THE LIABILITY OF CORPORATE GROUPS

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SUMMARY

Groups of companies have become a reality in our modern day economy. Companies often organise themselves into groups with the view of allocating capital in a manner that reduces the risks particular assets are exposed to, i.e risk diversification. Despite the fact that companies in a group often have their affairs and functions aligned, courts have developed the time-honoured principles of separate legal personality in deciding that each company in a corporate group is a separate legal entity with a separate legal personality together with rights, obligations, duties and liabilities distinct from those of the other group members. It is evident from the consideration of different jurisprudence that the courts' readiness to pierce the corporate veil varies quite considerably depending on the facts of each case; and as such it is difficult to categorise the principles premised on finitely determinable standards.

KEYWORDS:

Separate Legal Personality - Limited Liability - Piercing the Corporate Veil - Group of Companies - Law of Agency

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1 Introduction

The protective framework of limited liability and entity separation between a subsidiary and its holding company creates problems. The reason for this is that a subsidiary is viewed as a separate entity regardless of the fact that it forms an integral part of a corporate group that collectively conducts business and that "the holding company takes a leading role in the governance of the larger group of companies".[1] This places unwarranted burden on external creditors in enforcing their claims in general and in the event of liquidation of the subsidiary. Moreover, the principles of separate legal personality and limited liability set forth circumstances that make it possible for the holding company to escape liability in those circumstances where the holding company could have influenced the transactions between the subsidiary and the external creditors or exercised absolute control over the structured management of the company. It is evident from the cases that will be discussed under veil piercing, that there is some difficulty in identifying single and coherent principles governing circumstances in which the court may intervene by piercing the corporate veil in a group situation. For example in *Re a Company*[2] the court remarked that a court can use "its powers to pierce the veil if it is necessary to achieve justice".[3] In *Adams v Cape Industries*[4] the court stated that: ". . . save in cases which turn on the wording of particular statutes or contracts, the court is not free to disregard the principle of Salomon v Salomon and Co Ltd 1987 AC 22 merely because it considers that justice so requires".[5] I conclude that although the courts do not have a general discretion to pierce the corporate veil in order to hold the holding company liable for the acts of its subsidiaries, the South African courts have placed much reliance on section 20(9) of Companies Act 71 of 2008 (hereinafter referred to as "the Companies Act") to fasten a holding company with liability for the acts of the subsidiary company. Moreover, a proper consideration of South African jurisprudence reveals that, despite the fact that courts do not have a general discretion to pierce the corporate veil, our courts adopt a discernible liberal approach to piercing.[6] Although our courts will not lightly disregard a company's separate legal personality nor easily find recklessness, our courts will nevertheless pierce the corporate veil where justice so requires "and not only when there is no alternative remedy".[7] It should, however, be noted that fraud or some improper conduct has generally been present

[1] Havenga, Esser and Cullinan *Corporate Governance Review* (2012) 125.
[2] 1985 BCLC 333.
[3] *Re a Company* (n 2) 337.
[4] 1990 BCLC 479 513.
[5] *Adams v Cape Industries* (n 4) 536 and *Hülse-Reutter v Gödde* 2001 4 SA 1336 (SCA).
[6] *Ex Parte Gore* 2013 2 ALL SA 437 (WCC).
[7] *Ex Parte Gore* (n 6) par 28.

in those cases where the courts have relied on section 20(9) of the Companies Act with the view of piercing the corporate veil.[8]

2 Definition of a company

A company is defined in section 1 of the Companies Act as meaning a juristic person incorporated in terms of the Companies Act, a domesticated company, or a juristic person that meets the requirements of subsection (a) to (c).

In essence, the Companies Act applies to companies formed under the Companies Act; companies that were formed under the Companies Act 61 of 1973 (hereinafter referred to as "the 1973 Act"); and to close corporations that have been incorporated under Schedule 2 the Companies Act. Additionally, the definition of a company includes companies that were deregistered under the 1973 Act and have subsequently been re-registered in terms of the Companies Act.

3 Separate legal personality

The fundamental principle of company law that once a company is legally incorporated it has a personality distinct from its members was clearly established in *Salomon v Salomon Co & Ltd*.[9] The separate legal personality of a company has several consequences in company law. Firstly, the company enjoys perpetual existence; a company will retain its legal identity and continue to exist notwithstanding the death of its members, transfer of shares or any other cause that may result in the change of the company's membership.[10] Secondly, the company can own property and such property and assets belong to the company and not the shareholder.[11] The shareholders are only entitled to share in the division of the company's assets once the company is liquidated and only such assets remaining after satisfaction of the

[8] *Ex Parte Gore* (n 6) par 28.
[9] 1897 AC 22 (HL) 30 - 31. See also *EBM Co Ltd v Dominion Bank* 1973 3 ALL ER 555 564 and *Dadoo Ltd v Krugersdorp Municipal Council* 1920 AD 530 550.
[10] *Maasdorp v Haddow* 1959 3 SA 861 (C) 866 and *Stern v Vesta Industries (Pty) Ltd* 1976 1 SA 81 (W) 85.
[11] *Dadoo Ltd v Krugersdorp Municipal Council* (n 9). In *casu* the Appellate Division held that ownership of property by the company was not in substance ownership by the shareholders, and that ownership of such property vested in the company and the shareholders had no legal interest in the company's property.

claims of the company's creditors.[12] Thirdly, profits of the company do not belong to its members but solely to the company. Although shareholders have a financial interest in the overall performance of the company, they only have a right to dividends only once the company declares the dividend.[13] Fourthly, because a company is a legal person separate from its shareholders, a company is by all means able to conclude transactions or contract with its members or shareholders.[14] Fifthly, the company can "sue or be sued in its own name".[15] Therefore if the company sustains a loss for which it has a right of action, the members do not have a direct standing to institute legal proceedings to claim relief for the wrongs done to the company. The legal rights of the company belong to the company and the company itself must institute the action to obtain redress for the loss suffered or injuries caused.[16]

Seventhly, the company conducts its business as a separate person. Although a shareholder has a financial interest in the success of the company, such interest does not accord the shareholders a right to manage the company's business or bind the company to any contract.[17] Only persons authorised to act on behalf of the company may bind the company by entering into contracts on its behalf. Finally, the company is fully liable for its debts and liabilities save in exceptional circumstances.[18] This is further confirmed by section 19(2) of the Companies Act which provides that a shareholder or a director, solely by reason of being an incorporator, is not liable for any of the company's liabilities or obligations, except to the extent that the Act or the company's Memorandum of Incorporation provides otherwise.[19] Therefore, the shareholders of the company are not required to pay the debts of the company or provide security for the debts of the company. However, it is possible for shareholders to

[12]*Macaura v Nothern Assurance Co Ltd* 1925 AC 619 630 and 631. See also *Stellenbosch Farmers' Winery Ltd v Distillers Corporation (SA) Ltd* 1962 1 SA 458 (A) 471 and 472 and *Dadoo Ltd v Krugersdorp Municipal Council* (n 9) 550 and 551.

[13]FHI Cassim, MF Cassim, R Cassim, Jooste, Shev and Yeats *Contemporary Company Law* (2012) 36 - 38. See also *S v De Jager* 1965 2 SA 616 (A) where the court held that the shareholder's conduct of despoiling the company of its assets and money offends the concept of limited liability underlying company law, namely that the company is a separate legal person and owns the funds and properties and the shareholder's general right to participation is deferred until winding up subject to the creditors' claims.

