Company Law: Back to Basics – Piercing the Corporate Veil

[00:00:01.930] - Suzanne Kearney, Of Counsel

Welcome back to our Company Law: Back to Basics podcast series where we explore key principles of company law. I'm Suzanne Kearney, Of Counsel in the Corporate and M&A Department in Arthur Cox.

[00:00:13.030] - Tom Courtney, Partner

And I'm Tom Courtney, Partner in Arthur Cox.

[00:00:15.800] - Suzanne Kearney, Of Counsel

In this episode, we will be discussing the significance of a company having separate legal personality from its members and the circumstances in which such separate legal personality may be disregarded. In Ireland, a company is a separate legal entity. In other words, it is an independent legal person in its own right, with a legal identity separate and distinct from its members. Tom, it is this concept of separate legal identity or separate legal personality and its consequences which are the particular attraction of using a registered company to conduct business rather than other forms of unincorporated entity.

[00:00:50.330] - Tom Courtney, Partner

Yes, Suzanne, separate legal personality is possibly the key benefit of incorporation. This is because the risk, liability, obligations and duties associated with the business will rest with the company and not with the individual shareholders or members. The principle of separate legal personality was established in the 1897 House of Lords decision in Salomon and Salomon, where it was found that a company was a separate legal person with liabilities of its own and not merely an agent or a trustee for its members, or vice versa. Although a legal person, companies are sometimes described as being artificial or fictional persons. Although not technically correct, this is due to the very practical complication, which is that ultimately companies are only capable of acting, thinking, and making decisions through others, namely human persons. Separate legal personality goes hand in hand with another benefit of incorporation; limited liability. The clear distinction between actions of the company for which the company is responsible, and actions of its members or directors for which its members or directors are responsible, means that a limited company's liability is its own and is not passed on to its members or to anybody else.

[00:02:13.390] - Suzanne Kearney, Of Counsel

The benefits of incorporation, particularly separate legal personality, are not absolute, which leads us back to the title of this episode, "Piercing the corporate veil." So what does this actually mean? The principle of separate legal personality, where a company is a separate legal personality, distinct from its members or shareholders and directors, is sometimes referred to as the corporate veil. This term is often attributed to the decision in Saloman and Saloman which you mentioned, Tom, although the term 'corporate veil' was not actually used by the House of Lords in that case, the corporate veil essentially prevents third parties holding members accountable for the actions of the company. Piercing or lifting the corporate veil refers to the very rare circumstances where the court disregards the separate legal personality of the company and treats the actions or liabilities of the company as the actions or liabilities of those persons in control of the company. In essence, piercing the corporate veil involves a court overriding the principle of separate legal personality established in Salomon.

[00:03:15.510] - Tom Courtney, Partner

At the outset, it's very important to note that in practice it is extremely uncommon for courts to fix shareholders with the debts and liabilities of the company. Sometimes, on reading company law textbooks, one might be forgiven for thinking that disregarding separate legal personality is more common than it actually is in practice and that's because in practice, the golden rule is that a company is a separate legal person whose assets are its assets and whose debts are its debts and it's this golden rule which is rarely departed from.

[00:03:48.550] - Suzanne Kearney, Of Counsel

Tom, that's very true. In fact, so where is the event of a court piercing the corporate veil that an Irish case from last autumn where this occurred was reported on around the world? We will return to this case in a moment. One of the reasons for piercing the corporate veil is where the company's separate legal personality is being abused for the purposes of a wrongdoing. For example, where a company is formed for fraudulent or illegal purposes, or to avoid or evade existing legal obligations, such companies are often referred to as a sham or an alias by the courts. Even in Salomon the case, we have mentioned establishing the fundamental principle of separate legal personality, it was acknowledged that the principle applied where there was no fraud and no agency, and if the company was a real one and not a fiction or a myth. In the Irish case, Fyffes versus the DCC, the court cited with approval the principle that the courts will not permit the statutory privilege of incorporation to be used for fraudulent, illegal or improper purposes.

[00:04:46.020] - Tom Courtney, Partner

The current UK position on piercing corporate veil is as per the 2013 UK Supreme Court decision in Prest versus Petrodel. In Prest, it was argued that a number of properties were held by the respondent companies which were controlled by Mr. Prest, who was the defendant in matrimonial proceedings, the argument was that these were the property of Mr. Prest personally. However, the court found that Mr. Prest had no interest in, or was he entitled to, the property of the companies. The Supreme Court refused to pierce the corporate veil because they were not evading any legal obligations. It was held that the court may be justified in piercing the corporate veil only in very limited circumstances where a company's separate legal personality is being abused for the purpose of some relevant wrongdoing. Following Prest, commentators in the UK have remarked that the circumstances in which the courts are prepared to pierce the corporate veil are very limited. They're confined, in effect, to one where there's an abuse of the company's separate legal personality for the purposes of wrongdoing or evasion of legal duty, and two, where it is necessary to do so because there is no other available remedy.

[00:06:02.450] - Tom Courtney, Partner

I think this also typifies the approach of the courts here in Ireland.

