraudulent and wrongful trading

The second ground that justifies the lifting of the corporate veil and therefore deviates from the limited liability rule can be found in **Section 213-215 of Insolvency Act 1986** on fraudulent and wrongful trading. Fraudulent trading occurs when the business of a company has been carried on with the intent to defraud creditors of the company (or of any other person) or for a fraudulent purpose.³⁰ In such a case, the court may declare that any persons who were knowingly party to the carrying on of the business in that manner are to be liable to make such contributions to the company's assets as the court thinks proper (**Section 213 Insolvency Act 1986**).³¹ Because of the requirement of fraudulent intent, Section 213 Insolvency Act 1986 (and its predecessor, Section 332 Companies Act 1948) does not provide an easy ground for shareholder liability.

The liability was also extended to wrongful trading which is without any doubt a much broader concept. The aforementioned extension of liability was proposed by the Cork Committee, which prepared the reform of English insolvency law during the 1980s and that propose was finally followed.³² **Section 214 of Insolvency Act** deals with wrongful trading and enable the court to make a declaration where a company has gone into

²⁸ This legal provision has been deleted in the new corporate legislation of UK, namely the Companies Act 2006. I found it critical to quote it for academic and theoretical reasons.

²⁹ L.B.C. Gower, *Gower's Principles on modern Company Law*, 1992, p.110

³⁰ Karen Vanderkerckhove - *Piercing the Corporate Veil_ A Transnational Approach* - Kluwer Law International (2007) (1). p.89

³¹ F. Tolmie, *Introduction to Corporate and Personal Insolvency law* (London, Sweet & Maxwell, 1998), p.357-358; I.F. Fletcher, *The law of Insolvency* (London, Sweet & Maxwell, 1996), p.659-660; I.F. Fletcher, *The Law of Insolvency*, 3rd edition (London, Sweet & Maxwell, 2002) p.705-706.

³² F. Tolmie, (*Insolvency law 1998*) p.358-364; I.F. Fletcher, (*The Law of Insolvency 1996*), p.661-664; I.F. Fletcher, (*The law of Insolvency 2002*) p.707 et seq.

insolvent liquidation. More specifically, it provides for the same type of liability that may attach to any person who is or has been a director of a company that has gone into insolvent liquidation and that knew or ought to have concluded that there was no reasonable prospect that the company would avoid going into insolvent liquidation. At this point, we must note that the declaration is not to be made if the court is satisfied that the person took every step with a view to minimizing the potential loss to the creditors that he ought to have taken and to this end, the standard applied is one of a reasonably diligent person having the general knowledge, skill and experience to be expected of a person carrying out his or her functions in relation to a company and the general knowledge, skill and experience that he or she in fact has.³³ The importance of Section 214 for liability in corporate groups lies in the extension of the term of the directors with the inclusion of shadow directors³⁴ which 'raises the very real prospect of invoking Section 214 against the company's parent company'.³⁵

iii) Abuse of the company name

Another important legal ground for lifting the corporate veil can be found in the **Sections 216-217 of the Insolvency Act 1986**. The aforementioned provisions explicitly refer to the liability of the directors or shadow directors who, having run a company that got into insolvent liquidation, form, within five years after the insolvency, another company with an identical or very similar name that buys the undertaking and assets from the original company and through which they continue to trade. These companies are well known as the 'phoenix companies'. More specifically, according to section 216 of the Insolvency Act, anyone who was a director of a company shadow or not, at anytime during the 12 months preceding its insolvent liquidation to be in any way concerned during the next five years in the formation or management of a company or a business with a name by which an earlier company was known or is so similar as to suggest an association, bears the liability.³⁶ Section 217 provides for personal liability jointly with the company for the debts contracted during that period. However, the case law regarding the sections 216-217 of Insolvency Act as a ground for lifting the corporate veil seems that is rarely reported.³⁷

³³ J.H. Farrar & B.M. Hannigan, (4th edition), 1998, p.76

³⁴ Section 124(1) of the Insolvency Act of Companies Act 1985, s 741(2)

³⁵ Gower's Principles of modern Company Law (6th edition), 1997 p 154 et seq.

³⁶ L.B.C. Gower, Gower's Principles on modern company law, 5th edition, 1992, p.115; F. Tolmie, (Insolvency Law 1998), p.252-256; I.F. Fletcher, (The Law of Insolvency 1996), p. 664-667; I.F. Fletcher, (The Law of Insolvency 2002), p.712 et seq.

³⁷ F. Tolmie, (Insolvency Law 1998), p.255.

2.2.2 JUDICIAL LIFTING OF THE CORPORATE VEIL IN UNITED KINGDOM

The English courts have occasionally not applied the principle of separate corporate personality as been expressed in the Salomon case, known as the Salomon principle. These cases can otherwise be characterized as the exceptional cases in which the courts, rarely, do lift the corporate veil without statutory basis. "These cases are opaque and impassable", according to Gower.³⁸ Griffin finds that shareholder's liability depends on "a degree of judicial subjectivity" and remains "tangled in a mesh of uncertainty".³⁹ However, one must take into consideration that, in principle, the English courts follow the traditional principle of the separate corporate personality, and to this end, even in the cases in which they have decided to lift the corporate veil they have not done this in a systematic way by defining the proper ends of incorporation. They have therefore, moved to a case to case assessment of the circumstances under which they should lift the corporate veil, except from the cases of course where such lifting of the corporate veil is introduced by the law (legal piercing).⁴⁰

However, although there is no unifying principle that leads the courts to the lifting of the corporate veil, the English courts have established through their decisions all over the years some judicial grounds for the lifting of the corporate veil. This can be understood in the **Adams v. Cape Industries case**, which is a case of great importance for the concept of the piercing of corporate veil in common law as the Court of Appeal analyses three possible grounds for piercing: fraud, agency, and the single economic unit theory.⁴¹ But beyond these three grounds, all judicial grounds for the lifting of the corporate veil by the courts of United Kingdom will be analyzed in detail below.

i) Fraud

The Salomon principle observed to be used in some cases as an engine of fraud. Such violence of the Salomon principle could not be allowed by the courts and consequently, the English courts have systematically use the concept of the lifting of the corporate

³⁸ L.B.C. Gower, Principles of Modern Company law, 5th edition (London, Sweet & Maxwell, 1992) , p.88

³⁹S. Griffin, 'Holding companies and subsidiaries - the corporate veil' (1991) 12(1) Comp. lawyer p.17.

