CORPORATE PERSONALITY AND ABUSES: A COMPARATIVE ANALYSIS OF UK AND NIGERIA LAWS

A Thesis

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ABSTRACT

This thesis provides a comparative analysis of the problems of fraud and the abuse of the corporate form under UK and Nigerian company laws. The twin doctrines of separate legal personality and limited liability for members shield shareholders and directors from personal liability for the debts of the company with far reaching implications for creditors and wider society. Although this position is not immutable as demonstrated in *Salomon v Salomon*, an analysis of case law and statute within the general rubric of 'lifting the veil' or 'piercing the veil' in the two jurisdictions reveals that veil piercing approaches have for several reasons remained fundamentally flawed. There is no coherent principle upon which the courts may find exceptional circumstances to impose liability on shareholders and directors. Veil piercing approaches have been premised on loss allocation analysis and used only as a means to discard limited liability. No effort has been made to deny controlling shareholders and directors the benefits derived from fraud, an omission that is detrimental to the interest of creditors and thus demonstrates the need for a new approach.

This thesis therefore argues that gains made by fraudulent shareholders or directors constitute an unjustified enrichment which must be disgorged for distribution to creditors. To this end, the thesis proposes a 'responsible corporate personality model' which gives the creditors wider rights of action to initiate claims against corporate controllers to deny or prevent wrongful benefits or proceeds of unjust enrichment when the company is insolvent or approaching insolvency. The model addresses questions such as the role of constructive trust in combating fraud, tracing, fraudulent transfer of company's assets to third parties and obstacles imposed by the requirement of fiduciary relationship. It supports the approach to unjust enrichment, suggesting lessons for both the UK and Nigeria in order to preserve equity and prevent improper conduct of corporate controllers. A key argument is that the responsible corporate model can address certain socio-economic peculiarities of Nigeria and similar developing countries.

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For all those friends and relatives whose names are not mentioned in this work, I am grateful to them.

Kenneth Chinedu Uzoechi

DEDICATION

This thesis is dedicated to the memory of my beloved father Chief Stanislaus Nnadiegbulem Uzoechi for his profound love for the Legal Profession.

DECLARATION

It is hereby certified that the work embodied in this thesis is original and has not been submitted in part or full for any other Diploma or Degree of this or any other University.

ABBREVIATIONS

A.C	Appeal Cases
All E.R	All England Law Report
All N.L.R	All Nigerian Law Report
ALBERTA L. REV.	Alberta Law Review
A.J.C.L	American Journal of Corporation Law
AM. BUS. L.J	American Business Law Journal
App. Cas	Appeal Cases
ASCL	The American Journal of Comparative Law
Bond LR	Bond Law Review
Bus. Law	The Business Lawyer
Bus LR	Business Law Review
CAMB. J. Econ.	Cambridge Journal of Economics
Cant. L.R	Canterbury Law Review
CJE	Cambridge Journal of Economics
CL.J	Cambridge Law Journal
C.L.J	Cardozo Law Review
Ch	Chancery
Ch.D	Chancery Division
CLJ	Cambridge Law Journal
Chi. Kent L. REV.	Chicago Kent Law Review
CLQ	Comparative Law Quarterly
C.L.R	Commonwealth Law Report
Co Law	Company Lawyer
Columbia L. REV.	Columbia Law Review
Company Fin & Insol. L. REV.	Company Finance and Insolvency Law Review
Connecticut L. Rev	Connecticut Law Review
Co. Rep.	Coke Report
Cornell L.Q	Cornell Law Quarterly

Cornell L. Rev.	Cornell Law Review
D.B.C.L.J	DePaul Business and Commercial Law Journal
Delaware JCL	Delaware Journal of Corporate Law
D.L.J	Duke Law Review
E.B.O.L.R	European Business Organisation Law Review
Econ. Hist. Rev.	Economic History Review
EWHC	England and Wales High Court Decisions
F.BT.L.R	Failed bank Tribunal Law Report
F.W.L.R	Federation Weekly Law Report
F.S.C	Selected Judgment of the Federal Supreme Court
Hare	Hare's Reports (Chancery) England
Harv. LR	Harvard Law Review
H.K.L.J	Hong Kong Law Journal
I.C.L.Q	International Commercial Law Quarterly
I.L	Insolvency Lawyer
IL & P	Insolvency Law and Practice
Insol LJ	Insolvency Law Journal
Int. Insolv. Rev	International Insolvency Review
Iowa J. Corp. L.	Iowa Journal of Corporation Law
J.A.E	Journal of Accounting and Economics
J.A.L	Journal of African Law
J.A.R	Journal of Accounting Research
JBL	Journal of Business Law
JBSE	Journal of Business Systems and Ethics
J. CORP. L	Journal of Corporation Law
LJ Ch	Law Journal Chancery Division
JAPFC	The Journal of Asset Protection and Financial Crime
J.B.L	Journal of Business Law
J. Corp. L	Journal of Corporation Law

J. ECON. HIST.	Journal of Economic History
J.F.C	Journal of Financial Crime
JL & Soc’y	Journal of Law and Society
J. Finan. Econ	Journal of Financial Economics
J. Legal Stud.	Journal of Legal Studies
J.L.S	Journal of Law and Society
JMAS	The Journal of Modern African Studies
LMCLQ	Lloyds Maritime and Commercial Law Quarterly
JPL	Journal of Politics and Law
LQR	Law Quarterly Review
L.R.N	Law Report of Nigeria
K.B	Kings Bench
K.L.R	Kansas Law Review
Lloyd’s Report	Lloyds Law Report (England)
Malaya L. Rev.	Malaya Law Review
MELB. U.L REV.	Melbourne University Law Review
Michigan L. Rev	Michigan Law Review
MLR	Modern Law Review
MULR	Melbourne University Law Review
Monash U.L Rev.	Monash University Law Review
N.CL.R	Nigerian Commercial Law Report
N.L.J	Nigerian Law Journal
N.L.Q	Nigerian Law Quarterly
N.M.L.R	Nigerian Monthly Law Report
N.N.L.R	Northern Nigerian Law Report
N.S.C.C	Nigerian Supreme Court Cases
NSWLR	New South Wales Law Reports
N.W.L.R	Nigerian Weekly Law Report
NW. U.L. REV.	New York University Law Review

NZBLC	New Zealand Business Law Cases
NZLJ	New Zealand Law Journal
N.Z.L.R	New Zealand Law Review
N.Z.L.R	New Zealand Law Reports
OJLS	Oxford Journal of Legal Studies
Or. L. Rev.	Oregon Law Review
P.L.J	Philippine Law Journal
Q.B	Queens Bench
Q.B.D	Queens Bench Division
OKLA L. REV.	Oklahoma Law Review
Quart. J. Econ.	Quarterly Journal of Economics
S.A.L.J	South African Law Journal
Stanford L.R	Stanford Law Review
Singapore JLS	Singapore Journal of Legal Studies
SLR	Singapore Law Reports
SLT	Scots Law Times Reports
Syd L Rev	Sydney Law Review
Stanford LR	Stanford Law Review
Tex. L. Rev	Texas Law Review
TORONTO L.J	Toronto Law Journal
U.C.L.R	University of California Law Review
Uni. Chi. L Rev	The University of Chicago Law Review
U.I.L.R	University of Ife Law Reports
U. ILL. L. REV.	University of ILLINIOS Law Review
U. PITT. L.REV.	University of Pittsburg Law Review
UITM Law Rev.	University Teknogi Mara, Malaysia Law Review
Uni. Toronto LJ	The University of Toronto Law Journal
UNSWLJ	The University of South Wales Law Journal
Vand. L. Rev	Vanderbilt Law Review

Virgina LR	Virginia Law Review
Yale LJ	Yale Law Journal
Waikato LR	Waikato Law Review
Wash. L. Rev.	Washington Law Review
Wash. & Lee L Rev.	Washington & Lee Law Review
WASH. U.L.Q	Washington University Law Quarterly
W.LR	Weekly Law Report
W.R.N.L.R	Western Region of Nigerian Law Report
VA. L. REV.	Vanderbelt law Review

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NIGERIA

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CHAPTER 1 INTRODUCTION

1.1 Context

The concepts of corporate personality and limited liability are two key attributes of the corporate form. The corporate form is considered one of the best and most efficient forms of business organization for the modern commercial and industrial sectors of both developed and developing countries because of the separation of the company and shareholders and the limitation of liability which encourage enterprenuership.[1] In particular, it is the dominant form of business in Nigeria and in the United Kingdom, two countries who share a common legal heritage and are members of the commonwealth.[2] However, the corporate form has sometimes been abused by corporate controllers (i.e. shareholders, directors and corporate officers). This prompted the courts and the legislature to provide for exceptions to corporate personality and limited liability in an attempt to redress any injustice which may result from strict application of both concepts. These exceptions are better known as lifting, or piercing, of the corporate veil – a method employed to hold shareholders and directors liable for corporate obligations in certain cases of misbehaviour.[3]

Abuse of the corporate form, which has largely arisen from fraudulent, manipulative and opportunistic acts of shareholders, directors and corporate officers, appears to have been on the increase in Nigeria during the last few decades.[4] This has been explained, in part, as a consequence of the protection offered to these categories of persons by the principles of corporate personality and limited liability,[5] which make a company, once incorporated, legally recognised as a distinct person from its members and officers, and further limits the liability of members for the debts of the company.[6] It has also been attributed to the inadequacy of Nigerian corporate laws and the bureaucracy of those charged with regulatory responsibilities, particularly

[1] D. Singh, 'Incorporating with fraudulent intentions: a study of differentiating attributes of shell companies in India' (2010) 17:4, *Journal of Financial Crime*, 459. Corporate form of business structure implies, *inter alia*, any form of business duly incorporated with the state following enabling legislations by the state. In Nigeria, a company incorporated under the Company and Allied Matters Act 2004 would qualify for the corporate form and the same applies for a company incorporated under the Companies Act 2006 in the UK.
[2] O. Akanki, 'The Relevance of the Corporate Personality Principles', (1977-80) N.L.J, 10. See also *Marina Nominees Ltd v. Federal Board of Inland Revenue* (1986) 2 N.W.L.R (pt.20) at 48.
[3] *Ibid*. See also *Atlas Maritime Co SA v Avalon Maritime Ltd* (No 1) [1991] 4 All ER 769.
[4] *Ibid.*
[5] *Ibid.*
[6] *Salomon v. Salomon* [1887] AC 22

the Nigerian Corporate Affairs Commission, as well as the laxity and non-implementation of disclosure rules.[7] For example, it takes on average one month to get feedback on any inquiry about the status of a company in Nigeria.[8] This is likely to be because of over centralisation, inefficiency of the work force and poor technology in the activities of the Corporate Affairs Commission[9] – the body responsible under the Companies and Allied Matters Act 2004 for incorporating companies.[10]

In Nigeria, as in most countries, it is possible that persons who have few resources and lack good business knowledge and education can incorporate companies without substantial assets which can be used to defraud creditors and the general public.[11] Such persons, while misrepresenting their scope and objects, purport to be establishing companies which are carrying out legitimate and substantial business when, in real terms, there is no business activity going on. They thus fail to comply with the requirements for those seeking to do business in the corporate form in terms of the decision-making process, the board, and directors and officers, as well as accounts and reports. They appoint themselves directors and control the affairs of the company. In recent example among several others in Nigeria concerned the defunct Oceanic bank in Nigeria which was controlled by a single family. A top member of that family who was the managing director was convicted of fraud of such a serious nature that led to the collapse of the bank.[12] Similarly, a UK court found a former managing director of a Nigerian bank who was also a controlling shareholder liable for fraud which was one of the issues that led to the collapse of that bank as well.[13]

As they assume the position of shareholder, director and officer, it becomes increasingly difficult to demarcate the company from such persons, even when the formal features of legal personality as recognised by law are present.[14] The company may obtain credits with fictitious documents about its solvency, while its controlling directors and shareholders may provide phony personal guarantees with no intention

[7]Akanki, n.2 above.
[8] This is borne out of my experience as a legal practitioner in Nigeria.
[9] Company and Allied Matters Act 2004 s.1
[10] Ibid.
[11] See *Alade v Alic (Nigeria) Limited & Anor.* (2010) 19 NWLR (Pt. 1226) 111
[12] *Federal Republic of Nigeria v Dr (Mrs) Cecilia Ibru*, FHC /L/CS/297C/2009 (Unreported)
[13] *Acess Bank Plc v Erastus Akingbola and others*, [2012] EHWC 2148 (Comm) 1680
[14] *Alade v Alic (Nigeria) Limited & Anor.* (2010) 19 NWLR (Pt. 1226) 111

of repayment. The term 'phony' has been defined as counterfeit, fake; unreal.[15] Something not genuinely derived from the "old practice of tricking people..."[16] In this context, 'phony' approximates to the submission of fake and non-existent guarantees in order to obtain credits.[17]

Therefore, rather than being an independent and autonomous person acting in its own corporate interests though with directors and officers in place as agents, corporations may become what one commentator described as a mere 'sham' or 'dummies'.[18] Such a corporation may be seen as the instrument or indeed puppet of its controllers, manipulated by them purely in order to promote their own interests. It may then be correct to say that the corporation has "no separate mind, and will or existence of its own and is anything but a business conduit for its principal."[19] Thus, rather than being a legal instrument for transacting business and dealing genuinely with investors and creditors, the company is used as a vehicle of deceit, concealment and misrepresentation. This blurs the true spirit and intent of giving a separate legal personality to the company and limiting the liabilities of its members.

Abuse of the corporate form is linked more to close corporations,[20] or what may be termed 'small companies', where shareholders are heavily involved in the control of the business and tend to misuse that control to undermine third parties and creditors.[21] This is unlike large firms where shareholders are dispersed, and ownership and control are typically separate.[22]

On this note, Jianlin[23] has argued that the artificiality of the company's separate legal personality is made glaringly obvious when the company has only one

[15] I. Brookes (ed.,) *The Chambers Dictionary*, Chambers Harrap Publishers Ltd, Edinburgh, 2003 at 1130.
[16]Ibid.
[17] See Singh, n.1
[18] R B. Thompson, 'Piercing the Corporate Veil: An Empirical Study',(1991) 76 *Cornell L. Rev.*, 1036.
[19] *Ibid.*
[20] Ibid. In his empirical studies Thompson found out that most veil piercing claims occasioning abuse of the corporate form succeeded exclusively more against close corporations than in public corporations and that veil-piercing claims arose and prevailed more often in Contract than in Tort.
[21] *Ibid.*
[22] F. H. Easterbrook & Daniel R. Fischel, 'Limited liability and the Corporation', (1985) 52 *U. CHI L. REV.*, 89, 109; See also Henry G. Manne, 'Our Two Corporations Systems: Law and Economics', (1967) 53 *VA. L. REV.*, 259, 262.
[23] C. Jianlin, 'Clash of Corporate Personality Theories: A Comparative Study of One- member Companies in Singapore and China', (2008) *Hong Kong Law Journal*, 425.

owner/member, which raises several legal issues including concerns about the risk of possible abuse, fraud and the concentration of powers, particularly to third party creditors. [24] While creditors may protect themselves by asking for personal guarantees from directors or shareholders,[25] this may not apply to small creditors or involuntary creditors.[26] Commercial expediency dictates that small trade creditors are unlikely to expend time and money on making checks on the borrowing company, and may be in a perilous position in a *Salomon*- type situation of a company granting debentures to its *de-facto* owner.[27]

The use of a company for purposes such as fraud or opportunism other than what it was set up for whilst simultaneously exploiting corporate personality for escaping sanctions has become increasingly problematic.[28] A fraud, according to Singh, is a misrepresentation or suppression of facts made for personal gain or to cause damage to others.[29] A corporate fraud has been construed as a deliberate act of deception or misrepresentation for an illegal gain or benefit (otherwise not available) or to cause damage to another, by a corporation, or by someone using a corporate vehicle.[30]

In any event, abuse of the corporate form does not dwell only within the domain of close corporations. It is also likely to occur in public companies or even in holding – subsidiary groups as well.[31] Holding-subsidiary corporate groups is defined under the Companies Act 2006, as including the holding company which has a majority of voting shares in the subsidiary and/ or the holding company who is a member of the subsidiary and has the right to appoint or remove a majority of the board of directors.

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[24] Ibid.

[25] P. Davies & S.Worthington, *Gower & Principles of Modern Company Law*, 9th ed., Sweet & Maxwell, London. 2012. 211. See also H. Anderson, 'Directors' Liability to Creditors – What are the Alternatives?' (2006) *18 Bond L.R*, 2, 1-46.

[26] Ibid.

[27] S. Griffin, *Company Law Fundamental Principles*, 4th ed., Pearson Longman, London. 2006. 9.

[28] Shareholders can use their control over a corporation to act opportunistically toward corporate creditors. Opportunism in the contract setting implies deliberate efforts by one party to benefit itself by defeating the bargained-for expectations of the other party. Various tactics are possible. In each case, the corporation's inability to meet its obligations results from the efforts of shareholders deliberately or recklessly to impose losses on creditors that the creditors did not voluntarily accept. For a general discussion, see R. A. Posner, Economic Analysis of Law (5th ed. 1998) at 101-103 (explaining that purpose of contract law is to deter opportunistic behaviour).

[29] Singh, n.1; For common law definition of fraud see *Gagne v Bertran*, (1954) 43 *Cal.* 2d, 481, 487.

[30] Singh n. 29 above.

[31] P. Blumberg, *The Multinational Challenge to Corporation Law: The Search for a new Corporate Personality*, Oxford University Press, Oxford. 1993. 55

[32] For companies of this nature, it has been seen in many cases such as in *Adams v. Cape Industries Plc*,[33] that the separate legal personality of a company can be used to circumvent liabilities by holding companies, particularly in high risk ventures undertaken by their subsidiaries in order to evade tax obligations.[34]

For the first arm of the definition, this includes the holding company being a member of the subsidiary and controlling 'alone' pursuant to agreement with other members, a majority of voting rights in it.[35] The requirement of being a member' would be satisfied by holding a single share or (in companies without a share capital) by being a single member. This provides a way to sidestep the definition of holding and subsidiary even though there is effective control of the board or of a majority of voting rights. [36] The fact of control means, inevitably, that the corporation may not be truly independent from its members even if scrupulous attention is paid to legal formalities establishing separate existence.

Nevertheless, when fraudulent controllers are caught and prosecuted for fraud, or subjected to civil actions, they often[37] put up a defence to the effect that they were at all times acting on behalf of the company, and therefore the company should be held liable and not them individually. Consequently, corporate controllers exploit corporate personality as a shield against (personal) liability even when the corporate form is meant to act as catalyst for economic development.

Apart from outright fraud, the abuse of the corporate form may be manifested in the opportunistic tendencies of corporate controllers who engage in behaviour which the law does not endorse. For instance, opportunistic behaviour that derives from the conflict between fixed and equity claimants may consist in the abandonment of investment projects that were in place when credit was extended in favour of riskier

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[32] See Companies Act 2006, s.1159 (a) and (b). See also s.338 of Nigerian Companies and Allied Matters Act (CAMA) 2004 which defines a holding company as one which is a member of another company and controls the composition of its board of directors, or holds more than half in nominal value of its equity share capital. That other company is its subsidiary.

[33] [1991] 1 All E.R. 929. In this case the parent English company denied liability in respect of its American subsidiary in an action brought against the subsidiary in the United States. However the recent decision of Court of Appeal in *Chandler v Cape plc* [2012] EWCA Civ. 525 has shown that in appropriate circumstances liability may be imposed on a parent company for breach of duty of care to employees of its subsidiary based on assumption of responsibility.

[34] S. Ottolenghi, 'From Peeping behind the Corporate Veil, to ignoring It Completely' (May 1990), *Modern Law Review*, 338-339.

[35] See CA s.1159(1)(a) and (b).

[36] J. Birds et al., *Boyle & Birds Company law*, Jordan Publishing Ltd, Bristol, 2009. 71

[37] See *Alade v Alic (Nig) Ltd* [2010] 19 NWLR (Pt 1226) 111

investments that creditors could not take into account or foresee and which may have been only undertaken to exploit creditors.[38] They may violate contractual restraints against risky ventures and trading in a particular area – all to the detriment of third parties. Controllers can divert assets[39] from the company, by means of share buy-backs, distribution of dividends, excessive salaries, and so on. This especially holds true in small private companies where dominant shareholder participation in management is more prevalent. In the same vein, a company may, in order to defeat creditors' claims, engage in claim dilution by issuing additional debt of the same or higher priority [40] by transferring the assets of the company to the controllers, disregarding statutory requirements. This situation tends to defeat the purpose of setting up a company as a vehicle for transacting business in modern society and ultimately erodes investors and creditors confidence in dealing with companies as corporate entities.