[14]This is best illustrated in *Lee v Lee's Air Farming Ltd* 1961 AC 12 where the court held that the company could enter into a contract of service with one of its shareholders and that "there was no reason to deny the contractual relationship between the member and the company".

[15]*Magnum Financial Holdings (Pty) Ltd v Summerly* 1984 1 SA 160 (W) 163.

[16]*Magnum Financial Holdings (Pty) Ltd v Summerly* (n 15) 163.

[17]*Francis George Hill Family Trust v South African Reserve Bank* 1992 3 SA 91 (A) 97.

[18]For example, the shareholders will be compelled to pay the debts of the company where the court has pierced the corporate veil.

[19]It is important to note that s 19(3) of the Companies Act provides that in the case of personal liability companies, "directors and past directors are jointly and severally liable together with the company for any debts and liabilities of the company contracted during their respective periods of office".

voluntarily assume personal liability for the company's debts and liabilities in which event the limited liability enjoyed by the shareholders will be negated.[20]

4 Piercing the corporate veil

Once a company is legally incorporated, a "veil is drawn between the company and its shareholders and directors, which separates the company from its shareholders and directors and protects them from the liability for the debts and liabilities of the company".[21] In the sphere of incorporation, the shareholders and directors of the company are protected against personal liability.[22] However, such protection is not absolute and the court may, in exceptional circumstances, pierce the "corporate veil" and hold the directors personally liable for the company's debts.[23] The reason for this is that, companies may be imbued with a statutory identity in the sense that their separate existence is only a "figment of law".[24] It may therefore become necessary for the court to pierce the corporate veil in order to prevent a situation where a company has been used as an instrument to meet private interests of shareholders and directors.[25] The court in *Amlin (SA) Pty Ltd v Van Kooij*[26] stated that piercing the corporate veil necessitates that the court "opens the curtains of the corporate entity in order to see for itself what is obtained inside" and attribute personal liability to someone who abuses the principle of corporate personality.[27] When the court pierces the corporate veil, the company's rights, liabilities or activities will be treated as the rights, liabilities or activities of the company's shareholders.[28]

It is important to note that with regard to both companies and close corporations, the legislature has created a statutory remedy that permits the court to pierce the corporate veil. The first statutory remedy is section 65 of the Close Corporations Act 69 of 1984 (hereinafter

[20] *JH Rayner (Mincing Lane) Ltd v Department of Trade and Industry* 1990 2 AC 418 (HL).
[21] French, Mayson and Ryan *Company Law* (26 ed) 123 and FHI Cassim *et al* (n 13) 41.
[22] *Airport Cold Storage (Pty) Ltd v Ebrahim* 2008 2 SA 303 (C) par 19.
[23] *Airport Cold Storage (Pty) Ltd v Ebrahim* (n 22) par 19. See also *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd* 1995 4 SA 790 (A) par 27.
[24] *Ebrahim v Airports Cold Storage (Pty) Ltd* 2009 1 All SA 330 (SCA) par 15. It should be noted that the supreme court of appeal held that it was not necessary to consider the application of s 65 of the Close Corporations Act.
[25] *Airport Cold Storage (Pty) Ltd v Ebrahim* (n 22) par 25.
[26] 2008 2 SA 558 (C) par 12.
[27] *Amlin (SA) Pty Ltd v Van Kooij* (n 26) par 12. See also *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd* (n 23) par 28.
[28] *Atlas Maritime Co SA v Avalon Maritime Ltd* 1991 4 ALL ER 769 779.

referred to as the "Close Corporations Act"). The second statutory remedy is section 20(9) of the Companies Act which has been said to encapsulate section 65 of the Close Corporations Act.[29] It has been contended that section 20(9) of the Companies Act does not override the common-law principles in respect of piercing the corporate veil and where the requirements of section 20(9) cannot be satisfied and consequently cannot be relied on, the principles developed at common law would apply.[30]

When will a court pierce the corporate veil? There are no hard and fast rules that underlie the courts' decision to pierce the corporate veil; and as such veil piercing is an exceptional remedy.[31] Piercing the corporate veil is an extreme remedy and the supreme court of appeal in *Hülse-Reutter & Others v Gödde*[32] reiterated that courts do not have a general discretion to simply disregard a company's separate legal personality "whenever they consider it just or convenient to do so".[33] The drastic nature of veil piercing was confirmed by Dlodlo J in *Amlin (SA) Pty Ltd v Van Kooij,*[34] who stated that the remedy ought to be resorted to rather sparingly and as a remedy of "last resort in circumstances where justice will not otherwise be done between the two litigants".[35] The court did, however, identify general criteria relied upon in deciding whether or not to pierce the corporate veil.[36] The general criteria includes instances of "fraud, agency, evasion and abuse of the corporate form".[37] Moreover, the court may pierce or lift the corporate veil where the company is found to be a façade "concealing the true facts".[38] It is accepted that piercing the corporate veil is an exceptional remedy. However, the supreme court of appeal in *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd* held that veil piercing cannot be precluded solely on the basis that an alternative remedy exists.[39] In other words, if a litigant "has more than one legal remedy at his disposal he can select any one of them; he is not obliged to pursue one rather than the other". Therefore, the fact that an alternative remedy exists or a failure by a person to pursue the

[29]FHI Cassim *et al* (n 13) 57.
[30]*Ex Parte Gore* (n 6).
[31]*Airport Cold Storage (Pty) Ltd v Ebrahim* (n 22) par 21 and *Hülse-Reutter & Others v Gödde* (n 5) par 20. See also *Briggs v James Hardie & Co (Pty) Ltd* 1998 15 NSWLR 549 567.
[32]n 5 above.
[33]*Hülse-Reutter v Gödde* (n 5) par 20.
[34]*Amlin (SA) Pty Ltd v Van Kooij* (n 26) par 12.
[35]*Amlin (SA) Pty Ltd v Van Kooij* (n 26) par 23.
[36]*Amlin (SA) Pty Ltd v Van Kooij* (n 26) par 23.
[37]*Amlin (SA) Pty Ltd v Van Kooij* (n 26) par 23. See also *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd* (n 23) par 30 - 32 where the supreme court of appeal held that our courts do not have a general discretion to simply disregard the separate legal personality of a company "but should strive to give effect to and uphold it". Although the court could not define general principles for veil piercing, the court held that "fraud, dishonesty and improper conduct provide grounds for piercing the corporate veil".
[38]*Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd* (n 23) par 37.
[39]*Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd* (n 23) par 37.

alternative remedy will not necessary bar the court from granting consequential relief if the peculiar facts of the case justify veil piercing.[40] Although the availability of another remedy is not of overriding importance, it may be a relevant factor in considering the pertinent policy considerations.[41] The decision whether or not a court should pierce the corporate will depend on the peculiar facts of each case, public policy and judicial precedents.[42] Moreover, in determining whether it is legally appropriate for the court to pierce the corporate veil in the given circumstances, the court will have regard to "the fundamental doctrine that the law regards the substance rather than the form of things".[43]

