

VEILS, FRAUDS, AND FAST CARS

**LOOKING BEYOND THE FIXATION ON PIERCING TO THE ILLUSORY
PROTECTION PROVIDED BY INCORPORATION**

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“Things gained through unjust fraud are never secure”

Sophocles (497-406 BC)

TABLE OF CONTENTS

INTRODUCTION.....	1
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PART ONE: THE FIXATION ON PIERCING THE CORPORATE VEIL

CHAPTER ONE: THE ISSUE OF ABUSE IN “ONE PERSON COMPANIES” 4

A	Introduction	4
B	<i>Salomon v A Salomon & Co Ltd</i> is the “unyielding rock”	4
C	Concerns of “one person companies”	6
1	What is a “one person company”?	6
2	Specific concerns	6
D	Piercing as a response	9
1	Lifting v piercing fixation.....	9
2	Lord Denning’s golden age of lifting	10
3	United States laundry list approach	12
E	Retrenchment of piercing to avoid uncertainty.....	13
F	Conclusion	15

CHAPTER TWO: RE-EVALUATION AS A DOCTRINE, METAPHOR OR

LABEL?	16
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A	Introduction	16
B	Retrenchment confirmed in <i>Prest v Petrodel Resources Ltd</i>	16
C	Evasion principle as pure piercing.....	18
1	Lord Sumption’s distinction	18
D	<i>Moore Stephens v Stone & Rolls Ltd</i>	23
1	Lord Walker’s potential exception to the doctrine	23
2	Attribution of fraud in a “one person company”	24
3	Example of evasion or concealment?	25
E	Concealment principle	27
F	Conclusion	28

PART TWO: THE ILLUSORY PROTECTION PROVIDED BY INCORPORATION

CHAPTER THREE: THE USE OF STATUTORY MECHANISMS	30
A Introduction	30
B Participant liability.....	30
C Companies Act 1993	31
D Property (Relationships) Act 1976	37
E Fair Trading Act 1986	38
F Conclusion	39

CHAPTER FOUR: OTHER PRINCIPLES IN LIGHT OF *PREST V*

<i>PETRODEL RESOURCES LTD</i>	40
A Introduction	40
B Agency/Attribution	40
1 Attribution in a “one person company”	41
2 Innocent constituents	43
C Trust laws	46
D The future of piercing the corporate veil in New Zealand.....	47
1 Application of the doctrine after <i>Prest v Petrodel Resources Ltd</i>	47
2 The doctrine reconceptualised as a backstop common law remedy	48
3 Application to <i>Official Assignee v 15 Insoll Avenue Ltd</i>	50
E Conclusion	50

CONCLUSION	51
-------------------------	-----------

BIBLIOGRAPHY	52
---------------------------	-----------

APPENDIX 1	60
-------------------------	-----------

INTRODUCTION

“One person companies” are ripe for abuse.¹ The New Zealand Parliament has introduced specific statutory remedies to address such abuse. There is however, still a gap in the statutory landscape that allows the concealment of assets in corporate structures. This dissertation explores the mechanisms for dealing with abuse of one person companies. In particular, it focuses on the doctrine of piercing the corporate veil, which was introduced to respond to abuse of corporate structures. Following its introduction, the doctrine was plagued by uncertainty. It was reconceptualised by the United Kingdom Supreme Court in *Prest v Petrodel Resources Ltd*.² *Prest* recognises the statutory, common law and equitable remedies that courts should look to before turning to the doctrine. This dissertation argues that New Zealand courts have the same remedies to hold companies and their controllers liable. It contends that, in order to avoid uncertainty, the doctrine should be applied as a backstop remedy.

The landmark decision in *Salomon v A Salomon & Co Ltd* gave birth to “the legal structure of modern business”.³ The House of Lords held that a company and its controllers are separate legal persons and extended the advantages of incorporation to one person companies. This principle has its statutory footing in the New Zealand Companies Act.⁴ Section 10 states that a company must have “one or more shareholders... and one or more directors”, and 15 states that “a company is a legal entity in its own right separate from its shareholders”.⁵ Lord Templeman referred to the separate legal principle in *Salomon* as the “unyielding rock” on which company law is constructed, and on which “complicated arguments” might ultimately become “shipwrecked”.⁶ While separate legal personality is fundamental to modern company law, it is also a vital component of fraudulent behaviour.

¹ The definition of a “one person company” will briefly be discussed later in this chapter, and in depth in Chapter Four. For now it is assumed that it means one person owns and operates the company.

² *Prest v Petrodel Resources Ltd* [2013] UKSC 34 [“*Prest*”]. The development of company law in New Zealand has largely followed the United Kingdom so this decision while not binding, will likely be followed by New Zealand courts.

³ *Salomon v A Salomon & Co Ltd* [1897] AC 22 [“*Salomon*”]. See also *Prest*, above n 2, at [90] per Lady Hale.

⁴ Companies Act 1993.

⁵ Sections 10 and 15.

⁶ Lord Templeman “Company Law Lecture - Forty Years on” (1990) 11 Company Law at 10. See also *Prest*, above n 2, at [66] per Lord Neuberger.

One person companies provide an example of such abuse. The lack of separation between ownership and control provides opportunities for exploitation. This can occur through mismanagement of the corporate form, or hiding assets in the company to evade an existing legal obligation.⁷ Most people who incorporate one person companies assume s 15 of the Companies Act 1993 and the principle in *Salomon* provide absolute protection. This is a myth. A company and its controllers attract duties and liabilities in their own right.

Part One looks at the doctrine of piercing the corporate veil. Chapter One establishes the context in which abuse of one person companies has become apparent. It illustrates piercing the corporate veil as the court's response to such injustice, and the retrenchment of the doctrine following Lord Denning's golden age of lifting. Against this background, Chapter Two critically analyses the Supreme Court decision of *Prest*. The title of this dissertation, Veils, Frauds and Fast Cars, reflects Thorpe LJ's argument in *Prest* that failing to pierce the corporate veil to allow the transfer of family assets out of one person companies would present "an open road and a fast car to the money maker" to evade their legal obligations.⁸ The Supreme Court reduced that speed by confirming the retrenchment of the doctrine and the narrowing of its scope. The judgments of Lords Sumption and Walker can be interpreted to provide the basis for a more cohesive and unified conception of when the corporate veil can be pierced. It is suggested that the laws of attribution of fraud are an exception to Lord Sumption's evasion principle.

Part Two addresses the illusory protection provided by incorporation by evaluating the different statutory and equitable approaches that prevent abuse of the one person company in New Zealand. This confirms the black letter principle that a company and its controllers are separate legal persons and are subject to duties and individual liability. Chapter Three examines the various statutory approaches to dealing with one person companies. This primary method of intervention regulates the efficient and responsible management of companies. However, it fails to provide adequate remedies for hidden assets in companies. Chapter Four addresses this gap in the law

⁷ An example of mismanagement of the corporate form would be recklessly trading a company into insolvency, and hiding an asset would be concealing relationship property in a company to avoid equal sharing on separation.

⁸ *Petrodel Resources Ltd v Prest* [2012] EWCA Civ 1395 at [63].

by looking to the laws of attribution and trusts. These laws, while not exhaustive, are currently the most effective ways to prevent injustice in one person companies.

After concluding that the current law covers the majority of situations of abuse, Chapter Four also looks at the application of the doctrine in the cases following *Prest* and the future for the doctrine in the New Zealand context. It is my contention that placing the doctrine of piercing the corporate veil firmly on statutory footing is the best solution. Failing that, reconceptualising the doctrine as a backstop common law remedy based on the evasion principle provides the court with a practical remedy that it can apply in appropriate circumstances.

CHAPTER ONE: THE ISSUE OF ABUSE IN “ONE PERSON COMPANIES”

A Introduction

The family or one person company is a popular business structure worldwide and in particular in New Zealand.⁹ The protection of investors provided by limited liability aids global commercial and industrial development.¹⁰ While limiting liability has generally been regarded as a success, the consequential ability to “hide” behind that limited liability has raised concerns. The response of the courts to these concerns was to adopt a process for lifting or piercing the corporate veil.¹¹ While conceptually an appropriate response, the process has created greater uncertainty similar to that which exists in the United States. This chapter analyses the changing attitudes towards incorporation of one person companies through the prism of piercing the corporate veil.¹² It will consider some relevant cases in the United Kingdom, United States and New Zealand.

B *Salomon v A Salomon & Co Ltd* is the “unyielding rock”

Mr Salomon was a sole trader who manufactured leather boots. He wanted to form a company with his sons. He incorporated his business as Aron Salomon and Company Limited, with himself, his wife and five children as shareholders.¹³ Mr Salomon appointed himself as managing director and was the dominant shareholder, owning 20,001 of the 20,007 shares. Mr Salomon sold his business to Salomon and Co Ltd, in

⁹ In New Zealand, share ownership and control of a company are not widely dispersed, compared to the United Kingdom where there is a greater separation as most companies are publicly quoted. See also Ministry of Business, Innovation & Employment "Small Businesses in New Zealand: How do they compare with larger firms?" (March 2013) <<http://www.med.govt.nz/business/business-growth-internationalisation/small-and-medium-sized-enterprises>> which states 322,887 businesses in February 2012 had no employees. This is just a guideline however as the businesses may not be incorporated companies.

¹⁰ Lord Cooke of Thorndon "A Real Thing: *Salomon v. Salomon & Co. Ltd*" (Hamlyn Lecture Series, London, 3 April 1997).

¹¹ The distinction between lifting and piercing the corporate veil will be discussed later in this chapter.

¹² David Cohen "Theories of the Corporation and the Limited Liability Company: How Should Courts and Legislatures Articulate Rules for Piercing the Veil, Fiduciary Responsibility and Securities Regulation for the Limited Liability Company?" (1998) 51 Oklahoma Law Review 427 at 427.

¹³ See Companies Act 1862. Incorporation at that time required seven shareholders, each holding at least one share.

return for shares and a debenture over the company's assets. The company hit hard times and was put into liquidation. The creditors brought action against Mr Salomon seeking indemnity from him personally for the company's debts. They claimed that six of the seven shareholders were "dummies" under Mr Salomon's control, meaning the "company was a fraud designed to shield Aron Salomon from his creditors".¹⁴

In the High Court, Vaughn Williams J accepted the creditor's claim and held the company was an agent created for the sole purpose of protecting his business. His Honour found Mr Salomon liable to the creditors as the principal of the company.¹⁵ The Court of Appeal confirmed this decision, finding that Mr Salomon brought the Act into disrepute "by perverting its legitimate use".¹⁶ In the House of Lords, the creditor's claim was unanimously overturned on the grounds that despite the company looking the same from the outside as before incorporation, the company was legitimately incorporated as required by the Companies Act 1862.¹⁷ Lord Halsbury LC confirmed the corporate personality doctrine when he stated:¹⁸

[I]t seems to me impossible to dispute that once the company is legally incorporated it must be treated like any other independent person with its rights and liabilities appropriate to itself... whatever may have been the ideas or scheme of those who brought it into existence.

Consequently the corporate form could "be used legitimately to shield an 'owner' of the business from liability for the conduct of that business".¹⁹ This is true even when, as with Mr Salomon, the individual has absolute control of a company. The principle in *Salomon* has been described as the "unyielding rock" around which company law is formed. While their Lordships clearly recognised one person companies as legitimate structures, these structures have also given rise to abuse of the corporate form. So what are the limits of this one person structure?

¹⁴ Ross Grantham and Charles Rickett "The Bootmaker's Legacy to Company Law Doctrine" in Ross Grantham and Charles Rickett (eds) *Corporate Personality in the 20th Century* (Hart Publishing, Oxford, 1998) 1 at 3-4.

¹⁵ *Broderip v Salomon* [1893] B 4793.

¹⁶ *Broderip v Salomon* [1895] 2 Ch 323 at 339.

¹⁷ *Salomon*, above n 3.

¹⁸ At 30-31.

¹⁹ Grantham and Rickett, above n 14, at 5.

C Concerns of “one person companies”

1 What is a “one person company”?

The definition of a one person company is inherently uncertain. Lord Denning in *Wallersteiner v Moir (No 1)* described a one person company as a company “under the control of one man who owns all the shares and is the chairman and managing director”.²⁰ Thus, if there were two directors acting in concert, or if “dummy” directors or shareholders were involved, this would not constitute a one person company.²¹ This literal meaning is contrary to the House of Lords in *Salomon* who accepted a company with seven minority shareholders and one dominant shareholder (who is also the controlling mind) to be a one person company. Similarly, Hobhouse J in *Berg, Sons & Co Ltd v Mervyn Hampton Adams* adopted a negative test, namely that a one person company is:²²

[A] company which has no individual concerned in its management and ownership other than those who are, or must (because of their reckless indifference) be taken to be, aware of the fraud or breach of duty with which the court is concerned.

It is submitted that this is the correct approach. Wholly owned subsidiaries are an example of a one person company. The subsidiary company only has one shareholder, the parent company, which owns 100% of the company’s shares and which is therefore the controlling mind.

2 Specific concerns

Sham or façade

If the corporate form is used as a sham or façade for the benefit of the dominant shareholder, then the traditional insulation from personal liability has been abused. *Gilford Motor Co Ltd v Horne* is a prime example of a one person company being a sham or façade.²³ Mr Horne was subject to an employment contract containing a

²⁰ *Wallersteiner v Moir (No 1)* [1974] 1 WLR 991 1012. See also India’s new The Companies Act, 2013 which defines a “one person company” in s 3(1)(c) as having only one person.

²¹ A “dummy” director is a person on a company’s board who votes and acts under the direction of a non-board member, and a “dummy” shareholder is a person who holds shares in their own name, but the shares are in reality owned by someone else.

²² See Hobhouse J in *Berg, Sons & Co Ltd v Mervyn Hampton Adams* [2002] Lloyd’s Rep PN 41 [“*Berg*”].

²³ *Gilford Motor Co Ltd v Horne* [1933] 1 Ch 935 [“*Gilford*”].

restraint of trade clause that prevented him from engaging in competing business for a five year period. He left the company and set up a competing company with his wife and business associate as shareholders. The Court of Appeal issued an injunction against Mr Horne and the company to ensure Mr Horne was deprived of the benefit the company provided. Lord Hanworth MR described the company as “a mere cloak or sham” used as a “device” for Mr Horne to evade his obligations under the covenant.²⁴ This language is similar to that of Vaughan Williams J in *Broderip v Salomon* when he found the company was a “mere nominee” or “mere alias”.²⁵ The House of Lords rejected this reasoning.

A similar example can be seen in *Jones v Lipman*.²⁶ Mr Lipman entered into a sale and purchase agreement, then changed his mind and transferred the property to a company, Alamed Ltd, of which he and a nominee were the sole shareholders and directors. Mr Lipman argued that specific performance could not be used as he no longer owned the land. The Court ordered specific performance against Alamed Ltd and Mr Lipman to transfer the property to the plaintiff²⁷ describing the company as “a device and a sham, a mask which he holds before his face in an attempt to avoid recognition by the eye of equity”.²⁸ While the majority of one person companies are operated in the manner intended when limited liability was conceived, the concept of separate legal personality has been abused in some instances.

