THE CONUNDRUM OF SALOMON v A SALOMON: A CRITICAL CASE COMMENT

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ABSTRACT

The 'rigid fabricate' of company law, Salomon v A Salomon& Co Ltd,[1]established a centennial-old fundamental, that is, the independent legalidentity of a corporate institution, out of which 'the juristic construct of contemporary business was yielded; and consequently the titular conception of corporate veil stands debatable and uncontested. This paper ventures to critically analyse the concerned case and fosters an appraisal of the rigid application of the principle derived from it. The paper discovers that such an application, may every so often spawn into effectuating detriment to the rights of parties who involve themselves with the corporate because its regulators may be employing the corporate framework as a façade to bolster misdemeanors and wrong doings. Lastly, t*he paper also probes into what persists an open question of whether the verdict in Salomon was an inescapable result of a rational progression in the evolution of the law, and if the significance accredited to it has gravitated to eclipse otherwise desirable stratagems.*

INTRODUCTION

The remarkableness of Salomon v A Salomon & Co Ltd,[2]from which much of the separate lawful personality doctrine emanates from, has two facets. The first of these studies the legal construct for which it is splendidly recognized; that is, that the judgement constituted,[3] elucidated, or settled,[4] the rudimentary principle that a certified company is a distinct legitimate entity, separate from its shareholders, and is to be dealt as any different

[1]Salomon v. A Salomon & Co Ltd., (1897) AC 22.
[2]*Id.*
[3]PAUL L DAVIES AND SARAH WORTHINGTON, GOWER AND DAVIES' PRINCIPLES OF MODERN COMPANY LAW 35(Sweet & Maxwell9th ed2012).
[4]PAUL REDMOND, CORPORATIONS AND FINANCIAL MARKETS LAW 174 (Thomson Reuters6th ed 2013).

autonomous person possessing its own rights and liabilities.[5]The second vitalfacet of Salomon is observed in its importance in the progression of company law. The judgement is extensively reckoned as a, if not the, landmark verdict in the advancementof corporate legislation and an inception of modern company law.Contrastingly, it has also been sketched as 'calamitous',[6] as 'a gloomy ending for the peak liberalism of Victorian England',[7]and as having been more lately 'uncrowned from the locus of the most paramount case in company law'.[8]The dominance of the 'separate legal entity' theory in its own entitlement is comprehensible enough, but the fact that the case eventually conjectured its imposing stature as a landmark case has made it onerous, and often, effectively impossible, to challenge its laid principle.

SALMON: A LANDMARK CASE?

The facts of the case are widely familiar with and need only be conciselyexpounded. [9]Salomon lead a boot manufacturing commerce as an exclusive trader. He established a company which was incorporated in accordance with the 1862 Act. The declared shareholders were Salomon, his wife and five children, each of whom,in the early stages,possessed one share, henceforthcomplying with the legislative requisite that a company must have at least a total of seven shareholders. Salomon and his two eldest sons were the pronounced directors. Thereafter, the freshly incorporated company acquired Salomon's business, and the purchase denomination was inclusive of the shares, a debenture, cash and the ejection of the debts of the concerned business. Post the purchase price was reimbursed by the company to Salomon, the process of issuance of shares occurred. Salomon held 20,001 shares and the rest of the 6 shares were owned by the other family members. Unfortunately, the company eventuated into insolvency soon after and consequently declared itself into liquidation. The prime issue that had to be tackled with by the court was whether Salomon could asserthimself as a secured creditor, much before the unsecured creditors, on account of the debenture procured by a floating charge that he possessed as a portion of the purchase cost of the sale of his business to the company. The liquidator, however on the other endin the interests of the unsecured creditors,claimed that Salomon's

[5]Salomon v. A Salomon & Co Ltd., (1897) AC 22.
[6]O Kahn-Freund, *Some Reflections on Company Law Reform*, 7 MODERN LAW REVIEW 54, 54 (1944).
[7]Rob McQueen, *Life Without Salomon*, 27 FEDERAL LAW REVIEW 181, 201 (1999).
[8]Clive M Schmitthoff, *Salomon in the Shadow*, JOURNAL OF BUSINESS LAW 305, 312 (1976).
[9]L S Sealy, *Modern Insolvency Laws and Mr Salomon*, 16 COMPANY AND SECURITIES LAW JOURNAL 176 (1998).

assertion under the debenture was false and sued Salomon individuallyso as to recuperate funds to remunerate the unsecured creditors.