Therefore, the abuse of the corporate form raises the question as to what extent the principle of corporate personality and its strict application, can protect shareholders and directors on the one hand and creditors on the other. There is also the question of whether the current regime of corporate personality and limited liability in Nigeria and the UK, which tends to shift the risk of business failure away from entrepreneurs to creditors, should be sustained or whether there is room for improvement. The re-examination of corporate personality and limited liability has become particularly pertinent because of the abuse of the corporate form which has become so prevalent in modern society, particularly in Nigeria[41] as demonstrated by the the two bank cases highlighted above.

The thesis thus examines the application of corporate personality in Nigeria and the UK in the light of existing statutory, judicial and institutional mechanisms for mitigating corporate abuses. The thesis assesses the extent to which statutory measures regulating corporate controllers provide useful protection for creditors or whether they are unduly or unnecessarily restrictive.

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[38] J. Armour, 'Share Capital and Creditor Protection: Efficient Rules for a Modern Company Law', (2000) *The Modern Law Review* 63, at 360.
[39] Such asset diversion is sometimes referred to as 'milking the property'. *Vide*, S.A. Ross, R.W. Westerfield, J. Jaffe, *Corporate Finance*, 6th edition, 2002, 429.
[40] L. Enriques, J. Macey, 'Creditors versus Capital Formation: The case Against the European Legal Capital Rules', (2001) 86 *Cornell Law Review*, 1168 – 1169.
[41] O.Akanki, n.2

The thesis examines whether the present regime of corporate personality has made it difficult to impose sufficient sanctions on shareholders, directors and managers of companies for abuses of the corporate form. It argues that statutory and judicial interventions for curbing abuses appear not to be far reaching enough, owing largely to their narrow scope, strict application and the failure, apparent reluctance or rigidity of the courts to deal with issues arising from corporate personality.

The thesis proposes a 'responsible corporate personality model'. This model transcends the corporation by granting the creditor/claimant the right of action against the corporate controller for purposes of denying possibilities of wrongful benefits or proceeds of unjust enrichment. This approach, which concerns gain-based recovery rather than loss-based recovery,[42] is built around restitutionary[43] and equitable principles of disgorgement[44] of assets for fair redistribution and can only avail claimants when the corporation is unable to satisfy original claim against loss. Unlike the orthodox approach of limited liability framed on loss allocation,[45] the proposed model is detached from the underlying claim and thus operates independently of limited liability. As a result, courts are relieved of the strict application of corporate personality, but instead have equitable discretion to weigh the compelling merits of claims. This approach – which appears to be what veil piercing was originally designed to do – results in the application of tracing rules[46] operating independently of the corporate structure typology.[47] This presupposes that the ultimate holder of the misappropriated assets, whether money or property, can be identified and made subject to proprietary claims. The potential of what is being

[42] The orthodox approach defines the scope of shareholder liability according to its distributive impact on different types of creditors/claims, corporations, and shareholders. For this see Stephen M. Bainbridge, Abolishing Veil Piercing, 26 *J. CORP. L. 41*(2001).
[43] See Robert Chambers, 'Constructive Trusts in Canada', 37 *ALBERTA L. REV* , (1999) 173, 181-182.
[44] See R.B. Grantham & C.E.F. Rickett 'Disgorgement for Unjust Enrichment?' (2003) *Cambridge Law Journal*, 62(1), 159-180. Disgorgement has been defined as a repayment of ill-gotten gains that is imposed on wrong-doers by the courts. Funds that are received through illegal or unethical transactions are disgorged, or paid back, with interest to those affected by the action. Disgorgement is a remedial civil action, rather than a punitive civil action.
[45] Ibid.
[46] A.J. Oakley, *Constructive Trust*, 2nd ed. Sweet & Maxwell, London, 1996 at 8. The imposition of a constructive trust gives rise to the relationship of trustee and beneficiary which on any view is sufficient to satisfy the prerequisite of such an equitable tracing claim. See also Lionel D. Smith, The Law of tracing 10 (1997). Smith relates tracing to consist of two distinct processes: following and claiming.
[47] Ibid. Unlike all other trusts, a constructive trust is imposed by the court as a result of the conduct of the trustee and therefore arises quite independently of the intention of any of the parties.

proposed lies in the fact that abuse of the corporate form disentitles the corporate controller from the benefit of protection offered by the corporate shield. In Nigeria, the model has the capacity to both reinforce and enhance corporate responsibility by providing adequate mechanisms for tackling fraud and other misbehaviour.

Notwithstanding the novel approach proposed above, the thesis outlines further measures to deal with abuses of the corporate form through the adoption of a liberal approach to veil piercing by the courts. This may improve personal accountability and avoids a formalistic view of corporate personality and limited liability. The proposals are made with a view to protecting creditors' funds and transactions with the company in the event of a collapse.

This thesis advocates that, rather than abolishing limited liability for close corporations, additional requirements in terms of capital contribution and subsequent operations may be imposed. This should take the form of requiring individual incorporators of such companies to provide personal guarantees for incorporation.

Further, if a company becomes insolvent because of the sole shareholder, where it is a one person company as could be seen in the UK or shareholders (if they are more than one) as could be seen in two or more member companies in Nigeria, the creditors shall have the right to sue the shareholders who may have personal liability.

This proposed approach requires a new legislative framework to make it operational and will add a new impetus to finding solutions to the abuse of corporate personality. The proposal can promote scholarly efforts in the developing world with similar characteristics to Nigeria and beyond by highlighting difficulties and suggesting appropriate measures for tackling corporate fraud and abuses.

1.2 Research Problems

This thesis therefore identifies three fundamental problems with existing approaches to corporate form:

1.2.1 Negative Impact of *Salomon v Salomon*[48] on creditors.

The presumption of limited shareholder liability is a "bedrock" principle of corporate law as espoused by the Salomon's case.[49] The principle presupposes that in the event

[48] [1897] A.C. 22.H.L.

of business failure, shareholders will not lose more than they have invested by way of shareholding. This has consequences as it merely transfers the risk of loss from shareholders to creditors. It may be undesirable, since if shareholders[50] reap benefits, they ought to accept corresponding losses, yet this is what limited liability shareholding as espoused by *Salomon* prevents. This may be difficult to justify particularly for unsecured or tort creditors who receive little or nothing when undercapitalised limited liability companies collapse simply because they never bargained with the company.

1.2.2 Misuse of the corporate form

The corporate form may be misused for fraud, excessive risk taking and opportunistic behaviour by those who manage the affairs of companies. The misuse of a corporate form to perpetrate fraud depicts the failure of the regulatory system. The rigid application of the *Salomon* principle; coupled with limited liability shareholding, which extends the scope for fraud and opportunistic behaviour, may further institutionalise corporate irresponsibility.

1.2.3 Inadequacy of laws and measures to deal with abuse of corporate personality.

There has been a general tendency by the courts and legislatures in Nigeria and the UK to rigidly follow corporate personality, as manifested in their reluctance to pierce the veil of corporation except in limited circumstances.[51] The result is that those who have dealings with the company or who are affected by corporate actions may be left unprotected.

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[49] Ibid. See also *Prest v Petrodel Resources Limited and others*, [2013] UKSC 34; *VTB Capital Plc v Nutriek International Corporation & others*, [2013] UKSC 5; [2013] 2 W.L.R. 398; *Alliance Bank JSC v Aquanta Corpn* [2013] 1 Lloyd's Rep 175; *Ben Hashem v Al Shayif* [2009] 1 FLR 115.

[50] Small private company shareholders are usually directors, and cannot be said to be merely passive investors.

[51] See *Prest v Petrodel Resources Limited and others*, [2013] UKSC 34; *N.R.I. Ltd v Oranusi* [2011] All FWLR (Pt. 577) 760. See also P. Davis, *Introduction to Company Law*, London, Oxford University Press, Oxford, 2010. 31-100; S. Griffin, 'Limited Liability: A Necessary Revolution?', (2004) *Comp. Law*. 99; Thompson, n.18 at 1041

Indeed, the *Salomon* principle has never been seriously questioned by the courts and legislatures even though some academics have described the implication as calamitous.[52]

1.3 Research Questions

The thesis therefore addresses the following main research questions:

(a) Are there recognised exceptions to corporate personality and are they adequate to deal with abuses of the corporate form?

(b) Should further measures be introduced to make directors and controllers personally liable in cases of abuse of the corporate form?

(c) Should further measures be introduced to make controlling shareholders in limited liability companies liable beyond their agreed contribution, and if so in what circumstances?

1.4 Research Objectives

The thesis aims to propose measures to improve creditors and investors' confidence in dealing with companies, which may in turn enhance economic growth and expansion in Nigeria and the UK.

Unlike previous studies on this subject within these jurisdictions, this work is different in two major respects. First, it is the only known attempt to deal with the consequences of corporate personality in Nigeria and the UK with a comparative approach that draws from diverse environments and circumstances. Indeed, following a diligent period of research, it is safe to say that there is no previous thesis, journal article or text on this area in Nigeria. The closest works to my thesis are those on corporate governance, [53] and even then they have not looked at relevant issues from a comparative perspective as I have done.

[52] Khan-Freud, "Some Reflections on Company law Reform", (1944) *M.L.R.*, 54 at 54. Davies and Worthington have pointed out that decision in *Salomon* has remained controversial, but so entrenched in our law that the principle of limited liability for all companies, large or small, that nobody seriously advocates its reversal. See Davies & Worthington, n.25 at 209.

[53] See for example, T.I. Gusua, 'Oil Corporations and the environment: The Case of the Niger Delta', An unpublished PhD Thesis submitted to the University of Leicester, 2012; N.S. Okogbule, 'An Appraisal of the Mutual Impact between Globalization and Human Rights in Africa', An unpublished PhD Thesis submitted to the University of Glasgow, 2012; L. Osemeke, 'The Effects of Different

Second, unlike the previous approaches, this thesis advocates a new contextual framework of corporate personality suitable particularly in a developing country, such as Nigeria, which has a high incidence of corruption and weak legislative, regulatory and judicial institutions.[54] This is imperative because the existence of such a framework may well provide a parallel corporate liability regime and appropriate limitations to the benefits of the corporate shield. Doing so implies that those responsible for inappropriate behaviour – which causes financial and other losses to an outsider, especially creditors of the company unable to pay its debts, – are accountable and can incur personal liability for financial losses without being able to hide behind the shield of a company's legal personality.

1.5 Methodology

The research which is largely library based relies extensively on a qualitative style of enquiry which is concerned with exploring issues, understanding phenomena, and answering questions.[55] Within the context of this work, the approach seeks to give insight into the analysis of relevant laws, opinions and experiences of individuals and persons dealing with the subject matter of corporate personality. By adopting this method, the thesis aims to bring to light the abuses of the corporate form and how it has adversely affected creditors and the operation of corporations as effective tools of transacting business both in Nigeria and the UK.

Institutional Investors and Board of Director Characteristics on Corporate Social Responsibility of Public Listed Companies: The Case of Nigeria', An unpublished PhD Thesis submitted to the University of Greenwich, 2012; I.E. Usoro, 'Can the Law Assist Corporate Social Responsibility to Deliver Sustainable Development to the Niger Delta?' An unpublished PhD Thesis submitted to Nottingham Trent University, 2011; E.A. Adegbite, 'The Determinants of Good Corporate Governance: The Case of Nigeria', An unpublished PhD Thesis submitted to City Univeristy, London, 2010; P.E.G. Augaye, 'Evaluation of Corporate Governance in Nigeria', An unpublished PhD Thesis submitted to the Univeristy of Wales, Aberystwyth, 2008; J.O. Amupitan, 'Privatization and Corporate Governance in Nigeria', An Unpublished PhD Thesis submitted to the University of Jos, Nigeria, October, 2007; Asada Dominic, 'Effective Corporate Governance and Management in Nigeria: An Analysis', An unpublished PhD Thesis submitted to the University of Jos, Nigeria, October, 2007; U. Idemudia, 'Corporate Social Responsibility and Community Development in the Niger Delta, Nigeria; A Critical Analysis' An unpublished PhD Thesis submitted to the University of Lancaster, 2007; M.M. Gidado, 'Petroleum Development Contracts with Multinational Oil Corporations: Focus on the Nigerian Oil Industry', an unpublished PhD Thesis submitted to the University of Warwick, March 1992; J.O. Adesina, 'Oil, State Capital and Labour: Work and Work Relations in the Nigerian National Petroleum Corporation', An unpublished PhD Thesis submitted to the University of Warwick, 1988.

[54] O. Osuji, 'Asset Management Companies, Non Performing Loans and Systemic Crisis: A Developing Country perspective', (2012), J.B.R, vol. 13(2) 147-170.

[55] 'Qualitative research' available in http://www.qsrinInternational.com/what-is-qualit. accessed 26/5/2011.

To this end, the research involves the use and analyses of primary and secondary sources and covers the area of jurisprudence and comparative approaches to the statutory provisions of the Nigerian Companies and Allied Matters Act 2004, the UK Companies Act 2006 as well as other relevant Nigerian and English laws, cases and policies including judicial decisions of other common law jurisdiction countries.

It involves reviews of books, journal articles, scholarly commentaries, conference papers, media contributions, other publications and government and public documents.

Through the analysis of case law, legislations and scholarly commentaries in books and articles which reveal the inadequacy of the current law, it has become increasingly clear that the concepts of corporate personality and limited liability are fraught with problems and require urgent reforms if corporations are to achieve economic development in Nigeria and the UK and restore creditors' and investors' confidence in corporate affairs.

The significance of the analytical approach in this thesis lies in its potential not only to explain the problems associated with the application of corporate personality, particularly the rigidity and reluctance of the courts and the legislatures on issues affecting it, but its suggestion of the imperativeness of improvements in the current regime.

It is further hoped that with effective application of the analytical method, the facts and insights elicited from the research materials will provide the necessary coherence and logical progression of the thesis and the questions it seeks to answer. Moreover, it is expected that a comparison and references to the UK and other common law countries such as the US, will inform the choice of alternative measures to deal with the abuse of the corporate form in Nigeria.

The above position is supported by research evidence and is particularly important as comparative law is one of the ways for analysing a country's law or system. In relation to 'comparative law' Lepaulle[56] stated long ago that, "to see things in their true light we must see them from a certain distance as strangers, which is impossible

[56] P. Lepaulle, 'The Function of Comparative Law with a Critique of Sociological Jurisprudence' (1922) 35 *Harvard Law Review*, 838 at 858.

when we are studying phenomenon of our country. That is why comparative law should be one necessary element in the training of all those who are to shape society." The implication is that a comparative method of analysis allows the observation of how other societies at a similar stage of civilization face up to similar and corresponding problems.[57]

The practical values of comparative law analysis, as Zweigert and Kotz[58] submit, is that it can provide a much richer range of model solutions than a legal science devoted to a single nation, simply because the different systems of the world can offer a greater variety of solutions than would be thought up in a life time by even the most imaginative jurist who was corralled in his own system.

This study therefore proceeds to analyse and find solutions to the operation of the principle of corporate personality in Nigeria in the light of experiences of other jurisdictions particularly the UK, whilst recognising the inherent divergences of the two systems in relation to the context in which the courts and legislatures operate.

1.6 Outline

The thesis examines the operation of corporate personality principle in Nigeria with significant references to the UK because of the countries' shared history and to learn lessons pertaining to abuses in corporate affairs, creditor's protection and liabilities of directors. For convenience, clarity and better understanding of the issues involved, the thesis is divided into the following chapters:

Chapter 1 is this introduction which sets out the research context, problems, questions and aims and objectives as the foundation for the rest of the thesis.

Chapter 2 examines the theoretical analyses of a company and deals extensively on the theoretical underpinnings behind the legal personality of a corporation, showing that, in spite of it being accorded the status of an artificial person, a company has the attributes of a legal person. The chapter further deals with the principle of corporate personality of a company and its ramifications and the concept of limited liability and its justifications, consequences and impact on creditors, arguing that corporate

[57] K.B. Walker, Comparative law: A Theoretical Perspective, (1990) 42 *U.C. L.R*, 338.
[58] K. Zweigert & H. Kotz, *Introduction to Comparative Law*, translated from the German by T. Weir, 3rd ed., Oxford University Press, 1998, 15.

personality is indeed not absolute. The chapter therefore lays the basis for legal responses to the problems of corporate fraud and abuses in the UK in chapter 3 and in Nigeria in chapter 4.

Chapter 3 deals extensively with the problems and challenges posed by the application of corporate personality and limited liability for members in the UK in the aftermath of *Salomon's* case and within the realm of statutory and judicial responses to check corporate abuse and protect creditors. In this regard, it examines the circumstances under which corporate personality and limited liability for members may be disregarded in what is often regarded as 'lifting the veil of incorporation' or 'piercing the veil of incorporation', the liability of members and directors as well as creditors protection. The chapter argues that the legal response to the problems of corporate personality has been far from satisfactory. The reason is the strict adherence to the *Salomon's* case and the reluctance of the court and legislature to widen the scope of veil piercing approaches and provide more flexible and equitable standards to deal with the problems of the corporate form. The thesis therefore argues that there is a need to articulate more measures to deal with the abuse of the corporate form in order to protect creditors and make corporate controllers liable for their actions.

Chapter 4 follows the discussions in chapters 2 and 3 and analyses the operation of the doctrine of corporate personality in Nigeria, explaining how the application of Salomon's principle has been misapplied by those who run and manage the company for illegitimate ends and to the detriment of creditors. An outline of the history of Nigerian company law which goes back to the last half of the 19th century is given. The current state of the law, particularly the separate legal personality of the company, is difficult to understand without this historical picture. The chapter examines the existing laws and responses of the Nigerian courts and legislature to the abuse of the corporate form. It identifies the rigid application of *Salomon's* case, the lack of effective disclosure, weak judicial and regulatory mechanisms, and the absence of insolvency laws as the major problems militating against the effective operation of corporate personality in Nigeria. The chapter advocates the need for Nigeria to improve its laws and ensure effective judicial and regulatory mechanisms in order to stem the prevalence of abuses of the corporate form.

Chapter 5 draws on chapters 3 and 4 with regard to a comparative analysis of legal responses, common approaches and differences respectively adopted in Nigeria and the UK to combat corporate fraud and abuses. It argues that while there are areas Nigeria needs to learn lessons from the UK, particularly in the area of insolvency laws and effective judicial and administrative systems, there still remains an urgent need for the country to adopt equitable means to deal with the problems associated with the rigid application of the *Salomon* principles and existing common law approaches which have brought untold hardship to creditors.[59]

Chapter 6 articulates appropriate legal measures to tackle the problems posed by corporate personality in the UK and Nigeria whilst not discounting the efforts made by existing statutory provisions and case law. It examines the potential liability of shareholders in limited liability companies beyond agreed contributions and analyses how shareholders and directors could be held accountable for corporate abuses in order to improve protection given to creditors. The chapter proposes a 'responsible corporate personality model' for the disgorgement of unjust enrichment from corporate controllers, instead of the loss allocation approach which is prevalent in existing veil piercing approaches. The model favours a regime that allocates responsibility, liability and sanctions but nevertheless proceeds to recover gains made through unjust enrichment. It identifies the equitable remedy of constructive trust as a strong instrument to achieve this end. The model, with its primary focus on recovery of ill- gotten gains made by corporate controllers, is not only well-suited to a developing country such as Nigeria but ensures some certainty in this confused area of law.

Chapter 7 concludes and reappraises the principle of corporate personality whilst assessing its relevance or otherwise in meeting present and future challenges of corporations.

[59] See Peter B. Oh, 'Veil Piercing Unbound', (2013) 93 *Boston University Law Review*, No. 1, 89. See also S. Griffin, n.51 at 99-101

CHAPTER 2 THEORETICAL ANALYSES

2.1 Introduction

It is a fundamental principle of corporate law that a company is regarded as a distinct entity.[1] Once the requirements of the incorporation have been satisfied, a company is said to exist separately from, and independently of, the persons who established it, who invest in it, and who direct and manage its operations. This principle, which ensures the separateness of the company and enables the liability of its members to be limited to the amount they invested, is recognised both in UK and Nigerian laws. However, the duality of a company as both an association of its members and a person separate from its members has remained a perplexing legal concept.[2] The separate entity rule pervades company law and has had far-reaching implications for it in both theory and practice.

The chapter examines the theoretical and analytical framework of the separate legal personality of the company that undergirds the thesis. It focuses on the idea of a company as a separate entity, the nature of the corporation and the scope and ramifications of corporate personality.

The thesis adopts the artificial entity theory and its variant of concession theory as the framework for its analysis. The theory is premised on the claim that the notion of "person" is a legal conception.[3] Put simply, 'person' is presumed to be what the law makes it to mean.[4] Consequently, a corporation being an artificial person lacking body and soul comes into being by state action through regulatory and statutory processes. Thus the artificial entity theory, which is predicated on state action, and notwithstanding its being more persuasive than other theories of corporate personality in answering the questions raised in the thesis, also provides the legitimacy and foundation for action to tackle abuse of the corporate form. The theory was and is still the precursor of the evolution of English company law and practices which were later transplanted to Nigeria.