One person companies

One person companies offer more opportunity to abuse the corporate form due to the lack of separation between ownership and control. It is perhaps more tempting for an individual to commit fraud for their personal benefit by using the company’s assets as their own. Kahn-Freund believed that “the clash between the ‘law’ and the ‘truth and substance’” is detrimental to the creditors.²⁹ An example is where the individual behind a one person company sets up multiple one person companies to avoid liability by transferring assets from one company to another. This can be done quickly and

²⁴ At 961.

²⁵ *Broderip v Salomon* above n 16, at 330-332.

²⁶ *Jones v Lipman* [1962] 1 WLR 832 [“*Jones*”].

²⁷ New Zealand also has the Land Transfer Act 1952 so it is unlikely that a case with the same facts as *Jones* would pierce the corporate veil, as the Act gives a purchaser indefeasible title if they are a bona fide purchaser for value without notice, and they take a transfer from a registered proprietor.

²⁸ *Jones*, above n 26, at 836.

²⁹ Otto Kahn-Freund “Some Reflections on Company Law Reform” (1944) 7(12) MLR 54 at 57.

easily as the companies are entirely under the control of one person. Phoenix companies are another example where the directors of an insolvent company form a new company with the failed business before the company is placed into liquidation.³⁰ The new company has the advantage of the failed company's assets and reputation, but does not have to repay creditors.

Undercapitalisation of one person companies is a significant problem in insolvency.³¹ Especially in the case of entrepreneurs, individuals do not have the start up capital required for a business to succeed, so money is borrowed from banks, sometimes with little prospect of making repayments. This situation may be the result of mismanagement of the company's financial affairs, or conscious fraudulent tactics.³² While there is no bright line test, if a company appeared to know at the time it borrowed capital from creditors that it would be unlikely to pay it back, this may constitute an undercapitalisation concern. Some protection is available to creditors via the right of a liquidator of a company to hold directors liable for reckless trading or for incurring liabilities without reasonable grounds to believe those liabilities can be paid when due.³³ However, the liquidator's ability to sue is often curtailed by practical matters, such as ability to fund the litigation from the assets (if any) of the company and the difficulty in proving the duties were breached (absent overtly reckless behavior by the director).

Wholly owned subsidiaries

The wholly owned subsidiary possesses the same advantages of incorporation as the one person company. In *Adams v Cape Industries plc* the court confirmed the distinction between the parent and subsidiary companies as separate legal entities, regardless of whether they are "creatures of their parent companies".³⁴ A similar conclusion was reached in *Atlas Maritime Co SA v Avalon Maritime Ltd (No 1)* where Staughton LJ found that although allowing the subsidiary company to run under the direction of the parent is not the most honest way to do business, he held an

³⁰ Peri Finnigan "Phoenix companies: what exactly are the rules here?" (15 July 2013) <<http://www.mvp.co.nz/articles/by-mcdonald-vague/phoenix-companies--what-exactly-are-the-rules-here>>.

³¹ Helen Anderson "Directors' Liability to Creditors - What are the Alternatives?" (2006) 18(2) Bond LR at 9.

³² Roman Tomasic, Stephen Bottomley and Rob McQueen *Corporations Law in Australia* (2nd ed, The Federation Press, Sydney, 2002) at 38.

³³ See Chapter Three for a discussion of directors' duties in the Companies Act 1993.

³⁴ *Adams v Cape Industries plc* [1991] 1 ALL ER 929 per Slade LJ.

“agency relationship... would be revolutionary”.³⁵ The law therefore allows subsidiaries to be set up for high risk business, with very little liability. As Bokhary JA stated, it is perfectly acceptable to set up a company to evade future liability.³⁶ Thus, if a subsidiary company has assets available, the parent company may be able to restructure the assets so that a plaintiff’s action is worthless.³⁷

Wholly owned subsidiaries can also be abused though undercapitalisation if they are set up purely for the purpose of conducting risky ventures. This is advantageous for the parent company as their reputation is unscathed if the subsidiary trades into insolvency. Further, the parent is not liable for the subsidiaries debts.³⁸ This “moral hazard” has been asserted by Easterbrook and Fischel as encouraging parent companies to engage in a “socially excessive amount of risk activities”.³⁹

D Piercing as a response

1 Lifting v piercing fixation

The court’s response to the above concerns has been to adopt a process that allows the separate legal personality privilege of incorporation to be ignored. This is the doctrine of lifting or piercing the corporate veil. It is possible to argue that the doctrine was first raised in *Salomon*, but the House of Lords did not pierce due to the principle of separate legal personality.⁴⁰ It is important to briefly look at the court’s attempt to distinguish the terms piercing and lifting. Lord Neuberger in *VTB Capital plc v Nutritek International Corp* attempted to differentiate between the two terms, stating that they appear sometimes interchangeably throughout the authorities.⁴¹ In *Yukong Line Ltd of Korea v Rendsburg Investments Corp of Liberia (No 2)*, Toulson J observed “it may not matter what language is used as long as the principle is clear; but

³⁵ *Atlas Maritime Co SA v Avalon Maritime Ltd (No 1)* [1991] 4 All ER 769 at 571.

³⁶ *China Ocean Shipping Co v Mitrans Shipping Co Ltd* [1995] 3 HKC 123.

³⁷ *Ord v Belhavent Pubs Ltd* [1998] BCC 607.

³⁸ Ian Ramsay "Holding Company Liability for the Debts of an Insolvent Subsidiary: A Law and Economics Perspective" (1994) 17 UNSWLJ 520 at 525-526. Ramsay noted however that there are legitimate business reasons to incorporate subsidiaries, at 522-524.

³⁹ Frank H Easterbrook and Daniel R Fischel "Limited Liability and the Corporation" (1985) 52 U Chi L Rev 89 at 111.

⁴⁰ *Salomon*, above n 3, at 30-31 per Lord Halsbury LC.

⁴¹ *VTB Capital plc v Nutritek International Corp* [2013] UKSC 5 at [118] [*“VTB Capital”*].

there lies the rub”.⁴² In *Atlas Maritime Co SA v Avalon Maritime Ltd (No 1)*, Staughton LJ unequivocally separated the principles, on the basis that “pierc[ing]... is reserve[d] for treating the rights or liabilities or activities of a company as the rights or liabilities or activities of its shareholders”, whereas “lift[ing]... [is] to have regard to the shareholding in a company for some legal purpose”.⁴³ Finally, in *Ben Hashem v Al Shayif*, in the context of an alter ego company, Munby J held “in this context the expressions are synonymous”.⁴⁴ The range of views in court cases is widespread, but for the purposes of this dissertation the doctrine is considered under piercing.⁴⁵ It suggests a more direct attack on the corporate form that challenges whether incorporation should protect the shareholder from liability.

2 *Lord Denning’s golden age of lifting*

Lord Denning’s period in the Court of Appeal represented the pinnacle of the doctrine’s history, with his policy based approach looking at the substance rather than the form of the company. His most renowned developments responded to the sham or façade concern highlighted in *Gilford* and *Jones* and the concept of the single economic unit. Lord Denning’s drive to lift⁴⁶ the corporate veil started with his warning that “[t]he doctrine laid down in Salomon’s case has to be watched very carefully... the courts can, and often do, pull off the mask”⁴⁷, which is similar to the comments of Richardson P in *Re Securitibank (No 2) Ltd*.⁴⁸ This interventionist approach was carried into *DHN Food Distributors Ltd v Tower Hamlets* (1976), which is an example of the single economic unit exception.⁴⁹ DHN was the parent company of Bronze, a wholly owned subsidiary that owned the land of DHN’s business. The council acquired the land, but refused to pay DHN compensation under the legislation as they did not have any interest in the land. The Court refused to accept this and treated DHN and Bronze as a single economic unit. Lord Denning described the single economic theory as “virtually the same as a partnership in which

⁴² *Yukong Line Ltd of Korea v Rendsburg Investments Corp of Liberia (No 2)* [1998] 1 WLR 294 at 305.

⁴³ *Atlas Maritime Co SA v Avalon Maritime Ltd (No 1)* above n 35, at 779G.

⁴⁴ *Ben Hashem v Al Shayif* [2009] 1 FLR 115 at [150].

⁴⁵ See *VTB Capital*, above n 41, and *Prest*, above n 2. Both of these Supreme Court cases used the term piercing. See also David Noakes and Ian Ramsay “Piercing the Corporate Veil in Australia” (2001) 19 C&SLJ 250.

⁴⁶ During Lord Denning’s golden age period, the doctrine was referred to as lifting the corporate veil.

⁴⁷ *Littlewoods Mail Order Stores Ltd v Inland Revenue Commissioners* [1969] 1 WLR 1241 at 1254.

⁴⁸ *Re Securitibank (No 2) Ltd* [1978] 2 NZLR 136 at 158.

⁴⁹ *DHN Food Distributors Ltd v Tower Hamlets London Borough Council* [1976] 1 WLR 852.

all the companies are partners... [and] they should not be treated separately".⁵⁰ DHN controlled every movement of Bronze and Bronze was bound by DHN's instructions.⁵¹ However Lord Denning contradicted the argument that the parent controlled the subsidiary by drawing an analogy between DHN and Bronze as autonomous partners.⁵² This confusion is accentuated because no test was formulated for when the theory applies, or explanation given as to why the companies were treated as one.⁵³

In *Wallersteiner v Moir* Lord Denning applied his concept of the fraud exception.⁵⁴ The managing director, Wallersteiner, defrauded the company's other shareholders and creditors. He used various legal entities fraudulently as if they belonged to him, in order to buy a company in contravention of the financial assistance provisions. The other minority shareholders sought to expose the fraudulent conduct of Wallersteiner. The Court of Appeal held that the legal entities were being used by Wallersteiner as "puppets" since he controlled every move they made and no one else got within reach of them.⁵⁵ Consequently, the Court lifted the veil to treat the companies as Wallersteiner's in order to make him responsible. In *Re a Company* the Court stated:⁵⁶

In our view the cases before and after *Wallersteiner v Moir* [1974] 1 WLR 991 show that the court will use its power to pierce the corporate veil if it is necessary to achieve justice irrespective of the legal efficacy of the corporate structure under consideration.

Schmitthoff, a prominent commentator, argued that the above approach should be qualified because "modern English company law has abandoned the exaggerated view of *Salomon's* case".⁵⁷ The law subsequent to the *Wallersteiner* decision, however, became less flexible with the doctrine's application. Gallagher and Ziegler argued that

⁵⁰ At 860. See also Thomas Cheng "The Corporate Veil Doctrine Revisited: A Comparative Study of the English and the U.S. Corporate Veil Doctrines" (2011) 34 BCICLR 329 at 339.

⁵¹ At 339.

⁵² At 391.

⁵³ At 389.

⁵⁴ *Wallersteiner v Moir* (No 1) above n 20.

⁵⁵ At 1013.

⁵⁶ *Re a Company* [1985] 1 B.C.C. 99421 (A.C.) at 99425.

⁵⁷ Clive Schmitthoff "Salomon in the Shadow" (1976) 305 JBL at 306.

lifting the veil can have an inverse reaction on other areas of the law, such as directors' duties owed to the company as a whole.⁵⁸

3 *United States laundry list approach*

The United States approach parallels Lord Denning's golden age. Both approaches are liberal in nature and both have created uncertainty through their applications.⁵⁹ The "laundry list" approach is used in many States.⁶⁰ Cases list a series of standard factors but it is not clear how much weight each factor holds or if any are sufficient themselves to support piercing.⁶¹ Cheng argues the "altruistic nature and the inherent open-endedness" means that some degree of unpredictability is unavoidable.⁶² The case of *DeWitt Truck Brokers, Inc. v. W. Ray Flemming Fruit Co.*, involving a one person company, illustrates the vagueness of the United States doctrine:⁶³

[P]roof of plain fraud is not a necessary element in a finding to disregard the corporate entity... but in applying the "instrumentality" or "alter ego" doctrine, the courts are concerned with reality and not form... whether the corporation was grossly undercapitalized for the purposes of the corporate undertaking. The conclusion to disregard the corporate entity may not, however, rest on a single factor, whether undercapitalization, disregard of corporation's formalities, or what-not, but must involve a number of such factors; in addition, it must present an element of injustice or fundamental unfairness.

The case refers to the terms instrumentality, alter ego, undercapitalisation, unfairness, and injustice, all of which have more than one interpretation in this context. In *Secon*

⁵⁸ Lynn Gallagher and Peter Ziegler "Lifting the Corporate Veil in the Pursuit of Justice" (1990) 292 JBL.

⁵⁹ The difference now is that the United States approach remains the same while the United Kingdom has narrowed the doctrines application, see Chapter Two.

⁶⁰ This has also been described as the totality-of-circumstances approach, see Thomas Cheng "Form and Substance of the Doctrine of Piercing the Corporate Veil" (2010) 80(2) Mississippi Law Journal 497 at 550.

⁶¹ Maurice Wormser "Piercing the Veil of Corporate Entity" (1912) 12 Colum L Rev 496.

⁶² Cheng, above n 60, at 551.

⁶³ *DeWitt Truck Brokers, Inc. v. W. Ray Flemming Fruit Co.*, 540 F.2d 681, 684–87 (4th Cir. 1976). See also *Baatz v Arrow Bar* 452 N.W.2d 138, 141 (S.D. 1990) for a list of the six factors mentioned in *DeWitt Truck Brokers Inc.* "Factors that indicate injustices and inequitable consequences and allow a court to pierce the corporate veil are:

- (1) fraudulent representation by corporation directors;
- (2) undercapitalisation;
- (3) failure to observe corporate formalities;
- (4) absence of corporate records;
- (5) payment by the corporation of individual obligations; or
- (6) use of the corporation to promote fraud, injustice, or illegalities."

Service System Inc v St Joseph Bank & Trust Co, the United States Court of Appeal stated.⁶⁴

Such an approach [laundry list approach] requiring courts to balance many imponderables, all important but none dispositive and frequently lacking in a common metric to boot, is quite difficult to apply because it avoids formulating a real rule of decision.

Similarly the Delaware Court of Chancery in *Allied Capital Corp v GC-Sun Holdings LP* held the doctrine has been “rightly criticized for its ambiguity and randomness”, and its application “yield[s] few predictable results”.⁶⁵ Easterbrook and Fischel argued that “[p]iercing’ seems to happen freakishly. Like lightning, it is rare, severe, and unprincipled... [and] is among the most confusing in corporate law.”⁶⁶ The inherent uncertainty and unpredictable nature of the United States is created because the doctrine has no formula or test. Instead it is a jumbled mixture of concerns so that if the court is faced with injustice, it has various options available. Furthermore, Justice Cardozo’s reference to the “mists of metaphor” in company law, which “starting as devices to liberate thought... end often by enslaving it”, criticises this approach.⁶⁷ Metaphors like sham and alter ego are often too uncertain to enforce.

E Retrenchment of piercing to avoid uncertainty

While the United Kingdom courts initial response to the concerns of one person companies looked effective, the courts’ fixation on piercing has proved counter productive. Since the golden age, the courts have narrowed the doctrine to limit the scope of its application. Two years after *DHN*, the House of Lords in *Woolfson v Strathclyde Regional Council* expressly doubted the single economic unit argument.⁶⁸ Lord Keith in *Woolfson* suggested that piercing the veil could only be exercised “where special circumstances exist indicating that [the involvement of the company]

⁶⁴ *Secon Service System Inc v St Joseph Bank & Trust Co* 855 F2d (7th Cir, 1988) 406 at 414.

⁶⁵ *Allied Capital Corp v GC-Sun Holdings LP* 910 A2d (2006) 1020 at 1042-1043.