As already mentioned above, there are no rigid categories of the instances in which the courts will pierce the corporate veil, however, there are several legal principles established in case law which, if applied, will result in the members of the company being responsible for the company's debts and liabilities. Griesel J in *Airport Cold Storage (Pty) Ltd v Ebrahim*[44] stated that as a matter of principle, before the court can disregard the separate legal personality of a company, "there must at least be some misuse or abuse of the distinction between the corporate entity and those who control it".[45] Firstly, the court will pierce the corporate veil only where there are "special circumstances indicating that the corporation was a mere façade concealing the true facts".[46] Although fraud can be such special circumstance, it is not always essential.[47] Secondly, the separate legal personality of a company may be pierced by provisions of a particular statute stating that a company is, although separately incorporated, to be treated as sharing the same legal personality with its members in specified circumstances.[48] Although the constructive interpretation of such any statute may lead to the conclusion that the legislature intended to pierce the corporate veil, it is however expected that any legislative intention to pierce the corporate veil should be expressed in clear and unequivocal language. Thirdly, in certain instances, the court will pierce the corporate veil where the controlling shareholders treat the company as an "alter ego" or "instrumentality" to

[40] *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd* (n 23) par 38.
[41] *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd* (n 23) par 38.
[42] *Adams v Cape Industries* (n 4) 536; *Hülse-Reutter v Gödde* (n 5) and *Briggs v James Hardie & Co (Pty) Ltd* (n 31) 220.
[43] *Dadoo Ltd v Krugersdorp Municipal Council* (n 9) par 29.
[44] *Airport Cold Storage (Pty) Ltd v Ebrahim* (n 22) par 21.
[45] *Airport Cold Storage (Pty) Ltd v Ebrahim* (n 22) par 22.
[46] *Airport Cold Storage (Pty) Ltd v Ebrahim* (n 22) par 25.
[47] *Airport Cold Storage (Pty) Ltd v Ebrahim* (n 22) par 22 where Dlodlo J remarked that fraud, dishonesty and improper conduct could possibly be grounds for piercing the corporate veil.
[48] *Dimbleby and Sons Ltd v National Union of Journalists* 1984 1 WLR 427 435 and Hicks *Cases and Materials on Company Law* (2004) 94.

promote their own personal interests.[49] Although, Griesel J stated that the corporate veil may be pierced in certain circumstances where the company has been used as an "instrumentality" or an "alter ego" of its directors or controlling shareholders, it has been argued that the court will not necessarily pierce the corporate veil but lift the veil in such instances.[50]

Fourthly, the court will pierce the corporate veil where the company has been formed as a device or a sham or a cloak to evade a contractual duty or the enforcement of existing rights.[51] The appellate division in *Dadoo Ltd v Krugersdorp Municipal Council*[52] held that "a particular transaction may in truth be within the provisions of the statute, but the parties may call it by a name or cloak it in guise, calculated to escape those provisions. Such a transaction would be in *fraudem legis*, the court would then strip off its form and disclose its real nature, and the law would operate".[53] Larkin states that the theory underlying this approach would be that only a "real company", in other words "only a company in substance" and not just form would be able to claim entity status.[54] Larkin further argues that a company will be a sham where there is any reason to find that the contract was a simulated transaction.[55] And for this reason, Larkin submits that the disguise is not the company but the transaction, and it is the latter which must be pierced and not the corporate veil.[56]

[49]*Airport Cold Storage (Pty) Ltd v Ebrahim* (n 22) par 26.
[50]FHI Cassim *et al* (n 13) 52. See also *O'Donnell v Weintraub* CA 1968 277 – 278 where the court held that the corporate veil may be lifted under the alter ego doctrine when the corporation is organised and operated to merely channel the interests of some other legal person. Before "lifting" the corporate veil, the court stated that regard should be had in each case to the overall dealings of the corporation and various factors. These factors include: a) absence of corporate formalities; b) undercapitalization; c) degree of separation between the corporate entity and the individual's property; d) the amount of the individual's financial interest in the corporate entity; e) degree of control that the individual has over the corporation; and f) whether the individual has used the corporate entity to promote private interests.
[51]In *Gilford Motor Co Ltd v Horne* 1933 Ch 935 (CA) the defendant who was a former managing director of the plaintiff, had signed a restraint of trade agreement. According to the terms and conditions of the restraint of trade, the defendant was bound not to engage directly or indirectly in any business similar to that of the plaintiff for a period of five years after his employment. Following termination of his employment, the defendant attempted to evade the restraint of trade agreement not to compete with the plaintiff by getting his wife to form the company which conducted business in competition with the plaintiff. The court described the use of the company as "a device and a stratagem, in order to mask the effective carrying on of business [by the defendant]". The court further held that the purpose of the company was to enable the defendant under "the cloak or a sham, to engage in business which on the consideration of the agreement" he was restraint from carrying.
[52]n 9 above.
[53]*Dadoo Ltd v Krugersdorp Municipal Council* (n 9) 548.
[54]Larkin "Regarding judicial disregarding of the company's separate identity" 1989 *SA Merc LJ* 277 284.
[55]Larkin (n 54).
[56]Larkin (n 54).

In the event that the court decides to pierce the corporate veil for a specific purpose, the piercing will not result in the non-recognition of the company's independence and autonomy for all other purposes.[57]

5 The holding and subsidiary relationship

It is important to first refer to the provisions of the Companies Act when dealing with subsidiaries and holding companies as the existence of the relationship between a holding and subsidiary company bring into existence the concept of group of companies.

Section 1 of the Companies Act defines a group of companies as a "holding company and all its subsidiaries".[58] A holding company is defined in relation to a subsidiary, as meaning "a juristic person or undertaking that controls that subsidiary".[59] The definition of a subsidiary is determined in accordance with section 3 of the Companies Act. The Companies Act provides that a company is a subsidiary of another juristic person, firstly, if that juristic person, one or more other subsidiaries of that juristic person, or one or more nominees of that juristic person or any of its subsidiaries, alone or in combination: (i) is either directly or indirectly able to exercise, or control the exercise of, a majority of the general voting rights associated with issued securities of that company, whether pursuant to a shareholders agreement or otherwise; or (ii) has or have the right to appoint or elect, or control the appointment or election of, directors of that company who control a majority of the votes at a meeting of the board.[60] Secondly, a company is considered to be a wholly-owned subsidiary of another juristic person if all of the general voting rights associated with issued securities of the company are held or controlled, alone or in any combination, by persons contemplated in paragraph (a) of the definition of subsidiary relationship.[61]

Section 3 of the Companies Act goes further to provide for some guideline in deciding whether or not a person has control over all or a majority of the general voting rights relating

[57] *Nedco Ltd v Clark* 43 DLR 3d 714 (1973) 721.
[58] s 1 of the Companies Act.
[59] n 58 above.
[60] s 3(1)(a)(i) and (ii) of the Companies Act.
[61] s 3(1)(b) of the Companies Act.

to securities issued by a company. In making such a determination, section 3(2)(a) provides that if the aforementioned general voting rights are only exercisable in peculiar circumstances, such voting rights ought to be taken into account upon the emergence of those certain circumstances and for as long as they continue or "when those circumstances are under the control of the person holding those voting rights".[62] Moreover, section 3(2)(b) provides that a person will be considered to have control over all or a majority of the general voting rights if such voting rights are "exercisable only on the instructions or with the consent or concurrence of another person are to be treated as being held by a nominee for that other person".[63] According to section 3(2)(b) voting rights that are held by a person as a nominee or in a fiduciary capacity for another person will be treated as being held by that person. The word "hold" or any secondary word, alludes to the "registered or direct or indirect beneficial holder of securities conferring a right to vote".[64]

The Companies Act defines a juristic person as including a trust. It is therefore possible for a trust to be a holding company of a subsidiary company.[65].