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[1] *Salomon v. Salomon* [1897] AC 22

[2] D. French et al., *French and Ryan on Company Law*, 29th ed., Oxford University Press, London, 2012, 154.

[3] J. Dewey, 'The Historical Background of Corporate Personality' (1926) *Yale law Journal*, 35(6), 655

[4] Ibid.

The chapter is divided in two parts. The first part sets out the theoretical justification for the separate entity of the corporation and provides justification for state intervention on corporate matters, particularly in the event of the abuse of the corporate form.

The second part deals with the confirmation of the artificial entity theory in the UK in the case of *Salomon v Salomon*.[5] It argues that the separate personality and the limitation of liability of members in a company, as espoused in the Salomon's case, has the propensity of leading to abuse of the corporate form. This needs to be addressed, particularly as the case has demonstrated that the legal personality of a company is not absolute. Indeed, since *Salomon*, the courts and legislature in the UK and in Nigeria have found exceptions to the general rule of strict application of Salomon's principles, albeit only in limited circumstances. Consequently, where the recognition of separate legal personality may result in outcomes that are unjust or undesirable, the courts have deployed the equitable doctrine of 'piercing the corporate veil' whenever they have believed it necessary to impose shareholder liability and deny shareholders the protection that limited liability normally provides. This will be further discussed in chapters three and four of the thesis which deal with the legal responses to the strict application of separate legal entity principle in the UK and later in Nigeria in the wake of the aftermath of Salomon's case.

2.2 The Company as a Separate Entity

A corporation is specifically referred to as a "legal person"- a subject of rights and duties that is capable of owning real property, entering into contracts, and having the ability to sue and be sued in its own name.[6] A company belongs to a class of corporation known as a corporation aggregate.[7] A corporation aggregate is defined as:

> a collection of individuals united into one body, under a special denomination, having a perpetual succession, under an artificial form and vested by policy of law with capacity of acting in several respects as an individual particularly of taking and granting of property, of contracting obligations and suing and be sued, of enjoying privileges and immunities in common and of exercising a variety of political

[5] [1897] AC 22 HL
[6] S. Mohanty & V.Bhandari, 'The Evolution of the Separate Legal Personality doctrine and its exceptions: A Comparative Analysis, (2011) *Company Lawyer*, 32 (7), 194 at 195.
[7] R.W.M Dias *Jurisprudence*, 5th ed., Butterworth's , London, 1985, 253

> rights more or less extensive according to the design of its institutions, or the power of conferment upon it either at the time of creation or at any subsequent period of its existence.[8]

Corporation aggregate is therefore an incorporated group of co-existing persons having several members at a time, and different to a corporation sole which is an incorporated series of successive persons. Corporations aggregate are by far the more numerous and important. However, this definition has been criticised.

According to Frank Evans[9] it is not essential that a corporation should consist of many individuals.

Company has no strict legal meaning hence it is always been difficult to give a clear and correct definition of company. The nearest approach to the definition of a company is one found in *Re Stanley*[10] *Lennant v. Stanley* where Buckley J. said:

> The word company has no strict technical meaning. It involves I think two ideas, namely, first, the association of persons so numerous as not to be aptly described as a firm and secondly, the consent of all other members are not required for the transfer of members interest. It may include an incorporated company.

Prior to the decision in *Re Stanley*, James LJ in *Smith v. Anderson*[11] had attempted a definition by comparing a partnership with a company. The judge believed that the difference which the Companies Act 1862 intended between a company or association and ordinary partnership is that an ordinary partnership is composed of definite individuals bound together by contract between themselves to continue to be combined for some joint objects either during pleasure or during limited time and is essentially composed of persons originally entering into contract with one another. A company or association, on the other hand, is a result of an arrangement by which parties intend to form a ‘partnership’ which is constantly changing, a ‘partnership’ today consisting only of certain members and tomorrow consisting only of some members along with others who have come in. This means that there will be constant shifting of ‘partnership’ and determination of the old and creation of new

[8] Halsbury Laws of England, Article 3 Vol.9, 4.
[9] F. Evans, ‘What is Company?’ (1910) 26 *LQR* 259
[10] (1906) 1 Ch 131 at 134
[11] (1808) 15 CR D 247 at 267

‘partnership’. The effect is that so long as the intention of the people by agreement among themselves is to bring such a result, the new partnership shall succeed to the assets and liabilities of the old partnership.

Clearly the common law position is that a company is an association of persons which has a broader objective than that of partnership. But the word “association” in this context raises a problem since a number of people may associate for multifarious purposes. This prompted James LJ in *Smith v. Anderson*[12] to state that the word association as it is now commonly used is etymologically inaccurate for association and does not properly describe the thing formed, but does properly and etymologically describe the act of associating together. From this act there is formed a company or partnership.

According to Davies[13] a company, unlike a partnership with a small number of persons, may be seen as a complicated form of association, having a large and fluctuating membership. The organisation, which may be elaborate in form, is characterised by the conferment of corporate personality, making it a distinct legal person with rights and duties separate from that of its members.

A company can be identified in terms of a completion of the incorporation process. Among scholars who share this view are Sealy and Worthington[14] and Frank Evans.[15] According to Sealy, a company is a kind of legal entity or corporate body which is brought into being by the registration procedure laid down by the relevant legislation.[16] Its creation is evidenced by the issue of a certificate of incorporation.[17] Frank Evans defines a company as “an association of two individuals united for one or more common objectives, which whether incorporated or unincorporated: (a) in the Act or Charter by or under which it is constituted, called a company and (b) if it is not constituted and called, it is an ordinary partnership or municipal or reading corporation or a society constituted by or under a statement, but an association

[12]Ibid.
[13] P.L Davies & S. Worthinghton, *Gower & Davies’ Principles of Modern Company Law*, Sweet & Maxwell, 9th ed., London, 2012, 4.
[14] L. Sealy & S Worthington, *Sealy’s cases and Materials in Company law*, Oxford University Press, Oxford, 2010, 1
[15] Evans,n.9 at 263
[16] Sealy & Worthington, n.14 above.
[17] Ibid.

whose members may transfer their interests and liabilities in or in respect of the concerned without the consent of all the members."

However, a company may not necessarily be formed by two persons. As pointed out earlier, a company can come into being with a minimum of one member [18] as is the case with the UK Companies Act 2006. In Nigeria, a company is constituted by at least two members.[19]

The question that a company must be incorporated before it comes into existence is not in doubt. This is because under s.1 (1) of the 2006 Act, a "company" means a company formed and registered under this Act.[20]

It is clear from the analyses above, that a company is a creation of law and comes into existence both in Nigeria and in the UK by virtue of state law. Consequently, the law bestows certain rights and liabilities on the company. Thus, companies differ from any natural person in that they can only acquire or be subject to a very much restricted range of rights and liabilities than natural persons.[21] In law a company is recognised as having no physical attributes and no mind of its own. The clearest statement of the company's limitation in this respect is that of Buckley L.J. in *Continental Tyre and Rubber Co. (G.B.) Ltd*. v *Daimler Co*[22]:

> The artificial legal person called the corporation has no physical existence. It exists only in contemplation of law. It has neither body, parts, nor passions. It cannot wear weapons nor serve in wars. It can be neither loyal nor disloyal. It cannot compass treason. It can be neither friend nor enemy. Apart from its incorporators it can have neither thoughts, wishes, nor intentions, for it has no mind other than the minds of the corporators.

It therefore follows that the operation of a company is set out in its constitution and this in effect clothes the company with legal personality with which it transacts its business. The fact that the concept of separate legal entity has been made easily

[18] See CA 2006, s.7(1).
[19] See Companies and Allied Matters Act (CAMA) 2004, s.18
[20] See also CAMA s.19 (1) which requires registration for both private and public companies before they can operate to do business in Nigeria.
[21] For this reason the description of companies as the alter ego of their controlling shareholders is true only in a very loose sense.
[22] [1915] 1 KB 893 at 916

available for business people, it is submitted, may have very undesirable consequences which have actually led to abuses.

2.3 The Nature of the Corporate Person

The question of the nature of the corporate legal person has remained one of the most confusing areas of corporate law. Consequently, for many centuries, philosophers, political scientists, sociologists, economists, - jurists and legal scholars [23] have debated what constitutes the 'essence' of this 'soulless' and 'bodiless' person.[24] In this 'corporate personality controversy', a number of theories have emerged. These theories are not ones in which law and legal conceptions have the only or final voice; instead it is one where the law shares boundaries with other sciences, political science, ethics, psychology and metaphysics.[25]

There has been several different theoretical strands which have sought to illuminate, clarify and expand the scope of corporate personality and these reveal that much of the argument given to the subject of separate legal personality of a company focuses on developments in two key dimensions. The first dimension is the distinction between the corporation as an entity, with a real existence separate from its shareholders and other participants, and the corporation as a mere aggregation of natural individuals without separate existence. [26] The second dimension is the distinction between the corporation as an artificial creation of state law and the corporation as a natural product of private initiative.[27]

On the heels of these arguments there tends to be the dichotomisation of the corporation under the public/private paradigm. According to one view, corporations are separate entities given legal personality by act of state law under the broad social and political ramifications that justify the body of corporate law that is deliberately

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[23] M. Wolff, 'On the Nature of Legal Persons' (1938) 54 *LQR* 494 at 494. On the different theories of legal personality, see also Dias, n. 7 above; M.W. Arthur, 'Corporate Personality', (1911) 24 *HLR*, 260; B. Smith, 'Legal Personality', (1928) 3 *YLJ*, vol. 37, 283, 298; W. Friedmann, Corporate Personality in Theory and Practice: Legal Theory, 5th ed., Stevens, London, 1967; M. Dan-Cohen, '*Rights, Persons and organisations: A legal Theory For Bureaucratic Society'*, University of California Press, Berkeley, 1987. 44; S.R. Ratner, 'Corporations and Human Rights: A Theory of Legal Responsibility' (2001) 111 *Yale LJ*, 443, 452; Zuhairah Ariff Abd Ghadas, 'Real or Artificial? Jurisprudential Theories on Corporate Personality', (2007) 4 *US-China LR*, 6-12
[24] See Dewey, n.3 above.
[25] W.M. Geldart, 'Legal Personality' (1911), 27 *LQR*, 90 at 94
[26] D. Millon, 'Theories of the Corporation' (1990) 2 *Duke Law Journal*, 1, 201
[27] Ibid.

responsive to public interest concerns.[28] The alternative view sees the corporation as no more than the private relations involving the actors in the business for instance, the shareholders and the management.[29] Thus, the difference that has emerged is between a public law, a regulatory conception of corporate law which sees the corporation as separate from its members and comes into being by the positive acts of state law on one hand, and a private law contractual perspective of the constitutive elements which make up the corporation on the other hand.

Whilst some of these theories have been recurrent in the literature of corporate personality, they, unlike the artificial entity theory and its variant of concession theory, remain largely narrow and unpersuasive for this work as they fail to provide clear justification for the status and existence of modern corporations. These theories are briefly discussed below.

The aggregate theory, for instance, asserts the primary status of the individual and the private status of the corporation. It argues that the role of law should be limited to facilitating the formation of this contractual relationship. The theory posits that the law was not central to the formation of the company; rather, the company was an aggregate of the individuals who had contracted for its formation. Therefore the private individuals behind the aggregate are the focus of corporation rights and obligations.[30] The corporation in an aggregate analysis has no independent existence and everything is explained by the members of the corporation.[31]

The theory, with its leading scholars such as Jhering had two significant claims to make about the operation of company law.[32] First, as the company is formed by private contracting individuals, state interference in what is viewed as essentially a private arrangement becomes very difficult to justify as it would be an interference with the individual's freedom to contract.[33] Second, and more significantly, as everything to do with the corporation was only meaningful by giving credence or by recognising the contracting individuals behind it, the theory served to justify the

[28] Ibid at 202
[29] W.W Bratton, 'The 'Nexus of Contracts' Corporation' (1989) 74 *Cornell Law Review* 407 at 410
[30] P. Blumberg, *The Multinational Challenge to Corporation Law: The search for a new Corporate Personality*, Oxford University Press, Oxford, 1993, 28
[31] See Wolff n.23 at 497. See also A. Dignam & J. Lowry, *Company Law*, Oxford University Press, Oxford, 2009, 351-371
[32] See Zuhairah Arif Abd Ghadas, n.23 at 10.
[33] Note 'The constitutional Rights of the Corporate Person' (1982) 91 *Y.L.J* 641 at 1648.

primacy that company law gives to shareholders as the key contracting individuals behind the corporation.[34]

A major weakness of this theory is its inability to articulate the fact that the relationship between the corporation and its members has remained an issue of law and goes beyond mere claim to shareholding rights and this explains why the artificial entity theory more than the aggregate theory has offered a better understanding of the corporation and its associated problems. In sum, the aggregate theory tends to ignore the fact that the corporation is a useful legal concept because the common law regards it as both a separate person and an association of its members.[35]

The "real entity" metaphor of the corporation first emerged around the turn of the twentieth century as a major challenge to the artificial entity theory of the corporation, with an argument that the corporate entity is a natural creature, to be recognised apart from its owners, existing autonomously from the state.[36] The real entity theory generally views the corporate entity as a natural creature, to be recognised apart from its owners, and existing independently of the state.[37] To elaborate, a corporation is "an organic social reality with an existence independent of, and constituting something more than, it's changing shareholders."[38] The group asserts that an association of persons has a real personality which is merely recognised, and not created, by the process of incorporation.[39] For the realists, such as the German scholar Gierke, the state has no role to play in the formation and existence of the company.[40]

The economic or contractual approach to a corporation denies the existence of the organisation as an entity with separate existence from the individual contractors. For

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[34] For a review of arguments for and against concession theory, see S. Bottomley, 'The Birds, the Beast, and the Bat: Developing a Constitutionalist Theory of Corporate Regulation, (1999) 22 *F.L Rev.* 243.
[35] French, n.2 at 153
[36] P. Blumberg, 'The Corporate Entity in Era of Multinational Corporations', (1990) 15 *DEL. J. CORP, L.*,at 295. See also D. Millon, 'The Ambiguous Significance of Corporate Personhood' (2001) 2 Stanford Agora, available at http://www.law.Standford/agora accessed 20/1/12.
[37] Blumberg, n.30 above
[38] Ibid.
[39] French, n.2 at 154
[40] Zuhairah Arif Abd Ghadas, n.23 at 10.

this theory, the corporation is viewed as a "nexus of contracts"[41] consisting of a series of transactions, or contracts between investors, managers, employees, creditors and customers. In sum, the contractarian analysis treats the corporation as nothing more than shorthand expression for the multiplicity of private, consensual, contract-based relations between economic actors each seeking to maximise his or her own benefits. The behaviour of those involved, therefore, is regulated by market forces that regulate the company's relationship with outsiders. The corporation is regarded not a creation of the state but of private initiative and enterprise.

However, despite the promise and continued relevance of these theories, they do not provide a holistic understanding of the particularities of corporate personality in jurisdictions such as the UK and Nigeria where the state plays a prominent role in the formation and regulation of companies. Furthermore, they also seem to be incapable of addressing the questions raised in the thesis such as adequacy of the current law on corporate personality; imposition of liability on shareholders, directors and controllers; possible liability of controlling shareholders beyond their agreed contribution; and concerns of abuse of the corporate form which may result from the separateness of the company from its members.

The claim of this chapter is that the artificial entity theory and its variant of concession theory addresses to a considerable degree, the inadequacies that characterise the theories briefly surveyed above, particularly in its recognition of the separate existence of the company from its members and the role of the state in the existence of the company. It is to this theory that the discussion now turns to.

2.3.1 Corporation as Artificial Entities

This theory assumes that the legal personality of entities other than a human being is a fiction. Under the artificial entity theory, corporations are not people at all but rather they are the artificial creations of human beings and are given personhood status solely as a legal fiction in order to facilitate commerce. They are the "creature of the legislature, owing existence to state action, rather than to acts of shareholders or incorporators".[42]

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[41] M.C Jensen and W.H. Meckling, 'Theory of the firm: managerial behaviour, agency costs and ownership structure', (1976) 3 *J Fin Econ*,305 at 310-11
[42] Blumberg n.30 at 28. See also Wolff, n.23 at 510.

In his classic formulation of what became the "artificial person" of the corporation, Chief Justice Marshall described the corporation in vivid terms: "A corporation is an artificial being, invisible, intangible and existing only in the contemplation of law. Being mere creature of law, it possesses only those properties which only the charter of creation confers on it, either expressly, or as incidental to its existence".[43] These terms were borrowed from English Jurists such as Coke and Blackstone, but Marshall's emphasis on the term "artificial" was his own.[44] The essence of this view is that the corporation is a separate juridical unit created by state action, possessing, in addition to its essential core attributes, only such limited powers as are granted by the State. In Marshall's view, the corporation was precisely what the act of incorporation made it.[45] Although a separate legal entity, its legal capacity beyond its core rights depended on the charter and thereby differed decisively from the fuller panoply of legal rights possessed by natural persons.

The artificial or fictitious theory of corporate personality appears to have a Roman origin within the context of the church as shown in the work of its progenitor Pope Innocent 1V (1243-1254).[46] Religious foundations were often the donors of property, and it was necessary to find a legal mechanism which would enable such bodies to be recognised as owners of that property. A solution was found in canon law, which had come to regard ecclesiastical bodies as "fictitious persons" (personae fictae).[47] This idea was received into common law and took rapidly, since it provided neat solutions to the problems caused by the existence of numerous groups, most notably the boroughs, but also hospitals and ecclesiastical foundations.[48] This theory is associated with Savigny and Austin, who is said to have introduced the phrase "legal person,"[49] but in fact the theory had been in circulation well before both Savigny and Austin. Nonetheless, it is fair to say that Savigny did begin the scientific or metaphysical consideration of the subject. He observed the fact that property belongs

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[43] *Trustees of Dartmouth College v. Woodward*, 17 U.S (H. Wheat), 1819, 518 at 636; See also *Welton v Saffrey* [1897] AC 299 at 305 where Lord Halsbury LC described a registered company as an 'artificial creature' which must be dealt with 'as an artificial creation'.
[44] See the case of *Sutton's Hospital*, 10 Coke 250a, 253, 303; (i612) 77 Eng. Rep. 960, 970-971.
[45] *Trustees of Dartmouth College,* n.43 above
[46] Dewey, n.3 at 665
[47] Ibid.
[48] For histories of the English company, see W.S Holdsworth, *A History of English Law* (3rd ed) 1923, vol 3, 470-75, J. H. Farrar & B. Hanningan, Farrar's *Company Law* ,4th ed. Butterworth, London 1998, chapter 2.
[49] Farrar & Hanningan, n.48 above

in law to a corporation and not to any individual, and the question which he put to himself was, "who or what is the real owner of this property".[50] Savigny's answer was that the corporate property belonged to a fictitious being and not to any real person or entity. Consequently, since a corporation is not a human being, it cannot be a real person and cannot have a personality of its own.[51] It can only exist by the privilege of state action.

Significant developments to the corporate form as we know it today can be traced back to nineteenth century England. At this time, two main business vehicles existed for carrying out large scale ventures, namely the corporation and the joint stock company.[52]

Corporations had been used from the end of the sixteenth century and were created by the crown granting charters of incorporation.[53] They were legal entities distinct from their members, who were, theoretically, not liable for their debts.[54] However, limited liability was illusory in practice as the corporation would call on its members to meet its debts.[55] This form of incorporation also came with the expense and delay of attaining a charter.[56] On the other hand, the joint stock company had taken over the commercial scene by 1840.[57] It was essentially a sophisticated partnership with emphasis remaining on elements of association and joint stock.[58] Original partners could transfer shares according to partnership agreement.[59]However, even though their total number ran into four digits and the largest companies at the time had over one thousand members,[60] it was not recognised in law as a separate entity from its partners.

This remained the position until the passage of the 1844 Act under Gladstone leadership which provided for general registration and incorporation of Joint Stock

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[50] Ibid.
[51] P. D David, *Theories of legal personality and political pluralism*, Melbourne University Press, Melbourne 1958, 9.
[52] R. Grantham and C. Rickett "The Bookmaker's Legacy to Company law Doctrine" in R. Grantham and C.Rickett(eds) *Corporate Personality in the 20th Century*, Hart Publishing, Oxford, 1998, 1, 2.
[53] G.M *Charles worth & Morse Company Law*, 16th ed., Sweet & Maxwell, London 1999, 6
[54] Ibid.
[55] Davies & Worthington, n.13 at 22.
[56] Grantham & Rickett, n.52 at 3.
[57] L. Sealy "Perception and Policy in Company Law Reform" in D. Feldman and F. Meisel (eds), *Corporate and commercial Law: Modern Developments*, Lloyds of London Press, London, 1996, 22.
[58] Ibid.
[59] Grantham & Rickett, n.52 above.
[60] Sealy, n.57 above.