⁶⁶ Easterbrook and Fischel, above n 39, at 89. The veil has also been described as “vague and illusory” and as “a legal quagmire”, see Stephen B Presser *Piercing the Corporate Veil* (Thomson Reuters, 2012).

⁶⁷ *Berkey v Third Ave Ry* 155 NE 58, 61 (1926).

⁶⁸ *Woolfson v Strathclyde Regional Council* [1978] UKHL 5 [*Woolfson*]. This case signaled the decline of the doctrine.

is a mere façade concealing the true facts”.⁶⁹ Furthermore, in *Adams v Cape Industries plc* the Court of Appeal reviewed and rejected numerous grounds for piercing, such as agency, single economic unity and fraud.⁷⁰ Put simply, the Court had to decide whether Cape Industries fell under United States jurisdiction and was therefore subject to its judgment. The Court left only three options in which the veil can be pierced. Firstly when interpreting a statute or document, secondly where there is a façade concealing the truth, and thirdly using the agency principle.

The New Zealand courts have been cautious about piercing the veil. However, in *Official Assignee v 15 Insoll Avenue Ltd*, Paterson J pierced the veil of what was essentially a one person company.⁷¹ Mr Russell was a chartered accountant with previous convictions for fraud and forgery. He created a company and used it to purchase a property. He then changed the company’s name and created fictitious directors. He issued the shares in the company to his children who were minors at the time. This allowed him to subscribe as their parent. The children were unaware they held any shares and they never received any dividends. Later he transferred the shares to his girlfriend and finally to his wife. His fraudulent conduct caught up with him and he was discharged bankrupt. When the bank sought to pierce the veil, Paterson J held that it was a clear case of the company being used as a façade or sham concealing the true facts, and it was appropriate to pierce.⁷²

Despite this trend towards narrowing, the lack of any coherent principle has raised extensive judicial and academic debate. The New Zealand Court of Appeal said “to lift the corporate veil... is not a principle. It describes the process, but provides no guidance as to when it can be used”.⁷³ Justice Wilson in the Canadian Supreme Court asserted that “the law on when a court may... [‘lift’] the corporate veil’... follows no consistent principle”.⁷⁴ Neyers posed the question “How can the ‘legal person doctrine’ that is so central to corporate law in one sentence be disregarded so casually in the next?”⁷⁵ Finally, Oh articulated that “[t]he inherent imprecision in metaphors

⁶⁹ At 161.

⁷⁰ *Adams v Cape Industries plc*, above n 34, at 494, 545-547, 532-539.

⁷¹ *Official Assignee v 15 Insoll Avenue Ltd* [2001] 2 NZLR 492 [“*Official Assignee*”].

⁷² At [42]-[44].

⁷³ *Attorney-General v Equiticorp Industries Group Ltd (In Statutory Management)* [1996] 1 NZLR 528 at 541.

⁷⁴ *Constitution Insurance Co of Canada v Kosmopoulos* [1987] 1 SCR 2 at 10.

⁷⁵ Jason W Neyers “Canadian Corporate Law, Veil-Piercing, and the Private Law Model Corporation” (2000) 50 UTLJ 173 at 180.

has resulted in a doctrinal mess”.⁷⁶ This criticism is by no means exhaustive, but conveys the idea that the doctrine of piercing the corporate veil is “incoherent and unprincipled”.⁷⁷

The Supreme Court in 2013 was faced with two opportunities to provide some guidance on the appropriate scope of the corporate veil doctrine.⁷⁸ While many had hoped that a definitive test would be asserted, the Court avoided taking such a formulaic approach. The difficulty of the task confronted by the Court is not to be underestimated, as the doctrine is likely to be confined to the facts.⁷⁹ Nevertheless, claimants would benefit from more guidance, without which the principle may continue to be misused.

F Conclusion

The courts have recognised the potential abuse of the corporate form of one person companies. The response of both the United Kingdom and United States Supreme Courts has been to achieve justice by inventively and willingly pierce the corporate veil in an extensive list of circumstances. This approach has at times caused more uncertainty than justice, and threatened the protection that incorporation provides. A recent shift has seen the United Kingdom move towards a narrower application of the doctrine, to reinstate some certainty back into what has become a metaphorical mess. This narrow approach of the Supreme Court in *Prest* will be critically analysed in the next chapter.

⁷⁶ Peter B Oh "Veil-Piercing" (2010) 89 Tex L Rev 81 at 84.

⁷⁷ John H Farrar "Fraud, Fairness and Piercing the Corporate Veil" (1990) 16 CBLJ 474 at 478. See also Charles Mitchell "Lifting the Corporate Veil in the English Courts: An Empirical Study " (1999) 3 Co Fin and Ins LR 15 at 16 and Douglas Michael "To Know A Veil" (2000) 26 Journal of Corporation Law 41 at 55.

⁷⁸ *VTB Capital*, above n 41, and *Prest*, above n 2.

⁷⁹ Tomasic, Bottomley and McQueen, above n 32, at 44.

CHAPTER TWO: RE-EVALUATION AS A DOCTRINE, METAPHOR OR LABEL?

A Introduction

After acquiring an understanding of the background of piercing the corporate veil, we can now address the decision of the Supreme Court in *Prest* which is an example of hiding an asset within the corporate form. This case marks the first time since *Woollfsen* that the United Kingdom's highest court has recognised the jurisdiction to pierce the corporate veil.⁸⁰ This chapter re-evaluates the law's response to the doctrine in 2013, confirming the retrenchment of the doctrine to one with a narrower scope. It adopts an innovative interpretation of the case, as most academics have focused on the narrow scope of Lord Sumption's evasion principle.⁸¹ This approach recognises the differences between Lords Sumption and Walker at a superficial level, but critically analyses the unanimity of the Lordships at a functional level in finding that regardless of the doctrine's application, there are other more conventional remedies available at the court's discretion. It also introduces the laws of attribution as found in *Moore Stephens v Stone & Rolls Ltd* as a potential example of true veil piercing.⁸²

B Retrenchment confirmed in *Prest v Petrodel Resources Ltd*

The companies forming the Petrodel Group in *Prest* are classic examples of one person companies.⁸³ Mr Prest, a successful oil merchant, married Mrs Prest in 1993. Between 1995 and 2004, seven residential properties were transferred to a group of companies known as the Petrodel Group, which the Judge found to be wholly owned

⁸⁰ Brandon Kain "The Second Opinion: Presto! The UK Supreme Court Holds the Corporate Veil Can Disappear in *Prest v. Petrodel Resources*" (17 June 2013) <<http://www.canadianappeals.com/2013/06/17/the-second-opinion-all-in-the-family-the-corporate-veil-returns-to-the-uk-supreme-court/>>; See also *VTB Capital*, above n 41, which left open the question of whether a doctrine of piercing the corporate veil existed in English law.

⁸¹ See Alex Fox and Clare Arthurs "De-*Prest*: corporate veil remains securely drawn" (July/August 2013) *Commercial Litigation Journal* 12.

⁸² *Moore Stephens v Stone & Rolls Ltd* [2009] UKHL 39 ["*Moore Stephens*"].

⁸³ See Chapters One and Four for the definition of a one person company. Mr Prest was the only effective shareholder and he managed the companies' affairs solely for the benefit of him and his family. There was no separation of ownership and management. Therefore Mr Prest and the company were "one and the same".

and controlled by the husband.⁸⁴ In 2008 the parties divorced and Mrs Prest brought proceedings against her husband for ownership of the seven properties. The issue in the Supreme Court was whether Mrs Prest had a claim in the properties even though they legally belonged to Mr Prest's companies. Disregarding the corporate veil was raised as a possible legal basis to give effective relief,⁸⁵ however the seven member panel unanimously held that piercing the corporate veil could not be justified in this case by reference to any general principle of law and that there was no wider jurisdiction to do so under the Matrimonial Causes Act 1973.⁸⁶ The Court provided an alternative remedy. It maintained that the properties were held by the husband's companies on a resulting trust for him even though they were legally owned by companies in his control. Mrs Prest was therefore entitled to share in them.⁸⁷ In keeping within the scope of this dissertation, only the corporate veil issue will be considered. The commentary on this point was strictly speaking obiter⁸⁸ and although it was made in the context of a case concerning the transfer of property following divorce, it is clear the Supreme Court was addressing the issue across the law generally.⁸⁹ The judgments of Lords Sumption and Walker provide an academically challenging discourse for a novel interpretation of the case.

The judgments can be analysed at two levels. Superficially, Lords Walker and Sumption have contrasting views that illustrate the different options for how the doctrine could be narrowed. Lord Sumption's leading judgment reviewed the case law where previous judges have purported to pierce the corporate veil, or have considered it as an option and then declined to do so. His Lordship set out a new approach for the doctrine by formulating two distinct principles of concealment and evasion.⁹⁰ In contrast, Lord Walker's approach examined how the doctrine fits into the company

⁸⁴ *Prest v Prest* [2011] EWHC 2956 (Fam) per Moylan J.

⁸⁵ *Prest*, above n 2, at [9]. The other two bases for providing relief were under s 24(1)(a) of the Matrimonial Causes Act which could have been interpreted as conferring a distinct power on the court to disregard the corporate veil in matrimonial cases, or under trust principles where the circumstances meant the properties were held on trust for the husband.

⁸⁶ At [36]. Lord Neuberger (President), Lord Walker, Lady Hale, Lord Mance, Lord Clarke, Lord Wilson and Lord Sumption sat on the bench.

⁸⁷ At [49], [52] and [55].

⁸⁸ This case was obiter on the issue of piercing the corporate veil. See *Prest*, above n 2, at [63] per Lord Neuberger and [105] per Lord Walker. It was not mandatory to address this issue, but the Court felt that it could not avoid the issue any longer.

⁸⁹ At [37] Lord Sumption stated "courts exercising family jurisdiction do not occupy a desert island... if a right exists, it exists in every division of the High Court and in every jurisdiction".

⁹⁰ Lord Sumption was not on the panel that heard *VTB Capital*, so perhaps he saw this case as an opportunity to express his own opinion.

law framework rather than trying to establish its discrete application. This approach is consistent with the modern conception of the company and what we expect from its participants.⁹¹

The judgments can also be understood at a functional level. Both Lords Walker and Sumption agree that, regardless of the corporate veil doctrine, there are other more conventional principles the courts can use to hold companies and its controllers liable for wrongful conduct.⁹² Lord Sumption recognises this through the concealment principle,⁹³ and Lord Walker recognises this when he finds the doctrine is a label, with the potential exception of attribution in *Moore Stephens*.⁹⁴ A continuum can be drawn with evasion as an example of pure piercing sectioned off at one end, and then the other principles, which essentially achieve the same purpose as piercing diffused down the spectrum. Both approaches will be used to critique the judgments, and to argue where the laws of attribution best fit.

C Evasion principle as pure piercing

1 Lord Sumption's distinction

Lord Sumption's analysis focused on the need for certainty and clarification of when the veil can be pierced.⁹⁵ Having established the doctrine fits within the English company and insolvency laws,⁹⁶ he stressed that piercing the corporate veil means disregarding the separate personality of the company under:⁹⁷

[T]he true exceptions to the rule in *Salomon v A Salomon & Co Ltd*... where a person who owns and controls a company is said in certain circumstances to be identified with it in law by virtue of that ownership and control.

⁹¹ The company law framework has developed in New Zealand as we now expect more from the participants, being the shareholders and directors of the company. For example, see Chapter Three on how some directors' duties have extended to include creditors' interests.

⁹² All seven Lordships agreed.

⁹³ *Prest*, above n 2, at [28].

⁹⁴ At [106].

⁹⁵ V Niranjana "Petrodel v Prest: Lord Sumption's Masterly Analysis of the Corporate Veil" (13 June 2013) <<http://indiacorplaw.blogspot.co.nz/2013/06/petrodel-v-prest-lord-sumptions.html>>.

⁹⁶ *Prest*, above n 2, at [8].

⁹⁷ At [16]. Lord Sumption noted that the expression "piercing the corporate veil" is often applied to a range of situations in which the law attributes the acts or property of a corporation to those who control it, without disregarding its separate personality, for example joint liability or trust law. These situations however are not true cases of piercing the corporate veil.

A true exception, as such, may be described as the general aversions to fraudulent conduct which Lord Sumption found was the basis for the doctrine's existence.⁹⁸ His Lordship described the case law starting with *Woolfson* as characterised by "incautious dicta and inadequate reasoning".⁹⁹ Nonetheless, his Lordship found these authorities established that abuse of separate legal personality for the purpose of some relevant wrongdoing can justify piercing the veil.¹⁰⁰ The difficulty for Lord Sumption was to identify what this relevant wrongdoing is.

The expressions sham or façade have been used to describe justifications for piercing the veil, however Lord Sumption recognised that they are too malleable to provide a satisfactory answer.¹⁰¹ This aligns with the view of Lord Neuberger in *VTB Capital*, who reasoned that words such as "sham, cloak, device and puppet" may be useful metaphors, but are often dangerous in "assisting moral indignation to triumph over legal principles...and can risk causing confusion and uncertainty in the law".¹⁰² Against this background, Lord Sumption formulated the evasion principle and the concealment principle to categorise the relevant wrongdoing and therefore veil piercing.

The evasion principle is the only pure example of veil piercing. It allows the court to pierce the corporate veil where:¹⁰³

[T]here is a legal right against the person in control of the company which exists *independently* of the company's involvement, and a company is interposed so that the separate legal personality of the company will defeat the right or frustrate its enforcement.

Examples of this include where a person transfers property to a company to avoid performance of a contract, or where a husband disguises relationship property in a one person company and on separation, claims he has no ownership rights in that

⁹⁸ At [18].

⁹⁹ At [19]. See Chapter One for the history and analysis of the case law. Particularly during Lord Denning's interventionist years, the corporate veil was pierced to achieve justice, which is now not seen as an adequate ground.

¹⁰⁰ At [27]. The law has in recent times crystallised around the six principles formulated by Munby J in *Ben Hashem v Al Shayif*, above n 44, the most important that there must be "relevant impropriety" in the use of the corporate structure of avoid liability.

¹⁰¹ At [28]. Lord Sumption described the terms as "protean".

¹⁰² *VTB Capital*, above n 41, at [124]. See also Justice Cardozo's reference in *Berkey v Third Ave Ry* above n 67, to metaphors in company law which "starting as devices to liberate through... end often by enslaving it".

¹⁰³ *Prest*, above n 2, at [28].

property.¹⁰⁴ Lord Sumption illustrated this difference by looking to the cases of *Gilford*¹⁰⁵ and *Jones*,¹⁰⁶ and comparing them to *Gencor ACP Ltd v Dalby*¹⁰⁷ and *Trustor AB v Smallbone (No 2)*.¹⁰⁸

Lord Sumption argued that *Gilford* and *Jones* were examples of piercing the corporate veil through the evasion principle.¹⁰⁹ As we have seen in Chapter One, these cases were examples of a company being used as a sham or façade to evade an existing duty. In relation to *Gilford*, Lord Sumption agreed with the Court of Appeal in *VTB Capital* that this was a decision to pierce the corporate veil because the injunction issued against Mr Horne deprived him of the benefit the company provided so that he could not continue to breach his restraint of trade clause.¹¹⁰ Similarly in *Jones*, the specific performance ordered against the company, Alamed Ltd, is an example of piercing as the court treated the company as having the same obligations to the plaintiff as Mr Lipman had even though he was not a contractual party to the sale.

