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Dan D. Prentice

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I. INTRODUCTION

This article addresses some of the issues raised in the hypothetical that formed the focus of the discussion at the *Florida Journal of International Law's* Fourth Annual International Business Symposium.[1] At the outset, a number of general points need to be made regarding the structure of company law[2] in the United Kingdom.[3] A central principle of English company law is ease of access to the corporate form. It is both cheap and administratively simple to incorporate a company. Many companies are formed as what are referred to as "shelf-companies." These companies are incorporated for no specific, identifiable purpose at the time of their incorporation but can be taken "off the shelf" when the need arises.[4] Once incorporated, the Registrar

* Allen & Overy Professor of Corporate Law, Fellow of Pembroke College, Oxford.

1. The hypothetical for the Fourth Annual International Business Symposium can be found in Volume 10 Number 2 of the *Florida Journal of International Law*.

2. In the United Kingdom, the word "corporation" is not normally used to describe commercial trading entities. The word company is used to describe what in the United States is a corporation.

3. There are three separate jurisdictions within the United Kingdom: England and Wales, Northern Ireland, and Scotland. A company can be registered in only one of these separate jurisdictions (multiple registration is not possible), and although there are differences between the company law systems of each, these differences are not relevant for purposes of this article.

4. Shelf-companies are regularly incorporated by large law firms, and there are incorporation agents who have a supply of shelf-companies available for purchase. The extent of this phenomenon is not known. For a very rough guess, *see* Simon Goulding, *The Private Company in the United Kingdom*, *in* THE EUROPEAN PRIVATE COMPANY? 55, 58 (Harm-Jan De Kluiver & Walter Van Gerven eds., 1995). The authorities who regulate incorporation also approve of this practice since it does not result in sudden surges in demand for incorporation (*e.g.*, at the end of the tax year), such demands being met by the purchase of shelf-companies

of Companies' certificate of registration is considered conclusive evidence that, with respect to incorporation, the requirements of the 1985 Companies Act have been complied with.[5] There is no doctrine of defective incorporation; therefore, the company provides a secure legal form for carrying on business.

Not only is there ease of access to the corporate form, but also in certain circumstances, parties are required to carry on business in corporate form. Section 716 of the 1985 Companies Act provides that "[n]o . . . partnership consisting of more than 20 persons shall be formed for the purpose of carrying on business . . . unless it is registered as a company."[6] There are no quality controls placed on the granting of corporate status. In other words, there are no minimum standards of financial or commercial viability that must be satisfied before corporate status can be conferred.[7] An example of such a threshold requirement would be a minimum capitalization requirement, a requirement common in Continental European jurisdictions.[8] Lastly, as we shall see when we examine the decision of House of Lords in *Salomon v. Salomon & Co., Ltd.*,[9] English law has recognized the "one-man" company since the end of the nineteenth century.[10] This background picture demonstrates that not only is the company understandably an attractive commercial vehicle but also that legislative policy dictates that it should perform such a role.

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from incorporation agents.

5. Companies Act, 1985, ch. 1, § 13(7)(a) (Eng.) [hereinafter 1985 Companies Act]. The courts have given full literal effect to this section. *See, e.g.*, Hammond v. Prentice Bros., Ltd., [1920] 1 Ch. 201 (1919).

6. 1985 Companies Act, ch. 2, § 716(1). There are exceptions for lawyers, accountants, and various other professions. *Id.* § 716(2). The reason for this somewhat curious provision is the very undeveloped nature of English procedural law with respect to actions by and against fluctuating groups of persons (*i.e.*, the representative action). There also are acute difficulties when unincorporated trading groups go into insolvent liquidation. These difficulties are avoided where a business is carried on in corporate form.

7. The one exception to this is that public companies (broadly, companies that can distribute shares to the public) must have a minimum paid-up capital of £50,000. 1985 Companies Act, ch. 1, § 118. Given that public companies are almost invariably substantial concerns, the sum of £50,000 is insignificant. The requirement for an authorized minimum of paid-up capital is a requirement of the Second Council Directive on Company Law 77/91, art. 6(1), 1977 O.J. (L 26) 1.

8. *See* A NEW FORM OF INCORPORATION FOR SMALL FIRMS, A CONSULTATIVE DOCUMENT, 1981, CMND. 8171, at 41 tbl.C.

9. [1897] App. Cas. 22 (P.C. 1896) (appeal taken from Eng.).

10. Early English company legislation required that there be more than one incorporator, but this presented no real problem in forming the one-man company since the incorporators could hold their shares as trustees for a single incorporator. Currently, English company law does permit incorporation by a single person in the case of a private company. *See* 1985 Companies Act, ch. 1, § 1 (implementing the Twelfth Council Directive on Company Law, 89/667, 1989 O.J. (L395) 40).

II. THE *SALOMON* PRINCIPLE

While many of the questions raised by the hypothetical are familiar to English practicing and academic lawyers, they are not questions which have been addressed to any significant extent by our courts, or which counsel would naturally raise with the court. The reason for this is relatively straightforward: the principle in *Salomon*[11] remains the dominant principle of English company. The company law culture of English lawyers is such that an attempt to persuade the court to depart from the principle embodied in the *Salomon* case is not likely to be made, and even if made, is not likely to succeed. The hegemony of *Salomon* is so well entrenched in English law that for most purposes it can only be effectively diluted by legislative intervention. At the outset, a brief analysis of the *Salomon* decision is needed to provide a framework for this article.