[00:06:06.790] - Suzanne Kearney, Of Counsel

That's very true, Tom. The Irish courts are typically hesitant to disturb separate legal personality. The recent case which I mentioned earlier, Powers versus Greymountain, involved an Irish incorporated company, Greymountain, acting as an integral component into the success of a multi-million dollar international fraud. The company was used as an intermediary, giving customers of the fraudulent scheme the false impression that their funds were being invested with a regulated entity. The court found that the sole purpose of the company was as an instrument of fraud, concluding that the interest of justice required the court to pierce the corporate veil to find the shadow directors and nominee directors personally liable for the actions of the company.

[00:06:46.690] - Tom Courtney, Partner

This case makes very clear that there must exist fraud, illegality and the misuse of corporate form if the veil is to be pierced. What Greymountain did was act as a payment transmission service for payments made to the controllers of a multi-million dollar international fraud scheme. It lured customers into a false belief that the funds they invested were subject to EU regulation, when in actuality, the company channelled these funds directly out of the EU. However, no trades were ever executed in the names of the investors and their invested sums became irrecoverable upon closure of the trading website. The payment of these sums originally would not have been possible without the involvement of the company, Greymountain as the payment transmission service.

[00:07:35.540] - Suzanne Kearney, Of Counsel

Precisely, Tom. It's a perfect example of misuse of the corporate form, but also an illustration of how exceptional the circumstances must be in order for the court to disregard a separate legal personality. Hopefully, none of our listeners will encounter multi-million euro international fraud and in spite of the coverage of this case focusing on piercing the corporate veil, the practical takeaway from this judgement is in fact the finding that the nominee directors had breached their duty to acquire and maintain sufficient knowledge and understanding of the company's business to enable them properly to discharge their duties of directors, which in effect facilitated the longevity of the company's fraudulent operations. It is this aspect regarding director's duties which is in fact more noteworthy for company directors.

[00:08:20.830] - Tom Courtney, Partner

We should also note that where the controllers of a company have been guilty only of mismanagement rather than impropriety, it appears that the courts will not disregard the separate legal personality of the company. However, in this regard, there are some legislative provisions to protect creditors of companies from abuse of the corporate form, either through fraudulent or reckless trading but perhaps that's a discussion for another day.

[00:08:45.720] - Suzanne Kearney, Of Counsel

Another example of the Irish courts demonstrating a hands off approach in relation to interference with separate legal personality is in relation to the concept of a single economic entity. Tom, can you explain how the concept of separate legal personality applies in the context of a corporate group?

[00:09:02.590] - Tom Courtney, Partner

The concept of a company as a separate legal person distinct from its members also applies where its members are companies or other corporate entities within the same group. In a group structure, each company is a distinct legal person, regardless of its holding, subsidiary, or indeed sister companies and even where all companies are under the common ownership or control. The single economic entity approach argues that the separate legal personalities may be disregarded where the commercial and economic realities mean that the companies are managed as a single economic entity. This so called single economic entity approach never took root firmly in Ireland. Although it was taken in its time as evidence of a new exception to Salomon's case. It appears now that the courts will only apply it to determine who should be identified with the company when its separate legal personality is being disregarded in accordance with the Salomon principles. So we return to a necessity for fraud or serious wrongdoing to such an extent as to justify the interference.

[00:10:09.110] - Suzanne Kearney, Of Counsel

It is also worth noting that there are still circumstances in which a group company may be found liable for the actions or omissions of another company in the group without the need to pierce the corporate veil.

[00:10:20.150] - Tom Courtney, Partner

It's interesting that you mentioned that last point, Suzanne. In recent years, courts have taken an interesting approach to liability of parent and subsidiary companies. In two environmental law cases, the Vedanta decision and the Royal Dutch Shell decision, the courts indicated that there is a possibility to grant leave for the case to be heard in the jurisdiction of the parent company based upon the level of control and involvement demonstrated by the parent in the policies, procedures and operations of the subsidiary. It's important to note that this has been through the lens of precarious liability in tort actions and not on the basis of lifting the corporate veil. It's noteworthy that when such claims are heard by the Irish courts, the claim in negligence does not involve any veil lifting either, but is rather based on the relationship of proximity between the plaintiff and the tortfeaser, not as an employer or as a shareholder, but as a person who has placed himself by his own actions in such a relationship to the parent as to call upon himself the obligation to exercise care. This was certainly the approach of our own Supreme Court in Shinkwin versus Quin-Con Limited.

[00:11:37.000] - Suzanne Kearney, Of Counsel

And indeed the responsibility of a holding company for the operations of its subsidiaries in relation to environmental and human rights impacts throughout its value chains will soon be put on a statutory basis under the proposed EU Corporate Sustainability Due Diligence Directive. Again, this is separate from the concept of lifting or piercing the corporate veil.

[00:11:58.710] - Tom Courtney, Partner

Final thoughts? Conclusions well, the principle of separate legal personality is a fundamental principle of company law in Ireland. The courts will very rarely lift or pierce the veil so as to treat the company and its members as one and the same, or to impose liability on officers. Such circumstances are very much the exception and will only be considered in circumstances of fraud or other significant wrongdoing.

[00:12:25.370] - Suzanne Kearney, Of Counsel

That concludes today's episode. If you have any questions on anything we discussed today, or if there is any particular topic you would like to hear more about, please feel free to contact Tom or myself. We will be back with a new episode shortly, and in the meantime, thank you for listening and goodbye.