In Lord Sumption's opinion, *Gencor* and *Trustor* were cases of confusion between the evasion and concealment principles.¹¹¹ Both cases could have been decided without recourse to the doctrine and are not true veil piercing cases but instead examples of the concealment principle. The concealment principle does not involve piercing, but instead allows the court to look behind the corporate form to reveal the true actors where a company has been interposed to hide their identities.¹¹² Lord Sumption held that the evasion principle was not engaged as neither Mrs Dalby nor Mr Smallbone had used the corporate form to evade an existing liability. In *Gencor*, Mr Dalby was the formed director of a company who had claims brought against him for misappropriating funds.¹¹³ Rimer J in the High Court held Mr Dalby accountable for the money received by Burnstead, as it was "the alter ego through which Mr Dalby

¹⁰⁴ True examples of the evasion principle are difficult to formulate as in most cases there will be other remedies instead of piercing the veil. In these examples, the courts will require specific performance of the contract as it is evading an existing obligation, and the family home may be clawed out of the company for equal division under ss 44D-F of the Property (Relationships) Act 1976.

¹⁰⁵ *Gilford*, above n 23.

¹⁰⁶ *Jones*, above n 26.

¹⁰⁷ *Gencor ACP Ltd v Dalby* [2000] 2 BCLC 734 ["Gencor"].

¹⁰⁸ *Trustor AB v Smallbone (No 2)* [2001] 2 BCLC 436 ["Trustor"].

¹⁰⁹ *Prest*, above n 2, at [29]-[30].

¹¹⁰ *VTB Capital plc v Nutritek International Corp* [2012] EWCA Civ 808 at [65].

¹¹¹ *Prest*, above n 2, at [31]-[32].

¹¹² At [28].

¹¹³ The claim was for an account of a secret profit which Mr Dalby procured to be paid by a third party to a company under his control (Burnstead).

enjoyed the profit which he earned in breach of his fiduciary duty to APC”.¹¹⁴ While Rimer J claimed he was piercing the veil, Lord Sumption identified that the true relationship between Burnstead and Mr Dalby was unveiled, regardless of the legal personality of the company. Finally in *Trustor*, the legal relationship had to be decided between Mr Smallbone as the former managing director of Trustor, and Introcom Ltd which was owned and operated by a trust to which Mr Smallbone was a beneficiary. Mr Smallbone had transferred large amounts of money from Trustor’s accounts to Introcom Ltd, which the court subsequently found was held on Mr Smallbone’s behalf. The company therefore “received [the money] as his agent or nominee”¹¹⁵ and Mr Smallbone was liable to “account as a constructive trustee on the footing of knowing receipt”.¹¹⁶ These cases demonstrate the confusion where the courts were thought to have pierced the corporate veil, but in reality were circumventing to uncover the true facts.

Lord Sumption’s analysis clearly reflects the broader principle that the purpose of incorporation is to protect liability.¹¹⁷ The evasion principle will therefore only be invoked where incorporation is being abused. He proposed the following test that the doctrine applies in a limited sense:¹¹⁸

[W]hen a person is under an existing legal obligation or liability or subject to an existing legal restriction which he deliberately evades or whose enforcement he deliberately frustrates by interposing a company under his control. The court may then pierce the corporate veil for the purpose, and only for the purpose, of depriving the company or its controller of the advantage that they would otherwise have obtained by the company’s separate legal personality.

The limited scope shows that the application of the doctrine is rare. Where other more conventional remedies apply to the situation, the veil will not be pierced, as there is no public policy imperative to justify it.¹¹⁹ On the above reasoning, Lord Sumption held that Mr Prest did not meet this test. He had “acted improperly in many ways” but had not transferred the properties for the purpose of *evading* or *concealing* any legal

¹¹⁴ *Gencor*, above n 107, at [26].

¹¹⁵ *Prest*, above n 2, at [32].

¹¹⁶ At [22].

¹¹⁷ At [34].

¹¹⁸ At [35].

¹¹⁹ At [35]. Lord Sumption agrees with Munby J in *Ben Hashem v Al Shayif*, above n 44, that the veil can be pierced only in the absence of other more conventional remedies.

obligation to Mrs Prest.¹²⁰ Furthermore, the court would have only been able to ascertain the true facts of the case through the concealment principle.¹²¹ The result may have been different if Mr Prest transferred the properties to the company after separation and in order to defeat Mrs Prest's claim.

Although the decision was unanimous, the concurring judgments raised doubts as to whether Lord Sumption's development of the evasion principle was correct or complete.¹²² The concurring judgments of Lady Hale and Lords Wilson, Mance and Clarke do not isolate the evasion principle, but instead leave room for the development of new exceptions to be grafted on in the future.¹²³ However their reasons suggest that it will be rare to establish further additions to the evasion principle. Even Lord Sumption recognised that "in almost every case where it is satisfied, the facts will... make it unnecessary to pierce the corporate veil".¹²⁴ Lady Hale and Lord Wilson queried whether all cases could be neatly classified into either concealment or evasion.¹²⁵ Lord Mance suggested that it is "dangerous to seek to foreclose all possible future situations which may arise and I would not wish to do so".¹²⁶ His Lordship refused to accept that only cases falling within the evasion principle could be remedied by piercing the veil. However the most telling criticism of this judgment comes from Lord Clarke who stated:¹²⁷

[T]his was not a distinction that was discussed in the course of the argument and, to my mind, should not be definitively adopted unless and until the court has heard detailed submissions upon it.

Lord Sumption's approach appears to go too far in discussing an issue that was not raised in court. By overstepping this boundary, the persuasiveness of the distinction is discredited and does not provide a well reasoned principle of law. Later courts have

¹²⁰ *Prest*, above n 2, at [36].

¹²¹ The true facts were that the properties had been disposed of for wealth protection and tax avoidance long before separation and not to defeat Mrs Prest's claim.

¹²² Clifford Chance "Supreme Court pressed into lifting the veil on divorce" (21 June 2013) <http://www.cliffordchance.com/publicationviews/publications/2013/06/supreme_court_pressedintoliftingtheveil.html>.

¹²³ *Kain*, above n 80.

¹²⁴ *Prest*, above n 2, at [35].

¹²⁵ At [92] Lord Wilson agrees with Lady Hale.

¹²⁶ At [100].

¹²⁷ At [103].

been hesitant to apply this distinction and have asked for further clarification.¹²⁸ The evasion principle is finely crafted and “snappily formulated”, but excluding all other exceptions is hopelessly attempting to create black letter law which “may prove elusive”.¹²⁹ This can be contrasted to Lord Walker’s approach which takes a broad view of how the corporate veil doctrine fits into the company law framework. The question is whether the doctrine can exist independently of conventional legal principles?

D *Moore Stephens v Stone & Rolls Ltd*

1 *Lord Walker’s potential exception to the doctrine*

Lord Walker examined the corporate veil doctrine in less detail than Lord Sumption. He welcomed the discussion of the other judges but took the view that the doctrine is not a coherent principle,¹³⁰ but:¹³¹

[S]imply a label – often, as Lord Sumption observes, used indiscriminately – to describe the disparate occasions on which some rule of law produces apparent exceptions to the principle... in *Salomon v A Salomon and Co Ltd*.

Lord Walker was not as fixated as Lord Sumption about the uncertainty of the law, recognising that there are other ways of achieving justice.¹³² Remedies may be statutory, tortious or from the principles of equity, but most importantly they provide certainty whilst simultaneously allowing the separate legal personality to be ignored. This is a clear message from Lord Walker that there are alternative ways to circumvent the corporate veil without having to invoke the piercing doctrine.

¹²⁸ See *Antonio Gramsci Shipping Corp v Aivars Lembergs* [2013] EWCA Civ 730 [*“Antonio Gramsci”*] and *R v Sale* [2013] EWCA Crim 1306. This criticism will be discussed in Chapter Four.

¹²⁹ Rod Cowper and Michael Dockterman “US and UK courts are teasing the corporate veil” (27 August 2013) <<http://www.iflr.com/Article/3247993/US-and-UK-courts-are-teasing-the-corporate-veil.html>>.

¹³⁰ Lord Walker’s approach is not new. See *Attorney-General v Equiticorp Industries Group Ltd (In Statutory Management)*, above n 73, at 541. The Court of Appeal stated “to lift the corporate veil... is not a principle. It describes a process, but provides no guidance as to when it can be used.”

¹³¹ *Prest*, above n 2, at [106].

¹³² At [106]. Particularly in one person companies, where the shareholders are also directors, directors’ duties operate to impose personal liability upon them. This gives a similar result as you get with piercing the veil. Lord Sumption recognises these alternative ways to achieve justice, however his view is that they should be kept separate from the veil piercing doctrine. It is likely, however, that he would call these examples of the concealment principle.

The most striking aspect of Lord Walker's approach was his recognition of a potential exception in *Moore Stephens* where the metaphor of piercing the veil may operate as a true exception.¹³³ This case involves the laws of attribution of fraud. A company is only capable of acting and knowing if the acts or knowledge of human beings are attributed to it.¹³⁴ Multiple people, such as primary organisations,¹³⁵ officers, agents or employees can make decisions on behalf of the company. The issue arises as to whether the acts or knowledge of these individuals should be attributed to the company. Company law commentators have recognised these complexities stating:¹³⁶

With hindsight it can be seen that giving the company a separate legal personality was the bold and imaginative, but technically easy conceptual step. Giving that person the means of thought and action has proved a legally much more complex undertaking.

2 Attribution of fraud in a "one person company"

Moore Stephens involved a reverse piercing of the corporate veil. The company was held responsible for its shareholder's conduct instead of the shareholder being responsible for the company's liabilities.¹³⁷ Reverse piercing still involves the fundamental aspect of ignoring the separation between the company and its shareholders and therefore is relevant to the traditional doctrine analysis.

Moore Stephens considered the ability to attribute knowledge in a one person company. The company Stone & Rolls (S&R) came under Mr Stojevic's control in 1995. S&R was a one person company, and although Mr Stojevic was not formally a director, he was the "directing mind and will".¹³⁸ Mr Stojevic was also assumed to have beneficial ownership of all the shares in the company.¹³⁹ He engaged the services of a respected audit firm Moore Stephens, and convinced them to become

¹³³ At [106] per Lord Walker and [95] per Lady Hale, both Lordships recognised this exception. Lord Walker states this is a "small residual category" and the metaphor he describes is the label of piercing the corporate veil. See also *Moore Stephens*, above n 82.

¹³⁴ Paul Davies *Introduction to Company Law* (2nd ed, Oxford University Press, New York, 2010) at 33.

¹³⁵ Organisations could be the board of directors or the members in a general meeting.

¹³⁶ Davies, above n 134, at 52.

¹³⁷ Cheng, above n 50, at 396.

¹³⁸ *Moore Stephens*, above n 82, at [64] per Lord Phillips; [90] per Lord Scott; [126] per Lord Walker; [197] per Lord Brown; [219] per Lord Mance.

¹³⁹ The majority assumed this, with Lord Scott dissenting at [113]-[118]. All the shares in S&R were held by another company, and the shares of that company were held by a trust of which Mr Stojevic was the main beneficiary.

S&R's auditors. Mr Stojevic gave Moore Stephens fictitious financial statements as well as fraudulent accounts of business transactions. He then devised a fraudulent scheme and obtained credit from various banks worth \$US94 million. On discovery of the fraud, the main bank successfully sued S&R and Mr Stojevic for almost \$US100 million. S&R could not pay and went into liquidation,¹⁴⁰ so the liquidators turned to Moore Stephens as the auditors for a claim of \$US174 million.¹⁴¹

The issue relevant to this dissertation was whether Mr Stojevic's fraud could be attributed to S&R given the exception in *Re Hampshire Land Co (No 2)*.¹⁴² The majority of the House of Lords recognised Mr Stojevic and S&R were separate legal entities, but found that S&R was the vehicle used by Mr Stojevic to effect the frauds. Consequently, the fraud was attributed to the company, the exception did not apply and the liquidators had no claim against Moore Stephens.¹⁴³ Lord Brown's short and direct judgment was the closest approach to piercing the veil. His Lordship stated there could be no clearer instance of fraud than this case because Mr Stojevic and S&R were "one and the same person".¹⁴⁴ Lord Scott's dissenting judgment was based on a mistake of fact as he did not see S&R to be "owned" by Mr Stojevic, even though the agreed Statement of Facts and Issues stated that "Mr Stojevic was the... ultimate beneficial owner".¹⁴⁵ This distinction between ownership and control meant Mr Stojevic was a victim of his own abuse.¹⁴⁶

3 *Example of evasion or concealment?*

The importance of *Moore Stephens* rests on the fact that in a one person company the fraud of that person will be attributed to the company. Lady Hale stated this is a different way of "getting at" the individual:¹⁴⁷

¹⁴⁰ S&R went into liquidation as Mr Stojevic had stripped the company's assets.

¹⁴¹ The claim was for negligently failing to detect Mr Stojevic's fraudulent behaviour during the course of various audits, leading to ongoing losses to S&R's creditors.

¹⁴² *Re Hampshire Land Co (No 2)* [1896] 2 Ch 743. The effect of the exception is that knowledge will not be attributed to the principal where the knowledge is a result of the agent's own breach of duty. Therefore, it will not apply where an agent is using the company as a vehicle for fraud. See also Jessica Elder "Attribution of Fraud: Can a One-Man Company Really be the Victim of its Own Fraud?" (LLB (Hons) Dissertation, University of Otago, 2011).

¹⁴³ For a detailed analysis of the House of Lord's judgments see Elder, at Chapter Four.

¹⁴⁴ *Moore Stephens*, above n 82, at [196].

¹⁴⁵ At [116].

¹⁴⁶ At [117]-[118].

¹⁴⁷ *Prest*, above n 2, at [95]. A defence of *ex turpi causa* prevents a plaintiff's claim if it is a result of their own illegal act.

[N]ot for the purpose of suing him, but in order to attribute his knowledge to the company so that its auditors could raise a defence of *ex turpi causa* to the company's allegation that they had negligently failed to detect the fraudulent nature of its business.

Lord Walker saw attribution of fraud as an example of the “metaphor operating independently” in a small residual category.¹⁴⁸ That suggests it is a pure piercing example akin to Lord Sumption's evasion principle. But on Lord Sumption's reasoning, attribution must meet the threshold test in order to be an example of evasion.¹⁴⁹ Mr Stojevic acquired S&R before he convinced Moore Stephens to become S&R's auditors, and was therefore under no existing legal obligation that was frustrated by the company structure. Taking an orthodox interpretation, the company existed before the fraudulent behavior. It is therefore an example of the concealment principle rather than the evasion principle. Furthermore, Mr Stojevic's obligation to repay the banks was on behalf of the company and therefore not “independent of the company's involvement”.¹⁵⁰ The tension between the evasion principle and the potential exception of attribution can be rationalised by looking to Lord Neuberger's approach.