The facts in *Salomon* involved a common commercial transaction, the incorporation of a business that had previously been carried on in unincorporated form.[12] Mr. Salomon, the owner, transferred the business to "Aron Salomon and Company, Limited" (Salomon Ltd.), a company that he had formed.[13] The consideration paid to the company was composed of 20,001 shares and a secured debenture of £10,000.[14] The other shareholders in the company were Mrs. Salomon, four sons, and a daughter.[15] Salomon Ltd. went into liquidation, and if the debenture in favor of Mr. Salomon had been paid according to its priority,[16] there would have been nothing left for the unsecured creditors.[17] The House of Lords (a strong court) held that Salomon Ltd. was a separate entity from Mr. Salomon, he had entered into perfectly valid commercial arrangement with the company, and accordingly, the debenture was enforceable against the company.[18] By enforcing his

11. *Salomon*, [1897] App. Cas. at 22. The lower court decisions are reported at *Broderip v. Salomon*, [1895] 2 Ch. 323 (C.A. 1894). Both the first instance judge and the three judges of the Court of Appeal held for various reasons that Mr. Salomon could not enforce his debenture in the liquidation of Salomon Ltd. *Id.*

12. *Salomon*, [1897] App. Cas. at 23.

13. *Id.*

14. *Id.* at 24.

15. *Id.* at 23. At that time it was necessary to have seven shareholders. Companies Act, 1862, 25 & 26 Vict., ch. 1, § 6 (Eng.).

16. *Salomon*, [1897] App. Cas. at 24. Mr. Salomon had transferred the debenture, but this has no bearing on the analysis since the assignee only would take as good a title as the assignor (Mr. Salomon); therefore, the central issue before the court was, as a matter of substance, the right of Mr. Salomon to enforce his security in the liquidation of Salomon Ltd. and thus gain priority over the unsecured creditors. *Id.*

17. *Id.* The debt owing to the unsecured creditors was approximately £7,733. *Id.*

18. *Id.* at 27.

security, Mr. Salomon "scooped the pool,"[19] and there was nothing left for the unsecured creditors of Salomon Ltd.[20]

There are a number of features of the *Salomon* decision that account for its durability. First, it was fully accepted by all dealing with the case that Mr. Salomon never intended to raise any capital from the public, and the other shareholders had no real independence from Mr. Salomon.[21] The judges who heard the case fully appreciated that the issue at the heart of *Salomon* was the propriety of Mr. Salomon altering the legal status of his business so that he could obtain the privilege of limited liability.[22]

Second, the commercial significance of the decision was fully appreciated by the courts; therefore, it was not a situation where the courts may have unwittingly let the genie out of the bottle. Lord Justice Lindley in the Court of Appeal stated:

> The appeal raises a question of very great importance, not only to the persons immediately affected by the decision, but also to a large number of persons who form what are called "one-man companies." Such companies were unheard of until a comparatively recent period, but have become very common of late years.[23]

Finally, there is undoubtedly a certain lack of sophistication in the manner in which the lower courts, who held that Mr. Salomon should not be able to enforce his debenture, reached their conclusion. The lower courts seemed to reason that it was never intended that corporate status could be obtained by a person merely incorporating their business and using nominees as the other shareholders. Where such a ploy was entered into, the company in some way became the incorporator's agent, who as principal would be liable for its debts under normal agency principles. It would have been

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19. A.L. DIAMOND, SECURITY OVER PROPERTY OTHER THAN LAND ¶ 6.1.2 (Department of Trade & Indus. Consultation Document, 1986).

20. *Salomon*, [1897] App. Cas. at 23.

21. *See, e.g.*, *Broderip*, [1895] 2 Ch. at 329 (Vaughan Williams, J., at first instance); *id.* at 328 (Lindley, L.J., in the Court of Appeal).

22. *Id.* at 323. In the course of his judgment, Lord Justice Lindley referred to Salomon Ltd. as a

> mere device[] to enable a man to carry on trade with limited liability, to incur debts in the name of a registered company, and to sweep off the company's assets by means of debentures which he has caused to be issued to himself in order to defeat the claims of those who have been inprudent enough to trade with the company without perceiving the trap which he has laid for them.

Id. at 339; *see also Salomon*, [1897] App. Cas. at 31, 44, 53 (Lord Halsbury, L.C., Lord Herschell, and Lord Macnaghten, respectively, in the House of Lords.)

