PIERCING THE CORPORATE VEIL

"Those setting up complex corporate structures with intend to abuse the limited liability protection, must always remember that where their intentions are not honorable, the courts will intervene."

By Michalis Moushouttas

When a court rules that the directors, shareholders or beneficial owners of a company should be brought to account for their involvement and/or the role they may have played, in relation to liabilities or acts of a legal entity, this is known as piercing or lifting of the corporate veil. In the normal course of events, a limited company, is solely responsible for the debts it incurs and is the sole beneficiary of the credit it is owed.

An example of the making of such an order is found in Dublin County Council v Elton Homes Limited where the court issued an injunction against the directors of a company in addition to the company itself.

Common law countries usually uphold this principle, but in exceptional circumstances the limited liability of its promoters and or associates may be waived in favor of those that may have suffered hardship as a result of the legal entity's actions caused by its directors and or promoters and or beneficial owners.

A simple example would be where a businessman, living his job, having in the first instance signed a "non competing agreement" but subsequently decides to set up a company, in direct competition with his former employer. Technically, it would be the company and not the person competing. But it is likely that a court would find that the new company was just a "sham", a "fraud" and would still allow the old company to sue the man behind it, for breach of contract.

A court is likely to look beyond the "legal fiction" to the reality of the situation.

Piercing the corporate veil is not the only means by which a director or officer of a corporation can be held liable for the actions of a company. Liability can be established through conventional theories of contract, agency, or tort law. For example, in situations where a director or officer acting on behalf of a corporation personally commits tort, he and the corporation are jointly liable and it is unnecessary to discuss the issue of piercing the corporate veil. The doctrine is often used in cases where liability is found, but the corporation is insolvent.

The land mark case is that of ***Salomon v Salomon & Co***. firmly established the principle of the separate legal personality of a company i.e. that a company, once incorporated, is a legal person in its own right and is to be regarded as a separate entity from its members. The court in that case did however recognise that there could be instances where the courts would have to deviate from the principle of separate legal personality by stating that the principle was to be of general application provided that there was "…no fraud and no agency and if the company was a real one and not a fiction or a myth."

In general, courts have been known to lift the corporate veil if the case falls into any of the categories below: -

- Where a relationship of agency is found to exist;
- Where the company is being used as a mechanism to avoid legal obligations;
- In the case of a group of companies, where the justice of the case requires that the companies within that group should be regarded as a single economic entity; and
- Where the corporate veil is lifted to ensure compliance with a court order

In exceptional cases the courts have exercised this power and in doing so have lifted the corporate veil and issued an order against the directors or controllers of a company, in addition to the company itself.

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CONCLUSION

It is clear from available case law in this area that the courts are keen to reaffirm the importance of the Salomon principle in company law and that the separate legal personality of a company will not be disregarded with ease.

Nevertheless, those setting up complex corporate structures with intend to abuse the limited liability protection, must always remember that where their intentions are not honorable, the courts will intervene.