5.1 Group of companies

In order to determine whether there is an incidence of a corporate group, one would have to establish whether there is a holding company and whether any other company is a subsidiary of the holding company.[66] Moreover, the definitions of subsidiary and holding company are premised on the control that the holding company is able to exercise over the subsidiary company.[67] Control is therefore a pivotal characteristic of a corporate group.

The development of the “separate legal personality” doctrine and “limited liability” has not only benefited single entities but also companies in a group whose commercial and financial interests are managed on a central and unified basis and thus forming a single economic

[62]s (3)(2)(a)(i) and (ii) of the Companies Act.
[63]s 3(2)(b) of the Companies Act.
[64]s 3(3) of the Companies Act.
[65]Stevens *The External Relations of Company Groups in South African Law: A Critical Comparative Analysis* (2011 US) 11.
[66]s 3 of the Companies Act 2008.
[67]Connell “Holding companies to account: The expense apportionment conundrum” 2004 *SALJ* 117.

unit.[68] Although group structures may provide financial, commercial and organisational advantages for a group as a whole, such economic structures may lead to economic abuses.[69] These inherent economic abuses necessitated a form of legislative intervention because the common law was inadequate to regulate the "economic realities" and problems of group structures. Bhana explains that the inadequacy of the common law to regulate the problems inherent in group structures was due to the fact that the common law was mainly founded on the principle of separate legal personality of single entities and did not anticipate the emergence of corporate groups.[70] Moreover, as the phenomenon of corporate groups continued to emerge, economic abuse of the interrelationship between the holding company and subsidiary began to unfold and the real concerns of commercial fairness and equity played little role in the common law development of company law in this regard. Consequently, the common law failed to effectively address and appreciate the complete significance of group relationships particularly in terms of the propensity for "camouflage" and abuse.[71]

The inadequacy of the common law to effectively address the economic interrelationship between the holding company and subsidiary company resulted in legislative intervention.[72] The Companies Act 46 of 1926 (hereinafter referred to as the "1926 Act") did not initially include the concepts of holding and subsidiary companies.[73] The concepts were, however, later incorporated into the 1926 Act by way of amendment in 1939 (hereinafter referred to the "1939 Amendment Act"). The 1939 Amendment Act essentially followed the scheme of the English Companies Act of 1929 although the concept of "a subsidiary of a subsidiary" was introduced.[74] Following the amendment of the English Companies Act in 1948, the Companies Amendment 46 of 1952 (hereinafter referred to as the "1952 Amendment Act") was introduced in South Africa and the amendment, albeit following the wording of its English counterpart, introduced a new definition of holding and subsidiary company and thus

[68]Blumberg *The Multinational Challenge to Corporation Law* (1999) 59. The courts have, however, rejected the "single economic unit" argument. For example, the courts have refused to allow a claim against one company in a group to substitute the holding company or other group subsidiaries as defendant to that claim on the basis that the group may be a single economic entity.
[69]Bhana "The company law implications of conferring a power on a subsidiary to acquire the shares of its holding company" 2006 *Stellenbosch Law Review* 232 233.
[70]Bhana (n 69).
[71]Bhana (n 69).
[72]Bhana (n 69) 234.
[73]Stevens (n 65) 142.
[74]Stevens (n 65) 142.

replacing the definition in the 1939 Amendment Act.[75] The amendment to the 1926 Act "introduced provisions which were either aimed to provide sufficient disclosure of the financial position of a subsidiary in the annual financial statements of the holding company, or to prevent abuse".[76]

Certain provisions of the 1973 Act also evidence a legislative intervention to prevent economic abuse of the interrelationship between the holding company and the subsidiary. For example, sections 288 - 294 required the consolidation of financial statements in respect of group of companies.[77] In so far as the disclosure of financial statements is concerned, the 1973 Act treated the corporate group as a single entity. Although the 1973 Act recognised corporate groups as a single entity for purposes of compiling group financial in order to facilitate the disclosure of group's financial position, sections 288 - 294 did not, in any way, deny the legal personality of each company in the group.[78] However, the new Companies Act does not require a holding company to consolidate financial statements of a group.[79] Although the consolidation of group financial statements is not a requirement, section 29(4) provides that the Minister may make regulations prescribing financial reporting standards.[80]

According to the wording of section 30(3)(b) of the 1973 Act, a subsidiary company had the option to include in its annual financial statements a report by the directors with respect to its own state of affairs, business and profit and loss or that of the corporate group. Although the Companies Act no longer makes provision for rules and regulations on group of companies in relation to consolidated financial statements and group accounts, the provisions requiring the consolidation of financial statements and group accounts are in actual fact necessary to understand and examine each company separately.[81] The fact that courts will not ignore the separate legal personality of each company in a corporate group on the basis of legislative provisions requiring consolidated group account was confirmed in *Industrial Equity Ltd v Blackburn*.[82] The court had to determine whether in realizing the amount of profits available for distribution by the holding company "by way of a dividend is correct to look at the profit

[75]Stevens (n 65) 142.
[76]Stevens (n 65) 144.
[77]Stevens (n 65) 151 and s 30(3)(b); 41; 48; s 93(1)(b); and s 95 of the Companies Act.
[78]Stevens (n 65) 152.
[79]Stevens (n 65) 152.
[80]International Financial Reporting Standards (IAS) 27 and 1.
[81]From an economic point of view, it is argued that if the separate entities are an economic unit, it is important to assess the financial position of each economic entity by eliminating inter-corporate operations.
[82]1977 137 CLR 567 (H).

of the holding company itself or to the group profit as disclosed by consolidated accounts".[83] The high court of Australia held that the principle that prohibit the payment of dividends otherwise than out of profits on dividends refers "exclusively to the profits of the company declaring and paying the dividend" and this being "the natural consequence of the recognition of the separate personality of each company".[84] Mason J with the concurrence of the four other judges went further to state that the requirements for consolidated group accounts introduced in the United Kingdom by the Companies Act 1948 and in New South Wales by the Companies Act 1961 have, to some extent, alleviated the *Salomon v Salomon* doctrine.[85] Further, that the purpose behind the statutory provisions requiring consolidated group accounts is to ensure that the concerned persons dealing with the holding company have precise and accurate information as to the profit and loss and the state of affairs of the corporate group.[86] As a result, the corporate group is treated as a single entity merely for this purpose.

Consequently, it cannot be accurately asserted that the provisions of the 1973 Act requiring the consolidation of the corporate group's financial statements denied the separate legal personality of each company in the group. Thus, in the absence of a contractual agreement that provides for specific rights, a creditor will not be able to enforce his claim against another company in the group. Such debts are only recoverable from the subsidiary company and not the holding company or other subsidiaries in the group.[87]

The Irish high court in *Allied Irish Coal Supplies v Powell Duffryn International Fuels Ltd*[88] also rejected an argument that a provision governing consolidated group accounts denies the separate legal personality of each company within the group. The high court held that the only identification between a holding company and a subsidiary company was on the basis of group accounts and such identification was insufficient to turn the two companies into a single economic unit.