⁴⁰This ad hoc decision for the lifting of the corporate veil is explicitly expressed in the **Briggs v James Hardie &Co Pty Ltd** case of the New South Wales Court of Appeal in which Rogers AJA said that :

"The threshold problem arises from the fact that there is no common, unifying principle, which underlines the occasional decision of courts to pierce the corporate veil. Although an ad hoc explanation may be offered by a court which so decides there is no principled approach to be derived from the authorities....."

⁴¹ See Court of Appeal 27 July 27 (Adams v . Cape Industries pie),[1990]2WLR748).

veil in order to combat fraud. Further to the above, the fraud can be definitely characterized as an important judicial ground for the lifting of the corporate veil in Common law as the presence of an element of fraud is the most commonly seen factor which lead the courts to acknowledge the personal liability of the shareholders of a company. The whole concept behind the ground of fraud is of course the fact that the veil should be lifted when the defendant acted pursuant to some improper or fraudulent motive creating or utilizing a corporate facade as a sham or device to achieve something which it could not otherwise lawfully do.⁴² Therefore, there is no doubt that the courts are quite strict in cases in which physical persons under their capacity as members or directors of the company, abuse the corporate form by using fraudulent tactics. The English courts are not willingness to approve fraudulent actions under the invocation of the Salomon principle and this can be explicitly understood throughout their decisions in which they have repeatedly lifted the corporate veil in cases of any kind of fraud, meaning that the fraud here covers criminal fraud but also covers equitable fraud. In **Gilford Motor Co Ltd v Horne**⁴³, the managing director of the company entered into a covenant in a service agreement not to solicit customers from his employers. However, in contrast to the above agreement upon leaving the company's employment Mr. Horne formed a company in his wife's name to solicit the customers of the company and consequently, the company took some measures by bringing an action against him. The aforementioned case's facts were assessed by the Court of Appeal which held that the new company formed by the director was a mere sham to cloak his wrongdoings and, therefore, he could be restrained from committing a breach.⁴⁴

Moreover, from **Adams v. Cape Industries** case can be extracted that the crucial point in such cases is the timing of the switch to a different corporate entity meaning that

⁴² P. Davies in Palmer's Company Law (London, Sweet & Maxwell, 1992), 2224-2225, no. 2.1521;F.G. Rixon, 'Lifting the veil between holding and subsidiary companies' (1986) 102 LQR, 415 et seq., at 423.

⁴³ 1933, Ch 935, CA. See also Creasey v Breachwood Motors Ltd 1993 BCLC 480. The reason for the failure of the fraud here was that the exception was the timing of incorporation of the sham company. Mr. Creasey brought an action against wrongful dismissal against his employers BW. BW served a defence but four months later he was served a notice saying that the company was insolvent. BM took over all the business except the plaintiff's claim. The plaintiff obtained an order for damages and interest however before he received anything. BW was dissolved without going into liquidation. The plaintiff sought an order substituting BM for BW on the grounds of justice. As to criminal fraud see eg Hare v Customs and Excise Comrs 1996, 140 Sol Jo 67, CA

⁴⁴ See also Jones v Lipman, 1962, 1 ALL ER p. 442 in which a man contracted to sell his land and thereafter changed his mind in order to avoid an order of specific performance he transferred his property to a company. Russel judge specifically referred to the judgments in Gilford v. Horne and held that the company here was "a mask which (Mr. Lipman) holds before his face in an attempt to avoid recognition by the eye of equity" .Therefore he awarded specific performance both against Mr.Lipman and the company. See also Re Bugle Press Ltd, 1961 Ch 270 CA

when it occurs before the accrual of the cause of actions the courts will not pierce the corporate veil but it is otherwise where the switch is made after the cause of action accrued.⁴⁵ More specifically, what it may be inferred from *Adams v. Cape Industries* case is that a fraudulent motive can be found in cases which corporate transactions are sham and companies are used for the avoidance of existing liabilities.⁴⁶ In such a case as described above as well as in a situation in which the companies are used as a facade behind which “they are hiding the proceeds of their smuggling” the veil can undoubtedly be pierced by the courts.⁴⁷ Thus, it is quite clear that the Courts have been more than prepared to pierce the corporate veil when the elements of the case lead the judges to the conclusion that fraudulent tactics could be perpetrated behind the veil.

ii) Agency

Another important judicial ground for the lifting of the corporate veil in United Kingdom is the ground of agency. Agency, which is occasionally referred by the courts as “implied” or “constructive” agency⁴⁸ has been repeatedly cited as a ground of lifting of the corporate veil by a lot of commentators in the United Kingdom.⁴⁹ As a general rule, the construction of agency cannot be characterized as a strict ground for the lifting of the corporate veil, as the basic principle regarding the concept of agency is that the subsidiary is recognized as an independent legal person; The ground of Agency was of great importance to the landmark decision of *Salomon v Salomon* as in the aforementioned case o Justice Vaughan Williams expressed that the company was nothing but an agent of Solomon. "That this business was Mr. Solomon's business and no one else's; that he chose to employ as agent a limited company; that he is bound to indemnify that agent the company and that this agent, the company has lien on the assets....." However the House of Lords in straight contrast to the above held that the company was not automatically the agent of its shareholders. It was also held that such an agent relationship is not created automatically even in a situation of 98% controlling interest in a company by itself.⁵⁰

⁴⁵ J.H. Farrar & B.M Hanigan, p.72, *Farrar's Company Law*

⁴⁶*Kensington International Ltd v. Congo & Ors*, [2005] EWHC 2684.

⁴⁷*Re K & Ors* [2005] EWCA Crim 619.

⁴⁸ S. Ottolenghi, 'From peeping behind the corporate veil to ignoring it completely' (1990) *MLR*, 338, esp. 345.