23. *Broderip*, [1895] 2 Ch. at 336; *see id.* at 340 (Lopes, L.J., stating, "This is a case of very great importance.").

preferable if the courts had formulated a more sophisticated doctrine of subordination to cover situations where incorporators put capital into a company in the form of secured debt when they should have invested in the form of equity.[24]

III. VEIL PIERCING

English company law does, of course, recognize the principle of piercing the corporate veil, and examples of this abound.[25] When there is fraud,[26] the courts normally have no difficulty in piercing the veil. A recent example of this is *Re H and others (restraint order: realisable property)*.[27] There the court made a restraining order with respect to the property of a number of individuals who were charged with serious tax fraud. The order also applied to companies that they controlled. The companies appealed on the grounds that since they had not been charged with any offense, the court had no jurisdiction to make an order against them. On the facts, the Court of Appeal held that the companies had been used as vehicles for the tax fraud of their controllers, and that it was proper to "lift the corporate veil," because the companies were being used to evade limitations imposed by law.[28] Lord Justice Rose, giving the judgment of the court, stated:

> As to the evidence, it provides a prima facie case that the defendants control these companies; that the companies have been used for fraud, in particular the evasion of excise duty on a large

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24. English insolvency law does not have an equivalent to the U.S. principle of equitable subordination. *See, e.g.*, *In re* Carolee's Combine, Inc., 3 B.R. 324 (Bankr. N.D. Ga. 1980). The only claims subordinated in the winding up of an insolvent company are those by members in their "character of a member." Insolvency Act, 1986, ch. 1, § 74(2)(f) (Eng.). The courts have given this a very narrow interpretation. *See, e.g.*, Soden v. British & Commonwealth Holdings plc, [1996] 2 B.C.L.C. 207.

25. *See generally* L.C.B. GOWER, D.D. PRENTICE, B.G. PETTET, PRINCIPLES OF MODERN COMPANY LAW at ch. 8 (6th ed. 1997); Murray A. Pickering, *The Company as a Separate Legal Entity*, 31 MOD. L. REV. 481 (1968).

26. It is difficult to stabilize this concept. The only point that appears to be clear is that where a company is formed for the purpose of defeating an existing contractual or proprietary right, the court will be disposed to find fraud. *See, e.g.*, Gilford Motor Co., Ltd. v. Horne, [1933] 1 Ch. 935 (Eng. C.A.); Jones v. Lipman, [1962] 1 W.L.R. 832 (Ch. 1961).

27. *Re* H (restraint order), [1996] 2 All E.R. 391 (C.A. 1996); *see, e.g.*, *Re* a Company, [1985] B.C.L.C. 333, 333 (Eng. C.A.) (court piercing the corporate veil in a situation where a network of companies was set up to insulate the defendant's assets from any legal process).

28. *Re H*, [1996] 2 All E.R. at 402 (quoting Adams v. Cape Industries Plc., [1990] 1 Ch. 433, 544 (Eng. C.A. 1988)). The court did state, however, that "[a]s to the law, the general principle remains that which was enunciated in *Salomon v. Salomon & Co* . . . namely that a company duly formed and registered is a separate legal entity and must be treated like any other independent person with its own rights and liabilities distinct from those of its shareholders." *Id.* at 401.

scale; that the defendants regard the companies as carrying on a family business, and that company cash has benefited the defendants in substantial amounts.[29]

The overall problem with veil-piercing jurisprudence is that it is a wilderness of isolated precedents, or to put it slightly differently, the cases hunt in packs of two with the respective pack members going off in different directions.[30] A search of the specialist company law reports Butterworths Company Law Cases, which was started in 1983, indicates that there are only thirteen cases in which the issue of piercing the corporate veil was raised, and in only one was the plea successful.[31]

Two recent decisions, *Adams v. Cape Industries Plc.*[32] and *Re Polly Peck International plc (in administration)*[33] illustrate the iron grip that the *Salomon* principle has on English company law. The facts in *Adams*, somewhat simplified, were as follows. Default judgments had been given by a Texas federal court against two English companies, Cape and Capasco,[34] in connection with asbestosis claims. Proceedings were commenced in the United Kingdom to enforce the judgment. English courts will recognize a foreign court as competent to give an in personam judgment against a person, capable of enforcement against that person in the United Kingdom, where, inter alia, that person was resident in the foreign jurisdiction at the time the action is commenced against him.[35] In order to show residence on the part of a company, it is necessary that it has a place of business in the foreign jurisdiction, or that it carried on business there through an agent who has power conduct business on its behalf.[36]

It was argued that the English companies were present in the United States through the companies that marketed and sold the asbestos. The asbestos was marketed and sold through a wholly owned Illinois subsidiary of Cape, N.A.A.C., until 1978 when it was put into liquidation.[37] The court found that "N.A.A.C.'s dominant business purpose was to assist and encourage sales in the United States of asbestos mined by the Cape

29. *Id.* at 402.
30. *See generally* GOWER ET AL., *supra* note 25.
31. Creasey v. Breachwood Motors Ltd., [1993] B.C.L.C. 480 (Q.B. 1992). For further discussion, see *infra* notes 83-93 and accompanying text.
32. [1990] 1 Ch. 433 (Eng. C.A. 1988).
33. [1996] 2 All E.R. 433 (Ch. 1995).
34. The latter being a subsidiary of the former and both being part of the Cape Group of companies.
35. *Adams*, [1990] 1 Ch. at 523.
36. *Id.* at 524 (This statement is greatly simplified.).
37. *Id.* at 434.