[83] *Industrial Equity Ltd v Blackburn* (n 82) 575.
[84] *Industrial Equity Ltd v Blackburn* (n 82) 577 - 578.
[85] *Industrial Equity Ltd v Blackburn* (n 82).
[86] *Industrial Equity Ltd v Blackburn* (n 82).
[87] *Industrial Equity Ltd v Blackburn* (n 82).
[88] 1997 1 ILRM 306, 1998 2 IR 519. The Irish Supreme Court confirmed that the separate legal personality of a subsidiary is not affected by the subsidiary's control, financial and operational dependence on the holding company.

5.2 The doctrine of separate legal personality in the context of group of companies

It is important to note that the issue of liability of group of companies is not extensively addressed in the Companies Act. In *Bank of Tokyo Ltd v Karoon*,[89] Goff LJ stressed that although it may be technically possible to distinguish between a holding company and a subsidiary company, the concern was not of contextual economics but rather a distinction for purposes of law.[90] And accordingly, the distinction between a holding company and a subsidiary is of fundamental legal importance and cannot be bridged.[91] Although a group of companies forms a single economic entity, the separate personality of each member in the group cannot be ignored.[92] The fundamental principle of company law is that each company in the group structure is an independent entity with separate legal rights, duties, liabilities and obligations distinct from the other members of the group and the court is not entitled to disregard this principle and pierce the corporate veil simply because it considers it just to do so.[93] The holding company like any ordinary shareholder is insulated from the debts of the subsidiary. This is because the doctrine of separate legal personality within company law primarily functions to facilitate "the implementation of limited liability".[94] This proposition was asserted by Templeman LJ in *Re Southard Ltd & Co*[95] stating that:

"A [holding company] may spawn a number of subsidiary companies, all controlled directly or indirectly by the shareholders of the [holding company]. If one of the subsidiary company declines into insolvency to the dismay of its creditors, the [holding company] and the other subsidiary companies may prosper to the joy of shareholders without any liability for the debts of the insolvent subsidiary."[96]

In other words, the acts of a subsidiary company are not necessarily the acts of the holding company or vice versa and the creditors of each company will have claims to recover the debt only against the specific company that incurred the debt and the insolvency and liquidation of

[89]1987 AC 45.
[90]*Bank of Tokyo Ltd v Karoon* (n 89) 64F.
[91]Pettet *Company Law* (2001) 23.
[92]*Adams v Cape Industries* (n 4).
[93]*Adams v Cape Industries* (n 4) 532, 536 – 537 and 544. See also *R Milne and Erleigh* 1951 1 SA 791 (A) 827 – 828 and *Dithaba Platinum (Pty) Ltd v Econovaal Ltd* 1985 4 SA 615 (T) 625.
[94]Davies *Introduction to Company Law* (2 ed) 94 and Blumberg *Blumberg on Corporate Groups* (2 ed) 330.
[95]1979 1 WLR 1198.
[96]*Charterbridge Corp v Lloyds Bank* 1970 Ch 62 74 where the court considered the situation where a company would have separate creditors and suggested that the appropriate test in such circumstances must be "whether an intelligent and honest man in the position of a director of the company concerned, could, in the whole of the existing circumstances, have reasonably believed that the transactions were for the benefit of the company."

the subsidiary will not necessarily affect the solvency and liquidity of the holding company and its other subsidiaries.[97] Moreover, rights of one company in a corporate group cannot be exercised by another company in the same group despite the fact that such company or the corporate group may ultimately benefit from the exercise of those rights notwithstanding the company or body in whom those rights are vested.[98]

In spite of the fact that each company in a group of companies is a separate legal entity with its own separate legal personality, rights, duties and liabilities; it is, however, possible for the group to be structured in such a manner that will result in minimisation of liability of the holding company.[99] This right was expressly confirmed by Slade LJ in *Adams v Cape Plc* [100] stating that the court is not as a matter of principle entitled to lift the corporate veil as against a subsidiary of a corporate group merely on a finding that corporate group has been utilized to ensure that another member of the corporate group, rather than the litigant subsidiary company, will be legally liable for some or other future activities of the group.[101] Regardless of whether this is desirable, the privilege to utilize a company in this way is implicit in corporate law.[102] In *casu*, counsel had argued that the purpose of such operation was to ensure that Cape Industries plc would practically benefit from the group asbestos trade in the US, without the dangers of tortious risks.[103] As such, the court held that Cape Industries plc was entitled to structure the group affairs in a manner that would result in the liability of another member of the corporate group in respect of future activities of the group other than the defendant subsidiary and expect the court to ordinarily apply the time-honoured principles of *Salomon v Salomon*.[104]

[97] Haupt and Malange *Corporate Law for Commercial Students: Partnerships, Companies and Close Corporations* (2010) 10 – 12.
[98] *Ritz Hotel Ltd v Charles of the Ritz Ltd* 1988 3 SA 290 (A) 314.
[99] Under such arrangements, the holding company and all its subsidiaries may assume liability for each other's and the whole group's indebtedness. See Andenas and Woolridge *European Comparative Company Law* (2009) 480.
[100] *Adams v Cape Industries* (n 4) 544.
[101] *Adams v Cape Industries* (n 4) 544.
[102] *Adams v Cape Industries* (n 4).
[103] *Adams v Cape Industries* (n 4).
[104] See *Re Polly Peck International Plc* 1996 2 ALL ER 433 where it was held that a subsidiary that was incorporated as a single finance vehicle for the purposes of the issuance of bonds was not regarded as forming a single economic entity with its holding company despite the doubt that the creditors had lent on the basis of the credit of the holding company.

5.3 Piercing the corporate veil in the context of group of companies

The pertinent question remains whether the separate legal personality of each company in a group should always exist and each company ought to account for its liabilities, debts, obligations and duties separately. As already mentioned under the discussion of traditional single entities, piercing is an exceptional remedy and its "boundaries are exceedingly vague".[105] In *McInerney Ltd v Dublin County Council,*[106] Carrol J stressed that the corporate veil cannot be alternately upraised or lowered at the option of the holding company or the group.[107] Owing to this, it is difficult to discern any broad principles of company law that stipulate the circumstances in which a court will pierce the corporate veil in the context of group structures.[108] The reason for this is that, the case law authorities in which the corporate veil has been pierced are of little consistency.[109]

Firstly, there is a well-recognised exception to the rule disallowing veil piercing of the corporate veil and that it will be appropriate to pierce the corporate veil "only where special circumstances exist indicating that it is a mere façade concealing the true facts".[110] It has been contended that a façade denotes "outward appearance which is false or deceptive and imports pretence and concealment". [111] Therefore, the fact that the holding company or any incorporator of the company has absolute control over such company is insufficient to constitute the company as being a mere façade; instead the term suggests "deliberate concealment of identity and activities" of those incorporating the company.[112] Moreover, the court will pierce the corporate veil where the company has been used as a "cloak or a sham" to evade a person's obligations.[113] In *Sharrment Pty Ltd v Official Trustee in Bankruptcy*,[114] Lockart gave a useful elucidation of the word "sham". According to Lockhart, a sham is