⁴⁹ Karen Vanderkerckhove-Piercing the Corporate Veil_ A Transnational Approach-Kluwer Law International (2007) (1), p.92, see also *Rainham Chemical Works Ltd v Belvedere Fush Guano Co* (1921) 2 AC 465, HL; *Southern v Watson* (1940) 3 ALL ER 439, *Clarkson Co Ltd v Zhelke* (1967) 64, 2nd edition, p.457.

⁵⁰ *Kodak Ltd v Clark* (1903) 1 505, CA; *Denis Wilcox Pty Ltd v FCT* (1988) 14 ACLR 156

Nevertheless, the courts in some cases were willing to construe an agency of the company for its members. Such willingness by the courts was expressed in the Salomon case which did not exclude the possibility of there being an agent relationship in fact. Moreover, in light of the principle that the subsidiary is recognized as an independent legal person it is important to assess the role of the close control by the parent corporation as this control can be considered to be used for the exercise of the activities of the parent company.⁵¹ In such a case, it is clear that the parent corporation is held liable for the acts of its agent, especially if we take into consideration that the agent acted with the authority of its principal. The aforementioned agency relationship was tested in **Smith, Stone & Knight Ltd v Birmingham Corpn**⁵² case in which the overall question of whether the subsidiary was carrying on a business as the parent's business or its own was a question of fact. The court in order to give its answer to the question above has focused in the following factors:

- a) were the profits of the subsidiary those of the parent company?
- b) were the persons conducting the business of the subsidiary appointed by the parent company?
- c) was the parent company the "head and brains" of the trading venture?
- d) did the parent company govern the adventure?
- e) were the profits made by the subsidiary company made by the skill and direction of the parent company?
- f) was the parent company in effective and constant control of the subsidiary?

At the end of the day Mr. Atkinson J held that the subsidiary was the "agent or employee; or tool or simulacrum of the parent company". **Smith, Stone & Knight Ltd v Birmingham Corpn** case as being held it is quite important as it has been followed by later decisions like the **Hotel Terrigal Pty Ltd v Latec Investments Ltd** (No 2) by the New South Wale Supreme Court⁵³ where the court disregarded a purported sale by a mortgagee company of the mortgagee property to its wholly owned subsidiary for an improper purpose. However, one must take into consideration that the courts have been extremely reluctant to characterize a subsidiary, through their decisions, as the

⁵¹A.Wilkinson,'Piercing the corporate veil and the Insolvency Act 1986, 1987,Comp.Lawyer, 124, esp. 125.

⁵² 1939, 4 ALL ER p.116. A successful claim based on agency is found in Smith, Stone and Knight Ltd. v. Birmingham Corp.,

⁵³ 1969, 1 NSWRL 676.

agent of its parent for the transaction of the parent's business.⁵⁴ In **Adams v. Cape Industries**, the argument based on agency failed through the court's consideration that NAAC carried on its own business in the United States rather than that of Cape and/or Capasco; NAAC had no authority whatsoever to bind other group members to contracts for the supply or sale of asbestos.⁵⁵ Thus, must take into account that there is no presumption of any agency relationship in the absence of an express agreement between the parties and if not so it will be difficult to establish one. Otherwise, in cases where the agency agreement holds good and the parties concerned have expressly agreed to such an agreement then the corporate veil shall be lifted and the principal shall be liable for the acts of the agent.

iii) Single Economic Unit

The ground of the single economic unit as we will see in the analysis above is linked in fact with the ground of agency. However, the single economic unit constitutes an independent judicial ground under which the courts have based in some cases their reasoning for the application of the concept of the lifting of the corporate veil. But, what it is the ground of the single economic unit? The courts have sometimes shown a willingness to look upon a group of companies as a single economic unit⁵⁶ meaning that the court based on the single economic unit theory can ignore the separate legal character of the members of a corporate group in order to treat them as one unit.⁵⁷ Interestingly, the single economic unit argument was received favourably in at least one famous case, in **DHN Food Distributors v. Towler Hamlets London Borough Council**⁵⁸ case in which it has been held that the Courts may disregard Salomon's case whenever it is just and equitable to do so. More specifically, in the above-mentioned case the Court of appeal thought that the present case was one which was suitable for lifting the corporate veil. In the **DHN Food Distributors v Towler Hamlets London Borough Council case**, one company in the group owned the freehold and another company which carried on the business on the premises was a bare licensee. The court of Appeal was prepared to recognize the economic unit of the group as a single entity to enable them to recover their compensation. Lord Denning has remarked that we know that in many respects a group of companies are treated together for the

⁵⁴A.Wilkinson,'Piercing the corporate veil and the Insolvency Act 1986'(1987)Comp.Lawyer, p.125-126.

⁵⁵Court of Appeal 27July 1989(Adams v.Cape Industries pie.),[1990]2WLR694-698(first instance) and 744-745 (appeal) (other relevant factors are raised on p 761-762).

⁵⁶ See Gower, op cit, p.166 ff. H Collins gave also an interesting analysis, 1990, 53 MLR 731.

⁵⁷Karen Vanderkerckhove-Piercing the Corporate Veil,2007, p.93

⁵⁸Court of Appeal, DHN Food Distributors v. Towler Hamlets London Borough Council, 1976 1 WLR 852.

purpose of accounts, balance sheet, and profit and loss accounts. Gower too in his book says, "There is evidence of a general tendency to ignore the separate legal group". However it is quite clear that the court will pierce the corporate veil after an ad hoc assessment of the facts of the case and undoubtedly one of the most important indicators whether the court would pierce or not the corporate veil would be the nature of shareholding and control.