Company.[61] However, the 1844 Act was shortlived. The reason for the collapse of the 1844 Act can be attributed to three major factors. First, it was ineffective in that it could not prevent the transfers of stock as a means to avoid liability. Second, the 1844 Act made provision for joint and several, rather than pro rata, liability. This had the effect of deterring investment by wealthy individuals who feared that they might be primary targets for collection. Most importantly, the Depression of 1845-1848 and a public acceptance of limited liability for railways needed for industrialisation were major catalysts that led to reduced public opposition to limited liability.[62]

Before then, the South Sea Bubble had shifted the trajectory of English company law, so that instead of legal precedent arising from the seventeenth-century charter company activity, it now arose from nineteenth-century partnership law instead because the modern company emerged in a period when businesses were organised in the form of partnerships.[63] The impact of the partnership on the burgeoning company law lay in the application of its normative legal values of contract and agency laws. However, it was not until 1855, following the passage of the Limited Liability Act and the Joint Stock Act of 1856, that parliament adopted general limited liability.[64] It reaffirmed the provision of 1844 Act providing for general incorporation.

The acceptance of limited liability, asserts Blumberg, was a triumph of laissez-faire which made the process far from inevitable and the adoption became a reality only after a long struggle.[65] He contends that limited liability in England became available centuries after the emergence of the corporation as a legal unit[66] and the factors that favoured limited liability were increasing the scale of capital required for exploitation of continuing progress in technological innovation. This need encouraged an increased capital investment by middle-class persons, the growing

[61] Grantham & Rickett, n.52 at 3
[62] Blumberg, n.30 at17. See also P. Ireland, I.Grigg-Spell & D. Kelly, 'The Conceptual Foundations of Modern Company Law'(1987) 14 *Journal of Law & Society* 149.
[63] L.E Talbot, *Critical Company Law*, Rout ledge-Cavendish, Oxon, 2008, 11
[64] Although the acts excluded banks and insurance companies, banks were included in 1857 and insurance companies in 1862.
[65] Blumberg, n.30 at 17
[66] Ibid.

distribution of share ownership and declining shareholder participation in business, as well as the heavy capital investment required for railway construction.[67]

The history of the artificial entity theory outlined above demonstrates that the corporation's existence is a privilege granted by the state. The fiction or artificial person theory occupies a special place in English thinking, and has been called "the only theory about the personality of corporations that the common law has ever possessed."[68] It underlies Lord Macnaghten's famous dictum, in that most basic of all company law cases, *Salomon v, Salomon*: "The company is at law a different *person* altogether from the subscribers to the memorandum."[69] The artificial person theory raises two basic propositions: (1) that a corporation is an entity distinct from the sum of the members that compose it; and (2) that this entity is a person. These propositions are often confused; but they are properly quite distinct from one another.

The artificial entity view (otherwise referred to as fiction theory) is closely linked with the concession theory since, according to Dewey,[70] they both aimed toward the same general consequence, as far as the limitation of the power of corporate bodies is concerned. There are, however, different versions to this view. A strong version attributes the corporation's very existence to state sponsorship. A weaker version sets up state permission as a regulatory prerequisite to doing business.[71] Corporate status is presumed to apply once legislative prerequisites have been met. The judgement of the House of Lords in *Salomon's* case[72] is an example. In either version, the concession theory makes two claims about the corporation.

The first claim concerns the philosophical status of corporation: they are artificial entities. The existence of corporations as legal entities is dependent on law, as is the extent to which corporations can enjoy that existence: "corporate personality exists merely for legal and business convenience".[73]

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[67] Ibid at 17-18
[68] Holdsworth, n.48 above.
[69] *Salomon v Salomon,* [1897] AC 22
[70] Dewey, n.3 at 665
[71] W Bratton, 'The New Economic Theory of the Firm: Critical Perspectives from History' (1989) 41 *Stanford L.R*, 1471 at 1475.
[72] [1897] AC 22
[73] D. Bouham and D. Soberman, "The Nature of Corporate Personality" in Ziegel J.S (ed). *Studies in Canadian Company Law,* (1967) Butterworth's, Toronto, 5

The House of Lords decision in *Salomon v Salomon & Co Ltd* [74] provides an example of this aspect of concession theory. Lord Halsbury, for example, stressed that the company was an "artificial creation of the legislature" but stressed that once it was properly incorporated the company has a real existence".[75]

The second claim concerns the political status of the corporation. Concession theory sought to resolve the tension concerning the relationship of the company and the state. It tried to link the corporation's existence to the state, thereby preserving the separateness of the company from the individual. The theory claims that a group as such has no rights unless the state chooses to grant it legal personality. Concession theory therefore has the capacity to emphasise the interests of the public over the private interests of those individuals involved in it.[76]

The artificial entity theory, which views a corporation as a fictitious, artificial person, created by the state, existing only in contemplation of law, invisible, soulless and immortal, provides a convenient and useful framework for investigating the principle of corporate personality and its associated problems. The theory also provides further legitimation of a fuller application of social control through extension of the regulatory process over corporations and their economic activity.[77]

Whilst providing answers to the philosophy behind the evolution of a corporation and the fact that separate personality of the corporation is not absolute, the artificial entity theory has further been invoked when courts seek to go behind the separate legal entity of the corporation and impose liability on corporate officers.[78] Indeed, the theory establishes the basis for dealing with abuse of corporate personality.[79]

[74] [1897] AC 22
[75] Ibid.
[76] Bouham & Soberman, n.73 above
[77] Blumberg, n.36 at 29
[78] See Dewey, n.3; Zuhairah Ariff Abd Ghadas, n.23. See also the recent UK Supreme court decision in *Prest v Petrodel Resources Limited and others*, [2013] UKSC 34 at 36 ratio 80.
[79] Ibid.

There are limitations to the artificial entity theory such as the fact that it does not say much about what goes on inside the corporation in terms of private bargaining, individuals and private decisions in corporations.[80]

Despite its limitations, there is still potential in the theory particularly because of its far-reaching implications in the understanding of the nature of a corporation and the regulatory powers of the state in corporate matters.

2.3.2 Relevance of Theory to the Research

It has often been argued that none of the theories of corporate personality can adequately address all the issues in corporate law. John Dewey, for example, argues that there is no clear-cut line, logical or practical, between the different theories which have been advanced.[81] The basis of this position is that each of the theories has something to contribute.[82] As pointed out by Foster, the primary function of the English judge is to decide the case before the court, taking in mind policy considerations where possible, not to theorise about the nature of companies.[83] In this connection, Millon argues, decisions about the normative implications of legal theories, and indeed choices among theories themselves, take place against the background of interpretive conventions that are constantly shifting.[84] He asserts further that, even if we accept the general notion of a context that limits our beliefs about what is desirable, we need to keep in mind the context's dynamic, malleable property.[85] For him, therefore, it would not be safe to conclude that particular theories have a single or dominant tilt particularly in contemporary situations which keep changing in the midst of public policy controversies with normative implications which seems contestable at a very basic level, as does the choice of theory itself.[86]

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[80] Zuhairah Ariff Abd Ghadas, n.23 at 11. See also Bratton, n.29 above; M.C. Jensen & W.H. Meckling, 'Theory of the Firm: Managing behaviour, Agency Costs and Ownership Structure' (1976) 3 *J. Fin. Econ* 305.
[81] Dewey, n.3 at 669
[82] See Teubner,'Enterprise Corporatism: New Industrial Policy and the "Essence" of the Legal Person', (1988) 36 *AM J* 130, 138.
[83] N.H.D Foster, 'Company Law Theory in Comparative Perspective: England and France, (2000),4 *A J C L*, Vol.48 at 590. See also the general exposition given on this by Lord Diplock in *Roberts Petroleum Limited v. Bernard Kenny Limited*, [1983] 2 AC 192, HL at 192.
[84] Millon, n.26 at 250
[85] Ibid.
[86] Ibid.

For the purpose of this study, the artificial entity theory which considers the corporate entity as artificial, in the sense that a corporation owes its existence to the positive law of the state rather than to the private initiative of individual incorporators, will be used as a theoretical guide. Under this theory, the underlying entity of a legal person is an organisation which differs from its constituting members. The theory provides the conceptual basis for the evolution of corporation under the common law as well as the fundamental attributes of English company law which has been transplanted to Nigeria, such as legal personality itself, the law on fiduciary duty of directors (owed to "the company") and the law on minority protection (where it is "the company" which is the proper plaintiff in most circumstances).[87] It is credited as sufficiently explaining the underlying organisation characteristics of legal person, and explains the relationship between the organisation and its members. This theory is reflected in company law jurisprudence which recognises this underlying organisation.

The artificial entity theory views the corporation as a privilege granted by the state creating the artificial entity (concession). Under this understanding, the state is allowing this privilege for public benefit. Thus, where a company fails to operate in that manner, the artificial entity should be disregarded. This is the basis of veil piercing doctrine in corporation by the courts. As pointed out by Maurice Wormser, state's sufferance of the corporate form carried with it strong responsibilities, the shirking of which ought to result in the denial of corporate privilege.[88] He further wrote:

> A corporate entity will not be ignored at law and equity simply because the number of stockholders is few, or even one, unless the circumstances are such that would warrant the same disregard of the entity were there ten thousand shareholders... When the conception of corporate entity is employed to defraud creditors, to evade an existing obligation, to circumvent statute, or advertise or perpetuate a monopoly, or to protect knavery or crime, the courts will draw aside the web of entity, will regard the corporate company as an association of live, up-and doing, men and woman shareholders, and will do justice between real person.[89]

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[87] See Goddard, "Corporate Personality – Limited Recourse and its Limits," in R. B. Grantham & C. B. Rickett (eds.,), *Corporate Personality in the 20th Century*, Hart publishing, Oxford, 1998, 11. According to Grantham, "The theoretical underpinnings both "tilt" the outcome of cases and establish the criteria by which we evaluate the utility and legitimacy of the corporate form."
[88] S I. M. Wormser, 'Piercing the Veil of Corporate Entity' (1912), 12 *Colum. L. Rev.* 496,517.
[89] See S. B. Presser, *Piercing the Corporate Veil*, West Group Publishing Inc., Minnesota, 1997, 1-27.

Although Wormser's position has been criticised for relying very much on the discretion of individual judges and thus creating uncertainty for third parties, his view agrees with the premise of this research which is to find ways and means of dealing with those who abuse the corporate form under the guise of recognition of separate corporate personality and limited liability given to members of the corporation.

Again, the right to incorporate a corporation remains a privilege granted by the state, even if that privilege is exercised through the companies' legislation rather than through specific consents.[90] Indeed, Maitland considered that the Companies Act, rather than reducing the role of the state in controlling the existence of non-state groupings, actually increased it.[91] Indeed, it is impossible for a corporation to come into being in the UK today without being incorporated, which is an act of the state.[92] The recognition that a corporation is a separate legal entity in its own right is the foundation of modern corporate law.[93] Support for the principle of the separateness of legal personality, shared among academic commentators, has been unbroken in legislative and judicial circles. Similarly, the judiciary has, with minor exceptions, consistently reaffirmed the need to treat this legal doctrine seriously.[94] In other words, since the decision in Salomon's case, the complete separation of the company and its members has never been seriously doubted.[95] The ruling has, with few exceptions, stood the test of time.[96]

In sum, the independent legal personality of the company is fundamental to the whole operation of business through companies. This legal concept affects its

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[90] Such companies evolved from the societas of medieval law through various stages, with contributions from various sources, to the "deed of settlement" company which proliferated as a result of the Bubble Act (6 Geo 1, c 18) prohibition of companies acting as body corporate.
[91] Foster, n.83 at 583
[92] See Lord Templeman *in Arab Monetary Fund v. Hashim (No 3) [*1991] 2 AC 114, HL at 160: "registration under (under the Companies A ct) does not recognise a corporation but creates a corporation... when sovereign states enter into an agreement by treaty to confer legal personality on an international organisation, the treaty does not create a corporate body." See also Wedderburn, "Corporate personality and social policy: the problem of the quasi-corporation," (1967) *28 Mod. L. Rev. 67*. The only exception is the corporate sole.
[93] Salomon v Salomon, [1887] A.C. 22. HL
[94] R. Tomasic, J. Jackson, and R. Woellner, *Corporation law: Principles, Policy and Process*, 4th ed., Butterworths, Sydney, 2001, 97.
[95] Davies & Worthington, n.13 at 33
[96] Tomasic, Jackson, and Woellner, n.94 at 98

structure, existence, capacity, power, rights and liabilities. Although a company is a legal entity and has an independent legal personality, it is, of course, an artificial person or entity. Therefore, all the operations and activities have to be carried on by its organs and agents.[97]

However to hold that a company is attributable to an individual is a legal fiction; a company has no separate existence other than in the contemplation of law.

2.4 Corporate Personality Confirmed: The Salomon Case

The unanimous decision of the House of Lords in the famous case of *Salomon v Salomon*,[98] which is generally regarded as the cornerstone of English company law, established, or at least confirmed the principle that a company has a distinct legal personality with certain rights and duties, capable of owning property, entering into contract and suing and being sued. The rule in Salomon lies at the heart of corporate personality.

The facts of this case, which is known throughout the British Commonwealth and beyond were that one Mr Salomon carried on a business as a leather merchant.[99] In 1892, he formed the company Salomon & Co. Ltd. Mr Salomon, his wife and five of his children (who were nominal members) held one share each in the company.[100] Additionally, Salomon got £10,000 worth of secured debenture and £9,000 cash which represented the cost of sale of his private business to Salomon & Co. On being liquidated following collapse of the business, the company was able to pay debenture holders but not all unsecured creditors.[101] The question that arose on being taken to court was whether Salomon was the same person as Salomon & Co. so as to prevent him from taking priority over unsecured creditors. The claimants succeeded at both the High Court[102] and the Court of Appeal whereupon Salomon was found personally liable for the debts of the company. On further appeal to the House of Lords[103], the decision of the Court of Appeal was overruled. The conclusion of the House of Lords was that Salomon & Co, having been validly formed, enjoyed

[97] See *Trenco (Nig) Ltd v. African Real Estates Ltd* (1978) 1 L.R.N. 146, at 153, per Aniagolu J.S.C
[98] [1897] A.C. 22. HL
[99] Ibid at 23.
[100] Ibid.
[101] Ibid at 24
[102] Ibid at 26
[103] Ibid.

separate legal personality from Salomon and as such Salomon was not responsible for the company's debt.[104]

The company was not Salomon's agent and, consequently, Salomon's liability was to be determined solely by reference to the Companies Act 1862.

In the words of Lord Macnaghten:

> When the memorandum is duly signed and registered, though there be only seven shares taken, the subscribers are a body corporate "capable" forthwith', of exercising all the functions of incorporated company". Those are strong words; there is no period of minority on its birth, no interval of incapacity. I cannot understand how a body corporate such as this made capable by statute can lose individually by issuing the bulk of its capital to one person, whether he be a subscriber to the memorandum or not. The company is at law different person altogether from the subscriber... Nor are the members (subscribers) liable…[105]

In short, the House of Lords position was that the fact that some of the shareholders are only holding shares as a technicality was irrelevant; the registration procedure could be used by an individual to carry on what was in effect a one-man business.

Again, a company formed in compliance with the regulations of the Acts was a separate person and not the agent or trustee of its controller.[106] As a result, the debts of the company were its own and not those of members.[107] The member's liability was limited to the amount prescribed in the Companies Act-i.e. the amount they invested.

The Salomon case was a struggle between form and substance; whether to interpret the law literally or whether to consider more its presumed spirit and intention. Was a genuine association of seven proprietors really necessary to form a company, or would six nominees holding shares for the seventh suffice? Could a paper company really transact with the beneficial owner of its shares? The Lords accepted that if the

[104] Ibid at 27
[105] Ibid at 51
[106] Ibid at 31
[107] Ibid at 46

form of the company is within the letter of the law they would not look behind it to the substance.[108]

Thus the legal personality of the company affects its structure, existence, capacity, powers, rights and liabilities. Little wonder then that, Viscount Haldane L.C, in holding the same reasoning stated in *Lennards Carrying Co. v Asiatic Petroleum Ltd*[109] thus:

> A corporation is an abstraction, it has no mind of its own any more than it has a body of its own; its active and directive will must consequently be sought in the person of somebody who for some purposes may be called agent but who is really the directing mind and will of the corporation, the very ego and centre of personality of the corporation.

The significance of the House of Lords decision was that it supports the artificial entity view of the corporation and gave formal approval to shift in ideas about what "the company" was and about the uses it could be put. Today Salomon's case is commonly cited as authority for the notion of separate legal entity. In fact this principle was already established by the time the case had come to court;[110] the House of Lords merely gave the imprimatur of high opinion to the notion.

The decision of the House of Lords is not without both positive and negative effects. As Goulding explains, the reason for criticism of Salomon's case is two-fold.[111] First, the decision gives incorporators the benefit of limited liability in order to encourage them to initiate or carry on trade or business. Second, the decision affords opportunities to unscrupulous promoters of private companies to abuse the advantages that the corporations Act gives them by achieving "water-thin" incorporation of an undercapitalised company. This position appears to be true as it is evident that limited liability attracts small traders to the corporate form not because it represents an effective device with which to raise capital, but because it

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[108] A. Hicks & S.H. Goo, *Cases and Materials on Company Law*, Oxford University Press, Oxford, 2008, 96.

[109] (1915) A.C 705 at 713-714.

[110] See P. Ireland, "Legal Form, 1856-1914" in J. Adams (ed.), *Essays for Schmithoff* , Professional Books, Abingdon, 1983, 58. See also an early example of the application of separate legal personality in English company in the case of *Salmon v. The Harborough Co* which was decided in 1671. It has also been argued that the doctrine of separate personality is an ancient one which may be found in Roman law.

[111] S. Goulding, *Principles of Company Law*, Cavendish, Oxford Publishing Limited, London, 1996, 40

gives them access to an avenue via which they can escape the "tyranny of unlimited liability".[112] Criticisms of limited liability are addressed at its impact on creditors and on society at large.[113]

Separate legal personality and limited liability of members of corporations as held in Salomon's case applies in Nigeria.[114]

2.4.1 Implications of Salomon's Case

The principle of the Salomon case,[115] which establishes that a company is a legal entity distinct from its members, is strictly applied by the courts whenever it is sought to attribute the rights or liabilities of a company as belonging in law to its shareholders, or regard the property of a company as belonging in law or equity to the shareholders.[116] Thus, the fact that one shareholder controls all of or virtually all of the shares in a company is not sufficient reason for ignoring the legal personality of a company.[117] Furthermore, a company cannot be characterised as an agent of its shareholder unless there is clear evidence to show that the company was in fact acting as the agent in a particular transaction or series of transactions.[118] Likewise, the property of a company in no sense belongs to its members.[119] The company is not a trustee of its property for its shareholder even where the directors have been appointed trustees of some or all of the shares in a company.[120] A shareholder does not have an insurable interest in the assets of the company as restated in the case of *Macaura v Northern Assurance Co. Ltd*.[121]

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[112] F.B Palmer, *Private Companies: Their Formation and Advantages and the Model of Converting a Business into a Private Company*, 11th ed,. Stevens, London, 1901, 6.
[113] Farrar, n.48 at 66; Bonham & Soberman, n.73 at 5
[114] See CAMA s.37.
[115] [1887] A.C. 22. HL
[116] J. Birds et al., *Boyle & Birds' Company Law*, Jordan Publishing Limited, Bristol, 2009, 59. See also *Nigerian Civil Service Union (western State) v. Allen* (1972) U.I.L.R. 316 at 319.
[117] See, for example, *Tunstall v Steigmann [1962] BCC 593.*
[118] *Ebbw Vale UDC v. South Wales Traffic Area Licensing Authority [1951] 2 KB 366; Pegler v Graven [1952]* 2 *QB 69*
[119] *Bank voor Handel en Scheepvaart NV v Slatford [1953] 2 KB 366. See also Coleg Elidyr (Caephill Communities Wales) Ltd v Koeller [2005] 2 BCLC 379, at 401.*
[120] *Butt v Kelsen* [1952] Ch 197
[121] [1925] AC 619. Here an attempt by Macura to recover from the Insurance company the value of the burnt timber which he had sold to the Irish Canadian Saw Mills Ltd in return for the entire issued share capital of the company to be held by himself and his nominees and for which an Insurance policy was subsequently taken against the timber in his name was rejected by the House of Lords which held that the Insurance company was not liable, there being no insurable interest in the property even though he owned all the shares in the company.

The obvious lesson drawn from this case is that the company as a separate legal entity owns its own property and there is no legal connection between a share in the company and the company's property. Shareholders generally benefit from this because it facilitated limited liability, as the company also owns its debt. The shareholders in any company cannot exercise any rights in respect of property owned by their company simply because they have no estate or interest in that property. Conversely, as established by *Salomon's* case,[122] the company has no estate or interest in the property of its members.