[105]*Banco de Mozambique v Inter- Science Research and Development Services (Pty) Ltd* 1982 3 SA 330 345F-G, where Goldstone J referred to veil piercing as a "radical step".
[106]1985 IR 1.
[107]*McInerney Ltd v Dublin County Council* (n 106) 7.
[108]Ramsay and Noakes "Piercing the corporate veil in Australia" 2001 *Company and Securities Law Journal* 250 254. See also Farrar "Fraud, fairness and piercing the corporate veil" 1990 *Canadian Business Law Journal* 474 478.
[109]*Commissioner of Land Tax v Theosophical Foundation Ltd* 1966 67 SR (NSW) 70 75 and Ramsay and Noakes (n 108) 277.
[110]Per Lord Keith in *Woolfson v Strathclyde Regional Council* 1978 SC (HL) 90 161 referring to a passage in *Tunstall v Steigmann* 1962 2 QB 593 602, where it was stated that the corporate veil may be pierced only "where a company is a mere façade concealing the true facts". See also Ramsay and Noakes (n 108) 257.
[111]Hicks (n 48) 107.
[112]Per Ormerod LJ in *Tunstall v Steigman* (n 110) 603.
[113]*Jones v Lipman* 1962 1 WLR 832 and *Robinson v Randfontein Estates Gold Mining Co Ltd* 1921 AD 168.
[114]1988 82 ALR 530 and Ramsay and Noakes (n 108) 263.

something that is intended to be confused for something else or something that is not what it professes to be.[115] It is often a spurious impersonation, a camouflage or a façade extending beyond and above true meaning.[116] It is not real and absolute, but rather something made in impersonation of something else or made to give off an impression of being something which it is most certainly not.[117] It is something which is untrue or something that is made to imitate something in order to deceive.[118]

However, Ottolenghi argues that the requirement that the company should be a sham before the court can disregard the company's separate legal existence deprives courts of the potential possibility of issuing orders against the company in befitting circumstances.[119] In this regard, Moore proposes the substitution of "sham" for the "genuine ultimate purpose" test which may be used by a court in deciding whether or not to disregard the company's autonomous legal personality in any case where the company exists for the "ultimate purpose" of protecting its directors from real or potential liability, without any regard for any of the company's extensive or long-term goals.[120]

Secondly, the separate legal personality may be disregarded where specific legislation or contractual agreement makes provision for "veil-piercing".[121] In *Dimbleby and Sons Ltd v National Union of Journalists,*[122] Lord Diplock stated that if legislation permits the piercing of the corporate veil, which derives its effect in large part from the Companies Act, such legislation would be expected to be expressed in clear and unequivocal language.[123] This follows the recognition of the *Salomon v Salomon* ruling.[124] This does not, however, completely exclude the possibility that, even without an express provision indicating that in certain circumstances one company, albeit independently incorporated, is to be treated as having the same legal personality of another, a purposive account of the provision or statute may nonetheless considerably lead to an inference that veil piercing must have been the

[115]Ramsay and Noakes (n 108) 263.
[116]Ramsay and Noakes (n 108) 263.
[117]Ramsay and Noakes (n 108) 263.
[118]Moore "A temple built on faulty foundations: Piercing the corporate veil and the legacy of Salomon v Salomon" 2006 *Journal of Business Law* 180 198.
[119]Ottolenghi "From peeping behind the veil to ignoring it completely" 1990 *The Modern Law Review* 338 352.
[120]Moore (n 118) 198.
[121]*Dimbleby and Sons Ltd v National Union of Journalists* (n 48) and Hicks (n 48) 94.
[122]*Dimbleby and Sons Ltd v National Union of Journalists* (n 48) and Hicks (n 48) 94.
[123]*Dimbleby and Sons Ltd v National Union of Journalists* (n 48) and Hicks (n 48) 94.
[124]*Dimbleby and Sons Ltd v National Union of Journalists* (n 48) and Hicks (n 48) 94.

intention of the legislature.[125] In other words, a purposive reading of the statute may suffice and permit the piercing of a corporate veil in the absence of an express provision.[126]

Thirdly, the court may pierce the corporate veil in the context of group of companies where the subsidiary company has been used to perpetuate fraudulent activities. For example, Maugham J in *Re William C Leitch Bros Ltd*[127] stated that if a company continues to carry on business when the company is wound-up and the company incurs debts when the directors are of the knowledge that there is no reasonable prospect of the creditors receiving payment of those debts, the company will be regarded as carrying on business with the intent to defraud.[128] The directors would thus be personally liable for those debts.[129] The objective of arranging group affairs and as such minimising the holding company's exposure to liability does not necessarily amount to fraud or a fraudulent motive.[130] Milo argues that unless a creditor is able to prove "fraud, dishonesty or other improper conduct to such an extent that the court will be willing to disregard the Salomon v Salomon principle, the creditor will not be able to assign liability for the subsidiary on the holding company".[131]

Fourthly, if a corporate group conducts its business with little regard for the separate existence of the individual subsidiaries, it should constitute a gross abuse of the legal personality of all corporate entities concerned. In *Ex parte Gore NNO*[132] the court had to decide whether to pierce the corporate veil in circumstances where the affairs of the corporate group were conducted through the holding company and in a manner that did not distinguish between the separate existence of the constituent subsidiaries of the corporate group.[133] For example, the investors' funds would be transferred to whichever subsidiary in the group that needed the funds at the time and not to the specific subsidiary that the investor initially

[125]*Dimbleby and Sons Ltd v National Union of Journalists* and Hicks (n 48) 94.
[126]*Dimbleby and Sons Ltd v National Union of Journalists* and Hicks (n 48) 94.
[127]1932 2 Ch; *The Shipping Corporation of India Ltd v Evdomon Corporation and Another* 1994 1 SA 550 (A) 566C- F and Hicks (n 48) 96.
[128]*Re William C Leitch Bros Ltd* (n 127) 77.
[129]See Hicks (n 48) 96.
[130]*Adams v Cape Industries* (n 4) 544.
[131]Milo "The liability of a holding company for the debts of its subsidiary: Is Salomon still alive and well?" 1998 *SALJ* 318 326.
[132]n 6 above.
[133]*Ex parte Gore* (n 6) par 33.

sought to invest in.[134] Moreover, the flow of the corporate group's funds were determined by the need of management to sustain the operation of the financial scheme by "finding funds to pay out existing investors who wished to withdraw their funds".[135]

The court had to also determine the vexed issue of whether or not section 20(9) of the Companies Act has replaced the common law.[136] In this regard the court held that there is no express intention that the legislature intended to displace the common law.[137] In other words, section 20(9) of the Companies Act is supplemental rather than substitutive to the common law as there is no identifiable discord between the statutory provision and the common law.[138] The court further held that section 20(9) affords the court powers to pierce the corporate veil under "widely varying factual circumstances".[139] Moreover, the statutory provision may find application whenever the peculiar facts of the case justify piercing under section 20(9) or whenever the concept of juristic personality is used illicitly and with the result of some uncountenanced adverse effects on a third party.[140] Thus the statutory remedy militates the notion that veil piercing should be regarded as an exceptional or drastic remedy.[141] The court went further to state that this is apparent from the words "unconscionable abuse" and that the phrase "unconscionable abuse of the juristic personality of the company" presupposes terms such as "sham", "device", "stratagem".[142]

The court found that the assets of the subsidiaries were easily transferred between the subsidiary companies at the will of the controllers of the holding company.[143] Further, that the liquidators of the entities comprising the corporate group could deal with the assets of the subsidiaries as if they were the property of the holding company.[144] Simply put, the court held that the corporate group was operated as a single entity through the holding company.[145]

The court declared that the most pertinent improprieties in *casu* involved the operation of the group in a manner that drew no discernible separate legal personality between the individual constituent subsidiaries and the holding company; and the use of the investors' funds in a