A) Case Analysis and Interpretation

Vaughan Williams J, one of the Court of Appeal judges, proclaimed the shareholders other than Salomon as 'slender nominees of Salomon'. He was of a belief that no 'real' interest in the company was ever allotted to them or deliberated to be predisposed to them in the forthcoming.[10] Hence, he deemed the company as a 'mere fraud'. The business belonged to Salomon and he opted to appoint the company as his agent. Hence, from the said perspective the creditors of the company could have sued Salomon on the grounds that he was liable as a principal, or as an alternative, he was obligated to compensate the company as his agent. [11]The Court of Appeal furtheradvanced that inspite of the fact that there existed seven subscribers, in adherence with the legal necessities, six of them were mere relatives who were declared members exclusively with the intent of validating the seventh, Salomon himself, to conduct the business with limited liability. It was extrapolated that the seven members were not affiliated for a legitimatecause, but to accomplish an outcome not authorised or intended by the Act, and viewed the company as as an instrument to defraud and deceive creditors. However, the conclusionpostulated by the House of Lords,[12]on appeal, overturned the former decisions, andsubsequentlyexhibited a substantial switch in the attitude towards the case. The House of Lords judges[13] did not straightforwardly assessed the business morality of the parties or the purported intention behind the Act but restricted themselves to decoding the terms in the Act, opting for more of a literal approach in its statutory interpretation to evaluate whether the essentials of the Act were satisfied. Itadjudged that the prerequisites of incorporation had been met, and regardless of the fact that there existed only seven subscribers, they were a corporate institution 'competent forthwith' of utilizing the powers of an incorporated company. [14]

B) What can be deduced?

[10]Salomon v. A Salomon & Co Ltd., (1897) AC 22.
[11]*Id.*
[12]Salomon v. A Salomon & Co Ltd., (1897) AC 22.
[13]LORD COOKE OF THORNDON, TURNING POINTS OF THE COMMON LAW 8 (Sweet & Maxwell1997) .
[14]Salomon v. A Salomon & Co Ltd., (1897) AC 22.

The striking distinction in the viewpointsopted by both the courts firmly suggests that the stance taken by the House of Lords was not inescapable and inevitable. The literal approach opted by the House of Lords could very much be viewed as excessively legalistic and strict while disregarding the commercial aspect to it, with the implication of empowering a proprietor to employ a 'legal fiction' to deceive, or at the minimum vanquish, the lawfulcontentions of unsecured creditors. [15] However, the result of the verdict could also be viewed in lucrative and economic terms as fundamentally pragmatic. The Court of Appeal stance, while seemed to be rooting for a commercially realistic perspective with reference to the positioning of their creditors, might also have renderedsubstantial legal precariousness had it been permitted to stand. It would have demanded judges to determinefrom case to case whether incorporations were to be considered as legitimate, or dismissedas they were ' legal fictions' or fashioned to defraud creditors. Furthermore, courts would also have been conferred with the question of deciding in specific cases if or not shareholders were autonomous or mere 'dummies'.[16]

The crucial question is whether the mentioning of the term 'seven' or more 'associated persons' in the Actimplied that all seven individualsshall have the goal and intention to participate in a partnership or that they merely have to represent one true trader and six 'dummies'. [17]The founders of the company law legislation, in referring the term 'associated' implied a 'usual' common law partnership with unlimited personal liability. Therefore, it can be justly contended that the importance of the case was not infact its literal foundation of the legislation but the idea that the verdict warranted the one man company trading with limited liability. [18]

SALMON'S APPLICATION TO CORPORATE GROUPS AND TORT LIABILITIES

Incorporated corporate groups were comparatively uncommon in the 1890s and so it was by no means definite at the period of time that what became notable as the principle in Salomon would be employed to company groups as they are comprehended today. Nonetheless, it was not coherent when a subsidiary could be seen to be functioning as an agent for a parent company that