The artificial entity theory is also reflected in Nigerian company law jurisprudence. Indeed, separate legal personality and limited liability of members of corporations as held in Salomon's case applies in Nigeria. For instance, section 37 of the Companies and Allied Matters Act 2004[123] reflects the separate legal existence which accrues to a company once it has been incorporated. Section 37 of the Act provides as follows:

> As from the date of incorporation mentioned in the certificate of incorporation the subscribers of the memorandum together with such other person as may, from time to time become members of the company, shall be a body corporate by the name contained in the memorandum capable forthwith of exercising all the powers and functions of an incorporated company including the power to hold land, and having perpetual succession and a common seal, but , with such liability on the part of such members to contribute to the assets of the company in the event of its wound up as mentioned in the act.

Therefore, the legal personality of a corporate body can only be established as a matter of law by production in evidence of the certificate of incorporation. Independent of its members, a company is now capable of exercising its powers as a body corporate.[124]

The courts in Nigeria have similarly, and without hesitation, acknowledged the separate existence of a company. In *Marina Nominees Ltd v F.I.B.R*[125], the Appellant sought to avoid its corporate liability by claiming to be an agent of another company. Rejecting this, the Supreme Court observed inter alia, that-

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[122] [1887] A.C. 22. HL
[123] See CAMA 2004, s.37
[124] Ibid.
[125] (1986) 2 NWLR 48

> ......the device of agency by using one incorporated company for the purpose of carrying on an assignment for another company or person must not overlook the fact that an incorporated company is a separate legal entity which must fulfil its own obligation under the law.

2.4.2 Company Contracts

As with individuals, companies can enter into contracts. However, there is a complication in the analogy with natural persons because a contract requires *consensus ad idem* (i.e., a, meeting of minds), and yet a company has no mind or will of its own. However, companies can be regarded as persons in the limited sense that they can do everything that natural persons may do through others. Furthermore, companies may also be deemed to have knowledge or notice.

The cases considered thus far also provide authority for the proposition that a company may contract with its shareholders and directors. *Lee v Lee's Air Farming Ltd*[126]develops this point. In this case, it was held that Lee, who formed a company in which he was beneficial owner of all the shares and was also "governing director", was nevertheless a separate entity from his company and that he, as governing director, could, on behalf of the company, give orders to himself as servant.

Lee's case explains the fact that a company in exercise of its independent mind as a legal person to control the company can make a valid and effective contract with one of its members. It is therefore possible for a person to be at the same time wholly in control of a company (as its principal shareholder and sole director) and employee of that company, the latter acting in an independent capacity. This epitomises the fact that the company as an artificial entity is distinct from its members and can validly enter into contract with those that constitute it. It confirms *Salomon v Salomon & Co. Ltd* in making it clear that the number of shareholders and the nature of their interests in the company are irrelevant to any issues relating to, or derived from, the proper recognition and separation of the company as a legal entity.[127]Lee's case also epitomises the separation of a company's contractual and other proprietary rights and liabilities from those of its members and reiterates the principle, which tends to have universal effect, that the proprietary, contractual and other powers which a company

[126] [1961] AC 12
[127] M.A. Pickering, 'The Company as a Separate Legal Entity', (1968), 5 *M L R*, Vol.31, 490

may possess are in no sense derivative from or dependent upon its members.[128] In this connection, the company as an artificial person is an entity possessing independently of its membership the legal capacity to exercise proprietary, contractual and other powers. As such, even though Lee is a Governing director, the company is in law an entirely separate entity. Lee, as a manager, was not therefore controlling himself as an employee; instead, and as an employee, he was being controlled by the company through its director. When the company's existence and rights were recognised in this way Lee's status as "a worker" within the meaning of the law was no different from that of other employees.

In the Nigerian case of *Aso Motel Kaduna Ltd v Deyamo*[129], the appellant, a company wholly owned by the Federal Capital Development Authority (FCDA) established by section 3 of the Federal Capital Territory Act, Cap, 128 Laws of the Federation of Nigeria, 1990 and carrying on hotel and catering services in Kaduna State of Nigeria, was in default of payment in respect of several cartons of fish, turkey and chicken supplied to it on credit by the respondent. In an action brought against it under the undefended list for the sum of N969, 750 (nine hundred and sixty-nine thousand, seven hundred and fifty naira) being the principal amount and interest accrued, the appellant sought for an order setting aside the judgment of the trial court entered against it and for the Court of Appeal to strike out the suit for want of jurisdiction on the grounds that the appellant was an agent of the Federal Government.

Dismissing the appeal, the court held (among other things) that the company is in law a different person from the subscribers; it held that the fact of incorporation entails that the company has a distinct personality and distinct identity from its shareholders, subscribers and promoters. As such, it was not deemed an agent of its shareholders, meaning that the appellant cannot be held to be an agency of the Federal Government of Nigeria even if all its shares are wholly owned by that Government.

The question of whether a party, in his private capacity, can be made to indemnify another for the wrongful acts of a company of which he is a director and when the

[128] Ibid. at 499
[129] (2007) All FWLR, 1444 at 1448 ratio 1.

said company is in breach of a contract to pay money on sale of goods was answered in the negative by the Nigerian Supreme Court in *Okafor v. A.C.B Ltd & Anor.*[130] The facts leading to this case involved a claim by the African Continental Bank Ltd. (as plaintiffs) against Widi Jalo (as defendant) for money lent by the Bank to the said Jallo. The loan was made for the settlement of the purchase price of cement bought by a company known as Ekhanatone Ltd. from another company known as Misr (Nigeria) Ltd. On the application of Widi Jallo, Okafor was joined as a third-party by the court. Widi Jallo later admitted to the plaintiff claim but subsequently claimed contribution from Okafor in the third party proceedings which followed.

The learned trial judge gave judgment for the plaintiffs in their claim against Widi Jallo. In the third party proceedings for contribution brought against Okafor, the learned trial judge observed that Okafor was a joint adventurer with both Widi Jallo and Mikawi in the cement deal and that the loan, which is the subject matter of the plaintiff's claim, was advanced by the plaintiffs to Widi Jallo for the settlement of the purchase price of cement sold by Misr (Nig) Ltd to them. He then made contribution against Okafor.

The third party, Okafor, appealed against this order for contribution. In coming to the conclusion that a company is a separate entity from the person who owned it, the court held that the party who should reimburse Widi Jallo for the payment and who should have been called upon to indemnify him is Ekhnatone Ltd and not Okafor. The court further held that the parties (whoever they are) formed Ekhnatone Ltd. for the purpose of the business with Misr (Nig) Ltd. and Widi Jallo paid the money, not on behalf of himself and Okafor, but on behalf of Ekhnatone Ltd.

2.4.3 Perpetual Succession

The separate legal existence of a company presupposes that changes in membership have no effect on its status or existence. This is a major advantage of the incorporation of a company which other business enterprises such as partnership do not enjoy. Thus, with an incorporated company freedom to transfer of members' interest, both legally and practically can be readily attained. The company can be incorporated with its liability limited by shares, and these shares constitute items of property which are freely transferable in the absence of express provision to the

[130] [1975] N.S.C.C. , 276 at 277.

contrary, and in such a way the transferor drops out[131] and the transferee steps into his shoes.

As an abstract legal person, the company cannot die, although its existence can be brought to an end through the winding up procedure. As pointed out by Gower, a company is not susceptible to the thousand natural shocks that flesh is heir to.[132] It cannot become incapacitated by illness, mental or physical, and it has not (or need not have) an allotted span of life.[133] The death of a member leaves the company unmoved; members may come and go but the company can go on forever.

From the combination of these principles flow all the well-known practical aspects of separate legal entity. For example, due to its separate proprietary and other capacity the company may enjoy perpetual existence as an artificial entity recognised by law, its usefulness as an entity for accounting purposes is given a legal foundation, and the possibility is opened that its members may limit their liability.

2.5 Concept of Limited Liability

Although the doctrine of separate legal personality of the company and limited liability are distinct in origin, for the most part in business companies they go hand in hand. Salomon's case held that a company's property is not the property of the members and its debts are not the debts of the members. As such, and in combination with the principle of separate corporate identity, the principles have lent themselves to the concept of limited liability. Of course, it is for the company at the time of incorporation, to determine the liability of its shareholders and this is a matter removed from its corporate personality status. Also, a company can have legal personality without limited liability if that is how it is conferred by the statute.[134] However, companies formed for business purposes in practice invariably give the shareholders the benefit of limited liability. Consequently, for a variety of reasons including shareholders security and economic efficiency, most companies in the UK and in Nigeria, are limited by shares so that members may limit their level of investment. A person dealing with a company is dealing with a company as a

[131] CA 2006, s.544. Subject only to a possible liability under ss. 74 and 76 of the Insolvency Act 1986 if liquidation follows within a year and the shares were not fully paid up or were redeemed or purchased out of capital.
[132] Davies & Worthington, n.13 at 44.
[133] *See Daimler v Continental Tyre and Rubber Co* [1916] 2 A.C. 307 HL
[134] CA 2006, s.3

separate entity alone and the liabilities of members are limited by the amount they invested. Indeed, company as separate entity with liabilities of members limited create potential problems of abuse.

The limited liability company as a separate legal entity is a creation of statute and a key feature of the corporation. It is a privilege and concession of the state conferred on corporations for public interest, first in England in 1855 after much struggle[135] and then by subsequent legislations.

The legal existence of a company (corporation) means that it can be responsible for its own debts.[136] In a limited liability company, the liability of individual members is limited to the amount of money which each has agreed to contribute to the common capital fund. As soon as the person has paid for the amount of shares he has agreed to subscribe to, his liability is ended.[137] This invariably encourages investment and insulates the members from paying for the debt of the company beyond their investment in the case of failure. By contrast, in a partnership which is governed by the Partnership Act 1890,[138] Partnership law 1973,[139] Partnership law 1976,[140] and Partnership law of 1959,[141] members are liable to an unlimited extent to the last penny of their private fortune in order to meet the debts and obligations of the business.[142]

Limited liability presupposes that shareholders are under no obligation to the company or its creditors beyond their obligations on a par with the value of their shares or under their guarantee in case of a company limited by guarantee.[143] Analysed from two perspectives, limited liability, from a shareholder standpoint, is essentially set up to "restrict" shareholders' liability in order to contribute their own assets to the assets of the company in the event of its assets being insufficient to meet the claims of the creditors during liquidation".[144] Within Nigeria and in the UK,

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135 Blumberg, n.30 at16-17
136 N.Hawk, *Corporate Liability*,Sweet & Maxwell, London,2000, 108.
137 M.Bainbridge, Abolishing Veil Piercing, (2001) *J. Corp. L.*, 479, 480
138 A statute of general application applicable in Eastern and Northern States of Nigeria
139 Applicable in Lagos Nigeria
140 Applicable in former Bendel State (now Edo and Delta States of Nigeria)
141 Applicable in all Western States with the exclusion of Lagos State of Nigeria
142 See S.46 of partnership laws 1973; 1976 and 1959 applicable in Lagos State, former Bendel State and Western States of Nigeria.
143 Farrar, n.48 at 80
144 Insolvency Act 1986, s.74

either in a company limited by shares, or in a company limited by guarantee, no contribution is required from any member exceeding the amount (if any) unpaid on the shares or the amount undertaken to be contributed by him to the company's assets in the event of its wound up.[145]However, when a company with a share capital is wound up, "every member of the company is liable (in addition to the amount so undertaken to be contributed to the assets), to contribute to the extent of any sums unpaid on shares held by him."[146]

Although a company is "an artificial being, invisible, intangible and existing only in the contemplation of the law",[147] it is the company itself, rather than shareholders, that is responsible for the company's debts. It is the liability of the members to contribute to meeting those debts which are limited.[148]

From the creditor's viewpoint, their claims are limited to the assets of the company and cannot be asserted against the shareholders' assets.[149] The importance of limited liability shows itself in the legal relationship between the company and its shareholders if the company becomes insolvent because it has insufficient assets to meet the overall claims of the creditors.[150] In that situation, it is the company itself which bears unlimited liabilities for its debts, while its shareholders only assume the limited loss of their investment which has already been contributed to the company at the start.

Limited liability results in the shifting of the risks of entrepreneurship from shareholders to creditors.[151] If the company does well, the gains are passed on to the shareholders. But if the company fails, the creditors will suffer the losses.[152] The limited liability concept is aimed at giving investors minimum insurance in their business over their own private lives. Thus, creditors who have claims against the company may look only to the corporate assets for the satisfaction of their claims as creditors and generally cannot proceed against the personal or separate assets of the

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145 Insolvency Act 1986, s.2(d) & s.3.
146 Insolvency Act 1986, s.3
147 *Trustees of Dartmouth College v Woodward*, n.43
148 P. Davies, *Introduction to Company Law,* Oxford University Press, 2010, 10-11.
149 Ibid.
150 Ibid..
151 M. R Salim, Corporate Insolvency: Separate Legal personality and Directors' Duties to Creditors, available in http://ssrn.com/abstract=1462906 accessed on 16/2/11.
152 Ibid.

members. This has the effect of capping the investors risk whilst their potential for gain is unlimited. The rationale for limited liability according to Davies, lie essentially in the encouragement of public investment whilst facilitating public markets in shares.[153]

2.5.1 Justifications for Limited Liability

The limited liability company has been described as the flagship of the modern capitalist economy and the vehicle for economic expansion.[154] The limited liability company stimulates economic growth by significantly removing an individual shareholder and/ or director from the economic risks associated with business failure, thereby increasing the incentive for individuals to engage in business activity.[155] From this view, limited liability is a means to motivate the market supposedly to the advantage of the public good.[156]

Kraakman argues that limited liability has become a nearly universal feature of the corporate form and that its evolution indicates strongly the value of limited liability as a contracting tool and financing device.[157] According to him, limited liability is a (strong) form of 'owner shielding' as opposed to 'entity shielding'[158] which legal personality provides. He argues that while entity shielding protects the assets of the firm from the creditors of the firms owners, limited liability protects the assets of the firm's owners from the firm's creditors and both set up a regime of what he describes as 'asset partitioning' whereby business assets are pledged as security to business creditors, while the personal assets of the business's owners are reserved for the owners' creditors.[159]

Frank Easterbrook and Daniel Fischel in their classic work of law and economic scholarship, *The Economic Structure of Corporate Law,* argue that limited liability reduces transaction costs and enhances the efficient and smooth running of the

[153] Davies, n.148 above.
[154] S. Griffin, Limited liability: A Necessary Revolution?, (2004),*The Company Lawyer* Vol. 25 No. 4, 99.
[155] Ibid.
[156] Ibid.
[157] R. Kraakman et al., *The Anatomy of Corporate law: A Comparative and Functional Approach*, 2nd ed., Oxford University Press, Oxford, 2009, 1-5.
[158] Ibid.
[159] Ibid.

securities markets.[160] This in turn lowers the costs of capital, which in turn increases economic output and the public welfare.[161] They advance six reasons: (1) Limited liability reduces the entity's and its shareholders' need to monitor its agents, which makes passive investing and diversification a more rational strategy, reducing the costs of operating the entity.[162] (2) Limited liability reduces the need to monitor other shareholders to see whether they can properly bear the risks the entity plans to or is undertaking.[163] (3) Limited liability promotes the free transfer of shares, which creates incentives for managers to act efficiently since the results of their inefficient actions will be punished by the market.[164] (4) Limited liability makes shares homogenous commodities that reflect all the information publicly available about the entity. In situations of unlimited liability, not all shareholders would be able to access relevant risk information, and would thus value the share price differently. When all investors can trade on the same terms, investors will know the price reflects all information.[165] (5) Limited liability allows for more efficient diversification of one's assets. In a regime of unlimited liability, the rational strategy would be to minimize one's holdings since any one holding could explode and force one into bankruptcy. Diversification is desirable since it is a much safer strategy and will induce investors to put more capital into the markets; investors will be able to better balance their risks.[166] (6) Limited liability prevents managers from becoming unduly risk averse.[167]

The arguments above on the justification for limited liability are based on purely efficiency–based rationales or how to make the company grow. This seems to have neglected the potential for abuse such as fraud which may result from the concept. Corporate statutes all confer limited liability in general terms.[168] There is no distinction between contract and tort - based claims or between closely-held or

[160] F.H. Easterbrook & D.R. Fischel, *The Economic Structure of Corporate Law*, Harvard University Press, Cambridge, Mass., 1991, 40.
[161] Ibid.
[162] Ibid, at 41-42
[163] Ibid, at 42
[164] Ibid, at 42-43
[165] Ibid, at 43
[166] Ibid.
[167] Ibid, at 44; See also D.L 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), 3 *Oklahoma Law Review*, vol. 51, at 438.
[168] See for example CAMA 2004, s.21 (1) (a &b) and CA 2006, s.3 (1-4).

public corporations. This is very important because while transactions based on contract reflect a voluntary assumption of risk by parties entering into it, tort creditors are not party to any transaction and as such the risk is totally involuntary. As can also be seen below, the risk factor is greater in closely held companies than in public corporations [169] largely because of the nature and control of those corporations. This point relating to contract will further be developed in subsequent chapters.

2.5.2 Consequences of Limited Liability

Despite the benefits of limited liability, it presents certain obvious consequences.

First, limited liability encourages shareholders to seek opportunities and embark on excessively risky investments which tend to impair the efficiency of the capital markets. Although, risk is an ingredient in the generation of economic growth, the downside of risk is that it encourages continued trade in circumstances where the health of an enterprise is critical, to the point of fatality. Shareholders have an incentive to allow the company to undertake excessively risky ventures without adequate assets to carry the risk because they will gain all the resultant benefit but will not bear the high risk of failure since the risk has been externalised.[170] This shareholders' incentive to enlarge outcome in terms of profitability of the whole enterprise without taking correspondent responsibilities by transferring risk to creditors seriously impairs creditor's benefit. This can be regarded as a moral hazard[171] for the whole of society in terms of both undermining creditor's confidence and providing an incentive to encourage economic growth through the instrumentality of the corporation.

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[169] See R.B Thompson, 'Piercing the Corporate Veil: An Empirical Study', (1991) 76 *Cornell L. Rev*. 1036, at 1036-37. Thompson empirical studies revealed that piercing frequently occurs in the context of close corporation, due to the usually small number of shareholders.

[170] C. Stone, The place of enterprise liability in the control of corporate conduct, *Yale Law Journal,* 1980, 90, No.1, 1at 65-76.

[171] A moral hazard is where one party is responsible for the interest of another, but has an incentive to put his or her own interest first. As in a company, many of these moral hazards involve increased risk-taking by corporate controllers unanticipated by creditors when credit was given. Inadequate control of moral hazards is certainly a recurring theme on issues affecting the corporate form and often leads to loss of confidence by creditors and investment. For details of meaning of moral hazard see: http://www.org/pubs/Journal/cj29nl/cj29nl-1 accessed 1 November, 2011.

Another potential cost of limited liability could be most evident when those who benefit from limited liability also have control of the company's management. This has led to a situation whereby shareholders may be tempted to use their power of control in an opportunistic[172] manner so as to benefit themselves. A common behaviour in this regard is the tendency to shift assets into the company when they need to raise credit and out of the company when the time comes for repayment. This practice is clearly evident in small companies or what is called close corporations where the shareholders and directors may be the same people, so that the control of the company is directly in the hands of the beneficiaries of limited liability.[173]

Again, ever since the House of Lords handed down its decision in Salomon's case, legal doctrine regards each corporation as a separate legal entity. When coupled with the consequent attribute of limited liability, the principle provides an ideal vehicle for fraud.[174] Because of its malleability and facility for protecting directors and members against the claims of creditors, the corporate form has been responsible for the development of many different forms of fraudulent or anti-social activity. A typical illustration involves the situation where a small group of persons set up a limited liability company that is undercapitalised. The owners then cause the corporation to incur large debts in its own name, with little prospect of being able to repay the loans. When the company's creditors seek repayment of the debts, the owners argue that because the company as a separate legal person owes the debt, neither the directors nor members are liable.[175]

Thus when discussing the limits of limited liability, Easterbrook and Fischel also differentiate between smaller and larger firms, and parent and subsidiary firms.[176] They claim that in smaller firms, usually called "close corporations", there is much less separation between management and risk bearing. Since the suppliers of capital for small firms also tend to be involved in decision making, limited liability does not

[172] This term is used to refer to self-interested behaviour which involves some element of deception, misrepresentation, or bad faith. See O Williamson, *The Economic Institutions of Capitalism*, Free Press, New York, 1986, 30. According to Davies, the term is not a legal term and the law may or may not characterise a particular example of opportunistic behaviour as illegal. See Davies, n.137 at 61.
[173] Thompson, n.169 above; See also Easterbrook et al., n.160, at 56; Jenkins report of the Company Law Committee, Cmnd. 1749, 1962 at Para. 20.
[174] Tomasic, et al., n.94, at 97
[175] See *Nigerian Deposit Insurance Corporation v Vibelko Nigeria Limited* [2006] All FWLR, PT336, 386, at 391 ratio 6.
[176] Easterbrook, n.160, at 55-56

reduce monitoring costs as much. Additionally, since close corporation shares are not freely tradable, the other benefits of limited liability such as facilitating efficient risk bearing and monitoring by secondary markets are absent. Finally, managers in close corporations, have a greater incentive to engage in overly risky projects than managers in public corporations since they have less to lose.[177] Subsidiary firms, like close corporations, have a greater moral hazard problem than public corporations.[178] This is the case because allowing creditors to reach the assets of a parent does not create unlimited liability for any investor. Easterbrook and Fischel argue that this extra liability defence creates an incentive for subsidiary managers to engage in overly risky endeavours, or to engage in risks greater than they would if the subsidiary were an independent organization.[179] As a result of the above differences they find a stronger justification for limited liability in large corporations than in small firms or subsidiaries.