Lord Neuberger agreed with Lord Sumption's evasion principle but reasoned that the doctrine may not be limited to piercing.¹⁵¹ Instead, the well-established principle of “fraud unravels everything” forms a canopy over the evasion and other principles spectrum previously discussed.¹⁵² This proposes that all examples of ignoring the separate legal personality of a company can be traced back to the common principle of fraud. Lord Neuberger extended this idea by stating that the evasion principle could be analysed “based on agency or trusteeship in light of the words ‘under his control’”.¹⁵³ This brings the laws of agency and trusts within the category of the evasion principle, even if the test is not met. Furthermore, it confirms the existence of the doctrine as an “aspect of a more conventional principle”.¹⁵⁴

¹⁴⁸ At [106].

¹⁴⁹ At [28] and [34].

¹⁵⁰ At [28].

¹⁵¹ At [83].

¹⁵² At [18]. See *Lazarus Estates Ltd v Beasley* [1956] 1 QB 702 at 712 for Lord Denning's famous dictum on fraud. “No court in this land will allow a person to keep an advantage which he has obtained by fraud” shows that courts will be more willing to respond to cases involving fraud.

¹⁵³ At [83]. “Under his control” is part of the requirement of the evasion principle, see [35].

¹⁵⁴ At [83].

It is submitted that attribution¹⁵⁵ of fraud is an exception to Lord Sumption's evasion threshold and thus an example of pure piercing.¹⁵⁶ The narrow scope of the evasion principle can allow this exception for the following reasons. Firstly, the other Lordships left room for the development of new exceptions.¹⁵⁷ Secondly, Lord Clarke criticised Lord Sumption's distinction as the parties did not discuss it. That reduced the persuasiveness of such a strict category. Thirdly, Lord Walker and Lady Hale raised the laws of attribution in *Moore Stephens* as an example of the doctrine operating independently. This approach is a halfway house between Lords Sumption and Walker. It recognises the evasion principle as pure piercing, but qualifies attribution of fraud as an exception under the principle that fraud unravels everything.

E Concealment principle

Lords Sumption and Walker both agree that, regardless of the corporate veil doctrine, there are other more conventional principles available to the courts to remedy abuse of one person companies. Lord Sumption recognises these remedies under the concealment principle, which does not involve piercing the corporate veil but instead allows the court to look behind the corporate form to reveal the true actors where a company has been interposed to hide their identities.¹⁵⁸ Examples of the concealment principle have been seen in *Trustor* and *Gencor* above. Furthermore, Lord Sumption also recognises the injunction granted in *Gilford* could have been justified by imputing knowledge to the company so that the latter's conduct was unconscionable.¹⁵⁹ A strict approach recognises that imputing knowledge through agency laws is an example of the concealment principle. That threatens the doctrine's application because the evasion principle can only be invoked where there are no other remedies available.¹⁶⁰ If the novel interpretation that attribution of fraud is an example of this exception is adopted, imputing knowledge through agency can still be seen as an example of piercing through the evasion principle. That is so even though

¹⁵⁵ See Chapter Four. This dissertation is concerned with the primary rules of attribution, which are the laws of agency in the Companies Act 1993.

¹⁵⁶ See Chapter Four for further discussion on attribution. This exception is specific for attribution of fraud, not general attribution.

¹⁵⁷ Lady Hale and Lords Wilson, Mance and Clarke.

¹⁵⁸ *Prest*, above n 2, at [28].

¹⁵⁹ At [29].

¹⁶⁰ At [35]. See also Ernest Lim "*Salomon Reigns*" (2013) 129 LQR 480 at 483.

attribution of fraud is an alternative remedy. It is clear that Lord Sumption's reasoning is not completely coherent.

Alternatively, Lord Walker recognises these other remedies through describing the doctrine as a label. The doctrine therefore includes a piercing component, as well as statutory remedies, liability in tort and unjust enrichment. It is submitted that Lord Walker's approach is a wider view of Sumption's evasion and concealment distinction. At this functional level, the corporate veil doctrine is based on the principle that fraud unravels everything. The recognition of these other remedies shows that while the doctrine may have a limited scope since *Prest*, it does not matter. Functionally these other remedies will provide similar outcomes to piercing the corporate veil without the uncertainty of the doctrine's scope.

F Conclusion

So where does this case leave us? The decision in *Prest* is unlikely to be the final word from the Supreme Court. The case upheld the principle in *Salomon* that assets held within corporate structures are not the property of the controller of the company unless it is possible to rely upon the evasion principle or the exception of attribution of fraud.¹⁶¹ While the scope of the doctrine has clearly been narrowed, there is no clear ratio decidendi. This leaves academics and lawyers alike to anticipate further application, or not, of Lord Sumption's new rationalisation of the doctrine. Crystal ball gazing, this case is likely to effect the use of company structures to hold what are, in reality, personal assets.¹⁶² In the words of Mrs Prest's lawyer:¹⁶³

Decent husbands and wives have nothing to worry about. Honest company directors have nothing to fear. But for those who misuse companies to cheat their spouses on divorce and for company directors who hide the truth behind a bogus

¹⁶¹ Lord Sumption stated, "The separate personality and property of a company is sometimes described as a fiction, and in a sense it is. But the fiction is the whole foundation of English company and insolvency law" in *Prest*, above n 2, at [8].

¹⁶² Clifford Chance "Supreme Court pressed into lifting the veil on divorce", above n 122. The courts are armed with tactics to look through the corporate structure.

¹⁶³ Terri Judd "Victory for Nigerian oil tycoon Michael Prest's wife as 'cheats' charter' overturned in landmark Supreme Court divorce case" *The Independent* (12 June 2013) <<http://www.independent.co.uk/news/uk/home-news/victory-for-nigerian-oil-tycoon-michael-prests-wife-as-cheats-charter-overturned-in-landmark-supreme-court-divorce-case-8655133.html>> quoting Jeremy Posnansky QC.

corporate façade, the Supreme Court has shown that truth and reality will prevail.

The evasion principle provides the court with a remedy of last resort. Transferring assets to a company will no longer release a spouse from liability. The doctrine provides an effective response to the abuse of the corporate form, providing that its scope is narrow and its application is monitored. Therein lies the problem. The second part of this dissertation will focus on the illusory protection provided by incorporation and how companies and their controllers can attract individual duties and liabilities to remedy abuse of one person companies. It is submitted that regardless of the doctrine's application, these other remedies Lord Sumption refers to as concealment principles can achieve the same outcome as the piercing doctrine.

CHAPTER THREE: THE USE OF STATUTORY MECHANISMS

A Introduction

Chapter Two established that while the piercing doctrine has a limited and fairly uncertain application, Lords Walker and Sumption both agree that the judiciary has a palette of tools to ensure justice prevails.¹⁶⁴ Furthermore, Lord Neuberger stated that development of the doctrine past the principle that fraud unravels everything is a matter for Parliament to legislate on.¹⁶⁵ Parliament created separate legal personality therefore it should be for Parliament to remedy its abuse. This primary method of intervention aims to ensure the efficient and responsible management of companies to limit the instances where one person companies are abused. There is also an element of regulation to impose personal liability or other remedies for the wrongful use of the company.

The principle in *Salomon* and s 15 of the Companies Act 1993 are both misleading because they generate the myth that incorporation provides absolute protection. This chapter will challenge this myth by illustrating how companies and their controllers can attract statutory duties and liabilities, regardless of incorporation.¹⁶⁶ This illusory protection provided by incorporation will be addressed in the New Zealand context. The examples provided suggest some of the remedies available, rather than an exclusive list. They show that the application of these remedies specifically to one person companies achieve a similar result to piercing the veil.

B Participant liability

The incorporation myth is a novel term used to describe the illusory protection provided by incorporation. While the main reason the corporate structure is used to conduct business is to take advantage of limited liability, this limit covers shareholders, not directors. Even in one person companies where a director may also be a shareholder, actions can be brought against the director while acting in that

¹⁶⁴ Fox and Arthurs, above n 81, at 15.

¹⁶⁵ *Prest*, above n 2, at [83].

¹⁶⁶ Lord Sumption would describe these exceptions to separate legal personality as examples of the concealment principle he designed, see [28].

capacity. Watson and Noonan determined that “if a cause of action can be established against a director, there is no bar against proceeding”.¹⁶⁷ Put simply, participants¹⁶⁸ within a company can be held personally liable for their actions, regardless of incorporation. The fixation the law has placed on piercing the corporate veil is evolving towards the recognition of more conventional remedies that preserve the integrity of the corporate structure. Some of these remedies are examined next and focus specifically on the Companies Act 1993, the Property (Relationships) Act 1976, and the Fair Trading Act 1986.

C Companies Act 1993

The powers and duties of directors change according to the climate of the time.¹⁶⁹ Prior to the October 1987 stock market crash, directors generally gave little thought to the duties they owed to the company. Post crash however, disgruntled shareholders and creditors turned to directors for compensation where a company failed or suffered a loss. The Law Commission observed that the 1955 Act did not sufficiently set out the duties,¹⁷⁰ and responded by making dramatic changes in the 1993 Act.¹⁷¹

In drafting the Companies Act 1993 the Law Commission was concerned with striking a balance between the benefits of the corporate form to the economy and preventing abuse.¹⁷² The proposed legislation held directors responsible for the management of the company whilst at the same time imposing restrictions on them in terms of duties owed to the company. The long title of the draft Act, and now the Companies Act 1993, linked the restriction of these duties to the purpose of:¹⁷³

[E]ncouraging efficient and responsible management of companies by allowing *directors a wide discretion* in matters of business judgment while at the same

¹⁶⁷ Susan Watson and Chris Noonan "The corporate shield: What happens to directors when companies fail?" [2005] University of Auckland Business Review 27 at 28.

¹⁶⁸ Participant includes directors per the definition in Companies Act 1993, s 126.

¹⁶⁹ Hon Justice Tompkins QC "Stace Hammond Grace Lecture in Commercial Law on Directing the Directors: The Duties of Directors under the Companies Act 1993" (1994) 2 Wai L Rev .

¹⁷⁰ Companies Act 1955.

¹⁷¹ Companies Act 1993, ss 131-138. See New Zealand Law Commission *Company Law Reform and Restatement* (NZLC R9, 1989) at 186. The duties arose from complex case law in an attempt to make them more accessible.

¹⁷² At 186.

¹⁷³ Companies Act 1993, Long Title (d) [emphasis added].

time providing *protection* for *shareholders and creditors* against the *abuse* of management power.

Alan Galbraith QC emphasised that the concept of directors' diligence underlies the Act.¹⁷⁴ The key concept in the title is protecting shareholders and creditors from abuse of the corporate structure. This is not the place to address whether the Act achieves its purpose, but it is unlikely owners actively involved in one person companies will escape liability through incorporation.

The meaning of "director" is expanded under the 1993 Act indicating that there can be more than one type of director with differing roles and responsibilities. De jure directors are those who have been appointed and have consented to act as directors.¹⁷⁵ *Delegat v Norman* qualifies whether a person is a shadow or de facto director of a company.¹⁷⁶ Shadow directors are persons who influence and control the decision of the directors, although they are not formally appointed.¹⁷⁷ The test requires "on-going control or influence in the company's affairs".¹⁷⁸ In the case of a wholly owned subsidiary, the parent company can be classified as a shadow director and thus subject to directors' duties. De facto directors have also not been formally appointed, but openly exercise the same powers as a director.¹⁷⁹ The test requires the person to "assume the status and functions of a director" even though they have not been appointed as such.¹⁸⁰ If a person is acting in their capacity as a "director" under s 126 then they owe duties under the Act to the company or third parties.¹⁸¹

1 Pooling orders

Sections 271 and 272

A pooling order under s 271 of the Companies Act 1993 allows the court to look through the separate legal personality of related companies to satisfy the claims of

¹⁷⁴ Alan Galbraith "The 1993 Act. Balancing the rights of shareholders, directors, executive officers and creditors" (paper presented to the Company Law Conference, 1994).

¹⁷⁵ Companies Act 1993, s 126(1)(a).

¹⁷⁶ *Delegat v Norman* [2012] NZHC 2358. See Bell Gully "Shadow directors, de facto directors and duties not to trade recklessly" (27 March 2013) <http://www.bellgully.co.nz/newsletters/corporate_reporter/27mar13.asp> for a summary of the case facts.

¹⁷⁷ Section 126(1)(b).

¹⁷⁸ *Delegat v Norman*, above n 176, at [28].

¹⁷⁹ Section 126(1)(c).

¹⁸⁰ *Delegat v Norman*, above n 176, at [31].

¹⁸¹ *Lee v Lee's Air Farming Ltd* [1961] UKPC 33.

creditors of a company in liquidation.¹⁸² Section 271 substantially re-enacts the former s 315A of the 1955 Act with the addition that creditors and shareholders are able to apply, and without the protection given to secured and preferential creditors or guidance as to the ranking of unsecured creditors under s 315B(3). Pooling may be necessary where a parent company incorporates a subsidiary for the purpose of a risky business venture or with lack of adequate capital.¹⁸³ If the subsidiary is placed into liquidation leaving unpaid creditors behind, the court could pool the assets of the companies for the benefit of the creditors of the companies within the group.¹⁸⁴ This achieves a similar result to the piercing doctrine. The parent company is held directly liable for the loss of its subsidiary regardless of the companies' incorporation. That is done on the basis that the two companies were essentially one and the same.

In *Mountfort v Tasman Pacific Airlines NZ* a pooling order was granted in respect of a company and its subsidiary.¹⁸⁵ Baragwanath J held that as a general rule of application, "creditors of a subsidiary cannot be entitled to recover on a pooling application more than they would have secured had the directors complied meticulously with their obligations".¹⁸⁶ Although the two companies were separate entities, the parent company essentially serviced the subsidiary as it provided maintenance, servicing and was relied upon for the majority of its income. The court also recognised a transaction from the subsidiary to the parent company for \$650,000 when the subsidiary was insolvent, which was treated as a nil debt.¹⁸⁷ The pooling order was therefore granted as one company was dependent on the other, the transfer jeopardised the creditors of the subsidiary company and the companies had the same directors who breached their duties by allowing the insolvent transfer. *Mountfort* highlights the liability parent companies owe for the behaviour of their subsidiaries.

¹⁸² Gehan Gunasekara and Alan Toy "Lifting the veil on pooling orders under section 271 of the Companies Act 1993" (2007) 13 NZBLQ . See also Andrew Borrowdale "Commentary on Austin" in Ross Grantham and Charles Rickett (eds) *Corporate Personality in the 20th Century* (Hart Publishing, Oxford, 1998) at 94.

¹⁸³ Helen Anderson "Piercing the Veil on Corporate Groups in Australia: The Case for Reform " (2009) 33 MULR 333 at 357.

¹⁸⁴ An application under Companies Act 1993, s 301(1)(b) would also impose liability on the parent company's directors for breach of good faith under s 131 or duty of care under s 137.

¹⁸⁵ *Mountfort v Tasman Pacific Airlines NZ* [2006] 1 NZLR 104 .

¹⁸⁶ At [28].

¹⁸⁷ Gunasekara and Toy, above n 182.

2 *Duties beyond the company*

A company facing insolvency must be aware of the potential to cause significant loss to creditors through breaches of directors' duties.¹⁸⁸ Sections 135 and 136 set out the directors' duties for "reckless trading" and causing a company to "incur an obligation unless the director believes that... the company will be able to perform the obligation".¹⁸⁹ Section 131 requires "directors to act in good faith and in [the] best interests of the company" and s 301 has a wide power to enforce the breaches of these duties.¹⁹⁰ Cooke J in *Nicholson v Permakraft* described the recognition of duties to creditors as "a privilege healthy as tending to the expansion of opportunities and commerce, but it is open to abuse".¹⁹¹ Company failure is part of the risk taken when starting up a new business. It would be ludicrous to automatically impose liability in such an event,¹⁹² however incorporation will not cover a director who trades a company recklessly into insolvency. In a failed company creditors (via the liquidator) will often look to take action against directors, as they are likely to have deeper pockets than the insolvent company. Priestley J colourfully commented that:¹⁹³

The shield of incorporation will be of no avail to a director on the battlefield of trade if that director knows full well, or ought to have known, that creditors' claims cannot be met or if the shield-carrying director is allowing the company to trade recklessly.