subsidiaries."[38] The object of the liquidation of N.A.A.C. was stated by the lower court judge to be as follows:

> The minutes [of the board meeting of Cape at which the decision to wind up N.A.A.C. was taken] do not state but there can really be no doubt but that the decision to wind up N.A.A.C. was taken in order to try and avoid the danger of an argument that under English law Cape's interest in N.A.A.C.'s United States business sufficed to give [the U.S. court] . . . jurisdiction over Cape.[39]

Cape still needed to market its asbestos in the United States, and it continued to do so through an Illinois company, C.P.C., which was set up by the expresident of N.A.A.C.[40]

Two arguments were put forward to show that the defendant companies were present in the United States initially through N.A.A.C. and then through C.P.C. These were referred to respectively by the Court of Appeal as "the 'single economic unit' argument" and "the 'corporate veil' point."[41]

A. *The Single Economic Unit Argument*

The plaintiffs did not argue that the parent-subsidiary relationship would automatically give rise to a single economic unit, which would justify the court in treating the defendant companies as being present in the United States because of the presence of the subsidiary, N.A.A.C. in the United States.[42] Rather, the plaintiffs argued that the subsidiary should be treated as an integral economic part of the Cape group of companies, because of the degree of control which was exercise over it, with the consequence that its presence in the United States could constitute the presence there of other group members.[43] The court found that there was a significant degree of overall supervision of the affairs of N.A.A.C. by its English parent: its level of expenses, expenditure, business policy, borrowing, and dividends were all controlled by Cape.[44] Despite this high degree of commercial control, the

38. *Id.* at 472. There had been earlier proceedings involving asbestosis claims with respect to which Cape had submitted to the jurisdiction of the U.S. courts. *Id.* at 434.

39. *Id.* at 450.

40. *Id.* at 538-39. The marketing was not done directly by Cape but by a Liechtenstein company the shares in which were held in trust for one of the Cape group of companies. The court held that this company was merely a facade and had no independent existence. *Id.* at 434. However, this had no bearing on the jurisdictional issue.

41. *Id.* at 539.

42. *Id.* at 474-75. The lower court judge was willing to hold that if N.A.A.C. had been a branch rather than a company, Cape would have been present in the United States. *Id.* at 474.

43. *Id.* at 474-75.

44. *Id.* at 538.

court at first instance and on appeal held that the separate legal existence of the companies had to be recognized and the fact of residence by the subsidiary, N.A.A.C., could not give rise to a finding of residence in the United States by the parent, Cape.[45] It cited with approval the dictum of Lord Justice Goff in *Bank of Tokyo Ltd. v. Karoon (Note)*:

> "[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 the law. The distinction between the two is, in law, fundamental and cannot here be bridged."[46]

After finding that its wholly owned subsidiary was not part of the single economic entity composed by the group, it was inevitable that the successor company to the subsidiary, C.P.C., in which Cape had no shareholdings, would not be considered as forming part of a single economic entity so as to render Cape, or any other companies in the Cape group, resident in the United States.

As stated above, the liquidation of N.A.A.C. and the formation of C.P.C. were designed to deal with the Cape group's exposure to the asbestosis claims. On this the Court of Appeal stated:

> If a company chooses to arrange the affairs of its group in such a way that the business carried on in a particular foreign country is the business of its subsidiary and not its own, it is, in our judgment, entitled to do so. Neither in this class of case nor in any other class of case is it open to this court to disregard the principle of *Salomon v. A. Salomon & Co. Ltd.* . . . merely because it considers it just so to do.[47]

What also is of interest in *Adams* is that the Court of Appeal referred to *Bulova Watch Co. v. K. Hattori & Co.*[48] where the U.S. District Court held that it had jurisdiction over a Japanese parent corporation that was expanding into the U.S. market through the use of subsidiaries on the grounds that the parent company was carrying on business in New York.[49] However, this was to no avail. For the Court of Appeal, there was a difference between a

45. *Id.* at 539.
46. *Id.* at 538 (quoting Bank of Tokyo Ltd. v. Karoon, [1987] App. Cas. 45, 64 (1984)) (alteration in original).
47. *Id.* at 537.
48. 508 F. Supp. 1322 (E.D. N.Y. 1981).
49. Weinstein, C.J., stated that "these subsidiaries almost by definition are doing for their parent what their parent would otherwise have to do on its own." *Id.* at 1342.

situation 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."[50] In the latter situation, there is no presence on the part of the parent so as to make it amenable to the jurisdiction of the courts where the subsidiary carried on business.