Easterbrook and Fischel conclude their analysis of the limits of liability with the observation that the moral hazard inherent in limited liability will sometimes lead the courts to set aside the protections of limited liability.[180] They argue that the traditional doctrines advanced for piercing the corporate veil are "obscure," "arbitrary," and "singularly unhelpful".[181]

This raises the question whether limited liability for shareholders should be forsaken in favour of a new more appropriate standard which in the words of Dobson might be: "liability derives from control".[182] This would mean that whenever there is a finding of company control, liability for the debts of the controlled company should be placed on the controller when the corporate form has been abused, the company being used as an instrument of fraud or a "sham" or "facade", that the company is the agent of the shareholder, that the companies are part of a "single economic unit" or even that the "interests of justice" require the result.[183]

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[177] Ibid. This is the case because closely held corporations have proportionately fewer assets than public firms, and with limited liability their losses are limited to their assets.
[178] Ibid, at 56.
[179] Ibid.
[180] Ibid, at 54-55.
[181] Ibid.
[182] J. Dobson, 'Lifting the Veil in Four Countries: The law of Argentina, England, France and the US', (1986) 4 *The International Comparative Law Quarterly*, vol.35, 839-863.
[183] Davies & Worthington, n.13, at 217; See also *Re a Company* [1985] BCLC 333.

Commentators have further examined the economic effects and justifications of limited liability, exploring alternative regimes which includes but are not limited to the suggestion for an unlimited liability as it pertains to involuntary creditors.[184] Limited liability has been criticized, for example, on the basis of moral hazard,[185] its propensity to encourage excessive risk-taking at the expense of creditors.[186] Against this position, it has been argued that the abolition of limited liability would not obviate the problem of moral hazard and that ultimately a trade-off is involved, under which the benefits of limited liability, in facilitating separation of investment and management functions and in enhancing the efficiency of capital markets, outweigh its deficiencies.[187] This work holds the former view, and will go further to posit the notion that shareholders' protection in corporate matters has unduly been exploited to the detriment of creditors in Nigeria and thus there is the need to strike a better balance between them and the creditors.

In addition to the negative aspects of limited liability outlined above, the concept of limited liability may be attacked on other fronts. First, the ease by which private limited liability companies can be incorporated encourages undercapitalised concerns, so endangering small trade creditors, consumers and tort victims, the law frequently depriving the creditor, the consumer or the injured party of remedy.[188] Limited liability appears especially deficient when it serves to bar recovery for corporate injuries to certain persons such as involuntary creditors and the fact that it creates serious externalities and inefficiencies in particular areas is evident in these categories of persons mentioned above.

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[184] Easterbrook and Fischel, "Limited liability and the Corporation" (1985) 52 *U Chi L Rev.,* 89, at 104; Manne, "Our Two Corporation Systems: Law and Economics" (1967) 53 *Va L Rev* 259, at 262; Thompson, n.169; Hansmann and Kraakman, "Towards Unlimited Liability for Corporate Torts" at 1916, who argue, in relation to tort liability that "capital markets, and in particular the stock market, would continue to function efficiently with unlimited (*pro rata*) shareholder liability".

[185] Easterbrook, n.160 above. See also P. Halpern *et al.,* An Economic Analyses of Limited liability in Corporation Law, (1980) 30 *U. TORONTO LJ* 117, 129-31 ("The Existence of Organised Securities Markets"). The moral hazard problem highlights the relevance of broad policy considerations, in addition to efficiency, to determining the proper scope of limited liability; in the specific case of mass risk a trade-off is posed between stimulating corporate investment and protecting social welfare.

[186] See for example, Landers, " A Unified Approach to Parent, Subsidiary and Affiliate Questions in Bankruptcy" (1975) 42 *U Chi L Rev* 589.

[187] Easterbrook and Fischel, n.160

[188] Griffins, n.154 above.

2.5.3 Impact of Limited Liability on Creditors

Creditors in spite of their recognition as key participants in corporate affairs have remained a vulnerable group both in the UK and Nigeria. Their vulnerability has been attributed largely to the unique nature of the company as business vehicle characterised by separate legal personality and limited liability which creates externalities and uncompensated risk to them whilst insulating shareholders or those who own, run and manage the affairs of the company from liability in the event of corporate failure.[189] Members of the company by virtue of the limitation of their liability are not required by law to contribute their own capital to satisfy the company's obligations except if there is any amount unpaid in their shares. Consequently, creditors whose claims have not been satisfied by the company, cannot, in principle, proceed against the personal property of shareholders. Whilst voluntary creditors can adequately maintain action against the company for return of their credit, and notwithstanding the risk involved in the event of corporate failure, such action by the involuntary creditors has remained enmeshed in a great deal of controversy and in most cases has proved unsuccessful.[190]

2.5.3.1 Who is a Creditor?

Creditors of a company are those who, by their relationship with the company, advance credit or perform services for the company under a contract to whom the latter owe an obligation.[191] However, this definition is not all encompassing as, within the context of company law, creditors include not only those who lend money or perform services to the company under contractual terms such as banks, trade creditors, customers and employees but also those who do not have any relationship with the company but are victims of corporate actions such as tort victims or innocent third parties. Thus creditors are broadly divided into two types. These are voluntary creditors representing those who have a relationship with the company based on contract and those generally referred as to as involuntary creditors i.e. victims of tort. The two combined together make up what is called company creditors. They include customers, consumers, and employees, lenders including banks and financial institutions and tort creditors.

[189] P.Halpern, et al, n. 185 at 118.
[190] See *Adams v Cape Industries Plc*. [1990] 1 Ch. 433
[191] A O'Sullivan & S.M. Sheffrin, *Economics: Principles in Action*, Pearson Prentice Hall, Upper Saddle River, New Jersey, 2003, 204.

2.5.3.2 Voluntary Creditors

Three groups of creditors have emerged as those constituting voluntary creditor.[192] The first are trade creditors who supply goods and services to companies and then advance credit by not requiring immediate payment. The second consists of institutional lenders such as banks who lend money to companies. A key method of bank lending is the overdraft, which allows a company to borrow by overdrawing on a bank account. The third class is composed of creditors whose right to payment is evidenced by a certificate the company has issued. This group of persons are called debenture holders. Creditors get returns on their investment by way of yield or interest and the contract it maintains with the company ultimately stipulates the terms of repayment or maturity of yield.[193]

The relationship between a company and its creditors as pointed out earlier is largely contractual in nature and gives the creditors different rights from those of the shareholders who are members of the company. Consequently, the debt owed them is by the company and not the shareholders. However, they rank ahead of any claims which the shareholders have against the company. This is particularly evident in times of liquidation when creditors have priority over shareholders since the debt owed must be paid before any assets can be distributed to the members.[194]

Since the creditors enter into contract with the company "in substantial awareness of the risk of injury involved", it has been argued that they have to take the consequences of the risk involved if the company fails to meet its obligation. In view of the potential problem they face in contracting with the company, creditors have taken some protective or "self-help" measures to protect their interest by negotiating favourable terms in the contract, insisting on guarantee or security and other self-help mechanisms. These include getting adequate information about the financial stability of the company before initiating a transaction or exerting a premium payment in exchange for accepting the risk involved in the investment.[195]

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[192] B.R.Cheffins, *Company Law*, Clarendon Press, Oxford, 1997. 71
[193] Ibid.
[194] J. Charkham, *Keeping Good Company: A Study of Corporate Governance in Five Countries*, Clarendon Press, Oxford, 1994, at 36, 100-1, 299.
[195] F. Easterbrook & D. Fischel, n. 160 at 50.

For the big lenders such as banks, in particular, they can ask for higher interest rate as compensation for not only the money lent, but also for the risk they stand to face in the event of default in payment.[196] Not only can they charge adequate interest rates, but they can also insert loan covenants. These agreements may for instance generally restrict the freedom of borrowers to distribute assets to shareholders[197] or may prohibit distributions when financed by issuing debt.[198] They may also require compliance with a specific debt-to-equity ratio or a particular cash flow development.[199] Creditors can also include in the contract a requirement that would entail the company to furnish them with regular financial information.[200] Over all, loan covenants tends to provide some control rights to creditors, so that the risk of default is not opportunistically higher than it was at the time of contracting. In addition to the above, creditors can still request for security in form of a charge or a floating charge which will crystallize due to the manner set out in the contract.[201] Obtaining security for these big creditors has the tendency of reducing their financial exposure as they are given a privileged position if the debtor becomes insolvent. However, it is not a viable option for many creditors, especially the smaller ones, as the costs and time involved in organising security could well mean that their profit margins are grossly depleted.[202] It is also most likely that they will not be familiar with the necessary arrangements for the taking, and the benefits, of security.

In terms of close corporation setting, where statutory limited liability may have only limited value, many creditors, especially banks and other lenders as well as many suppliers, require a personal guarantee from the corporation's shareholders.[203]

For trade creditors who supply goods and services to the company in return for full or instalment payments at a later date, their position seems precarious as they do not request personal guarantees from shareholders and lack the skill and capacity like the

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[196] Ibid.

[197] Luca Enriques & Jonathan Macey, 'Creditors versus Capital Formation: The case Against the European Legal Capital Rules', *Cornell Law Review*, 86, 1172.

[198] Ibid at 1188.

[199] Wolfgang Schon,'The Future of Legal Capital', (2004) *European Business Organisation Law Review* 5, 439.

[200] Halpern, et al . n.189 at 135.

[201] P. Davies, 'Legal Capital in Private Companies in Great Britain', *Aktiengesellschaft*, 1998, 386.

[202] V. Finch, 'Directors' Duties: Insolvency and the Unsecured Creditor', in A. Clarke (ed), *Current Issues in Insolvency Law*, Stevens, London, 1991.

[203] W.A. Klein & J.C. Coffee Jr., *Business Organisation and Finance*, Oxford University Press, Oxford, 2002, 142.

big lenders to gather enough information about the transaction before bargaining and spreading risk. Again, they do not have an incentive to spend considerable time and resources for exhaustive negotiations with a company, since they do not extend huge amount of credit. Competitive pressures can even cause them to shy away from demanding the contractual protection they might value.[204] And because they provide goods and services to a great number of customers, trade creditors do not negotiate terms with each of them separately. Instead, they make use of standard forms of contract.[205] In consequence, therefore, what emerges is the use of standard forms of uniform terms which apply to all contracts in order to save transaction costs. Following these inadequacies of lack of bargaining skills and widespread use of standard for contracts, trade creditors rarely embark upon an investigation of the creditworthiness of a particular company.[206] To this extent, trade creditors remain the most vulnerable group among the voluntary creditors.

In view of the above, the question whether trade creditors are voluntary or involuntary creditors has been a subject matter of debate among commentators with no agreement on their status. For Blumberg, trade creditors "are simply not in business to bargain for credit".[207] On the contrary, Easterbook and Fischel regard them as voluntary creditors able to demand compensation for the risk that they face.[208] Since the trade creditors have a clear relationship with the company in terms of goods and services supplied, it is difficult to put them in the class of involuntary creditors. It is submitted that trade creditors are voluntary creditors notwithstanding the perceived anomalies in their transactions with the company.

Nonetheless, some form of protection still exists for trade creditors. This may come in the form of higher prices for goods supplied or the inclusion of retention of title clauses in their contracts with the company.[209] The retention of title clauses meant, in effect, that goods supplied to the company are subject to the reservation of title to the seller until the payment of the price thereof. Although this procedure is widely in use in most of continental Europe and in the US for a long time, it became an acceptable

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[204] Cheffins, n.192 at 540.
[205] See R. Goode, *Commercial Law*, Sweet & Maxwell, London. 1982.
[206] For issues relating to standard form of contracts, see J.M. Landers,' Another Word on Parents, Subsidiaries and Affiliates in Bankruptcy', 43 *Univ. of Chi. L.Rev.*, 1976, 527 at 530.
[207] Blumberg, n.36
[208] Easterbrook & Fischel, n.160, at 104
[209] Cheffins, n.192 at 82.

feature in the UK in 1975 following the decision in *Aluminium Industries Vaassen Bv v. Romalpa Aluminium Ltd*.[210] Thereafter, such clauses became known as "Romalpa clauses". In Nigeria, such clauses are not readily available in the absence of any authority. However, there is an implied term in the contract that the reversionary interest in the goods supplied still remains with the seller until payment is made. In any event, the perceived protection afforded by retention of title clauses to trade creditors is neither comprehensive nor always effective. Its operation seems to be in favour of sellers of goods and not those who perform some services to the company. Besides, their validity is not always upheld.[211] This is largely because, in most cases, the courts treat them like charges with the effect that their non registration renders them valueless, as against a Receiver or a liquidator.[212]

From the above, it is submitted that creditors, particularly trade or small creditors, bear enormous risk from the effects of limited liability who lack the capacity to negotiate and elicit favourable terms from the company. The risk of a company's failure is shifted to them and the likelihood that they will take enough measures to avoid such risk remains largely remote. To this extent, limited liability remains a potential source of danger to this class of creditor.

2.5.3.3 Involuntary Creditor

Involuntary creditors refer to persons who become creditors of the company not by agreement or contract with the company but by virtue of the company's action or omission to them.[213] Accordingly, since they never wanted to become a creditor of the company, they are inherently weak or non-adjusting.[214] The class of persons who fall under this category are essentially victims of accident and consumers. Unlike the voluntary creditors, involuntary creditors do not have any opportunity to assess the possible dangers as regards the company or bargain for personal guarantees or other

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[210] [1976] 2 All E.R. 552.
[211] N. Savage & R. Bradgate, *Business Law*, Oxford University Press, Oxford, 1987, 325-328
[212] See *Compaq Computer Ltd v. Abercorn Group Ltd*, [1991] B.C.C. 484.
[213] A. Keay, *Company Directors' Responsibilities to Creditors*, Routledge-Cavendish, New York, 2007, 15
[214] F.S. Machado, Effective Creditor Protection in Private Companies: Mandatory Minimum Capital Rules or *Ex Post* Mechanisms?, available at: http://ssrn.com/abstract=1568731, assessed 14 November, 2012.

protection in the absence of contract with the company.[215] They are therefore not in a position to avoid or monitor the risk to which the company is exposing them.[216]

In view of the externalisation of risk against these kinds of creditors arising from negligent or otherwise tortious conduct of the company, commentators have argued that limited liability should not apply to them.[217] Some of these commentators have even argued, nonetheless, that the present regime of limited liability which places tort victims in a precarious state should be reformed in a manner which can enable them to recover from the shareholders personally.[218] The degree and scope of this reform is yet to be determined. It is submitted here that one way the problem of tort creditors can be addressed is for the company to take out insurance as to cover in the event of such a problem occurring. However, since the risk is unforeseen, the mere probability that the company itself may be insured against a great dimension of potential tort events does not satisfactorily protect potential tort victims, unless the company is obliged to be insured, as in the case of car accidents. Alternatively, well considered public policy judgment to protect tort creditors should be made to sort out issues arising from such problems. Public order and safety should discourage the deliberate disregard of the safety of third parties through the provision of limited liability.

2.6 Conclusion

This chapter has provided the theoretical foundation for corporate personality and for dealing with the questions raised in the thesis. Among the theories of corporate personality discussed, the thesis favours the artificial entity theory and its variant of concession theory. This is premised on the fact that it provides a clear basis for understanding the nature and existence of modern corporations and justification for action to tackle abuse of the corporate form.

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[215] L. Lopucki, 'Cooperation in International Bankruptcy: A Post Universalist Approach' *Cornell Law Review*, 1998-1999, 84, 739

[216] H. Hansmann & R. Kraakman, n.184 above

[217] Ibid.

[218] For detailed comments on this issue, see R.E. Meiners et al, 'Piercing the Veil of Limited liability' (1979) 4 *Del. J. of Corp. L.* 351; Hansmann & Kraakmann, n.184; A. Schwartz, 'Products liability, Corporate Structure, and Bankruptcy: Toxic Substances and the Remote Risk Relationship' (1985) 14 *J. of Legal St.* 689, at 717-18.

The chapter further reveals that the fact that a company is treated as a separate entity, as well as the limitation of liability of members poses a difficulty in terms of dealing with a company. Indeed, this difficulty has resulted in abuse of the corporate form as a vehicle for transacting business. This identified problem will be further discussed in subsequent chapters in order to evaluate and determine how these problems can be addressed.

It should be noted that the principles of corporate personality and limited liability are not absolute, particularly where the application of the principles has led to abuses and manipulations. Thus, the law in certain situations has intervened through the courts and legislative action to check these abuses. From time to time, courts acknowledge the need for limits on the availability of the limited liability shield to prevent shareholders, directors and officers of the company from using it to achieve illegitimate ends. This is the challenge faced by the courts and the legislature in the aftermath of Salomon's case in the UK, and later in Nigeria. But how effective these actions are, with regards to proffering solutions to the abuses inherent in the corporate form in Nigeria and in the UK, still remain inconclusive. This has therefore made it imperative to look at the adequacy of the current law with a view to suggesting possible improvements. The subsequent chapters will deal with these issues.

CHAPTER 3 SEPARATE LEGAL PERSONALITY OF THE COMPANY IN ENGLISH LAW SINCE SALOMON

3.1 Introduction

It is widely accepted that a company is an artificial entity. This has long been affirmed in the decision of *Salomon v Salomon*[1] decided well over a hundred years ago. *Salomon's* case has undoubtedly attributed the personality of a company to a fiction and so its existence is dependent on the law. Although rarely questioned, as Granthan and Rickett would point out,[2] the strict application of *Salomon's* case may sometimes lead to abuses as well as unjust and unpredictable results. In particular, it has given unscrupulous promoters of private companies an opportunity to abuse the advantages the law has provided to them in what one commentator described as the 'wafer thin' incorporation of an under-capitalised company.[3] Its adverse effect can be seen on a wide range of people – creditors, consumers, shareholders of related companies, victims of torts, and taxation authorities.

Nevertheless, since the decision in *Salomon*, the courts and legislature have been trying to grapple with the problems associated with the separate legal personality of the company in the UK. Whilst holding tenaciously to a formalistic approach to the doctrine, they have also tried to deal with the problem by devising a number of schemes to enable them go behind the corporation in order to determine the realities[4] of the situation. Thus, the courts, on rare occasions, may deny the corporators the benefit of hiding behind the corporate veil with a view to imposing liabilities on corporate controllers where necessary.[5] The courts will intervene, if for instance, the

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[1] [1897] AC 22, HL; See also *Prest v Petrodel Resources Limited and others*, [2013] UKSC 34; *VTB Capital plc v Nutriek International Corpn* [2013] 2 WLR 398; *VTB Capital plc v Nutritek International Corpn and others*, [2013] UKSC 5.

[2] R. Grantham & C. Rickett, 'The Bootmaker's Legacy to Company Law Doctrine' in R. Grantham & C. Rickett, eds., *Corporate personality in the 20th Century* Hart Publishing, Oxford, 1998, 1. Here it was stated that the century old decision of the House of Lords in *Salomon v Salomon & Co Ltd* is probably the most cited company law case in the jurisdiction of the commonwealth. The case is credited with having articulated the founding propositions of company law, and it is accordingly treated by judges and academics alike with reverence bordering on the religious.'

[3] See S. Goulding, *Company Law*, 2nd ed., Cavendish Publishing Ltd, London, 1992

[4] *Tunstall v Steigmann* [1962] 2 QB 593.