[134] *Ex parte Gore* (n 6).
[135] *Ex parte Gore* (n 6) par 12.
[136] *Ex parte Gore* (n 6) par 31.
[137] *Ex parte Gore* (n 6) par 31.
[138] *Ex parte Gore* (n 6) par 32.
[139] *Ex parte Gore* (n 6) par 32.
[140] *Ex parte Gore* (n 6) par 32 - 34.
[141] *Ex parte Gore* (n 6) par 34.
[142] *Ex parte Gore* (n 6).
[143] *Ex parte Gore* (n 6).
[144] *Ex Parte Gore* (n 6).
[145] *Ex Parte Gore* (n 6).

manner that conflicted with what had been represented.[146] Thus the court declared that, in terms of section 20(9) of the Companies Act, the first category of impropriety denoted "an unconscionable abuse" by the controllers of the separate personalities of the constituent subsidiaries as separate legal entities and the case fell within the "ambit" of section 20(9) of the Companies Act.[147]

Pursuant to this declaration, the court held that the separate legal personalities of the constituent subsidiaries could be disregarded in respect of any legal duty and obligations of the subsidiaries.[148] Consequently, the "King" group of companies was regarded as a single entity and the holding company was treated as if it were a single company.[149]

Finally, it has been held that the anti-competitive behaviour of a subsidiary company within the European Community, acting on the instructions of its holding company could be attributed to the holding company for purposes of ensuring effective enforcement of competition law.[150]

Despite the courts of different jurisdictions having stressed the importance of the separate legal personality of each company in a group and that piercing the corporate veil is only appropriate in special circumstances; the court of appeal took a different approach in *DHN Food Distributors v London Borough of Tower Hamlets*.[151] The court of appeal held that despite the fact that the business was carried on in the subsidiaries' name, the holding company was entitled to compensation for the disturbance of its business by a local authority. Referring to the relationship between the holding company and its subsidiaries and concluding that the holding company was entitled to compensation, Lord Denning stated:

"These subsidiaries are bound hand and foot to the [holding company] and must do just what the [holding company] says. . . This group is virtually the same as a partnership in which all

[146] *Ex parte Gore* (n 6) par 33.
[147] *Ex parte Gore* (n 6) par 33.
[148] *Ex parte Gore* (n 6) par 37.
[149] *Ex parte Gore* (n 6) par 37.
[150] This is in accordance with Articles 81 and 86 of the European Community Treaty, rules pertaining to undertakings and "aimed at economic units which consist of unitary organisation of personal, tangible and intangible elements which pursues a specific economic aim on a long-term basis". If a group of companies is thus found to form an undertaking, the whole group can be found to have broken the rules of competition law. See also Pettet (n 92) 196.
[151] 1976 1 WLR 852, 1976 3 ALL ER 462 and French *et al* (n 21) 143.

three companies are partners. They should not be treated separately so as to be defeated on a technical point. They should not be deprived of the compensation which should justly be payable for disturbance. The three companies should, for present purposes be treated as one, and the [holding company], DHN, should be treated as that one. So DHN are entitled to claim compensation accordingly."[152]

Seemingly, the court of appeal in *DHN Food Distributors v London Borough of Tower Hamlets*[153] decided to turn to the economic realities present in the particular facts and pierced the corporate veil on the basis that the two subsidiaries were wholly-owned and further had no separate business operations.[154] However, the correctness of the decision of the court of appeal in *DHN Food Distributors v London Borough of Tower Hamlets*[155] was questioned by Lord Keith in *Woolfson v Strathclyde Regional Council*[156] who stated that he [Lord Keith] had "some doubts" about whether the appeal court in *DHN Food Distributors v London Borough of Tower Hamlets*[157] "properly applied the principle that it is appropriate to pierce the corporate veil only where special circumstances exist indicating that [the holding company] is a mere façade concealing the true facts".[158] Moreover, the court of appeal in *Adams v Cape Industries Plc*[159] also commented on *DHN Food Distributors v London Borough of Tower Hamlets*[160] stating that the relevant parts of the judgement in DHN case must be viewed as decisions on the specific legislative provisions regarding compensation despite the fact that such provisions were to some extent "broadly expressed" and the House of Lords in *Woolfson v Strathclyde Regional Council*[161] doubted the correctness of the decision.[162]

It is important to note that *DHN Food Distributors v London Borough Tower Hamlets*[163] dealt only with compensation and has not been applied to hold one company legally liable for the debts or some legal duty of another company in the corporate group. Therefore, the general

[152]*DHN Food Distributors v London Borough of Tower Hamlets* (n 151) 860 and French *et al* (n 21) 144.
[153]n 151 above. See also French *et al* (n 21) 143.
[154]*DHN Food Distributors v London Borough of Tower Hamlets* (n 151) 861 and French *et al* (n 21) 144.
[155]French *et al* (n 21) 143.
[156]1978 SC (HL) 90 and French *et al* (n 21) 145.
[157]French *et al* (n 21) 145.
[158]*Woolfson v Strathclyde Regional Council* (n 156) 161.
[159]n 4 above.
[160]*Woolfson v Strathclyde Regional Council* (n 156) and French *et al* (n 21) 145.
[161]*Woolfson v Strathclyde Regional Council* (n 156) and French *et al* (n 21) 145.
[162]*Adams v Cape Industries* (n 4) 536.
[163]French *et al* (n 21) 143.

principle remains that the holding company with a legal personality distinct from its members will not be liable for the debts of its subsidiary.[164]

6 The agency law argument

In light of the close control exercised by the holding company over the subsidiary company, one could possibly argue that since the subsidiary company is often used mainly for the purpose of commercial activities of the holding company, the holding company should be held liable for the acts of the agent (subsidiary) since the subsidiary acted with the authority of its principal.[165] One commentator has contended that the law of agency is a convenient way to escape the rigid interpretation and application of the time-honoured *Salomon v Salomon* principles.[166] Schmitthoff argues that the agency construction is the most effective means "to give effect to modern theory of holding company and subsidiary company as a single economic unit".[167]

Although subsidiaries in a group structure may often act as agents of the holding company, this does not necessitate an exception to the general rule, and the separate legal personality of each company within the group will not be ignored.[168] Under the general rules of law, a holding company and subsidiary company are separate legal entities and one company cannot merely be regarded as an agent of the other in the absence of a valid agency contract between the two companies.[169] In *Salomon v Salomon*,[170] Lord Herschell said that although a company can be regarded as conducting business on behalf of its shareholders, this does not, however, constitute a valid agency agreement between the shareholders and the company or render the shareholders at risk to repay the debts incurred by the company.[171]

[164]In *Reeda v Nova Securities* 1985 1 WLR 193 201, Lord Templeman stated that: ". . . the theoretical independent existence of every corporation enables a group of companies to escape liability at common law for the losses of an individual member of the group". See also French *et al* (n 21) 146.
[165]Muchlinski *Multinational Enterprises and the Law* (1995) 331.
[166]Schmitthoff "Salomon in the shadow" 1976 *Journal of Business Law* 305 307.
[167]Schmitthoff (n 166) 309.
[168]*Adams v Cape Industries* (n 4) 545 and 549.
[169]*Ebbw Vale Urban District Council v South Wales Traffic Area Licensing Authority* 1951 2 KB 366 370; French *et al* (n 21) 133.
[170]n 9 above.
[171]*Salomon v Salomon* (n 9) 43.