B. *The Corporate Veil Point*

The corporate veil point was a more conventional approach to the problem. The Court of Appeal accepted that one of the purposes of liquidating N.A.A.C. and carrying on business through C.P.C. was to reduce "by any lawful means available to it the risk . . . [of being] subject to the jurisdiction of the United States courts."[51] The court held on established authorities that it would pierce the corporate veil where the company was in some sense a "facade," a phrase of no real clear meaning.[52] On the facts, it found that C.P.C. had a sufficient independent existence so that it could not be considered a facade of Cape.[53] More importantly, it was argued that the court should pierce the corporate veil where a company had been formed for the purpose of evading "such rights of relief as third parties may in the future acquire."[54] To this the Court of Appeal replied:

> [W]e do not accept as a matter of law that the court is entitled to lift the corporate veil as against a defendant company which is the member of a corporate group merely because the corporate structure has been used so as to ensure that the legal liability (if any) in respect of particular future activities of the group (and correspondingly the risk of enforcement of that liability) will fall on another member of the group rather than the defendant company. Whether or not this is desirable, the right to use a corporate structure in this manner is inherent in our corporate law.[55]

Re Polly Peck International[56] is in many ways a more significant example of the strict application of the *Salomon* principle, and it is difficult to imagine it reflecting the law in many other jurisdictions. Polly Peck International Plc (Polly Peck) went into administration in October 1990.[57]

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50. *Adams*, [1990] 1 Ch. at 536.
51. *Id.* at 541.
52. *Id.* at 542-43.
53. *Id.*
54. *Id.* at 544.
55. *Id.*
56. [1996] 2 All E.R. 433 (Ch. 1995).
57. *Id.* at 433. Administration was introduced for the first time by Part II of the Insolvency Act 1986. *See* Dan Prentice et al., *Administration: Part II of the Insolvency Act*

It had incorporated a wholly owned Cayman island company, PPIF, as a special purpose financial vehicle to obtain funding for the Polly Peck group of companies.[58] PPIF made a series of bond issues to banks totalling £485 million.[59] The bond issues were guaranteed by Polly Peck, and the proceeds of the issues were on-loaned to Polly Peck.[60]

To understand the relevance of the *Salomon* principle for the matter in dispute in *Re Polly Peck International*, an explanation of some aspects of English insolvency law is needed.[61] The principle of double proof in English insolvency law precludes more than one proof with respect to the same debt. If there were no such rule, a creditor could maximize his return on the insolvency of his debtor by persuading his debtor to enter into contracts with several persons with respect to the same debt so that on the insolvency of the debtor all could prove.[62] The most common situation where the principle of double proof operates is where a person guarantees the debt of a company that goes into insolvent liquidation. In this situation it is not possible both for the creditor to prove in the insolvency for the principal debt and for the surety to prove with respect to the company's contingent liability to indemnify the surety with respect to his liability to the creditor on the guarantee. The right of the surety to be indemnified is merely the reflection of the debt owed by the company to the creditor, and in this situation, it is only the creditor who can prove.[63]

Both the bondholders, under Polly Peck's guarantee of PPIF's liability under the bonds, and PPIF, with respect to the debt owed to it in connection with the on-loans of the bond proceeds to Polly Peck, submitted claims in the administration of Polly Peck.[64] The order made in the administration provided that the principle of double proof would apply to creditor claims,[65]

1986, *in* CURRENT DEVELOPMENTS IN INTERNATIONAL AND COMPARATIVE CORPORATE INSOLVENCY LAW at ch. 5 (Jacob S. Ziegel ed., 1994). It enables, inter alia, a company in financial distress to be restructured. *Id.* It is compared, wrongly it is submitted, with Chapter 11 of the American Bankruptcy Code. *Id.*

58. *Re Polly Peck Int'l*, [1996] 2 All E.R. at 433.

59. *Id.*

60. *Id.*

61. As a matter of English nomenclature, insolvency refers to company liquidations, whereas the term bankruptcy is confined to individuals.

62. *See In Re* Oriental Commercial Bank, ex parte European Bank, [1871] 7 L.R.-Ch. 99, 103-04 (Ch. App.).

63. The surety could of course pay off the creditor and prove in the company's liquidation with respect to the amount owed to him under his right of indemnity. There would still be only one proof, namely, that of the surety. See generally *Barclays Bank Ltd. v. T.O.S.G. Trust Fund Ltd.*, [1984] App. Cas. 626 (1983) (appeal taken from Eng.) for a discussion of the principle of double proof.

64. *Re Polly Peck Int'l*, [1996] 2 All E.R. at 433.

65. *Id.* at 447. It is common where an administration order is made with respect to an insolvent company for the court order to provide that the distribution of the company's assets

and the administrators sought the court's guidance as to whether or not this precluded both the bondholders and PPIF from simultaneously lodging proof with respect to their respective claims.[66]

Counsel for the administrators argued that as a matter of substance the debt of PPIF to the bondholders was the debt of Polly Peck, and there was therefore no independent liability of Polly Peck to PPIF with respect to the funds that it had allegedly on-loaned to Polly Peck.[67] He argued that there were two distinct conceptual routes by which one could arrive at this conclusion.[68] Either PPIF could simply be treated as the nominee of Polly Peck in making the bond issue, or alternatively, Polly Peck and PPIF could be treated as a single economic entity so that there was in reality only one debt owed by the group.[69] The factors justifying these approaches were argued (and accepted as existing by the court) as follows:

> (i) PPIF was incorporated solely for the purpose of the bond issues; (ii) it had no separate, independent management; (iii) it had a very small paid-up capital; (iv) it did not pay the costs of the transactions and could not have done so; (v) it had no normal bank account and no separate financial records (in practice PPI [Polly Peck] saw to everything and acted as PPIF's banker and bookkeeper); (vi) the terms of the on-loan were not independently negotiated, did not serve any commercial purpose and in any case were never finally agreed, nor was the 1/4% turn paid otherwise than as a paper transaction; and (vii) no lender could or would have relied on PPIF's covenant, as opposed to PPI's [Polly Peck] (which could substitute itself as principal debtor if it got the approval of the principal paying agents).
>
> In short, Mr. Kosmin [counsel for the administrators] submits that PPIF had only a nominal role in the arrangements, and that as a matter of substance PPI [Polly Peck] should be recognised as having borrowed direct from the original bondholders, so depriving the on-loan of any legal significance (or indeed existence).[70]

Both conceptual routes argued by counsel for the administrators finding that the loans made to PPIF were in fact made to Polly Peck were rejected by the court.[71] The agency argument, that is, that PPIF in making the bond

should be on the same basis as if the company were in liquidation, thus providing for a notional liquidation before the company goes into formal liquidation.

66. *Id.* at 435.
67. *Id.* at 443.
68. *Id.*
69. *Id.*
70. *Id.* at 445.
71. *Id.* at 446-47.

issue was the agent of Polly Peck, was rejected on the very formalistic grounds that the documentation relating to the bond issues made it clear that the bond issues were those of PPIF and not Polly Peck.[72] The court also held that any agency relationship could not be inferred "simply because a subsidiary company has a small paid-up capital and has a board of directors all or most of whom are also directors or senior executives of its holding company."[73] The single economic entity argument advanced by counsel for the applicants was simply that PPIF and Polly Peck, along with other companies in the group, should be treated as a single legal entity because they were a "closely-integrated group of companies."[74] This argument also failed. The companies, despite the degree of economic integration, were separate legal entities. The court applied what purported to be a substantive test in determining whether or not companies were separate entities, but there, "substance means legal substance, not economic substance."[75]

IV. SUCCESSOR LIABILITY

Before examining some of the reasons for the English courts' continued adherence to the strict *Salomon* principle, the issue of "successor liability" needs to be examined. It would be presumptuous for the present author to attempt to delineate the concept of successor liability in U.S. law. However, a paradigm case will be taken as a backdrop for analyzing the English law. One variant of successor liability is the "mere continuation doctrine." Under this doctrine, a successor company that is a separate legal entity is made liable for the obligations of its predecessor where "the successor has the same stockholders as the predecessor and conducts the same business with the same management, facilities, employees, products, and trade names."[76] In other words, all that has changed is the legal form; as a matter of commercial substance, there is identity. In this situation, which presents the most clear-cut case for a doctrine of successor liability, there is no serious possibility that under English law the successor company could be made liable for the

72. *Id.* at 446.

73. *Id.* at 445. There is no objection in principle to a subsidiary acting as an agent for its parent, but this relationship cannot simply be inferred from the parent/subsidiary status, something more is required.

74. *Id.* at 447.

75. *Id.* at 448. Another case that shows the court's unwillingness to pierce the corporate veil even where issues of basic company law principle are involved is *Acatos & Hutcheson plc v. Watson*, [1995] 1 B.C.L.C. 218 (Ch. 1994) (Eng.). It is a principle of English company law that except under stringent conditions, a company may not purchase its own shares. *Id.* at 220. Nevertheless, in the *Acatos* decision, the court held that a company could purchase another company whose sole asset was shares in the purchasing company. *Id.* at 224-25. The court refused to pierce the corporate veil. *Id.*

76. Phillip I. Blumberg, *The Continuity of the Enterprise Doctrine Corporate Successorship in United States Law*, 10 FLA. J. INT'L L. 371 (1996).

debts of its predecessor.[77] No doubt, if both companies remain in existence, the courts might be willing to pierce the corporate veil.[78] But this very uncertain doctrine will be of no avail where the predecessor company has gone into liquidation.

In English company law, there is a procedure for reviving companies that have been liquidated,[79] but it is only of value if the company that is being *revived* has assets that were not distributed by the liquidator.[80] Also, if there has been a distribution of assets to contributories, that is, members, it would appear that there is no mechanism whereby the overpaid contributories should disgorge in favor of the underpaid creditors.[81]

Thus, if one were to take our hypothetical problem, the issue in paragraph C is not one that can be raised with any serious chance of success under English law. For the purposes of argument, assuming that Explodewin and Explodeco were English companies, an English court would simply not hold the former liable in damages for defective products manufactured and sold by the latter. *Creasey v. Breachwood Motors Ltd.*[82] is a good example, and one of the few that illustrates the operation of English law in this regard.

In *Creasey*, Eric Creasey had been employed by Welwyn Ltd. (Welwyn), a motor retailer, and claimed to have been unfairly dismissed.[83] Breachwood Motors Ltd. (Motors) also was a motor retailer, and its shareholders and directors were Mr. Ford and Mr. Seaman.[84] Ford and Seaman also were the sole shareholders of Welwyn.[85] Welwyn got into financial difficulties. It transferred its assets to Motors, and Motors paid off Welwyn's debts but made no provision for its contingent liability to Creasey with respect to any damages claim he might possess with respect to his unfair

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77. If the successor could not be made liable in this situation, it would difficult to envisage how liability could arise in less compelling circumstances.