However, although the ground of the single economic unit was received favourably in *DHN Food Distributors v. Towler Hamlets London Borough Council* case, it was later questioned as a ground and it was, indeed, explicitly doubted by the House of Lords in the **case of Woolfsan**⁵⁹ in which the house of lords held that there was "no basis consonant with the principle upon which on the facts of this case the corporate veil can be pierced to the effect of holding Woolfsan to be the true owner of Campbell's business or the assets of Solfred," the two subsidiary companies that were jointly claiming compensation for the value of the land and disturbance of business. Furthermore the House of Lords added "properly applied the principle that it is appropriate to pierce the corporate veil only where special circumstances exist indicating that it is a mere facade concealing the true facts". The ground of the single economic unit as a ground for the piercing of the corporate veil failed in the **Adams v. Cape Industries** case as well as in *Bank of Tokyo Ltd.v. Karoon* in which Mr Hoffmann explicitly stated the following: "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."⁶⁰

iv) Trust

What is noticeable from the case law of the English courts, is that, occasionally, the courts based in the concept of trust their reasoning for the implementation of the piercing of the corporate veil in order to look at the characteristics of the shareholders. Here it is important to quote the **Abbey Malvern Ltd v Ministry of Local government and Planning case**⁶¹ in which the court lifted the corporate veil. More specifically, in *Abbey Malvern Ltd v Ministry of Local government and Planning* case a school was carried on in the form of a company, but the shares were held by trustees on educational charitable trusts. The court pierced the corporate veil in order to look at the terms on which the trustees held the shares.

v) Tort

⁵⁹ House of Lords, *Woolfsan v. Strathclyde Regional Council*, [1 978] SLT 1 59.

⁶⁰Court of Appeal 24 May 1984 (*Bank of Tokyo Ltd.v Karoon*),1986 3WLR414-431.

⁶¹ 1951, Ch 728

One of the judicial grounds for the lifting of the corporate veil is the tort. However one must take into consideration that it is a rare phenomenon for the English courts to use tort remedies to lift the corporate veil. Such practice is not common in Common Law jurisdictions apart from Canada where there is an increasing use of tort as ground, by the courts, in order to bypass the Salomon principle.

vi) Enemy Character

In times of war the court is prepared to lift the corporate veil in order to reveal who are the actual controlling shareholders of the companies. This is what happened in the **Daimler Co Ltd v Continental Tyre and Rubber Co case**⁶² where German shareholders held the shares of an English company during the time of First World War.

vii) Tax

At times tax legislations lead to the lifting of the corporate veil. The courts are also prepared to disregard the separate legal personality of companies in cases which there is tax evasion or over-liberal schemes of tax avoidance without any necessary legislative authority. In cases as being described above the courts have occasionally dismissed the company as a mere sham.⁶³

2.3 GROUNDS UNDER WHICH THE CORPORATE VEIL IS LIFTED IN CYPRUS

Type Of Cyprus' Legal System

The Cyprus legal system is largely based on common law and consequently Cyprus, as a former British colony, inherited common law doctrines and principles which were codified into legislation when the Republic of Cyprus was established in 1960. Such principles are of course, the common law and equity principle and Cyprus as a genuine common law country has widely recognized and further applied English case law as a valuable guidance to the Cyprus courts. The absolute dependence of the Cyprus law to the UK law is clear in the corporate law of the two countries too as Cyprus' Companies Law is extensively based on English Law, particularly in the field of commercial and private transactions. Thus, it is not a coincidence that in essence the Companies Law, Cap. 113 reproduces almost verbatim the Companies Act of the United Kingdom (1948). However, since the accession of Cyprus to the European Union several amendments have been made in order Cyprus' national legislation to be aligned with the EU legislation. Nevertheless, such amendments did not occur in the field of Cyprus Companies Law as the national corporate legislation remains strictly connected or possibly almost a reproduction of the English Companies Law.

⁶² 1916, 2 AC 307, HL

⁶³ See Gower, op cit, p. 164

Regarding the lifting or piercing of the corporate veil in Cyprus, it is quite clear from the already given analysis of this paper that Cyprus has adopted the basic common law principle, which firstly appeared in the United Kingdom, according to which a company “is at law a different person altogether” from its shareholders, directors, or secretary and it is not in law the agent or trustee of any of them. As a result, the basic characteristic of a Cyprus limited liability company which is a characteristic of the English company too, is that its members’ liability is limited to the nominal value of the shares subscribed by them⁶⁴. Thus, the Cyprus limited liability company, following the English principle, known as the Salomon principle, is accompanied by the consequences of the separate legal personality as the latter have been extensively analyzed in subchapter 1.3 and generally in the first chapter of this paper.

However, the aforesaid principle of the separate corporate personality is also subject to certain exceptions in the Cyprus reality too. These exceptions allow the state or the courts to “lift or pierce the corporate veil” and consequently allow them to reveal the identity of the shareholders of the company and of course to determine the true nature of any specific transaction in which the company is a party. The next subchapters will be focused on the grounds or the exceptions which lead to the “lifting” or “piercing” of the corporate law as the latter have been introduced by the Cyprus law with a distinction in the legal piercing and judicial piercing of the corporate veil. Nevertheless, it is already mentioned that United Kingdom as well as Cyprus belong to the common law countries family and as a result it will be quite clear from the analysis above that the concept of the lifting of the corporate veil in the two countries is applicable almost under the same circumstances. Thus, I find it critical to emphasize on the legal elements of the Cyprus law regarding the piercing of the corporate veil that differ from the English law but also to quote important Cyprus case law in regard to the grounds that are adopted from the English law respectively.

2.3.1 LEGAL LIFTING OF THE CORPORATE VEIL IN CYPRUS

i) Members severally liable for debts where business carried on with fewer than seven

The first legal ground of the Cyprus law that lead to the lifting of the corporate veil can be found in the companies Act and more specifically in **Cap. 113, article 32**. According to article 32 of Cyprus Companies Act “if at any time the number of members of a company is reduced, in the case of a public company, below seven, and it carries on business for more than six months while the number is so reduced, every person who is a member of the company during the time that it so carries on business after those

⁶⁴ This is the only risk by the shareholders holding shares in a limited liability company as the shareholders and members of a company are not liable for the company’s obligations in any shape or form.

six months and is cognizant of the fact that it is carrying on business with fewer than seven members, shall be severally liable for the payment of the whole debts of the company contracted during that time, and may be severally sued therefore.”⁶⁵ Thus, it is obvious that the legislator tried to impose with this provision personal liability regarding the company debts, to any person who knowingly participated in the conduct of the company with intent to defraud third parties during the company’s liquidation.⁶⁶

ii) Chapter 113 Article 103 (4) Companies Act

The next ground for the lifting of the corporate veil in Cyprus can be found in **Cap. 113, Article 103 (4)**. This article introduces personal liability if an officer of a company or any person on its behalf:

(a) uses or authorizes the use of any seal purporting to be a seal of the company whereon its name is not so engraved as aforesaid; or

(b) issues or authorizes the issue of any business letter of the company or any notice or other official publication of the company, or signs or authorizes to be signed on behalf of the company any bill of exchange, promissory note, endorsement, cheque, or order for money or goods wherein its name is not mentioned in manner aforesaid; or

(c) issues or authorizes the issue of any bill of parcels, invoice, receipt or letter of credit of the company wherein its name is not mentioned in manner aforesaid;

In such a case, it is explicitly referred in **Cap. 113, Article 103 (4)** that the person who acts in such a manner will be personally liable to the holder of the bill of exchange, promissory note, cheque or order for money or goods for the amount thereof unless it is duly paid by the company.⁶⁷

iii) Civil liability for misstatements in prospectus Cap. 113, Article 43 Companies Act

⁶⁵<http://www.cylaw.org/nomoi/arith/CAP113.pdf>

⁶⁶ Here and pursuant to the analysis above in regard to the cases of the intent to defraud third parties during liquidation procedure it is important to mention another legal ground of the Cyprus law that lead to the lifting of the corporate veil and it can be found in **article 311 of Cap 113** Companies Act. Article 311 read as follows: “ If in the course of the winding up of a company it appears that any business of the company has been carried on with intent to defraud creditors of the company or creditors of any other person or for any fraudulent purpose, the Court, on the application of the official receiver, or the liquidator or any creditor or contributory of the company, may, if it thinks proper so to do, declare that any persons who were knowingly parties to the carrying on of the business in manner aforesaid shall be personally responsible, without any limitation of liability, for all or any of the debts or other liabilities of the company as the Court may direct.”

⁶⁷Multi Klima Maliotis Engineering Ltd v. Republic of Cyprus, joined cases 483/97 and 484/97, dated 18/02/2000

Article 43 of Cyprus Companies Act reads as follows:

“Where a prospectus invites persons to subscribe for shares in or debentures of a company, the following persons shall be liable to pay compensation to all persons who subscribe for any shares or debentures on the faith of the prospects for the loss or damage they may have sustained by reason of any untrue statement.” Moreover, there is no doubt that **Cap. 113, Article 43** belongs to the legal grounds for the lifting of the corporate veil as the application of the latter imposes on directors the obligation to proceed to compensation payment to those who suffered damage by reason of any untrue statement in the call.

iv) Keeping of books of account - Financial statements

Cyprus Companies Act introduces the responsibility of the directors of the company “to keep the books of accounts which are considered necessary for the preparation of financial statements in accordance with this Law.”⁶⁸ The violation of the aforementioned obligation by the directors of the company constitutes a legal ground for the lifting of the corporate veil. More specifically Cap 113 article 141(4) introduces straight liability in a case where a director of a company fails to take all reasonable steps to secure compliance with the provisions of article 141. In such a case “the director shall commit a criminal offense and on conviction thereof be liable to imprisonment.....”.

v) Obligations of the Directors as to the Administration and Management of the Company

Article 169F of Cyprus Companies Legislation refers to the actions that shall be taken in the event of significant loss of share capital. In light of the above, based on Cap 113 Art.169 in cases in which public companies have lost more than 50% of their share capital due to damages or other reasons are obliged to convene an extraordinary general meeting of shareholders to discuss whether it should take similar measures or whether there is a need to dissolve the company. “Failure by the directors of the company to act as above, shall constitute a civil offense and shall render them responsible for compensation. Such responsibility shall be personal, unlimited, joint and several.”⁶⁹ Thus, it is quite clear that the aforementioned article introduces straight liability to the directors of the company and undoubtedly constitutes a legal exception of Cyprus Law to the Salomon principle.

⁶⁸ Cap 113, Article 141 Cyprus Companies act.

[http://www.olc.gov.cy/olc/olc.nsf/all/E1EAEB38A6DB4505C2257A70002A0BB9/\\$file/The%20Companies%20Law.%20Cap%20113.pdf?openelement](http://www.olc.gov.cy/olc/olc.nsf/all/E1EAEB38A6DB4505C2257A70002A0BB9/$file/The%20Companies%20Law.%20Cap%20113.pdf?openelement)

⁶⁹ Cap. 113, Article 169F (2)

[http://www.olc.gov.cy/olc/olc.nsf/all/E1EAEB38A6DB4505C2257A70002A0BB9/\\$file/The%20Companies%20Law.%20Cap%20113.pdf?openelement](http://www.olc.gov.cy/olc/olc.nsf/all/E1EAEB38A6DB4505C2257A70002A0BB9/$file/The%20Companies%20Law.%20Cap%20113.pdf?openelement)

However, although the most important source for the legal grounds of the lifting or piercing of the corporate veil is the Cyprus Companies Act, Cap 113, in Cyprus law one can find legal grounds for the lifting of the corporate veil in other legislations too, such as in the Criminal Law provisions, Tax Law provisions, Public Law provisions , etc.⁷⁰

2.3.2 JUDICIAL LIFTING OF THE CORPORATE VEIL IN CYPRUS

As already mentioned above Cyprus, as a common law country, has recognized and further introduced case law from its courts as well as from courts of other common law countries (United Kingdom, India, Canada , etc.) as a main source of its national law. Thus, it is quite important to mention that Cyprus courts have repeatedly followed the approach of the English courts regarding their decision for the lifting of the corporate veil and it is not surprising at all, that as per the judicial grounds of the lifting of the corporate veil between UK and Cyprus there is a complete identification. Consequently, in this subchapter I will focus on the judicial grounds of the lifting of the corporate veil in Cyprus, trying of course to avoid any repetition, as a full analysis of the topic was given in previous subchapter which was dedicated to the judicial grounds of the lifting of the corporate veil as being introduced by English courts. Furthermore, in this subchapter I will refer to the most important case law of the Courts of Cyprus which in cases approve or refuse the lifting of the corporate veil in order to have a more clear view on how the judges in Cyprus reacted to cases related to possible lifting of the corporate veil and which judicial grounds have been recognized by them through their decisions all over the years.