[5] A. Hicks & S.H. Goo, *Cases and Materials on Company Law*, Oxford University Press, Oxford, 2008, 103

corporate structure itself is a fraud, a device, a facade or a sham.[6] The tendency to act in this manner in respect of corporate identity has often resulted in the metaphorical use of the words ‘lifting of the veil’ or ‘peeping through the veil’. This expression is used to refer to situations where corporate insiders are made personally liable for a corporation’s acts, where two or more related corporations are treated as one, or where the corporate entity is treated as one, or where the corporate entity is treated as a sham.[7] The doctrine of piercing the veil has remained the primary method through which the courts have mitigated the hard and unpleasant realities occasioned by the strict application of the realisation of the separate legal personality concept. Pickering,[8] has pointed out two reasons why ‘veil piercing’ is important. The first is that a company cannot at all times and in all circumstances be treated as an ordinary independent person. For instance, a company has no *mens rea* and therefore is incapable of committing a delict or a crime, unless the courts lift the veil and impose the intention of the directors or members on the company. He further argues on a second note that the absence of veil piercing with regard to the separate personality rule would mean that directors or members might hide behind the shield of limited liability and this may likely result in potentially disastrous consequences.[9]

Whilst the courts have applied this mechanism of lifting the corporate veil on a case by case level, there appears not to be any common, unifying or principled approach to be derived from authorities except ad hoc explanations.[10] In many cases, the judicial approach has been haphazard and largely of limited impact.[11] Over the years, companys legislation has also been amended to admit a number of exceptions to the separate legal entity. The legislative impact on the abuse of the corporate form became increasingly felt soon after the insolvency reforms of the 1980s following

[6] See *Yukong Line Ltd of Korea v Rensburg Investment Corporation of Liberia* [1998] 1 WLR 294; See also *Snook v London and West Riding Investment Ltd* [1967] 2 QB 786 where Lord Diplock thought the word “sham” to mean in relation to acts or documents that the parties to them intended them not to create the legal rights and obligations apparently created.
[7] See S. Ottolenghi, ‘From Peeping Behind the Corporate Veil, to Ignoring it Completely’ (1990) 53 Mod. L.R 338, for a thorough discussion of different approaches subsumed within the notion of “Lifting the Veil” of incorporation.
[8] M.A. Pickering, The Company as a Separate Legal Entity, (1968) 5 *M.L.R*, Vol. 31, 481 at 503
[9] Ibid, at 504
[10] See the dictum of Roger AJA in the New South Wales Court of Appeal in *Briggs v James Hardie & Co Pty Ltd*, [1989] 16 NSWLR 549 at 567
[11] S. Griffin, ‘Limited Liability: A Necessary Revolution?’, (2004) *The Company Lawyer*, Vol. 25 No. 4

the Cork Committee Report.[12] Of immense importance to this legislative effort is the requirement of disclosure rules and wide publicity as condition precedent to recognition of corporate personality with limited liability,[13] and the ensuring that assets of the company are not removed to frustrate creditors claims.[14]

The chapter will deal with how the law has dealt with the problems associated with the strict application of the separate personality and limited liability principles in the UK following the decision in *Salomon v Salomon*. By analyzing and evaluating the law in relation to the attitude of the UK towards corporate personality and limited liability of the corporation, the chapter attempts to provide helpful reflection for Nigeria in its eventual application of the principles.

3.2 Categorisation Approach

Many writers as well as the courts themselves have explored categorisation analyses to identify particular legal categories used to justify the piercing of the corporate veil. The problem with this approach is that cases have been linked together to support lifting the veil rather than because there are real similarities between the cases. The result is that there may be instances where cases which can qualify to lift the corporate veil are thrown out simply because they do not fit into any of these categories. This is likely to result in injustice on parties.

According to Kershaw,[15] four categories of cases dealt with by the courts exist. These include instances which attempt to articulate the identity or nationality of a company being disputed upon for purposes of its veil being disregarded; cases where a company is being used to commit fraud or to evade existing obligations; issues involving the parent and its subsidiary companies and finally when the justice of the case demands that the veil shall be pierced.[16]

On the other hand, Farrar and Hannigan, while accepting the difficulty of rationalising the cases have attempted to articulate nine broad headings under which lifting the veil of incorporation may apply. These are agency, fraud, group

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[12] *P.L. Davies & S. Worthington, Gower & Davies Principles of Modern Company Law, 9th ed., Sweet & Maxwell, 2012*
[13] *Ibid*, at 198.
[14] *Ibid*, at 199
[15] D. Kershaw, *Company Law in Context Text and Materials,* Oxford University Press, 2009, 47
[16] Ibid.

enterprises, trusts, tort, enemy, tax, companies' legislation and other legislation.[17] These categories are just a guideline and by no means exhaustive.

Ottolenghi has identified peeping behind the veil, piercing the veil, extending the veil and ignoring the veil as four existing categories for lifting the veil.[18] Whilst peeping behind the veil attempts to look behind the corporate form only for purposes of exerting fresh facts which might be useful in deciding the matter at hand, [19] piercing the veil tends to impose liability on shareholders for acts of the company. With regards to extending the veil, questions are being raised as to the separate existence of the corporation, independently from a group of companies. The final category which is termed ignoring the veil brings to the fore questions as to the very existence of the company as being a sham or facade.[20]

Gallagher and Zeigher whilst carrying out a comprehensive analysis of veil piercing cases in Australia, Britain and America argue that all the categories which have traditionally applied for purposes of lifting the veil can be subsumed into one category viz: the prevention of injustice.[21] Although the prevention of injustice is obviously an important objective of the law, it is not in itself an overriding factor particularly in the UK where the veil of the corporation cannot be lifted simply because justice demands that it be done.[22]

Other commentators such as Schmithoff[23] and Friedman[24] have also attempted to state the headings under which the veil of the corporation can be pierced. In the case of the former, he asserts that courts apply the doctrine under two headings relating to agency relationship, and when there is abuse of the corporate form. For the latter, the courts will disregard the privilege of the corporate form when it becomes a tool to evade tax, when the real purpose of a transaction undermines the corporate form, and

[17] J.H Farrar & B.M Hannigan, *Farrar's Company Law,* 4th ed., Butterworths, London, 1998, 69-70
[18] Ottolenghi, n.7, at 342
[19] See for example *Daimler Co Ltd v Continental Tyre and Rubber Co Ltd* (1916) 2 A.C. 307 HL where the court held that in times of war, courts could look at the nationality of shareholders of a company to determine its enemy character.
[20] See *Jones v Lipman* [1962] 1 W.L.R 832 Ch D; *Gilford Motor Co Ltd v Horne* [1993] Ch. 935 CA
[21] L.Gallagher and P. Ziegler, 'Lifting the Corporate Veil in the Pursuit of Justice' (1990) *JBL* 292 at 292
[22] See *Adams v Cape Industries Plc*, (1990) Ch. 433
[23] C.L. Schmittoff, 'Salomon in the Shadow' [1976] *JBL,* 305, at 307.
[24] W. Friedman, *Legal Theory*, Stevens, London, 1967, 523

when the controllers disguise themselves through the fronting of subsidiaries in order to conceal their identities.

It is submitted in this chapter that the categorisation process has major flaws. In particular, it has resulted in the courts sending conflicting messages. This has been attributed largely to the fact that it is difficult to fashion any clear cut coherent principle from the myriad of cases on the particular approach the court will most probably adopt in lifting the veil.[25] This is perhaps because of the diversities of commentaries on particular case laws and doubts that categorisation of these cases under different headings will follow exactly the same pattern.[26] There is also a lack of consensus in terms of number of categories, their doctrinal imperatives, or cases which approximate to each category.[27] This, it is submitted, is due mainly to the fact that English courts have generally confined themselves to traditional common law concepts and principles thus making their approach to veil piercing somewhat sluggish, rigid and problematic. These courts have developed a number of factors to assess whether the conditions of lifting the veil has been met, none of which is dispositive. The state of affairs is not wholly satisfactory because the categories sometimes overlap and many do not articulate the principles on which they were decided.[28] Nonetheless, these factors or categories tend to underscore the high barrier a party must surmount to pierce the corporate veil. Disturbed by this scenario, Mayson, French, and Ryan have correctly stated that in view of the current conceptualisation of the company, it may not be possible to reconcile the large number of cases on this subject let alone many academic opinions.[29] It is posited here that the problematic nature of this approach has made many believe that the laws are inadequate and incapable of dealing with the vast nature of issues bordering on the abuse of the corporate form.

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[25] Thompson has asserted that corporate veil piercing is the most litigated issue in corporate law. See R.B. Thompson, 'Piercing the Corporate Veil: An Empirical Study', (1991) 76 Cornell L. Rev., 1036

[26] F. Flannigan, 'Corporations Controlled by Shareholders: Principals, Agents Or Servants?' (1986) 51 *Sask.L.Rev*. 23 at 25; See also Pickering, n.12 above.

[27] Pickering, n.8, at 483; J.W Neyers, Canadian Corporate Law, Veil piercing, and the Private Law Model Corporation, 2 *University of Toronto Law Journal*, vol. 50, 173 at 181; A. Beck, 'The Two Sides of the Corporate Veil' in J. Farrar, ed., *Contemporary Issues in Company Law*, Commerce Clearing House, New Zealand, 1987, 71 at 72.

[28] See R.C Williams, *Concise Corporate and Partnership Law*, 2nd ed., Elsevier Science & Technology Books 1997, 100

[29] D. French, et al., *Mayson, French & Ryan on Company Law*, 29th ed., Oxford University Press, 2012, 153.

The categorising approach hardly gives one concrete idea about which conduct does or does not trigger the piercing of the corporate veil doctrine. It is very difficult to follow any particular approach or to make any principled sense of the cases that are presented as lifting or piercing cases. This is largely because most of the cases or factors listed as capable of piercing the corporate veil lack proper evaluation. It is against this background that common law approaches, as well as the legislative responses to the abuse of the corporate form through the process of piercing the corporate veil, must be examined. While some key UK decisions are considered, the research seeks to demonstrate how the lack of coherent principle has brought an element of inconsistency and uncertainty into the law.

3.2.1 Fraud, Facade or Sham

Where an individual or a corporate body creates or runs a company to act as shield for fraudulent purposes or as a sham or facade to avoid existing obligation,[30] the corporate veil will be lifted, if not ripped or rudely torn away.[31] To succeed under this category, it must be placed on preponderance of evidence that the controller have the intention to use the corporate structure as a 'mask' to hide his real purpose and to deny the plaintiff some pre-existing legal right.[32]This position of the law recognised in Salomon's case has been reflected in a long list of authorities beginning from *Gilford Motor Co Ltd v Horne*[33] to the more recent case of *Adams v Cape Industries Plc*.[34] In *Gilford Motors Co Ltd v Horne* the defendant, a former managing director of the plaintiffs company, had entered into a covenant with it agreeing not to solicit for customers when his employment ceased. Contrary to the said agreement, and upon leaving the company the defendant set up J.M Horne & Co which for purposes of this action was the second defendant to do so. The court agreed with the plaintiff's position that the creation of the defendants company was in breach of the covenant, and expressed its satisfaction that the company was formed as a device in order to mask the effective carrying on of the business of Mr Horne. Summing up the views of the court after hearing evidence, Farewell J. had said:

[30] See J. Payne, 'Lifting the Corporate Veil: A Reassessment of the Fraud Exception' (1997) 56 *Cambridge Law Journal* 284, 290
[31] *Jennings v CPS* [2008] 4 All ER 113(HL)
[32] *Ibid*.
[33] [1933] Ch 935
[34] [1990] 1 Ch 433

> I am quite satisfied that this company was formed as a device a stratagem, in order to mask the effective carrying on of a business of Mr E.B.Horne. The purpose of it was to try to enable him, under what is a cloak or a sham, to engage in business which, on consideration of the agreement which had been sent to him just about seven days before the company was incorporated, was a business in respect of which he had a fear that the plaintiffs might intervene and object.[35]

On appeal, this view was upheld. Lord Hanworth MR granted an injunction against the defendant to which Lawrence L.J and Romer L.J. concurred.[36] Specifically, Romer L.J emphasized as follows:

> The defendant company was formed and was carrying on business merely as a cloak or sham for the purpose of enabling the defendant Horne to commit the breach of the covenant that he entered into deliberately with the plaintiffs on the occasion of and as a consideration for the employment as managing director. For this reason, in addition to the reasons given by Lords, I agree that the appeal must be allowed, with the consequences which have been indicated by the Master of the Rolls.[37]

The decision of both the High Court and the Court of Appeal was triggered by the fact that the company in question could not for all material purposes be deemed to engage in the "carrying on" of its incorporator's business but was, rather, "being carried on" by its incorporator in the latter's general strategic plans.[38]

Gilford Motor Co Ltd v Horne was followed by *Jones v Lipman.*[39] Here, the defendant, Mr Lipman, had agreed to transfer his interest in land belonging to him through sale to Jones. Later in time, he changed his mind and reneged on the completion of the sale. In order to effectively circumvent the transaction, he formed a company whereupon he purportedly transferred his interest in the land to the said company. He then proceeded to claim that the property no longer belonged to him and therefore he could not comply with the contract. The court per Russell J., refused his position and ordered specific performance of the contract whilst noting that the creature of the first defendant (Mr Lipman's company) was a mere device,

[35] See n. 33, at 956
[36] Ibid., at 965
[37] Ibid., at 969
[38] M. Moore, A Temple built on Faulty Foundations: Piercing the Corporate Veil and the Legacy of *Salomon v Salomon,* (2006) JBL (March issue) 180 at 198
[39] [1962] 1 WLR 832.

sham, or indeed a mask which he held before his face in order to avoid recognition in the eyes of the law.[40] It was clear from records that the purported Lipman's company did not comply with corporate formalities there being no issued share capital and no real existence.[41] It did not have any director appointed.[42] It thus was clear that the company had no genuine economic substance and was used solely to evade the defendant's contractual obligation.

Another factual situation linking the piercing of the corporate veil as mere facade came in the case of *FG Films Ltd*[43] where under–capitalization was the underlying reason. The facts of this case were that an American corporation, Film Group Incorporated, invested in the making of a film costing £80,000. It was in evidence that the applicants company, inter alia, FG Films Ltd which was an English company purporting to be the maker of the film and thus had the intention of registering it as a British film. The issued share capital of the company was £100 with dominant shareholding in the hands of the president of FG Films Ltd. The company, as it was formed, had no assets in terms of facilities and staff. Specifically, it had no film making facility to carry out the project. The attempt to register the film as a British film was rejected by the respondent and this was upheld by the court.[44]

Another and more recent instance, of the court lifting the veil arose in the case of *Creasey v Breachwood Motors Ltd.*[45] Creasey had been a manager employed by a garage, Breachwood Welwyn Ltd. He had been dismissed in circumstances where he probably had a substantial claim for damages for wrongful dismissal. The proprietors of the business wanted to avoid paying these damages. Before Creasey put in his claim they formed another company, Breachwood Motors Ltd, transferred the entire undertaking of Breachwood Welwyn Ltd to it and then had Breachwood Welwyn struck off from the company register.

It was held that Creasey could present his claim for damages directly against the new company, Breachwood Motors Ltd, it having been formed specifically to get the proprietors out of their legal liability to Creasey.

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[40] Ibid at 836-837
[41] *Ibid,* at 835
[42] *Ibid.*
[43] [1953] 1 WLR 483
[44] Ibid, at 485
[45] (1992) BCC 638

However, the Court of Appeal in *Ord & Anor v Belhaven Pubs Ltd*[46] saw it differently and held that the approach followed in *Creasey's* case was inappropriate and wrong in law. It cited with approval its own previous decision in *Adams v Cape Industries plc*[47](details of which shall be stated below) and consequently overruled Creasey. In *Ord* the defendant, who was engaged in the business of acquiring old pub premises, refurbishing them, and then letting them to tenants, had made various misrepresentations as to the potential profitability of the premises to the claimant. By the time these came to light, the company from which the lease was taken had practically ceased trading, and had no substantial assets from which any judgment against it could be satisfied. The claimant sought leave of court to substitute the defendant company's holding company, and the judge at court of first instance followed *Creasey* and allowed the substitution. The Court of Appeal decided that this was incorrect, as the original company had not been a mere facade for the holding company, nor vice versa. Unlike the new company in *Creasey*, neither company had been created as a sham to avoid liability, there had been no element of asset stripping, and as such, the veil should not be lifted. Hobhouse LJ, giving the judgment of the court, restated the fact that *Creasey* had been wrongly decided and could not be sustained. For the court, *Creasey* represents a wrong adoption of the principle of veil piercing and accordingly, it declared that it should no longer be regarded as authoritative.

It is has become clear following *Adams v Cape Industries plc*[48] that the courts are now increasingly reluctant to lift the veil of the corporation in the absence of sham or where the wording of particular statute or contract requires so. In short, the *Adams* case has restated the position in unequivocal terms that the veil will not be lifted simply because it would be in the interest of justice unless accompanied by evidence that the company in question is a sham or a facade. As pointed out by Slade LJ in *Adams*, one must look to see if the company is a facade which is concealing the true facts.[49] A determinant factor in such a test is the motive of the perpetrator which may be material.[50] However, without further guidance, this statement is unhelpful. For the fraud exception to succeed there needs to be a pre-existing legal right. Thus, if such a

[46] (1998) BCC 607
[47] (1990) Ch 433
[48] Ibid, at 536
[49] Ibid, at 539
[50] Ibid, at 542

pre-existing legal right is not in existence, the intention to deceive the plaintiff is purely speculative. If the legal right crystallises before the corporate form is used to evade the right such as in *Gilford Motors* and *Jones v Lipman*, the mental element of the defendant to deny the plaintiff of his right is established. On the other hand, if the legal right crystallises after the corporate form is used to evade the right, the mental element would be impossible to satisfy.

The *Adams* adherence to *Salomon's* case has been followed in subsequent cases. *In Trustor AB v Smallbone (No 2,)*[51] the Court of Appeal was minded to grant the claimants' request to lift the corporate veil against Smallbone for using a company with no connection to third parties to engage in various forms of impropriety. Smallbone, a director of Trustor AB, had without the consent of other directors, transferred huge sums of corporate funds into another company controlled by him, Introcom Ltd. He subsequently removed some of those funds from Introcom Ltd's bank account into his own private account. The court having regard to all circumstances of the case was not in doubt that Smallbone was jointly and severally liable with Introcom Ltd for those sums received by him from his bank account. However, like *Adams*, the court as per Sir Andrew Morritt VC, rejected the third head of the claimants' argument that the corporate veil be lifted in the interest of justice.[52]

In *Ben Hashem v Al Shayif,*[53] Munby J formulated six guiding for the court in deciding whether or not to pierce the corporate veil. First, ownership and control of a company were not enough to justify piercing the corporate veil.[54] Second, the court cannot pierce the corporate veil, even in the absence of third party interests in the company, merely because it is thought to be necessary in the interests of justice. Third, the corporate veil can be pierced only if there is some impropriety. Fourth, the impropriety alleged must, as Sir Andrew Morrit said in *Trustor* must be "linked to the use of the company structure to avoid or conceal liability".[55] Fifth, to justify piercing the corporate veil, there must be "both control of the company by the wrongdoer(s) and impropriety that is (mis) use of the company by them as a "façade"

[51] [2001] 1 WLR 1177
[52] Ibid at para. 23
[53] [2009] 1 FLR 115
[54] Ibid at para. 159
[55] Ibid at para. 160

to conceal their wrongdoing".[56] The sixth principle relates to the fact that the company may be a "façade" even though it was not originally incorporated with any deceptive intent, provided that it is being used for the purpose of deception at the time of the relevant transactions. The implication therefore is that the corporate veil could only be pierced in so far as it is necessary in order to provide a remedy for the particular wrong which those controlling the company had done.

In *VTB Capital plc v Nutritek International Corpn*[57] the Supreme Court while dismissing the claimants appeal refused to pierce the corporate veil. The court held that there would be no justification to make a company's controllers party to its contracts with third parties. Nonetheless, the court adopting both the reasoning of the Court of Appeal and the view of Munby J reiterated the fact that the doctrine permitting the court to pierce the corporate veil is limited on whether there was relevant impropriety by the controller and wrongdoer at the time of the relevant transaction.[58]

Prest v Petrodel Resources Limited and others[59] reaffirmed the limits to piercing of the corporate veil if there had been a relevant impropriety or where a person was under an existing legal restriction or liability or subject to an existing legal restriction which he deliberately evaded or the enforcement of which he deliberately evaded through the use of another company under his control. However, the court while considering what constitutes a relevant wrongdoing decried the indiscriminate use of terms such as 'façade' or 'sham' as totally unsatisfactory. As Lord Walker observed:

> …piercing the corporate veil is not a doctrine at all, in the sense of a coherent principle of law. It is simply a label – often, as lord Sumpton observes, used indiscriminately – to describe the disparate occasions on which some rule of law produces apparent exceptions to the principle of the separate juristic personality of a body corporate reaffirmed by the House of Lords in *Salomon v A Salomon and Co Ltd* [1897] AC 22.[60]

The above analysis reveals the inherent difficulty the courts face in finding a common and unifying standard to pierce the corporate veil. Although, the

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[56] Ibid.at para. 163
[57] [2013] UKSC 5; See also *Antonio Gramsci Shipping Corp & ors v Lembergs* [2013] EWCA Civ 730
[58] Ibid at paras 128, 145.
[59] [2013] UKSC 34
[60] Ibid at para. 106

courts may pierce corporate veil when there is glaring cases of impropriety or evasion of existing legal obligations, the limits of the doctrine are far from settled in case law. As pointed out by Oh, the inherent imprecision in metaphors used by the courts has resulted in doctrinal mess.[61]

It is therefore submitted that, rather than relying on opaque assertions that the corporate form is to be disregarded because the company is a mere façade, it will be more appropriate to impose liability on shareholders when the company is potentially used for purposes outside the contemplation of the law.