If a company is in a situation where there is a substantial risk of serious loss to its creditors or a director cannot hold a reasonably grounded belief that the company will perform its obligations then the company should cease to trade. The shield is not required after surrender and will not protect a combatant who refuses to surrender.

¹⁸⁸ See *Sojourner v Robb* [2008] 1 NZLR 751 at [25], this is the basis for directors' duties in ss 135 and 136 aimed at protecting creditors.

¹⁸⁹ Sections 135 and 136.

¹⁹⁰ Sections 131 and 301. Section 301 allows the enforcement of directors' duties by the shareholders and creditors. This power is mainly used by liquidators, as the money or assets recovered is disposed of into the pool or assets, not directly to the shareholder or creditor bringing the claim. See Peter Watts "Part C: Directors' Duties" in Peter Watts, Neil Campbell and Christopher Hare (eds) *Company Law in New Zealand* (LexisNexis, Wellington, 2011) at 602.

¹⁹¹ *Nicholson v Permakraft (New Zealand) Ltd (in liq)* [1985] 1 NZLR 242 at 250.

¹⁹² See Stephen Nicholas "Don't become another statistic" *Ministry of Business, Innovation & Employment* (May 2012) <<http://www.business.govt.nz/news-and-features/newsarchive/may-2012/don2019t-become-another-statistic>> one in ten small businesses fail in their first year, and 70 percent capsize within the first five years.

¹⁹³ *Re Group Hub Ltd (in liq); The PC Company Ltd v Sanderson* Hamilton High Court CP 18/00, 1 November 2001 at 10-11.

Sections 135 and 136

Section 135 is an objective test¹⁹⁴ requiring the substantial illegitimate risk of serious loss to creditors.¹⁹⁵ Generally creditors should be able to look after their own interests, however creditor protection in some cases is needed. Examples are where directors have failed to prevent insolvent trading, or where parent companies have failed to prevent insolvent trading of their wholly owned subsidiaries. The distinction made by William Young J in *Re South Pacific Shipping Ltd (in liq)* between illegitimate and legitimate business risks ensure that s 135 does not unduly deter directors.¹⁹⁶ This distinction was adopted by the Court of Appeal in *Mason v Lewis* which set out “the essential pillars of s 135”.¹⁹⁷ What is needed “when the company enters troubled waters... [is] a ‘sober assessment’ by the directors... of an ongoing character, as to the company's likely future income and prospects”.¹⁹⁸

Shadow directors of a company can be held liable for reckless trading. In *Krtolica v Westpac Banking Corporation*, the court had to decide whether Westpac, in its capacity as a creditor of the principal debtor Seamart, had acted as a shadow director of Seamart, and that as a shadow director, its actions amounted to reckless trading.¹⁹⁹ The court held Westpac was not a shadow director, but went on to consider if the actions amounted to reckless trading. Westpac had two options when the company became insolvent, to put Seamart into receivership or to extend the credit facility. In extending the credit facility, the court adopted the test in *Mason v Lewis* and held this was a legitimate business decision and that the assessments Westpac made “were reasonable and sober”.²⁰⁰

Section 136 prohibits a director from agreeing to a company incurring an obligation unless the director “believes on reasonable grounds that the company will be able to perform the obligations when it is required”.²⁰¹ In *Fatupaito v Bates*, O’Regan J held the accountant of the company was in breach of s 136 as he had been aware of the

¹⁹⁴ See *Mason v Lewis* [2006] 3 NZLR 225 at [46]. The purely objective standard has been described as more akin to negligence than recklessness.

¹⁹⁵ The potential abuse reckless trading causes was emphasised in Clause 4 of the Companies and Limited Partnerships Amendment Bill 2011 (344-1) which proposed to criminalise a breach of s 135 following mismanagement leading to the collapse of finance companies last decade.

¹⁹⁶ *Re South Pacific Shipping Ltd (in liq)* (2004) 9 NZCLC 263,570 at [125].

¹⁹⁷ See *Mason v Lewis*, above n 194, at [51] for the “essential pillars”.

¹⁹⁸ At [51].

¹⁹⁹ *Krtolica v Westpac Banking Corporation* [2008] NZCCLR 24.

²⁰⁰ At [198].

²⁰¹ Section 131.

company's insolvency, and it was not reasonable for him to believe the company could meet its obligations as they fell due.²⁰² *Delegat v Norman* considered that ss 135 and 156 are similar, but s 135 may be more appropriate when challenging a breach over an extended period of time whereas s 136 relates to specific liabilities.

Section 131

Section 131 is essentially a fiduciary standard that requires a director to act in "good faith" and in the "best interests of the company".²⁰³ In *Sojourner v Robb* the scope of this duty was extended to the best interests of the creditors.²⁰⁴ The case involved a company in financial trouble disposing an asset at undervalue to a separate company.²⁰⁵ Mr and Mrs Robb were the directors of the company, and they also had a significant interest in it. The transaction was contrary to the company's interests because of the company's impending insolvency. It was therefore also contrary to the creditors' interests.²⁰⁶ The Court held that the Robbs had breached their duty under s 131. Regardless of its subjective appearance, the test under s 131 requires the directors' belief to be objectionably reasonable.²⁰⁷

Section 301

If ss 135, 136 or 131 have been breached, the creditor, liquidator or shareholder may apply for an order under s 301(1). This gives the court the power to require persons to repay money or return property, and if the creditor makes the application then the payment or transfer is owed directly to the creditor.²⁰⁸ The Court of Appeal in *Mason v Lewis* discussed the quantum of damages that directors should contribute. The court observed that for a breach of s 135 the:

[S]tandard approach has been to begin by looking to the deterioration in the company's financial position between the date inadequate corporate governance

²⁰² *Fatupaito v Bates* [2001] 3 NZLR 386.

²⁰³ Section 131. See Jessica Palmer "Understanding the Directors' Fiduciary Obligations" (2006) 12 NZBLQ 314 at 315.

²⁰⁴ *Sojourner v Robb* [2006] 3 NZLR 808; *Sojourner v Robb* above n 188. See also Lord Mance in *Moore Stephens*, above n 82, at [265]. He stated the critical fact to be that the company was insolvent, as he believed that the powers and duties of directors and shareholders during insolvency, or potential insolvency, are qualified. This sits in line with the New Zealand approach.

²⁰⁵ The directors of this company were also its shareholders.

²⁰⁶ *Sojourner v Robb*, above n 188, at [103]-[105]. See also *Nicholson v Permakraft (New Zealand) Ltd (in liq)* above n 191, at 250.

²⁰⁷ *Sojourner v Robb*, above n 188, at [102] and [105].

²⁰⁸ Section 301(1)(c).

²⁰⁹ *Mason v Lewis*, above n 194, at [109]-[110].

became evident (The ‘breach’ date), and the date of liquidation. Once that figure has been ascertained, New Zealand courts have seen three factors — causation, culpability, and the duration of the trading — as being distinctively relevant to the exercise of the Court's discretion.

This award is of an equitable character.²¹⁰ The protection that incorporation provides to the company does not therefore shield an individual from s 301, and instead personal liability holds the individual responsible for their acts. Liability of directors for creditor losses when a company is insolvent provides access to company funds for compensation as well as deterring adverse risky behaviour.²¹¹

D Property (Relationships) Act 1976

1 Sections 44D-F

Sections 44D-F of the Property (Relationships) Act 1976 provide compensation where relationship property has been disposed of to a qualifying company to defeat the equal sharing regime of the Act.²¹² The power to order disclosure of information in s 44E and to order compensation in s 44F can only be exercised if the dispositions were made to a “qualifying company” in s 44D. The purpose of s 44F is very similar to s 44C. The requirements are the same except the disposition must have been made to a qualifying company not a trust.²¹³

A qualifying company requires the spouse or partner to hold either directly or indirectly, equity securities that carry at least 50 percent of the voting rights.²¹⁴ One person companies will likely qualify as there is usually a sole or majority shareholder. In *F v W*, the company did not qualify under s 44D as the husband did “not hold a

²¹⁰ At [118].

²¹¹ Anderson, above n 31, at 35.

²¹² Property (Relationships) Act 1976, ss 44D-F.

²¹³ Section 44F. The requirements are a disposition of relationship property by either or both spouses or partners, to a qualifying company, since the relationship began, which has the effect of defeating the rights of one of the parties and to which s 44 does not apply. Section 44F was introduced along with s 44C to provide compensatory relief for situations falling outside of s 44.

²¹⁴ Securities Act 1978, s 2 defines “equity security” as any interest in or right to a share in, or in the share capital of, a company; and includes –

(a) a preference share, and company stock; and

(b) a security that is declared by regulations to be an equity security for the purposes of this Act; and

(c) a renewal or variation of the terms or conditions of any such interest or right or a security referred to in paragraph (a) or paragraph (b);–

but does not include any such interest or right or a security referred to in paragraph (a) or paragraph (c) that is declared by regulations not to be an equity security for the purposes of this Act.

controlling or beneficial interest in the company as required by the Act”.²¹⁵ Section 44F looks to have the same narrow scope and limited sources of compensation that restricts s 44C which means that often it does not apply even though, but for the disposition the assets it would have been classified as relationship property.²¹⁶

If however a disposition can be proved, the court has the discretion whether to make an order for compensation. The order can be a transfer of relationship or separate property, or a sum of money out of relationship or separate property.²¹⁷ This essentially ignores the company’s separate legal personality to provide assets or a monetary payment for the spouse.

E Fair Trading Act 1986

1 Section 9

If a company is facing financial difficulty, it is common for creditors to seek reassurance from the company director that the company is stable enough to repay its debts when due.²¹⁸ However, a director may mislead the creditors as to the company’s financial position. If the company later fails, then the director who made the false statement may be held personally liable for the creditor’s loss under s 9.²¹⁹ Incorporation therefore does not protect directors, regardless of whether the statement was made on behalf of the company.

In *Hill Country Beef NZ Ltd v Sharplin*, Sharplin was a shareholder and director of a butchery company that was supplied large quantities of meat by Hill Country.²²⁰ The butchery company was unable to pay for the meat, but Sharplin assured Hill Country that its financial position was improving and that the debts would be repaid. The butchery company went into liquidation and Hill Country sued Sharplin under s 9 of the Fair Trading Act for misleading conduct. Gallen J held Sharplin liable as he gave

²¹⁵ *F v W* CIV-2009-485-000531 at [63].

²¹⁶ See Sean Conway "What's Mine Is Yours, Or Is It? Accessing Spousal Trusts for the Purposes of the Property (Relationships) Act 1976" (LLB (Hons) Dissertation, University of Otago, 2012) Chapter Two for an analysis on why s 44C is failing to achieve a just division of assets in spousal trusts.

²¹⁷ Section 44F, in contrast to s 44C, does not give the court power to divert income from the company so the company is not affected by orders under s 44F.

²¹⁸ Watson and Noonan, above n 167.

²¹⁹ Fair Trading Act, s 9.

²²⁰ *Hill Country Beef NZ Ltd v Sharplin* 18 March 1996, Napier High Court, Gallen J.

personal assurance as to the butchery company's financial state when there were no reasonable grounds to support the statements.²²¹

F Conclusion

Parliament has chosen to legislate in specific areas to prevent abuse of the corporate form. The examples of the three legislative Acts outlined in this chapter demonstrate how the courts are able to circumvent the corporate veil, not by piercing it, but by employing statutory remedies to impose liability on a company's controllers. It is therefore submitted that a black letter principle exists that once a company is incorporated, its directors owe duties and obligations to the company and beyond.²²² Most of these remedies adequately respond to mismanagement abuse where directors have traded recklessly or breached their duties to the company. However, there is a gap in the law to provide assistance where assets are hidden in the corporate form to evade an existing legal obligation, independent of the company. Sections 44D-F of the Property (Relationships) Act 1976 are an example of a remedy to allow a spouse to retrieve relationship property from a qualifying company, though this is where Parliament intervention ceases. Chapter Four will address this gap in the law by looking to the laws of attribution and trusts as alternative responses.

²²¹ At 15. See also Income Tax Act 2007 for another example of a statutory remedy. Under s HD 15 the Commissioner is able to recover the income tax, GST, penalties and UOMI liabilities of a company from its directors and shareholders, circumventing the veil of incorporation, treating directors and shareholders as mere agents of their company. See David Weaver "Directors & Shareholders Liability for Company Tax Debts" (23 October 2009) <<http://www.nsatax.co.nz/Knowledge+Centre/White+papers++articles/Articles/Directors++Shareholders+Liability.html>>.

²²² The same can be argued that natural persons have limited liability, as they are only liable to the extent that their assets will cover.

CHAPTER FOUR: OTHER PRINCIPLES IN LIGHT OF *PREST V PETRODEL RESOURCES LTD*

A Introduction

Chapter Three discussed statutory provisions that respond to the practice of company mismanagement, however it highlighted the gap in the law to provide assistance where assets are hidden in the corporate form. This chapter analyses the possible alternatives to deal with this gap by looking to the laws of attribution and trusts. In light of *Prest*, these principles seem the most effective remedies to retrieve assets held by companies, without sacrificing certainty. In Chapter Two, attribution of fraud was raised as an example of when the doctrine of piercing the corporate veil could be invoked. It was submitted that even though attribution of fraud in *Moore Stephens* did not fit within Lord Sumption's evasion principle, it is an exception to the threshold and thus an example of pure piercing. Trust law is important as it formed the basis for disregarding the separate legal personality of the companies in *Prest*. The equitable nature and benefit oriented analysis provides a remedy with validity and certainty. Furthermore, future cases are likely to involve corporate vehicles holding assets in trusts.

This chapter will also explore the application of the doctrine and its future in New Zealand. It is submitted that the doctrine should be reconceptualised as a backstop common law remedy to apply in limited circumstances.

B Agency/Attribution

The New Zealand Companies Act 1993 sets out principles to determine how the acts and knowledge of participants in the company affect the legal position of that company.²²³ Lord Hoffman in *Meridian Global Funds Management Asia Ltd v Securities Commission* analysed the principles governing the attribution of conduct and states of mind to companies.²²⁴ His Lordship set out three main "rules of

²²³ John Farrar and Lyn Taylor *Company and Securities Law in New Zealand* (Thompson & Brookers, Wellington, 2008) at 100. Section 18 is the main section dealing with attribution.