[15]Justice Paul Finn, *Opening Remarks*, 27 FEDERAL LAW REVIEW 173, 173 (1999).
[16]MICHAEL J WHINCOP, AN ECONOMIC AND JURISPRUDENTIAL GENEALOGY OF CORPORATE LAW51-2 (Ashgate, 2001).
[17]Salomon v. A Salomon & Co Ltd., (1897) AC 22.
[18]*Id.*

exertedfull power over that subsidiary's business. [19]The inquiry of whether a subsidiary performs as an agent of its holding company or some other company in its unit has conferred trouble ever since. Sometimes, the courts seem more braced to construe an agency or trust relation and look past the corporate veil, but in other instances the Salomon principle has transpired to conduct as an 'unyielding rock' on which 'complex contentions' turns out to be 'shipwrecked'. [20] One of the primary mentions to Salomon in the discourse of a holding company and subsidiary relationship was in *The Gramophone and Typewriter Ltd v Stanley* case. [21]In the concerned case, Walton J enforced the rule in Salomon and announced that the German company is an existent person and a distinct personality from the English company, and henceforth the outcome of the judgement, when seen through the lens of Salomon v Salomon, is that the German company is not a mere alias, or an agent for the English company, even though its shares belonged to the English company. [22] In Salomon itself, Lord Halsbury LC kept the prospect of a company to perform' as an agent for a shareholder' much open. [23] The consequence of employing a company to function as an agent of its holding company is to ascribe the functions, property or liabilities of that corporate institution to those who govern it. However, it does not necessitate the courts to pierce the corporate veil in the spirit of dismissing the separate legal personality of the company. [24]

Since the 1970s, the route opted by the English courts has viewed the Salomon rule as sacrosanct and so cardinal to the composition and construct of company law that to deviate from it would becloud the rudimentary differentiation between a company and its shareholders, and consequently effectuate substantial legal and commercial precariousness. Lord Sumption in Prest postulated that the corporate veil might only be pierced 'when an individual is under a persisting lawful duty or liability or susceptible to an existent legal limitation which he intentionally dodges or whose application he purposely thwarts by interjecting a company under his power'. [25]The restricted areas where the courts will pierce the corporate veil do not emerge to expand to cases wherein a holding company isolates the plausible or expected future tort liabilities of a group

[19]Apthorpe v. Peter Schoenhofen Brewing Co Ltd., (1899) 4 TC 41.
[20]Lord Templeman, *Company Law Lecture — Forty Years On*, 11 COMPANY LAWYER 10, 10 (1990).
[21]The Gramophone and Typewriter Ltd v. Stanley, (1908) 2 KB 89.
[22]*Id.*
[23]Salomon v. A Salomon & Co Ltd., (1897) AC 22.
[24]Prest v. Petrodel Resources Ltd., (2013) 2 AC 415.
[25]Prest v. Petrodel Resources Ltd., (2013) 2 AC 415.

within a subsidiary since it might be challenging to exhibit there was an existing lawful duty or obligation or liability that was intentionally eluded by insinuating a superintended company.

The issue posed by the enforcement of the Salomon principle to corporate groups is specifically severe where the creditors in consideration are tort creditors, since significant public policy concerns then elevate regarding who should sustain the losses generating from negligent or perilous behaviour. [26] This turns out to be a dangerous factor in situations wherein the subsidiary that ends up becoming the 'runt of the litter', owing to an intended scheme of the holding company, has been deployed so as to conduct a specifically risky pursuit, or to assume liabilities cropping up from such pursuits. In conducting out this scheme, the holding company foresees that, should considerable liabilities increase in the future from the operation of such hazardous pursuits, the remaining companies in the group will be shielded from liability on the grounds that come under' separate legal entities'. Tort creditors are known as the 'involuntary creditors' since they' lack choice in the option of the tort feasor' and are incapable to pragmatically be anticipated to make themselves conscious of a corporate group framework and analyze which companies making part of the group will possess funds to satisfy their assertions in the instance of insolvency. [27]Tort victims are, by and large incapable, to foretell the probability or nature of the damage or harm they endure, and so are impotent to safeguard themselves by resources of insurance or relieve the loss they have undergone in some other way.

The exercise of the Salomon rule onto the corporate groups is particularly questionable since holding companies have the liberty to set up subsidiaries and determine the size and funding of the diverse juristic entities in the group, and to sketch the boundaries between them. [28] Past advancements in tort law have witnessed several cases where the duty of care has been outstretched to inflict liability on holding companies for damages spawned to employees of their subsidiaries. [29] Tort law has acted better in terms of responsiveness, particularly to the social and economical conflicts elevated in mass tort cases, by empowering tort victims to detour 'Salomon' to seize a parent company accountable in situations where the parent company itself

[26]Briggs v. James Hardie & Co Pty Ltd., (1989) 16 NSWLR 549.
[27]*Id.*
[28]Lynn M LoPucki, *The Death of Liability*, 106 YALE LAW JOURNAL 1 (1996).
[29]CSR Ltd v. Wren, (1997) 44 NSWLR 463.

was under an obligation to render a duty of care to employees of a loss-making, bankrupt or delisted subsidiary.