In addition, Lord Summer in *Gas Lighting Improvement Co Ltd v Inland Revenue Commissioners*[172] also stated:

"Between the investor, who participates as a shareholder, and the undertaking carried on, the law interposes another person, real though artificial, the company itself, and the business carried on is the business of that company, and the capital employed is its capital and not in either case the business or the capital of the shareholders. Assuming of course, that the company is duly formed and it is not a sham . . . the idea that it is mere machinery for effecting the purpose of the shareholders is a layman's fallacy."[173]

Therefore an agency relationship cannot be implied merely because the holding company holds all or a majority of the subsidiary's general voting shares, if there is nothing else to indicate the existence of an agency. In other words, a relationship of agency and principal cannot be easily inferred from the control exercised by the holding company over the subsidiary.[174] As a result, a holding company is not treated as the owner of the assets belonging to the subsidiary except where the circumstances permit the court to discover a relationship of agency.[175] The reason for this is that, there is no common group liability for the obligations of the individual companies within a group structure and the liabilities of each of the companies are that of the individual company as incurred by it.[176] If liability is to be attributed to shareholders or directors as principals, the agency of the company "must be established substantively and cannot be inferred from the holding of the director's office and the control of shares".[177] The holding company will be held liable for the debts of its subsidiary under agency law where the general principles of agency law have been satisfied.[178] In other words, the holding company will be bound by the acts of the subsidiary acting as an agent where those acts are within the scope of express authority.[179] A creditor wishing to sue the holding company for the debts of its subsidiary will not be able to resort to a cause of action based on common-law principles of agency law unless the creditor can prove that the holding company expressly authorised the subsidiary to act on its behalf.

[172]1923 AC 723.
[173]*Gas Lighting Improvement Co Ltd v Inland Revenue Commissioners* (n 172) 740 and 741 and French *et al* (n 21) 124.
[174]*Ex Parte Gore* (n 6).
[175]Per Lardner J in *Re Frederick Inns Ltd* 1994 ILRM 387 395 and French *et al* (n 21) 142.
[176]*Re Frederick Inns Ltd* (n 175) and French *et al* (n 21) 142.
[177]*British Thomson-Houston Co Ltd v Sterling Accessories Ltd* 1924 ALL ER 294 296 and French *et al* (n 21) 133.
[178]*Gas Lighting Improvement Co Ltd v Inland Revenue Commissioners* (n 172) 328.
[179]*Gas Lighting Improvement Co Ltd v Inland Revenue Commissioners* (n 172).

In addition, six factors were advanced by Atkinson J in *Smith, Stone and Knight Ltd v Birmingham Corporation*[180] which he considers pivotal in determining the existence of an agency relationship between a holding company and a subsidiary company. These factors include:[181]

1. Firstly, are the profits of the holding company treated as such?
2. Secondly, did the holding company appoint the persons conducting the business of the subsidiary company?
3. Thirdly, was the holding company in absolute control of the business venture?
4. Fourthly, did the holding company exercise control in the daily operations of the business or the subsidiary company and make a determination as to how capital ought to be set out on the venture?
5. Fifthly, were profits derived from the skill and direction exercised by the holding company?
6. Sixthly, did the holding company exercise effective and constant control of the subsidiary company?

Atkinson J held that the six factors were satisfied on the facts and hence the subsidiary was held to have been carrying on business as an agent of the holding company.[182] These six criteria were used in the Federal court of Australia to establish agency in *Spreag v Paeson Pty Ltd.*[183] However, the presence of these six criteria will not necessarily lead to the court ignoring the company's separate legal personality.[184]

In *Firestone Tyre & Rubber Co Limited v Llewellin*;[185]*Smith, Stone & Knight Limited v Birmingham Corporation*[186] and *Munton Bros Ltd v Secretary of the State*[187] companies in a

[180]1939 4 ALL ER 116 and French *et al* (n 21) 134.
[181]*Smith, Stone and Knight Ltd v Birmingham Corporation* (n 180) 121 and French *et al* (n 21) 134.
[182]*Smith, Stone and Knight Ltd v Birmingham Corporation* (n 180) and French *et al* (n 21) 134.
[183]1990 94 ALR 679 and French *et al* (n 21) 135.
[184]*Yukong Line Ltd v Rendsburg Investment Corporation* 1998 1 WLR 294 and French *et al* (n 21) 134.
[185]1857 1 WL R 464 and French *et al* (n 21) 134.
[186]n 180 above.

group structure were found to have acted as an agent or nominee of another and the court placed emphasis on the fact that such "agent" company was undercapitalized and as result an agency relationship could be found in the corporate group. However, this does not suggest that undercapitalization will necessarily influence the court in finding that an agency relationship is always present in group structures and thus make one company liable to creditors of another in the group.

7 Conclusion and Recommendation

"The law is far from settled with respect to the circumstances in which the courts may pierce or lift the corporate veil."[188] It is also evident from the consideration of South African and foreign jurisprudence that courts continue to grapple with formulating general principles with regard to piercing the corporate veil and the courts' inclination to pierce or lift the corporate veil will be contingent on the peculiar facts of each case. It is therefore, difficult to categorise the decision of the courts to pierce or lift the corporate veil into common and ascertainable principles. Each case will require an enquiry into the facts and surrounding circumstances which may be of significant importance in reaching a decision whether or not to pierce the corporate veil.[189] In contrast to the United Kingdom where it appears that "equivalent provisions" have rarely been used to find directors personally liable, the South African courts have experienced much reliance, by claimants, on section 64(1) and 65 of the Close Corporations Act and section 20(9) of the Companies Act.[190] In spite of the fact that South African courts will never "lightly disregard" a company's separate legal personality, such conclusions can be justified in an attempt to keep corporate governance genuine.[191] The separate legal personality of companies remains nothing more than a statutory creation and "figment of law" which may be curtailed when the objects of the corporate structure are "abused or thwarted".[192]

In order to prevent the undesirable and amorphous effects of piercing the corporate veil, I propose the apportionment of liability model. The apportionment of liability and/or damages

[187]1983 NI 369, where Gibson J held that the wholly-owned subsidiary had no commercial existence and was thus a mere agent or alter ego of the holding company. See also French *et al* (n 21) 145.
[188]*Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd* (n 23) par 28.
[189]*Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd* (n 23).
[190]*Ex Parte Gore* (n 6).
[191]*Ebrahim v Airports Cold Storage (Pty) Ltd* (n 24) par 15.
[192]*Ex Parte Gore* (n 6).

requires the establishment of a nexus between the action or damage caused by the subsidiary company and the holding company. In other words, liability should be attributed to the holding company in those cases where the holding company has imposed a centralised and integrated management structure within the subsidiary and as a result, it was informed, aware, or ought to have been aware of the general situation that led to the harm, damage or injuries by the subsidiary company.[193] Simply put, the holding company should be held liable in those cases where the subsidiary lacks economic independence. Moreover, the courts should be able to apportion damages where the peculiar facts of the case show the holding company's direct involvement, participation in and influence or absolute control over the subsidiary's day-to-day operations. In the alternative, a holding company should partly compensate the victims in the event that the subsidiary has insufficient or no means or capital to compensate the victims.

[193]See n 151 above and *French et al* (n 21) 144. For instance, where the holding company owns all the shares of the subsidiaries to an extent that it can control the subsidiary company's actions.

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