Overview Of Cyprus' Case Law Route Regarding The Lifting Of The Corporate Veil

Historically speaking, taking a look at the case law of the Cyprus Courts regarding the lifting of the corporate veil over the years one would notice that Cyprus courts were in principle very reluctant to lift the corporate veil in their examining cases. This can be understood from their initial decisions in which without a doubt Cyprus courts showed unwillingness to recognize any ground that could justify a lifting of the corporate veil and totally remained stable to the Salomon principle. In light of the above it is important here to quote a landmark decision for the Cyprus courts, the Michaelides case⁷¹ in which the Cyprus Supreme Court emphasized in the Salomon principle and the same it

⁷⁰ Cap148, provisions relating to the law of representation, action before the civil courts, Article 51A of the Assessment and Tax Collection Law, [http://www.mof.gov.cy/mof/taxdep.nsf/All/F0A697ED5915F58BC2257DCF004020AF/\\$file/1978_004_and_1963_53_VEVEOSEOS_KE%20ISPRAXEOS_FORON_-_2016_037.pdf](http://www.mof.gov.cy/mof/taxdep.nsf/All/F0A697ED5915F58BC2257DCF004020AF/$file/1978_004_and_1963_53_VEVEOSEOS_KE%20ISPRAXEOS_FORON_-_2016_037.pdf)

⁷¹Michaelides v. Gavrielides (1980) 1 C.L.R. 24

has been upheld by Cyprus courts ever since⁷². More specifically, Cyprus Supreme Court held that:

"We consider it necessary to note that ever since Salomon v. Salomon decision, it has been repeatedly said that the company and the person or people who founded the company are separate legal entities, regardless of the absolute control exercised by one or more of these persons on the company. This is the essence of the registration of a limited liability company and it would be against the provisions of the Company Law to deviate from this principle". Thus, there is no doubt that **Michaelides v. Gavrielides, (1980) 1 C.L.R. 244** can be characterized as the judicial continuance of the Salomon case in Cyprus and consequently has been a guideline for the Cyprus Courts examining whether they should lift or not the corporate veil.⁷³

The aforementioned strict approach was followed by the Cyprus courts until 1985, when was firstly held that under certain conditions and circumstances and of course in some specific cases, the lifting of the corporate veil could be justified. However the courts did not specified or determined what that specific circumstances could be.⁷⁴ Nevertheless, Cyprus case law all over the years showed that following English case law and more specifically following the landmark case **Adams v. Cape Industries case**, has established a number of relevant principles, which must be applied, when deciding whether the corporate veil may be lifted⁷⁵. Such judicial ground which can be characterized as the main judicial ground for the lifting of the corporate veil was recognized by the Cyprus courts in Onisiforou case⁷⁶in which the court held that in cases where the incorporation of a company is used as a fraudulent mean or even regarding some issues related to tax law, and in other cases, which the legal literature deals in detail with, the lifting of the veil of legal personality is applied. More specifically, in the aforementioned case the Cyprus Supreme court held that "the independent legal status of a limited liability company by its shareholders has embedded Case Salomon. There is no existing case law which lifts the corporate veil to justify the avoidance of tax. The corporate veil is lifted only to prevent illegality or fraud of public money." This

⁷²The Bank of Cyprus (Holdings) Ltd. v. The Republic (1985) 3 C.L.R. 1883, Peletico Ltd. v. Republic (1985) 3 C.L.R. 1582.

⁷³In Bank of Cyprus (Holdings) v. Republic of Cyprus the Court referred to the Michaelides case as follows: "**Michaelides v. Gavrielides, (1980) 1 C.L.R. 244**, a rent control case, left no room for lifting the veil of corporation under any circumstances. We are of the view that notwithstanding what was said in Michaelides case, in a proper case there may be exceptions to the rule in Salomon case."

⁷⁴Bank of Cyprus (Holdings) v. Republic (1985) 3 C.L.R. 1883

⁷⁵ Cases of **Apostolou v Ioannou (2012)**, **Hadzigavriel v Ellinas Finance Public Company Ltd** summarized the grounds which lead the Cyprus courts as the English courts to exercise their jurisdiction to lift the corporate veil.

⁷⁶Ταμείο Πλεονάζοντος Προσωπικού. Παναγιώτας Ονησιφόρου (1989) 1 ΑΑΔ 504

position has also been reaffirmed by the Cyprus Supreme court in **Multi Klima Maliotis Engineering Ltd case**⁷⁷ stating that: "... the principle of separate legal entity of the companies came from very old (Salomon v Salomon & Co 66 L.J. Ch. 35). The courts have ever since demonstrated their willingness to lift the corporate veil where corporate property is used either for illegal or improper purposes." In **Exalco case**⁷⁸ the Supreme Court refused to examine possible lifting of the corporate veil as the parties did not raise an allegation of fraud.

To this end in the next paragraphs I will make a distinction of the most important cases in which the Cyprus courts have either refused or approved the claim of the lifting of the corporate veil, in order to examine the exact judicial grounds for the lifting of the corporate veil by the Cyprus Case law.

i) Cases in which the Cyprus courts refused to lift of the corporate veil

Cyprus' courts have always been stable to the Solomon principle and consequently in numerous cases have refused to lift the corporate veil. To be more specific, one could notice their refusal to lift the corporate veil in cases where renting law is applicable⁷⁹. The court has also refused to lift the corporate veil in a case which dealt with the compensation for redundancy where an employee of a family company was transferred to another company, which had the same shareholders and managers with the first company. The court here held that the employment relationship with the first company is considered to have stopped and that in this case the veil could not be lifted by the courts by claiming that the employment relationship continued from the first company.⁸ Additionally, one can find other cases in Cyprus case law in which the courts have refused to lift the corporate veil. More specifically and in addition to the above, the courts have refused to lift the corporate veil in cases of imposing capital gains tax on profits from the sale of subsidiary shares⁸¹ as well as in cases of recognition of a group as a single entity for purposes tax imposition⁸².

ii) Cases in which Cyprus courts "lifted or pierced" the corporate veil

⁷⁷Multi Klima Maliotis Engineering Ltd v. Κυπριακής Δημοκρατίας, Συνεκδικαζόμενες Υποθέσεις 483/97 και 484/97, ημερομηνίας 18/02/2000(unpublished)

⁷⁸Exalco S.A . v. Αλουμινέξ Λτδ κ.α. (2007) 1 B AAD 991

⁷⁹Κυριάκος Γαλιδης v. Zako Estates Limited (1989) 1 AAD 490

⁸⁰ Ταμείο Πλεονάζοντος Προσωπικού v. Παναγιώτας Ονησιφόρου (1989) 1 AAD 504

⁸¹Ανδρέας Γεωργίου v. Κυπριακής Δημοκρατίας διά του Διευθυντή του Τμήματος Εσωτερικών Προσόδων (1994) 4B AAD 770.