78. This normally would not be necessary if the principles of company law were observed, that is, the predecessor corporation has been paid for the sale of its assets and presumably is therefore in a position to satisfy claims against it.

79. 1985 Companies Act, ch. 6, §§ 653, 656; *see* GOWER ET AL., *supra* note 25, at 848-85.

80. The type of situation where this can occur is where it is discovered after the liquidation that the company had an insurance policy covering an insurable loss of which policy the liquidator was ignorant.

81. Butler v. Broadhead, [1975] 1 Ch. 97 (1973); LORD GOFF OF CHIEVELEY & GARETH JONES, THE LAW OF RESTITUTION 586-87 (4th ed. 1993).

82. [1993] B.C.L.C. 480 (Q.B. 1992). The decision in the *Adams* case can be seen as involving successor liability, in that case the successor liability being that of C.P.C. for the debts of N.A.A.C; *see also In re* Baglan Hall Colliery Co., [1870] 5 L.R.-Ch. 346 (Ch. App. 1870).

83. *Creasey*, [1993] B.C.L.C. at 482.

84. *Id.*

85. *Id.*

dismissal by Welwyn.[86] Creasey eventually obtained a default judgment against Welwyn for damages for unfair dismissal.[87] Creasey sought to have Motors joined as a party to the proceedings against Welwyn which was insolvent,[88] so that Motors could satisfy the judgment for damages. The argument was akin to a successor liability argument, which looked particularly compelling in the light of the judge's finding of facts. The court stated:

> The facts can be summarised shortly: (1) The contract was with Welwyn, and at the date when Welwyn ceased to trade (30 November 1988) Welwyn had a contingent liability to Mr Creasey for damages for breach of contract, contingent on Mr Creasey obtaining judgment establishing such liability. (2) On 1 December 1988 Motors took over all Welwyn's assets and its business . . . under the same trade name with the benefit of Welwyn's goodwill and customers. (3) That take-over of Welwyn's assets was carried out without regard to the separate entity of Welwyn and the interests of its creditors, especially Mr Creasey. (4) As a practical matter Motors had to pay off the liabilities of Welwyn (except the contingent and later actual liability to Mr Creasey) in order to carry on the business at 36 Brownfields,[89] and Motors did so. (5) As a result of the actions of Mr Ford, Mr Seaman and Motors, Mr Creasey finds himself with a judgment against Welwyn, an insolvent company, the assets of which they have removed to Motors, a company which refuses to meet any part of the judgment, and which does not even offer to return the assets or their value to Welwyn.[90]

It was argued that under English company law, there is a presumption that a company's liabilities, which include its contingent liabilities, are transferred when the company sells its undertaking as a going concern.[91] The court held that the transfer of a company's undertaking to another company with the same directors and shareholders did not transfer the liabilities of the former to the latter.[92] However, the court in *Creasey* was willing to pierce the corporate veil on the grounds that the affairs of Welwyn

86. *Id.* at 483.
87. *Id.* at 484.
88. *Id.* at 483. Welwyn had been struck off the register of companies pursuant to section 692 of the 1985 Companies Act. *Id.* at 484. This is a much used procedure that enables the Registrar of Companies to strike moribund companies off the register without proceeding by means of a formal liquidation.
89. This was the location from which W Ltd. carried on its business. *Id.* at 482.
90. *Id.* at 485.
91. *Id.* at 486. This proposition was allegedly the position under Scots law. *See* 1 GORE-BROWNE ON COMPANIES § 1.4.1, at 1.007 & n.1 (A.J. Boyle ed., 44th ed. 1986).
92. *Creasey*, [1993] B.C.L.C. at 489-90.

and Motors had been commingled to such an extent that Motors should be liable to Creasey for the debt owed by Welwyn.[93]

V. CORPORATE GROUPS

English law does not, to any significant extent, deviate from the *Salomon* principle. There are a number of reasons for this. One of the reasons why English law is unwilling to pierce the corporate veil or to develop a more sophisticated doctrine of enterprise liability relates to its treatment of corporate groups.

There is no exhaustive empirical survey of the phenomenon of groups in the United Kingdom,[94] but it is clear from the surveys that have been conducted that it is a widespread phenomenon. Thus, R. I. Tricker, in surveying the group structure of companies within *The Times* 1000 top U.K. industrial quoted companies lying in the 1-100 and 401-500 size bands, came up with the following figures:

No. of companies in the sample	Rank in *Times* 1000	Total No. Subsidiaries	Average No. Subsidiaries	Range
44	1-50	10,127	230.16	5-858
39	51-100	4,083	104.69	2-259
35	400-450	1,252	35.77	1-211
26	451-500	665	25.57	2-74
144		16,127	111.99	

Table 1 **Total and average number of susidiaries in large groups, ranked by company size[95]**

The top fifty companies have more than 10,000 subsidiaries with the arithmetical average of 230. However, this survey fails to present a complete picture of the group phenomenon because many unlisted, private companies also make use of the group structure.