²²⁴ *Meridian Global Funds Management Asia Ltd v Securities Commission* [1995] UKPC 5.

attribution”²²⁵ but for the purpose of this dissertation only the general rules of attribution concern us, which are the principles of agency in the Companies Act.²²⁶ Generally speaking, if an agent acts for the company in the course of their employment,²²⁷ with actual or apparent authority,²²⁸ then those acts are attributed to the company. The company therefore, not the agent, is liable for the acts.²²⁹ This safeguard ensures that agents are not held personally liable for the company’s contracts, but third parties can still attribute that liability back to the company. However, if the agent acts outside the scope of their authority, the agent will be personally liable.²³⁰ An exception to this is when the company has in some way misled a third party into thinking that the agent has authority to act in this way.²³¹

The laws of attribution were considered in Chapter Two in the case of *Moore Stephens*. Although a company is a separate legal person, its status as an artificial person means it is capable of acting and knowing only if the acts or knowledge of human beings are attributed to it.²³² While *Moore Stephens* showed that in a one person company, knowledge of fraud could be attributed to the company, one of the main concerns is that there is uncertainty as to how far the definition of a one person company extends.

1 Attribution in a “one person company”

Lords Walker and Phillips in *Moore Stephens* accepted that a one person company could have more than one fraudster or shareholder involved. Lord Walker adopted the

²²⁵ At 506. The three categories were primary rules of attribution, general rules of attribution and special rules of attribution. See 506 for a description of these rules.

²²⁶ Section 18.

²²⁷ See *Lister v Hesley Hall Ltd* [2001] 2 All ER 769 and *Dubai Aluminium Co Ltd v Salaam* [2003] 1 BCLC 32. The ordinary course of employment has an extended scope for these purposes to include acts so closely connected with the acts the employee was authorised to do, that the acts can be said to be done in the ordinary course of business.

²²⁸ See *Kelly v Fraser* [2012] UKPC 25 at [12]-[15]. The Privy Council revisited the issue of whether an agent can be said to have ostensible authority on the basis of his own representations. The court supported the reasoning in *First Energy (UK) Ltd v Hungarian International Bank Ltd* [1993] BCLC 1409 CA and held the secretary has ostensible authority “by virtue of his functions” to communicate what the board has decided. This development was important as the board of directors or other senior management cannot always communicate directly with third parties, at [13], so an agent has the authority to pass on information. However the false representation of authority by an agent as in *Armagas Ltd v Mundogas SA* [1986] 2 All ER 385 will not be accepted.

²²⁹ *Montgomerie v United Kingdom Mutual Steamship Association Ltd* [2001] 1 QB 370 at 371.

²³⁰ Davies *Introduction to Company Law*, above n 134, at 28.

²³¹ At [28]. When a company is liable for the wrongful acts of its agent or employee, a distinction must be drawn as to whether the company faces vicarious or primary liability to the third party for the acts. See also the issue of self-authorising agents.

²³² Davies, above n 134, at 33.

reasoning of Hobhouse J in *Berg*,²³³ which is consistent with Lord Phillips' defining a one person company as cases "where shareholders together run the company".²³⁴ It is submitted that this is the correct approach.

This interpretation is also consistent with case law in the United States, where courts have held that there is a "sole actor exception" to the "adverse interest rule".²³⁵ While the United States and English law concepts are not transposable, the United States approach is more developed and therefore must be considered.²³⁶ In the leading case of *The Mediators Inc v Manney*, the court applied the sole actor exception where an agent who had committed fraud was also the shareholder and president of the corporation.²³⁷ The court stated:²³⁸

[T]he adverse interest exception does not apply to cases in which the principal is a corporation and the agent is its sole shareholder... where the *principal and agent are one and the same*, the adverse interest exception is itself subject to an exception styled the "sole actor" rule. This rule imputes the agent's knowledge to the principal notwithstanding the agent's self-dealing because the party that should have been informed was the agent itself albeit in its capacity as principal. Where, as here, a sole shareholder is alleged to have stripped the corporation of assets, the adverse interest exception to the presumption of knowledge cannot apply.

In *Official Committee of Unsecured Creditors v R F Lafferty & Co Inc*, the key phrase, principle and agent are one and the same, was used to justify the extension of the sole actor exception to a whole family.²³⁹ Two companies, Walnut and its wholly owned subsidiary ELCOA, were being run as a ponzi scheme. The Shapiro family owned and operated both companies with the assistance of other defendants. Walnut began experiencing financial difficulties and was unable to raise sufficient capital through selling debt securities. The Shapiro family organised to sell debt securities

²³³ *Berg*, above n 22. See also Chapter One.

²³⁴ *Moore Stephens*, above n 82, at [64].

²³⁵ Amelia Rudolph and Elizabeth Tanis "'Invoking *In Pari Delicto* to Bar Account Liability Actions Brought by Trustees and Receivers'" (2008) ALI-ABA Study Materials IV.C.3 for a list of cases that have accepted this rule. See also *In Re Mediators*, 105 F 3d 822 (2d Cir 1997) at 827.

²³⁶ Lord Walker in *Moore Stephens*, above n 82, at [162] warns that the United States cases should be treated with caution. However for the purposes of this dissertation, they are useful for a strict approach to the meaning of a one person company.

²³⁷ *The Mediators Inc v Manney* 105 F 3d 822 (2d Cir 1997).

²³⁸ At 827 [emphasis added].

²³⁹ *Official Committee of Unsecured Creditors v R F Lafferty & Co Inc* 267 F 3d 340 (2001) ["*Lafferty*"].

through ELCOA instead, so it looked like a new independent company, with a clean financial record. Multiple investors purchased these debt securities, but eventually the scheme collapsed and the companies went into bankruptcy. The court held that the sole actor exception clearly applied as the Shapiro family was the sole representatives in the alleged fraud.²⁴⁰ Even though it involved a family rather than just one actor, their knowledge was still imputed to the corporations because the principal and agent are one and the same”.²⁴¹

In *In re Nat'l Century Fin. Enters., Inc* the court also held that the sole actor exception applied to multiple fraudulent actors, who were not family members, but who had worked in concert in order to orchestrate their fraudulent scheme.²⁴² The sole actor exception has been expanded over time and as a result the doctrine now includes wrongdoings by agents who exercised “complete control” or domination over the corporation.²⁴³ Therefore, the exception can now apply when there are multiple participants who are engaged in the fraud.²⁴⁴ In light of Hobhouse J’s statement in *Berg*, it is likely that the courts in New Zealand and the United Kingdom will adopt a similar approach to the one person company as the United States. Where there are multiple actors working together, there is “no individual concerned in its management and ownership other than those who are... aware of the fraud”.²⁴⁵ Whether the presence of innocent shareholders or directors affects that approach will now be addressed.

2 *Innocent constituents*

The issue is whether knowledge or conduct can still be attributed where there are multiple controllers of the company, or where not all of the controllers have knowledge of the fraudulent conduct. This is relevant to attribution in a one person company. Secondly the definition extends wider than having only one person involved. The House of Lords in *Moore Stephens* never addressed the effect that

²⁴⁰ At 360. See also *Vail Nat'l Bank v Finkelman* 800 P 2d 1342 (CCA 1990) at 1345.

²⁴¹ *In Re Mediators*, 105 F 3d 822 (2s Cir 1997) above n 235, at 827.

²⁴² *In re Nat'l Century Fin. Enters., Inc*. No. 2.03-md-1565, 2011 WL 1397813 (SD Ohio April 12 2011) at [13]-[14].

²⁴³ *Nisselson v Lernout* 469 F 3d 143 (1st Cir 2006).

²⁴⁴ See *Lafferty*, above n 239.

²⁴⁵ *Berg*, above n 22, at [161].

innocent constituents will have on the outcome.²⁴⁶ In the United States however, the court have considered what effect “innocent decision makers” have on the application of their adverse interest doctrine.²⁴⁷ In *In re CBI Holding Co., Inc.* the court argued that it would be unfair to punish non-culpable shareholders where only some of the actors had been guilty of misconduct.²⁴⁸ Had the innocent members been informed, they would have stopped the corporate agents’ wrongdoing. This represents a separation between the principal and agent and therefore knowledge will not be imputed. However, there is real uncertainty as only some courts have accepted the sole actor exception. The Supreme Court of Nevada recently discussed the effect that innocent decision makers should have on the exception.²⁴⁹ The court stated that:²⁵⁰

[B]ecause the sole-actor rule operates to impute conduct otherwise subject to the adverse interest exception when *the corporation and its agent are indistinguishable from each other*, we conclude that the presence of innocent decision-makers is only relevant to assess whether there is indeed a sole actor. If some corporate decision-makers are unaware of wrongdoing then there exists no unity between the agent and the corporation such that the agent’s complete adversity will impute to the corporation.

The existence of innocent decision makers therefore appears to be irrelevant in most courts. For example in *Lafferty* the court thought that the possible existence of any innocent decision makers would not alter the fact that the Shapiro’s controlled and dominated the debtors.²⁵¹ This irrelevance is based on a decision made 20 years ago in the Colorado Court of Appeal where the court stated that the exception could apply to cases in which the agent “dominated” the corporation.²⁵²

Elder suggests the answer to this uncertainty is to distinguish between innocent shareholders and innocent directors.²⁵³ The same distinction between ownership and control has been the basis for piercing the corporate veil. When all the shareholders

²⁴⁶ David Halpern "Stone and Rolls v Moore Stephens: An Unnecessary Tangle" (2010) 73(2) Manitoba Law Journal 487 at 488. Halpern’s opinion is that it is “tantalizing” that the situation where even one innocent shareholder was not addressed.

²⁴⁷ The term “innocent decision makers” can refer to the presence of either innocent shareholders or innocent directors.

²⁴⁸ *In re CBI Holding Co., Inc.* 311 BR 350 (SDNY 2004).

²⁴⁹ *In re Amerco Derivative Litig.* No. 51629 2011 WL 1836807 (Nev 12 May 2011).

²⁵⁰ At 20.

²⁵¹ *Lafferty*, above n 239, at 360.

²⁵² See *Vail Nat’l Bank v Finkelman*, above n 240.

²⁵³ Elder, above n 142, at 41. Elder notes that there is the possibility that the decision maker is both a shareholder and director.

are involved in carrying out the fraud, then it is clear that their conduct and knowledge should be attributed to the company, and the presence of an innocent director is irrelevant.²⁵⁴ It is suggested that the shareholders would have only used the corporate vehicle to try and limit their personal liability. Thus it is hard to see how the attribution of knowledge or conduct is unfair, as “the corporation and its agent are indistinguishable from each other”.²⁵⁵

In contrast, when the directors have been fraudulent but there is an innocent shareholder, the approach becomes unsettled. The question becomes “should this innocent shareholder be expected to bear the loss that would result if the directors’ fraudulent intentions were attributed to the company?”²⁵⁶ Provided the shareholder is an active²⁵⁷ shareholder, Elder submits that it would be unfair to punish a non-culpable shareholder for the management’s misconduct.²⁵⁸ This view is reflected in *Hampshire Land* where the court refused to attribute fraudulent conduct where there were innocent shareholders involved in the operation of the company.²⁵⁹

The approach that courts in New Zealand and the United Kingdom will take is not certain. It is reasonable however, to assume that a company with all its directors and active shareholders involved in the fraud can be classified as a one person company. Furthermore, the presence of “dummy” directors or shareholders will not affect a one person company.²⁶⁰ This is, however, likely to be where the court will stop as they are unlikely to find that a company is still a one person company where innocent shareholders are involved.²⁶¹

²⁵⁴ The attribution of fraud to the company may cause damage to the company, for example decreasing the value of the shares, however since the shareholders are responsible for the fraudulent acts they should bear the costs. See *In re Amerco Derivative Litig.* No. 51629 2011 WL 1836807 (Nev 12 May 2011), above n 249, at 20, “the corporation and its agent are indistinguishable from each other”.

²⁵⁵ At 20.

²⁵⁶ Elder, above n 142, at 42.

²⁵⁷ Compared to a “dummy”, see above n 21.

²⁵⁸ Elder, above n 142, at 42. See also *Re Hampshire Land Co (No 2)*, above n 142, where the court refused to attribute fraudulent conduct due to the presence of an innocent shareholder, and Lord Scott in *Moore Stephens*, above n 82, where he stated that the company is a victim of the directors’ abuse.

²⁵⁹ *Re Hampshire Land Co (No 2)*, above n 142.

²⁶⁰ See *Royal Brunei Airlines v Tan* [1995] 2 AC 378 at 393. Mrs Tan was a director and shareholder of her husband’s company, but Mr Tan had control over the company’s every act and “was the company”, therefore Mrs Tan would be a “dummy” director/shareholder.

²⁶¹ Nicholas Davidson “A Sideways look at Stone & Rolls” (2010) 26(2) PN 66 at 80.

C Trust laws

In light of *Prest*, careful attention must be given to trust law principles. The Supreme Court provided some limited guidance for future cases in the context of resulting trusts. Lord Sumption noted that it is highly fact specific to decide whether assets vested in a company are beneficially owned by its controller.²⁶² However, the presumption of a resulting trust will be the starting point in cases where property has been transferred or purchased in the name of the other party.²⁶³ This presumption has been confirmed to apply even where the property has been transferred gratuitously for nominal consideration. The court did however leave a number of uncertainties such as what the relevance of the concept of “wealth protection and taxation” is, which will likely be addressed in future cases.²⁶⁴

Oh argues that veil piercing is an “equitable remedy... [and] what started as a means for corporate creditors to reach into the personal assets of a shareholder has devolved into a doctrinal black hole”.²⁶⁵ To fix the problem with the law, he proposes re-conceiving veil piercing based on the law of restitution and more specifically the constructive trust. The constructive trust can be imposed in the presence of fraud, concealment, misrepresentation and undue influence, where the burden is on the party seeking to have the trust imposed to show that it would be inequitable for the other party to retain the property.²⁶⁶ It shifts the focus from determining whether a party is liable, to whether the party should retain benefit derived from a misappropriated asset.²⁶⁷ That party becomes a constructive trustee upon retention constituting unjust enrichment. Cheng agrees, highlighting the prevention of unjust enrichment as the “most apposite principal objective of the corporate veil doctrine”.²⁶⁸ Unlike veil piercing’s implicit deterrence regime which sets out a list of amorphous principles, the “unjust” benefit oriented analysis under the constructive trust provides certainty and validity.²⁶⁹ If the party cannot provide a valid reason for their unjust enrichment of the asset, this is “a reason for restitution which is not a manifestation of consent

²⁶² *Prest*, above n 2, at [52].

²⁶³ Daniel Lightman and Emma Hargreaves “Petrodel Resources Ltd v Prest: where are we now?” (2013) *Trusts & Trustees* at 5.

²⁶⁴ At 6.

²⁶⁵ Peter B Oh “Veil-Piercing Unbound” (2013) 93 *B U L Rev* 89 at 89.

²⁶⁶ At 126.

²⁶⁷ At 129.

²⁶⁸ Cheng, above n 60, at 540.

²⁶⁹ Peter Birks *An Introduction to the Law of Restitution* (Oxford University Press, New York, 1985) at 18-19.

and not a wrong”.²⁷⁰ The constructive trust is therefore another way of preventing the misappropriation of an asset into a company, as it achieves what veil piercing is supposed to.

Resulting and constructive trusts are equitable remedies that efficiently restore rights in property to their original owner.²⁷¹ However they are not the only examples. There is a selection of other trusts the courts can impose. While there is an inherent difficulty importing equitable principles into the context of commercial law, which occurs when trusts are used in commerce, upholding commercial certainty should not be understood as merely upholding structures, especially if they appear suspicious and provoke ill trust.²⁷² If a company holds assets on trust for an individual, traditional trust law principles should be applied if an obligation is being evaded through the use of the company-trust structure.