In the case of *CSR Ltd v Wren and CSR Ltd v Young*,[30] the enforcement of tort principles rendered the plaintiff with an instrument of recovery against the holding company. The judges in the concerned case remarked upon the inter-linkage of tort law and corporate law, further extrapolating that the infliction of a duty of care did 'not do any violence' to the rule laid down by Salomon. This argument is accurate in the sense that the corporate veil was not straightaway pierced, but the principle in Salomon was efficaciously eluded by the enforcement of a 'duty of care' in order to effectuate a correspondent outcome as would have transpired had the corporate veil been pierced.

THE CURRENT POSITION

The present stance is declared by the case of *Adams v Cape Industries Plc*,[31] wherein the Court of Appeal discovered no lawful contravention and repudiated to lift the veil on a strict application of the Salomon rule. SLADE LJ held "*we do not accept that the court is entitled to lift the corporate veil merely because the corporate structure has been used so as to ensure that the legal liability in respect of particular future activities of the group will fall on another member of the group. Whether or not this is desirable, the right to use a corporate structure in this way is inherent in our corporate law*".[32] The same legal stance has been extrapolated in cases such as *Connelly v RTZ Corp Plc*,[33] *Ord v Belhaven Pubs Ltd*,[34] or *Lubbe v Cape Industries Plc*.[35] The *Adams v Cape Industries plc* case altered the attitude of the courts on the subject-matter of lifting the veil only to further construct a dominant interest or an economic unit. Prior to *Adams v Cape Industries*, several cases such as *Holdsworth & Co v Caddies*[36] or *DHN Food Distributors Ltd v Tower Hamlets LBC*[37] indicated that an economic

[30] *Id.*
[31] Adams v. Cape Industries Plc., (1990) Ch 433.
[32] *Id.*
[33] Connelly v. RTZ Corporation Plc., (1997) UKHL 30.
[34] Ord v. Belhaven Pubs Ltd., (1998) 2 BCLC 447.
[35] Lubbe v. Cape Plc., (2000) UKHL 41.
[36] Harold Holdsworth & Co (Wakefield) Ltd. v. Caddies, (1955) 1 WLR 352.

unit could be founded where the holding company exercised a considerable level of power over the dealings of the subsidiary company, to the degree that the holding company commanded the corporate plan of action of its subsidiary. However, with the case *Adams v Cape Industries to the limelight*, a company's power to dictate the whole policy framework of some other company is unlikely, of itself, to be adequate to uphold the lifting of the corporate veil. To oust the corporate veil of the subsidiary, the discovery of a *façade* is requisite with regards to the incorporation of the subsidiary company. It can be evidently deduced that the court herein modified their legal standing only to reassert the Salomon principle even more than before.

CONCLUSION

Since the time *Salomon v. A Salomon & Co. Ltd.* settled, several exceptional conditions have been discovered, both by the judiciary and the legislature, but the underlying hypothesis of the judgment *stands* intact even today. The courts have refused to "infringe the divine canon of limited liability". This paper attempts to assert that the Salomon case has been ascribed an overemphasized and unsubstantiated significance. It can be fairly postulated that the verdict in Salomon furthered no momentous modification in the path of the law, since the idea of a company having a lawful personality distinct from its shareholders had already been mostly established in a legal and economic sense much before the case was finally declared. Viewed from this perspective, the outstanding value that has been affiliated to Salomon was by no means predestined. Corporate groups were merely known by the end of the 19th century and henceforth didn't fall within the ambit of inspection of the Law Lords who postulated the judgement in Salomon. However, with the enforcement of the Salomon rule, and the power of corporate groups to bound the liability to involuntary tort creditors, comes in significant social and economic issues concerning the disapproval of extravagant risk-taking, and the externalisation of risk by corporate groups that continue to gain from hazardous pursuits while deflecting liabilities when such a pursuit causes damage. These complicated issues could be dealt with in more adequate manner if the courts were more equipped to see behind or dismiss set ups which were fashioned to protect group assets from the contentions of tort creditors. In this regard, tort law

[37] DHN Food Distributors Ltd v.Tower Hamlets London Borough Council,(1976) 1 WLR 852.

and corporate law can be viewed as 'antithetical bed fellows' as the former has been proved to be more responsive in tackling the social and economic conflicts elevated in mass tort cases and henceforth, is more desirable when compared to the dead hand of Salomon.