⁸²Bank of Cyprus (Holdings) v. Republic (1985) 3 C.L.R. 1883 and βλ. Stereo Development Co. Limited v. Έφορου Φόρου Εισοδήματος (1998) 4A AAD 651

In the previous section I referred to the most important case law in which the courts showed their unwillingness to lift the corporate veil. However, taking a deep look at the case law one can find cases in which the Cyprus courts have lifted indeed the corporate veil. The grounds that led the courts to lift the corporate veil can be found in cases where a company tried to break the confidentiality of the tenders and consequently to violate free competition.⁸³ In Othon Galanos case, the two offers were submitted and signed by the same person representing two companies and consequently the court lifted the corporate veil as the aforementioned action constitutes a straight violation of free competition. Another case where the Cyprus court lifted the corporate veil is the Ioannou case⁸⁴ where the company here was incorporated and took over the assets and operations of another company with the same shareholders aiming to avoid to pay off its creditors as being determined by the judgement.

Thus, it is quite clear that Cyprus Courts following the English courts have all over the years been reluctant to accept claims based on piercing of the corporate veil and consequently, such claims have been successful only in very limited circumstances. However, above the aforementioned reluctance of the Cyprus courts to lift the corporate veil, one can notice from the Cyprus case law that the lifting of the corporate veil has in exceptional circumstances been applied by the Cyprus courts too, especially where the company in question, is a sham or façade and has been used by its controller for an improper purpose. In such cases where the concept of a company accompanied by the principle of the independent legal personality is misused for fraudulent purposes the courts are always ready to lift the corporate veil.

2.4 A COMPARATIVE ANALYSIS OF THE APPROACH ADOPTED IN UK AND IN CYPRUS REGARDING THE LIFTING OF THE CORPORATE VEIL

In this subchapter, I aim to give a comparison of the approach of UK and Cyprus regarding the lifting of the corporate veil. What one must take into consideration when examining the approach of the UK and Cyprus regarding any corporate issue and more specifically regarding the lifting of the corporate veil is that the existing corporate law in the two countries is almost the same. It has repeatedly mentioned in this study that Cyprus as a genuine common law country has reproduced the English companies Act in its own company legislation. Consequently, it is a common phenomenon for the Cyprus courts to follow the approach of the UK Courts and this tactic is also followed by the Cyprus courts when examining possible lifting of the corporate veil. Thus, there

⁸³Othon Galanos Tax Free Shops Ltd v. Κυπριακής Δημοκρατίας (1990) 3 A.A.Δ. 2234

⁸⁴Σοφούλλα Ιωάννου κ.α. v. Polly-Frocks Ltd (2000) 1A 398

is no doubt that in the following comparison one will find more similarities between the approach of each country than differences.

First of all, I find it critical to note that both countries have adopted the Salomon principle and consequently due to its benefits⁸⁵, the most commonly used forms of legal entities in the two countries is the form of a limited liability company. Thus, the first similarity of the two countries is noticeable in their common approach regarding the adoption of the general principle of the separate legal personality. However in contrast to the aforementioned principle, both countries have introduced an exception to the latter, which is known as the mechanism of the lifting of the corporate veil under which both countries either by using a legal provision or a judicial ground do lift the corporate veil. This lead us automatically to a significant similarity of the approach of the two countries for the lifting of the corporate veil which is the distinction of the grounds that can lift the corporate veil into the legal grounds and the judicial grounds. These legal provisions are most commonly seen in the Companies Act of each country, but in both countries legal provisions for the lifting the corporate veil can also be found in other legislations⁸⁶. Examining the legal grounds of each country it is understood that there are common legal provisions in the two countries but there are also some differentiations. More specifically, it is obvious that both countries have introduced specific legal provisions which mostly cover fraudulent acts by the members of a company, meaning that the legislator was aiming to secure that the company will not be used as a mean of the members of a company in order to serve their own fraudulent interests. This can be clearly understood in the legal provisions of each country that were quoted in chapter II.⁸⁷ Additionally and further to the common legal provisions in regard to fraudulent actions by the members of a company, the two countries have also commonly introduced through a legal provision straight liability for the members of a company for debts where business carried on with fewer than seven.⁸⁸ However, beyond of the identification of the legal provisions between the two countries one can note differences too, as Cyprus has further extended the legal provisions for the lifting of the corporate to other reasons, instead of the situation where the members of a company acted fraudulently. Without any doubt, this is a differentiation of the Cyprus

⁸⁵ The next chapter will focus extensively on the benefits and problems that occur from the Salomon principle.

⁸⁶Such as in tax law, criminal law, etc. See subchapter 2.3.1

⁸⁷ More specifically in Section 213-215 of Insolvency Act 1986 (UK) dealing with fraudulent and wrongful trading as well as in Sections 216--217 of the Insolvency Act 1986 (UK) regarding the fraudulent abuse of a company name. Similarly, Cap. 113, article 32. of Cyprus Companies Act deals with any person who knowingly participated in the conduct of the company with intent to defraud third parties during the company's liquidation.