D The future of piercing the corporate veil in New Zealand

1 Application of the doctrine after Prest v Petrodel Resources Ltd

The comments of the Supreme Court in *Prest* have not gone unnoticed.²⁷³ While the ink of the judgment is still drying, the Court of Appeal has already confirmed it as a starting point in *Antonio Gramsci* and *R v Sale*. Beatson LJ in *Antonio Gramsci* set out the evasion principle and stated:²⁷⁴

As to further development of the law, doing so by classical common law techniques may not be easy... Absent a principle, further development of the law will be difficult for the courts because development of common law and equity is incremental and often by analogical reasoning.

The Supreme Court in *Prest* should have indicated how later courts should approach further development. This need for clarification falls against the backdrop of the differences between their Lordships in how they narrowed the doctrine. The lack of a

²⁷⁰ Peter Birks *Unjust Enrichment* (2nd ed, Oxford University Press, USA, 2005) at 13.

²⁷¹ Peter Birks "Restitution and Resulting Trusts" in S Goldstein (ed) *Equity and Contemporary Legal Developments* (Jerusalem, 1992) at 363-364.

²⁷² *Westdeutsche Landesbank Girozentrale v Islington London Borough Council* [1996] AC 669.

²⁷³ Lightman and Hargreaves, above n 263, at 3.

²⁷⁴ *Antonio Gramsci*, above n 128, at [65]-[66].

single principle makes it harder to apply²⁷⁵ and unless a case clearly falls within the evasion principle, a claimant seeking to pierce the corporate veil must be prepared to pay for the cost and uncertainty of litigating up to the Supreme Court.²⁷⁶ It is likely, however, that claimants with skilful lawyers will continue seeking to extend the doctrine where all else fails.²⁷⁷

Some of this uncertainty changed when the criminal court handed down its judgment in *R v Sale* which confirmed the application of piercing the corporate veil in *Prest* equally to criminal confiscation order cases.²⁷⁸ Mr Sale was the sole shareholder of a contracting company. He used that company to bribe an employee of a customer. Sale pleaded guilty and was sentenced, however confiscation orders against him claimed that Sale had benefitted from the crime.²⁷⁹ The issue was whether the benefit should be linked to the company's turnover or gross profit. Treacy LJ pierced the corporate veil on somewhat controversial grounds, treating Mr Sale as the beneficiary.²⁸⁰ The case did not meet the evasion threshold as no legal obligation was being frustrated, but the Judge treated the concealment principle as an independent basis for piercing the veil, finding "what the company did served to hide what the shareholder was doing".²⁸¹ This conflicts with Lord Sumption's conception that evasion cases are the only true instances of veil piercing,²⁸² and he would likely criticise the Court of Appeal for not providing substantive reasons for piercing under the concealment principle.

2 *The doctrine reconceptualised as a backstop common law remedy*

The Supreme Court in *Prest* confirmed that piercing the veil has scope in the company law framework, but is unlikely to define those limits until an appropriate case is litigated. In particular, the "recognition of a limited power to pierce the corporate veil in carefully defined circumstances is necessary if the law is not to be

²⁷⁵ There is the potential for debate about the extent to which this doctrine will be formally binding in later courts given that the comments were all obiter.

²⁷⁶ Rod Cowper and Michael Dockterman "US and UK courts are teasing the corporate veil" above n 129.

²⁷⁷ Lightman and Hargreaves, above n 263, at 3.

²⁷⁸ *R v Sale*, above n 128, at [20].

²⁷⁹ See Proceeds of Crime Act 2002, s 76. It provides that a person benefits from conduct if he obtains property or a pecuniary advantage as a result of or in connection with the conduct.

²⁸⁰ Note the Supreme Court handed down the judgment in *Prest* after this case, however the Court of Appeal in *R v Sale* had the benefit of Lord Sumption's formulation.

²⁸¹ *R v Sale*, above n 128, at [41].

²⁸² See *Prest*, above n 2, at [28].

disarmed in the face of abuse”.²⁸³ The New Zealand Parliament had an opportunity to review the corporate veil doctrine when passing the Companies Amendment Act 2006, however they chose to ignore it completely.²⁸⁴ This suggests that Parliament is not willing to put the doctrine on a statutory footing in the near future, and that legislation will only be created for specific exceptions such as the Property (Relationships) Act 1976. Securing the doctrine in statute would be the best reform.²⁸⁵ However, however given Parliament’s lack of response, it seems unlikely.

The doctrine should therefore take the form of a “backstop common law remedy” and remain in the judicial legal armoury until its battle is ready to be fought.²⁸⁶ This was the approach taken by the Court of Appeal when dealing with the prime necessity doctrine, and it is submitted that the piercing doctrine should be given the same treatment. The phrase “a bygone age where legislation had a limited role” illustrates the judicial narrowing of the doctrine seen in Chapters One and Two.²⁸⁷ After *Salomon*, the doctrine was an important remedy to access the shareholders of a company where individual liability was not enforced on participants. There were no other ways to hold the shareholders liable. In today’s context, statutory, common law and equitable remedies provide the courts with other techniques, and while not exhaustive, they have increased the threshold of what the law expects from a company and its controllers.

²⁸³ At [27].

²⁸⁴ Companies Amendment Act 2006.

²⁸⁵ Other options for reform have included adopting a Closely-Held Companies Act see Matthew Farrington "A Closely-Held Companies Act for New Zealand" (2007) 38 VUWLR 543; Developing a “genuine ultimate purpose” test see Marc Moore "A Temple Built on Faulty Foundations: Piercing the Corporate Veil and the Legacy of *Salomon v Salomon*" (2006) JBL 180; Ignoring the doctrine see *Prest*, above n 2, at [79].

²⁸⁶ See *Vector Ltd v Transpower NZ Ltd* [1999] 3 NZLR 646 at [51]. The prime necessity doctrine was given the same treatment by the Court of Appeal in this case, “The doctrine is a somewhat blunt instrument. It speaks of a bygone age where legislation had a limited role. It gives no guidance as to how the doctrine is to operate to fix prices in the complex environment of a modern economy and extensive legislative landscape. *It is perhaps best viewed as a backstop common law remedy applied in the absence of other remedies and where there are no contra-indications to its use.*” [emphasis added]. See also Rex Ahdar "Battles in New Zealand's Deregulated Telecommunications Industry" (1995) 23(2) ABLR 77.

²⁸⁷ At [51]. See Chapter One for an overview of the case law and Chapter Two for a critical analysis of *Prest*.

3 *Application to Official Assignee v 15 Insoll Avenue Ltd*

Returning to the New Zealand case of *Official Assignee*, this case is an example of piercing through the evasion principle.²⁸⁸ Mr Russell interposed the company to evade his previous fraud and forgery convictions. The property he purchased through the company was hidden in the corporate form and upon being declared bankrupt, the property looked to be protected by incorporation. This case can also be argued under the exception of attribution of fraud. Mr Russell is similar to Mr Stojevic in *Moore Stephens*. Mr Russell's fraudulent behaviour would be attributed to the company therefore piercing the veil of incorporation. New Zealand courts should use this case as a reference when deciding whether or not to pierce the corporate veil.

E Conclusion

The law has shifted from the fixation on piercing as seen in Chapters One and Two, to the illusory incorporation that companies provide in Chapters Three and Four. The examples in Chapters Three and Four show courts circumventing the corporate veil, not by piercing it, but by employing statutory and equitable remedies. Participant liability acknowledges that incorporation is an entirely legitimate operation of company law, and that companies and their controllers are only liable through the retrospective application of the remedies.

The future of the doctrine in New Zealand is as a backstop common law remedy. New Zealand courts since Lord Denning's golden age have been cautious with their application of the doctrine, and it seems that the availability of alternative, more conventional remedies, provides the basis for ignoring the separate legal personality of companies. If the court is still uncertain about the doctrine's scope, *Official Assignee* should be used as a reference point.

²⁸⁸ See Chapter One for the case facts.

CONCLUSION

This dissertation set out to examine the abuse of one person companies and the mechanisms to deal with such abuse. The doctrine of piercing the corporate veil was analysed in light of *Prest* to determine when it can be invoked and the proposition made that a test that limits the scope of the doctrine is desirable, given the importance of certainty in the commercial context.

It has been argued that two elements must be met for the corporate veil to be pierced. Firstly, no other more conventional remedies must apply. Secondly, a company must be interposed to evade or frustrate a legal obligation that exists independently of the company. Further it has been submitted that the only exception to the evasion threshold is the laws of attribution of fraud. The court in *Prest* has narrowed the doctrine's scope. In addition it is clear that the corporate veil is not as thick as once thought and that a palate of statutory, common law and equitable remedies can impose liability on companies and their controllers.

Veil piercing has been labelled as “Our Lady of the Common Law”,²⁸⁹ while Oh has offered a more graphic description of its transition in stating that:²⁹⁰

Over the years... she [the corporate veil] has been dragged through the mud and pilloried, withstanding attempts at expulsion from corporate law... and all the while the culprit has stood in our midst.

The law, until now, has taken a myopic view of the protection incorporation provides. While *Prest* is important for reconceptualising the veil, it canvasses the array of remedies that apply before the corporate veil doctrine can be invoked. It is the movement away from the fixation on piercing the veil to these other remedies that New Zealand law must follow to restore the certainty and integrity in the doctrine as a remedy of last resort.

²⁸⁹ Maurice Wormser *Disregard of the Corporate Fiction and Allied Corporation Problems* (Baker, Voorhis & Co, New York, 1927) at 40.

²⁹⁰ Oh, above n 265, at 136. See also Michael, above n 77, at 42.

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APPENDIX 1

A Companies Act 1993

131 Duty of directors to act in good faith and in best interests of company

(1) Subject to this section, a director of a company, when exercising powers or performing duties, must act in good faith and in what the director believes to be the best interests of the company.

(2) A director of a company that is a wholly-owned subsidiary may, when exercising powers or performing duties as a director, if expressly permitted to do so by the constitution of the company, act in a manner which he or she believes is in the best interests of that company's holding company even though it may not be in the best interests of the company.

(3) A director of a company that is a subsidiary (but not a wholly-owned subsidiary) may, when exercising powers or performing duties as a director, if expressly permitted to do so by the constitution of the company and with the prior agreement of the shareholders (other than its holding company), act in a manner which he or she believes is in the best interests of that company's holding company even though it may not be in the best interests of the company.

(4) A director of a company that is carrying out a joint venture between the shareholders may, when exercising powers or performing duties as a director in connection with the carrying out of the joint venture, if expressly permitted to do so by the constitution of the company, act in a manner which he or she believes is in the best interests of a shareholder or shareholders, even though it may not be in the best interests of the company.

135 Reckless trading

A director of a company must not—

(a) agree to the business of the company being carried on in a manner likely to create a substantial risk of serious loss to the company's creditors; or

(b) cause or allow the business of the company to be carried on in a manner likely to create a substantial risk of serious loss to the company's creditors.

136 Duty in relation to obligations

A director of a company must not agree to the company incurring an obligation unless the director believes at that time on reasonable grounds that the company will be able to perform the obligation when it is required to do so.

301 Power of court to require persons to repay money or return property

(1) If, in the course of the liquidation of a company, it appears to the court that a person who has taken part in the formation or promotion of the company, or a past or present director, manager, administrator, liquidator, or receiver of the company, has misapplied, or retained, or become liable or accountable for, money or property of the company, or been guilty of negligence, default, or breach of duty or trust in relation to the company, the court may, on the application of the liquidator or a creditor or shareholder,—

(a) inquire into the conduct of the promoter, director, manager, administrator, liquidator, or receiver; and

(b) order that person—

(i) to repay or restore the money or property or any part of it with interest at a rate the court thinks just; or

- (ii) to contribute such sum to the assets of the company by way of compensation as the court thinks just; or
- (c) where the application is made by a creditor, order that person to pay or transfer the money or property or any part of it with interest at a rate the court thinks just to the creditor.

270 Liquidator may be required to elect whether to disclaim onerous property

If a person whose rights would be affected by the disclaimer of onerous property gives a liquidator notice in writing requiring the liquidator to elect, before the close of such date as is stated in the notice, not being a date that is less than 20 working days after the date on which the notice is received by the liquidator, whether to disclaim the onerous property, the liquidator is not entitled to disclaim the onerous property unless he or she does so before the close of that date.

271 Pooling of assets of related companies

(1) On the application of the liquidator, or a creditor or shareholder, the court, if satisfied that it is just and equitable to do so, may order that—

- (a) a company that is, or has been, related to the company in liquidation must pay to the liquidator the whole or part of any or all of the claims made in the liquidation:
- (b) where 2 or more related companies are in liquidation, the liquidations in respect of each company must proceed together as if they were 1 company to the extent that the court so orders and subject to such terms and conditions as the court may impose.

(2) The court may make such other order or give such directions to facilitate giving effect to an order under subsection (1) as it thinks fit.

B Property (Relationships) Act 1976

44D Definition of qualifying company

(1) In sections 44E and 44F, *qualifying company* means a company in which a controlling interest is held by, as the case requires,—

- (a) one of the spouses or partners; or
- (b) the estate of the deceased spouse or partner.

(2) For the purposes of this section, a person holds a controlling interest in a company if that person holds (whether directly or indirectly) equity securities in that company that carry in the aggregate 50% or more of the voting rights at a general meeting of the company.

(3) For the purposes of this section, a person holds equity securities in a company (*company A*) if—

- (a) that person is beneficially entitled to, or is beneficially entitled to an interest in, any equity securities in that company (whether or not the whole or any part of the legal ownership of the equity securities is vested in that person); or
- (b) that person holds a controlling interest in another company (*company B*) that holds equity securities in company A.

(4) For the purposes of subsections (2) and (3), *equity security* has the same meaning as in section 2 of the Securities Act 1978.

44E Court may require party to disclose information about dispositions of property to qualifying company

(1) In any proceedings for an order under section 25(1)(a), the court may make an order requiring a spouse or partner to disclose to the court such information as the court specifies relating to the disposition of relationship property by either or both spouses or partners to a qualifying company since the marriage or the civil union or the de facto relationship began.

(2) The court may make the order under this section on the application of either party to the proceedings or on its own initiative.

44F Compensation for property disposed of to qualifying company

(1) This section applies if the court is satisfied—

(a) that, since the marriage or the civil union or the de facto relationship began, either or both spouses or partners have disposed of relationship property to a qualifying company; and

(b) that the disposition has the effect of defeating the claim or rights of one of the spouses or partners; and

(c) that the disposition is not one to which section 44 applies.

(2) If this section applies, the court may make 1 or more of the following orders for the purpose of compensating the spouse or partner whose claim or rights under this Act have been defeated by the disposition:

(a) an order requiring one spouse or partner to pay to the other spouse or partner a sum of money, whether out of relationship property or separate property:

(b) an order requiring one spouse or partner to transfer to the other spouse or partner any property, whether the property is relationship property or separate property.

(3) The court may make 1 or more orders under subsection (2) if it considers it just to do so, having regard to—

(a) the value of the relationship property disposed of to the qualifying company:

(b) the value of the relationship property available for division:

(c) the date or dates on which relationship property was disposed of to the qualifying company:

(d) whether the company gave consideration for the property, and if so, the amount of the consideration:

(e) any other relevant matter.

C Fair Trading Act 1986

9 Misleading and deceptive conduct generally

No person shall, in trade, engage in conduct that is misleading or deceptive or is likely to mislead or deceive.