Coupled with this, it is not strictly accurate to say that the United

93. *Id.* at 492.

94. *See generally* Dan Prentice, *A Survey of the Law Relating to Corporate Groups in the United Kingdom, in* GROUPS OF COMPANIES IN THE EEC 279 (Eddy Wymeersch ed., 1992).

95. R.I. TRICKER, CORPORATE GOVERNANCE 56 tbl.1 (1984) (Source: Corporate Policy Group Study based on 1981/82 data).

Kingdom does not have a law of corporate groups. The following statement made with respect to the law of corporate groups in the member states of the European Community is certainly applicable to the United Kingdom.

> This [that is, the definition of a group] is not a question solely for accounting law — labour law, tax law, competition law, bankruptcy law, all to a greater or lesser extent, have their own definition of groups in each Member State. . . . [I]t would appear that in this matter, legal science is suffering from an excess of quantity rather than from any shortage.[96]

This is significant because the legislature has intervened to deal with various issues relating to corporate groups. As a result, English courts consider that their function in formulating any overarching principle of enterprise liability is greatly circumscribed. The courts, even the House of Lords, are reluctant to intervene in a matter that has received legislative attention, even where that attention is arguably defective.[97] As the group situation presents the most compelling situation for departing from the strict application of the *Salomon* principle,[98] it is not difficult to appreciate why the courts will not depart from it in other circumstances.

It also is clear that English law considers risk shifting by use of the corporate form as perfectly legitimate. This policy was accepted early on by the courts. In *In re Baglan Hall Colliery Ltd.*, the owners of a colliery that they had not been working successfully decided to change it into a limited liability company in order to avoid the risk of incurring liability.[99] The Court of Appeal, held that the owners had not done anything inappropriate since it was "the policy of the *Companies Act* to enable this to be done."[100]

The policy of risk shifting has never been seriously challenged. For example, in the case of a voluntary creditor, such as a bank that provides financing, it can be argued that the creditors accept the risk associated with

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96. Michel Petite, *The Conditions for Consolidation Under the 7th Company Law Directive*, 21 COMMON MKT. L. REV. 81, 84 (1984).

97. A good example of this is provided by the recent case of *Westdeutsche Landesbank Girozentrale v. Islington London Borough Council*, where a majority of the House of Lords refused to award compound interest on damages even though the "strength of the moral claim" was recognized. [1996] 2 All E.R. 961, 999. Their reason for doing so was that Parliament had addressed this issue on two occasions (1934 and 1981) and had conferred on the courts jurisdiction to grant only simple interest on damages. *Id.*

98. For example, it does not involve a complete jettisoning of the principle of limited liability because the shareholders in the parent company normally would still benefit from it.

99. *In re Baglan Hall Colliery*, [1870] 5 L.R.-Ch. at 346-47. "The owners went on working the colliery, not very successfully, and then determined to form a limited company, in order to avoid incurring further personal liability." *Id.* at 356.

100. *Id.* at 356.

limited liability by voluntarily dealing with those companies.[101] Voluntary creditors can protect their interests either by adjusting the price to reflect the enhanced risk or by obtaining security. However, these risk-minimizing strategies are not available to involuntary creditors. There are a number of reasons why the plight of involuntary creditors has not produced a significant challenge to the policy of risk shifting in the United Kingdom. They include: (1) compulsory insurance (industrial accidents/traffic victims) entails that the interests of many involuntary creditors are protected; (2) employees who have to extend credit to corporate employers are given, up to a limited amount, priority claims for unpaid renumeration in insolvency;[102] and (3) small trade creditors, who could be viewed as involuntary creditors, lack the cohesion to constitute a viable lobby group for change or, alternatively, their claims individually are for such small amounts that these can be written off as a de minimis cost of doing business.[103]

Finally, there is a strong principle of stare decisis in the United Kingdom, and even the House of Lords exercises a very limited jurisdiction to depart from its previous rulings.[104] Judicial activism or the perception by the court that in appropriate circumstances, it can perform a quasi-legislative role, is not a characteristic of English courts. This again further entrenches the binding effect of precedent.[105]

VI. CONCLUSION

It is the hundredth anniversary of the *Salomon* case in 1997. It is rightly seen as a landmark decision in English company law. It has proven remarkably durable, and it is hard to think of another nineteenth century English decision that has remained so unaffected by the passage of time. It also is interesting that there has been little criticism of the *Salomon* principle and little demand for its modification either judicially or legislatively. On current form, the *Salomon* principle may endure for another hundred years.

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101. A company's name must indicate that the liability of its members is limited. 1985 Companies Act, ch. 2, § 25(1).

102. Insolvency Act 1986, ch. 10, § 386, sched. 6 (Eng.).

103. This may merely be an example of the old adage that for a fraudster it is it safer to relieve five million persons of £1 each rather than to relieve one person of £5,000,000.

104. *See generally* ALAN PATERSON, THE LAW LORDS (1982).

105. The contrast between English and U.S. judicial techniques is developed in PATRICK S. ATIYAH & ROBERT S. SUMMERS, FORM AND SUBSTANCE IN ANGLO-AMERICAN LAW at chs. 4, 20 (1991).