⁸⁸The truth is that such a legal provision is rarely invoked especially in Cyprus and has been deleted from the new Companies Act of UK. (2006).

legislator, who introduces also liability to the officers of the company in cases of a failure of the latter to fulfill their legal obligations of their position as a director.⁸⁹

Moving on with the comparison of the judicial grounds of the lifting of the corporate veil it is obvious that the approach of the courts of each country regarding the examining issue is almost identical. This can be understood if we take into consideration the Cyprus' courts dependence to the English courts. This dependence can be clearly identified in the judicial grounds for the lifting of the corporate veil as Cyprus' courts have repeatedly used the reasoning of the English courts when examining possible lifting of the corporate veil. However, it is quite important to note here that although the courts in UK and in Cyprus are very reluctant to lift the corporate veil in their cases, the number of the cases in which the lifting of the corporate veil has been applied is higher in UK than in Cyprus. This can be justified by the approach of the two countries, as the courts of UK have recognize more judicial grounds for the lifting of the corporate veil than Cyprus. More specifically, Cyprus' courts following the English courts do lift the corporate veil mostly in a situation where a company, is a sham or façade and has been used by its controller for an improper purpose. On the other hand, English courts have extended their grounds for the lifting of the corporate veil instead of fraud in other situations such as in agency, torts, single economic unit, etc. However, according to the comparative analysis above and despite the slight differentiations in each country it is absolutely clear that UK and Cyprus have adopted the same approach regarding the lifting of the corporate veil.

Chapter III

Overall critical assessment

Salomon principle constitutes a vital tool for the development of the economy of the countries have adopted it⁹⁰. Thus it is not excessive to characterize the separate legal personality and limited liability of the companies as a pole for attracting investments and funds to the countries. This is what also happens in UK and in Cyprus where one can notice that due to the concept of the separate legal personality the percentages of new companies incorporations are rising radically. This developing investment trend in the two countries, can be justified if we take into consideration a significant benefit that the separate legal personality offers which is the opportunity to invest and trading with

⁸⁹ This is the cases as has been analyzed in subchapter 2.3.1 where it is noted that directors may have straight liability in case of failure to fulfill their obligations such as management obligations, for misstatements in prospectus or for their failure to keep the books of account that are necessary for the preparation of the financial statements.

⁹⁰ The importance of the Salomon principle as well as the concept of limited liability was explicitly referred also in subchapter 1.4.

low risk. What we mean by the term low risk is that the shareholders of the company who may also be potential investors or traders are liable only on the par value of their shares.⁹¹ Furthermore, much of the businesses today due to the extension of the Salomon principle are now carried out through a group of holding and subsidiary companies rather than a single company. Thus, there is not doubt that the concept of separate legal personality constitutes a vital tool as it gave a strong financial injection to the countries have adopted it.

However, the concept of the separate legal personality has been under the spotlight and has received a lot of criticism so far. Thus, I find it necessary in this study to note my critical assessment too. Despite all the financial opportunities the two concepts of separate legal personality and limited liability offer, the latter can definitely be criticized as per their negative aspects. The negative aspects can be understood from the creditors' point of view, meaning that the creditors' claims due to the consequence of the limited liability principle are restricted to the company's assets. This practically means that the creditors of a company cannot assert their claims against the shareholders' assets, at the same time that shareholders benefit from the profits of a company. It is clear that the creditors are unsecured and they bear the whole risk.

If Salomon principle applied inflexibly, it can shield parties unreasonably, to the detriment of persons dealing with companies.⁹² This is also my opinion as I strongly believe that for the reasons analyzed above the separate legal personality of the companies should have some limits, meaning that it is important that sufficient information about the prosperity of a particular company should be available to creditors in order to promptly decide whether or not they would invest their money into the business. And, of course, sufficiently flexible regulative frameworks⁹³ are necessary in order to protect investments and combat fraudulent behavior. Taking a look at the business reality in UK and in Cyprus I find it very important to strengthen their legal provisions for the lifting of the corporate veil as fraudulent use of the company is a common phenomenon. Furthermore, I believe that the courts should have a more active role when examining potential lifting of the corporate veil meaning that they should enrich their judicial grounds in order to cover a wide variety of violences to the concept of the separate legal personality. Even morally speaking, current legal provisions and judicial grounds should be strengthen as they currently seem

⁹¹ The shareholders do not risk more than their capital contribution.

⁹²⁹²H Leigh Ffrench, Guide to Corporations Act, 4th edition, Butterworths, Sydney, 1994, p 19.

⁹³ It is not surprising at all that following the Salomon case, the Parliament in UK has enacted in the Companies Act 1900 provisions requiring public registration of charges on company property and by the Companies Act 1907 enabled liquidators to avoid floating charges given to secure pre-existing debts.

inadequate to cover the injustice arising from the misuse of the concept of separate legal personality. So, to sum I totally support the concept of the separate legal personality with its benefits as mentioned above, but I strongly believe that the concept should have some legal limitations.

Conclusions

Without a doubt, this paper delivered one of the most fundamental principles of corporate law in common law jurisdictions, namely the principle of the separate legal personality as the latter was expressed in the so called decision by the English courts, the Salomon case. It is moreover clear that in respect to Salomon principle the corporation is such an autonomous legal subject and consequently, the corporate entities with limited liability are separate from their shareholders. However, the aforementioned principle can be under specific circumstances lifted or pierced either based on a legal provision or by the courts based on judicial grounds. The lifting of the corporate veil remains one of the most controversial subjects in corporate law and as discussed in the essay, the doctrine remains only an exceptional act as the courts in principle respect the Salomon principle.

Examining the approach of UK and Cyprus regarding the corporate veil, this study focused on the legal grounds for the lifting of the corporate veil of each country on the one hand and on the judicial grounds on the other hand. In general the approach of the two countries is identical and mostly cover cases where a limited liability company is used as a mean of fraud. In such a case there are specific legal provisions and judicial grounds which lead the courts to disregard the separateness of the corporation and hold a shareholder responsible for the corporation's action as if it were the shareholder's own.⁹⁴ However, as already mentioned above the courts of both countries are extremely reluctant to lift the corporate veil as in principle are stable to the Salomon principle. This approach seems to be inadequate in my opinion in order to secure the genuine character of a limited liability of a company. The concept of separate legal personality of the companies should be the rule indeed, but the legislator and the courts have to be ready to set some limitations to it by lifting the corporate veil.

⁹⁴ see footnote 23

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