It is further submitted that the de-emphasis of justice is fundamentally wrong since veil piercing was a child of equity, itself intended to meet the ends of justice. The restoration of justice for purposes of lifting the corporate veil in the UK has therefore become imperative. In doing so, it may perhaps be important for the courts in the UK to advert their minds to the Louisiana Supreme Court decision in *Glazer v Commission on Ethics for Public Employees*,[62] where the court had the opportunity to emphasise that the veil may be pierced by balancing the "policies behind recognition of a separate existence" with the "policies justifying the piercing". It is submitted that the balancing approach would result in the separate personality of the company being maintained in some instances, whilst in other situations it would be discarded. The need to preserve corporate identity would, in such circumstances, have to be balanced against policy considerations which arise in favour of piercing the corporate veil; a court would then be entitled to look at the substance rather than the form in order to arrive at the true facts, and if there has been a misuse of a corporate personality to disregard it and attribute liability where it should rightly lie. Following a balancing approach, a court may feel justified in piercing the corporate veil on the basis of improper conduct, instead of lumping, rationalising or categorising it on grounds of fraud or dishonesty, neither of which are the same. The balancing approach at least compels the ventilation of the contested issues. The fact that the court does lift the corporate veil for a specific purpose in no way destroys the recognition of the corporation as an independent and autonomous entity for all other

[61] P. Oh, Veil Piercing (2010) 89 *Texas Law Review* 81 at 84.
[62] 431 So 2d 752 La 1983. See also A. Domanski, 'Piercing the Corporate Veil – A New Direction' (1986) 103 *South African Law Journal*, 224; A. Beck, 'The Two sides of the corporate veil' in Farrar (ed.,) Contemporary Issues in Company Law, New Zealand, 1987, 71 at 75.

purposes. The balancing approach tends to conclude that for the court to justify piercing the corporate veil, the facts must indicate either a misuse of the separate entity privilege or a need to limit the privilege in the interest of justice and equity. The latter ground, let it be noted, is very broad in and of itself.

Although the balancing approach does not seek to provide all the answers to veil piercing, it will ultimately usher in some element of dynamism in dealing with the concept and may prove capable of bringing order, certainty and consistency to this area of law. Thus, rather than rigid standards followed by UK courts, the *Glazer* test will usher in flexibility having regard to the separate and distinguishable facts of each case whilst providing a key in outlining a basis for unifying the decisions of courts in the British and Commonwealth jurisdictions of which Nigeria is a part.

3.2.2 Agency

Salomon's case in confirming the separate personality of a company had reiterated the fact that the company is not an agent of its shareholders. However, where a parent company permits its subsidiary to act as its agent it may so act if it has authority to do so. In those circumstances, the parent company will be bound by the acts of its agent, provided the acts are within the actual or apparent scope of authority.[63] But it is important to note that there is no presumption of such an agency relationship. In the absence of an agreement between the two corporate personalities it will be very difficult to establish one.

The development of the courts' attitude to agency in a company context has tended not to produce clear rules or result, perhaps until recently. The agency principle first came to light in the case of *Smith, Stone & Knight Ltd v Birmingham Corporation*[64], in the context of whether a subsidiary company was the agent of its holding company. The facts leading to this case were that a paper manufacturing company took over a business of waste paper merchants and continued to run it through a subsidiary company in the form of a department. Both the parent and the subsidiary had the same directors and the subsidiary exclusively got its remuneration from the

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[63] See *Adams v Cape Industries Plc*, (1990) Ch 433.The term agency indicates an authority of capacity of one person to create legal relations between a principal and third parties. An agency relationship can be created by the express or implied agreement (whether contractual or otherwise) of principal and agent whereby the agent consents to so act.
[64] [1939] 4 All ER 116

parent. This was evident because of the facts that the parent company had full and exclusive access to the subsidiary books, the subsidiary had no employees other than a manager. The subsidiary occupied the parent's premises as yearly tenants and paid no consideration. The only evidence of its supposed independent existence was its name on the stationary. The parent company also owned or controlled all the share capital of the subsidiary company. When it became apparent that the Corporation of Birmingham wanted to purchase the premises where the business of the subsidiary was run pursuant to its compulsory powers, the parent sought to claim compensation. If the claim had been made by the subsidiary, the corporation of Birmingham would have escaped liability under the provisions of section 121 of the Lands Clauses Consolidation Act 1845, which disentitles compensation to an occupier whose tenancy did not exceed one year. In piercing the veil and holding that agency was established, Atkinson J,[65] departing from *Salomon*, held that the question of whether a company was carrying on its own business or that of its parent's was a question of fact determinable by the following set of criteria:

a) Were the profits of the subsidiary those of the parent company?
b) Were the persons conducting the business of the subsidiary appointed by the parent company?
c) Was the parent company the "*head and brains*" of the venture?
d) Did the parent govern the venture?
e) Were the profits made by the subsidiary company made by the skill and direction of the parent company?
f) Was the parent company in effective and constant control of the subsidiary?

Applying these criteria, there was no doubt in the judge's finding that the parent had complete control of the operations of the subsidiary. In the circumstance, the existence of the subsidiary as a separate legal entity was unable to hinder the court from treating the business as that of the parent.

Although the efforts to articulate the criteria for piercing the veil of the corporation in *Smith, Stone and Knight v Birmingham* have not been followed in subsequent cases, it remains the first comprehensive attempt by an English court to set down a criteria for veil piercing. There are two reasons that can account for this reluctance

[65] Ibid

by English Judges to follow the comprehensive criteria laid down in this case. The first is that English courts favoured the application of traditional common law concepts instead of what may be regarded as a judicially crafted list of criteria. *Smith, Stone and Knight* could be regarded as constituting judicial activism[66] which was inconsistent with the nuances of the rapidly growing number of conservative English judges. These conservative judges found it difficult to follow the lead exemplified in the case. Secondly, it was also explained that the reluctance of judges to follow the case could be attributable to its unique nature. The case, as it was formulated, was one whereby the company requested that its own veil be pierced in order to obtain compensation from the Government. Having a regard for the nature of this case and its prevailing circumstances, it became easily susceptible to being distinguished by subsequent courts. In *Adams v Cape Industries plc,*[67] the Court of Appeal departed from it and held that implied agency following the activities of the subsidiary cannot bind the parent in the absence of express agreement between the parties.

As in *Adams,* the agency ground as applied in *Smith, Stone & Knight Ltd v Birmingham* does not have strong support as an independent ground for piercing the corporate veil in Australia and has been extensively criticised.[68] Even in New Zealand, the veil will not be pierced on the mere excuse of degree of overlap between the operations of the parent and its subsidiary in terms of common management and shared finances.[69] In contrast, however, Canadian courts have built upon the ruling in *Smith, Stone & Knight* to develop a deep line of precedent that uses, inter alia, the six questions raised in the case to pierce the corporate veil on the basis of an agency relationship.[70] Two leading cases exemplifying the Canadian courts inclination towards piercing the corporate veil on the basis of an agency are

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[66] Lord Denning was remarkable for breaking new grounds in English law while sitting both at the Court of Appeal and in the House of Lords during his lifetime. For his views on judicial conservatism, see P.Mulchlinski, 'Limited Liability and Multinational Enterprises: A case for Reform', (2010) 34 *CJE*, 915, at 920.
[67] [1990] Ch 433
[68] See J. Harris, 'Lifting the Corporate Veil on the Basis of an implied Agency: A Re-evaluation of Smith, Stone and Knight' (2005) 23 C & SLJ 7: A. Hargovan and J. Harris, "The Relevance of Control in Establishing an Implied Agency Relationship between a Company and Its Owners" (2005) 23 *C & SLJ* 459. See also the following Australian cases: *Eurest (Australia) Catering & Services Pty Ltd v. Independent Foods Pty Ltd* (2003) 35 ACSR 352; *Burswood Catering and Entertainment Pty Ltd v ALHMWU (WA Branch)* [2002] WASCA 354.
[69] *Savill v Chase Holdings (Wellington) Ltd* [1989] 1 NZ 297.
[70] See *Bow Valley Husky (Bermuda) Ltd v Saint John Shipbuilding Ltd* (1995) 126 DLR (4th) 1 (NfId CA); *Sun Sudan Oil Co v Methanex Corp* (1992) 5 Alta LR (3d) 292.

the Supreme Court of Canada's decisions in both *Toronto (City) v Famous Players Canadian Corp*[71] and *Aluminium Co of Canada v Toronto*.[72] In *Famous Players*, the Supreme Court dismissed an appeal against the lower court ruling that the assessable income of the parent should include the income earned by the subsidiaries. In coming to this conclusion, the court justified piercing the veil on the basis that the parent effectively controlled the policies and operations of its subsidiaries. Applying this view in the subsequent case of *Aluminium Co*, Rand J. stated that the corporate veil may be pierced where:

> It can be said that the [subsidiary] company is in fact the puppet of the parent; when the directing mind and will of the [parent] reaches into and through the corporate facade of the [subsidiary] and becomes itself, the manifesting agency.[73]

Rand J. further made a distinction between what he called formal agency and conduct whereby the parent company is in fact in such an intimate and immediate domination of the subordinate company that the latter in all true sense of expression lacks independent functioning of its own.[74]

It is argued here that by taking the Canadian approach, the basis for piercing the corporate veil is not agency as per the legal relationship between a principal and agent, but rather is based on factors akin to a relationship that arises based on the intervention or control by the parent over the affairs of the subsidiary. Thus the Canadian position which finds expression in what Blumberg called "quasi-agency"[75] predicated on extensive interventionist control as a lack of demonstration of independent existence on the part of the subsidiary, has become an accepted feature of veil piercing decisions in the United States.[76] It can thus be safely argued that Canada, following the examples from the United States where veil piercing is regarded as the most litigated doctrine in corporate law,[77] has moved away from its

[71] [1936] 2 DLR 129
[72] [1944] 3DLR 609
[73] Ibid, at 15
[74] Ibid, at 16
[75] P. Blumberg, K. Strasser, N. Georgakopoulos and E. Gouvin, *Blumberg on Corporate Groups*, 2nd ed., Aspen, 2005, at 16.05 (B).
[76] See Thompson, n.25. In the United States, it is common to find expression of a variety of terms such alter ego, instrumentality, puppet alongside agency to demonstrate the relationship between a parent company and its subsidiaries.
[77] Ibid.

British roots and other common law countries by allowing the lifting of the corporate veil whenever it is established that a parent company has exercised complete domination and control over the affairs and activities of a subsidiary.[78] This is a welcome development to other common law countries in their efforts to find solutions to the strict application of the Salomon's case.

3.2.3 Corporate Enterprises as a Single Economic Unit

Salomon's case which conferred limited liability on individual investor-shareholders in a single corporation to encourage their investment and limit their exposure, has now been extended to corporate groups. Consequently, the doctrine of separate personality and limited liability also applies to group enterprises as it is between an individual and a company. As pointed out by Blumberg,[79] corporate veil litigation has increased since the dawn of the twentieth century. With the increasing number of multinational enterprises it has even become more complex and controversial. This however raises some concern apparently because of the greater potential for harm such a group structure can have on the society. In *Re Southard and Co Ltd,*[80] Templeman LJ expressed this concern using the scenario where a parent company may incorporate many companies in a group controlled largely by the shareholders of the parent company. Suddenly, a member company in the group becomes insolvent; the creditors will suffer whilst the shareholders of the parent and other subsidiaries in the group prosper without any liability imposed on them. The problem is made even where the assets of the subsidiary company are claimed by another member of the group pursuant to a right of debenture holding.[81]

Lord Denning while lifting the veil in *Littlewoods Mail Order Stores Ltd v IRC*[82] and declining to treat a subsidiary as a separate and independent entity from the parent in an income tax case had cautioned against blind adherence to the doctrine laid down by Salomon.[83] Lord Denning was very careful to stress the following:

> I decline to treat the [subsidiary] as a separate and independent entity.The doctrine laid down in *Salomon v Salomon* has to be

[78] See *Smith v National Money Mart Company* (2006) CanL11 14958 (ON C.A)
[79] P.I Blumberg, *The Multinational Challenge to Corporate Law: The Search for a New Corporate Personality*, Oxford University Press, New York,1993, 65-150
[80] [1979] 1 WLR 1198
[81] Ibid., at 1208
[82] [1969] 3 All E.R. 855
[83] Ibid.

> watched very carefully. It has often been supposed to cast a veil over the personality of a limited company through which the courts cannot see. But that is true. The courts can and often do draw aside the veil. They can, and often do, pull off the mask. They look to see what really lies behind. The legislature has shown the way with group accounts and the rest. And the courts should follow suit. I think we should look at the [subsidiary] and see it as it really is-the wholly-owned subsidiary of the tax payers. It is the creature, the puppet, ofthe taxpayers in point of fact; and it should be regarded in point of law.[84]

This decision was predicated on the action of the claimants whereby they sought to obtain a tax advantage relying on the fact that their wholly owned subsidiary was a separate legal entity. The Court of Appeal decided that the claimants were not entitled to the advantage because "looking at the reality of the position and notwithstanding the *Salomon v Salomon & Co. Ltd*., that subsidiary was not a separate and independent entity but a creation of the tax payers [parents]"[85].

A notable attempt by the English court at aligning itself to piercing the veil of companies in a group was eloquently illustrated in *DHN Food Distributors v Tower Hamlets London Borough Council*[86], the facts of which were arguably very similar to *Smith, Stone and Knight*. In *DHN,* the plaintiffs ran a wholesale grocery business from premises owned by its wholly-owned subsidiary known as Bronze Investments Ltd. The vehicles used in the business were owned by another wholly-owned company subsidiary company named D.H.N Food Transport Ltd. The defendants compulsorily acquired the premises, and, as a result, the plaintiffs, and their two wholly owned subsidiaries went into voluntary liquidation. The acquiring authority (the council) paid compensation only for the value of the land registered in the name of the subsidiary. The plaintiffs claimed that they were also entitled to compensation for disturbances of business and submitted three reasons for that. In particular, they argued that the veil should be lifted and that the parent company should be treated as the owners of the premises.[87] Rejecting this argument, the trial court held that *DHN* was not entitled to substantial compensation for disturbance as they had no great interest in the land other than that of a yearly tenant.[88]

[84] Ibid.
[85] Ibid.
[86] [1976] 1 WLR 852
[87] See also *City of Glasgow District Council v Hamlet Textiles Ltd*, [1986] *S.L.T*. 415
[88] See *DHN*, n.86 above

Reversing the decision of the trial court and upholding the plaintiffs claim, the Court of Appeal saw the case as one in which the court was "entitled to look at the realities of the situation and to pierce the veil."[89] The court, most importantly, further held that the group of companies was in reality a single economic entity and should be treated as one.[90] Lord Denning concluded by saying thus:

> We all know that in many respects a group of companies are treated together for the purpose of general accounts, balance sheet, and profit and loss account.They are treated as one concern.[91]

The *DHN* case has attracted mixed reactions from a number of commentators. Lord Denning who propounded the single economic unit theory – where companies in a group structure were treated as being a single entity - did not elaborate on his judgment, neither did he lay down clear circumstances or guidelines under which the theory would apply. Although Denning has been criticized for doctrinal failure in *DHN*[92] his enunciation of single economic unit theory in relation to company groups and his call for flexibility in dealing with issues of corporate form should be commended. The main area of attack on Denning is his logical reasoning in the case. It is submitted that to require companies operating as a group to report their accounts on consolidated basis is one thing yet to ignore their separate legal personality is quite another. Whilst reporting on group finances may be, for purposes of information, its intention as provided by statute, ultimately it might not have anything to do with limited liability. As will be seen later, it was not long before later decisions began to question the whole idea of single economic unit theory. It has been noted specifically that the House of Lords questioned the reasoning in *DHN* in *Woolfson v. Strathclyde Regional Council*.[93]

Notwithstanding the lack of elaboration on *DHN*, commentators such as Hayton view the result of the case on the veil - piercing issue as very sensible.[94] Sugarman and Webb, saw it as hardly surprising having regard to the facts and weight of

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[89] Ibid, at 861
[90] Ibid., at 867
[91] Ibid., at 860
[92] See Lord Keith in *Woolfson v Strathcylde Regional Council*, [1978] S.L.T. at 160
[93] Ibid.
[94] D.Hayton, 'Contractual Licences and Corporate Veils', [1977] *C.L.J*, 12 at 13

authority.[95]However, other commentators such as Powles took a contrary position and saw the decision as an unnecessary violence done on corporate personality even though, based on the facts, it was a clear victory for common sense over technicality. In spite of these differing views, the single economic unit theory reflects the commercial reality in terms of the relationship of parent companies and their subsidiaries.

The *DHN* case seemed to weaken the importance attached to *Salomon*. This was however short lived as it did not take long before it met serious opposition in later cases. One such case is the House of Lords decision in the Scottish appeal of *Woolfson v Strathclyde Regional Council*[96] which did not follow *DHN*. Here, the appellant relied on *DHN* to claim compensation for disturbance caused by the compulsory acquisition of premises occupied by a company in which he held 999 of the 1000 shares owned by himself and another company in which himself and his wife were the only shareholders.

Dismissing the appeal, the House of Lords held that there was no basis consonant with the principle upon which on the facts of the case that the corporate veil can be pierced as to hold Woolfson to be the true owner of the premises.[97] Notwithstanding that the case was distinguishable on the facts from *DHN*, Lord Keith cast some doubt on whether the Court of Appeal in the *DHN* case had properly applied the principle that it is appropriate to pierce the corporate veil only where special circumstances exist indicating that it is a mere facade concealing the true facts.[98] The decision in *Woolfson* has been followed in *Ord v Bellhaven*[99] where the Court of Appeal refused to substitute the parent company or another subsidiary as a defendant in order to satisfy a judgment debt.

The question of whether companies in a group should be treated as single units or separate entities has been settled by the Court of Appeal in *Adams v Cape Industries Plc*.[100] This case was a striking restatement of the *Salomon* principle of strict separate personality and the rejection of the single economic unit theory espoused by

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[95] D.Sugarman & F.Webb, 'Three in One: Trusts, Licences and Veils', (1977) 93 *L.Q.R.* at 173
[96] (1978) S.L.T. 159
[97] Ibid., at 162
[98] Ibid., at 161
[99] [1998] BBC 607
[100] [1990] All ER, 102

Lord Denning in *DHN*. In fact the case of *Adams v Cape Industries Plc* appears to be a clear attempt by the upper echelon of the judiciary in the UK to ensure clarity of interpretation on issues arising from *Salomon's* case. The Court of Appeal in this case de-emphasized the application of the doctrine of veil piercing to corporate groups and tort claims thus laying to rest any attempt to apply the doctrine in these areas of law. The case, it is submitted, highlights how separate legal personality and limited liability of corporations can result in significant injustice to claimants against multinational enterprises. Indeed, it illuminates how the legal form of the subsidiary company may be an obvious contradiction to the concept of justice.

The facts of this case relates to the enforcement of a foreign judgment obtained in United States in England against Cape Industries Plc, a UK multinational company who until 1979 mined and marketed asbestos. The company had in its worldwide conglomerate another English company, named Capasco, who in turn had a US marketing subsidiary incorporated in Illinois, named NAAC. In 1978, NAAC was closed down by Cape and other subsidiaries formed with the express purpose of reorganising the business in the USA to minimise Cape presence there for purposes of taxation and other liability issues.

Following a series of litigations between 1978 and 1979 arising from injuries caused by the operations of its subsidiaries, a default judgment was entered against Cape and Capasco, by which time Cape had sold its asbestos mining and marketing business and therefore had no assets in the US to satisfy its judgment debt. The claimants thus sought to enforce the judgments in England where Cape had most of its assets. The issue before the court was how to link Cape to the activities of its US subsidiaries for purposes of liability of the claim and lifting of the corporate veil.

The court, while finding as a fact the relationship between Cape and its subsidiaries nonetheless upheld the sanctity of corporate personality for the respective companies. Consequently, it went ahead to hold that the claimants cannot recover from Cape. The Court of Appeal, as per Slade LJ, stated as follows:

> We do not accept as a matter of law that the court is entitled to lift the corporate veil against a defendant which is the member of a corporate group merely because the corporate structure has been used so as to ensure that the legal liability (if any) in respect of particular future activity of the group...will fall on another member of the group rather

> the defendant company. Whether or not this is desirable, the right to use a corporate in this manner is inherent in our corporate law.[101]

This landmark case denoted three circumstances under which the corporate veil can be lifted. They include where there is in issue the interpretation of a statute or document, it could be a bar to corporate personality and the court can treat a group as a single entity. This leaves out numerous tort claims from injuries that could arise as a result of the activities of multinational corporations.[102]

Secondly, the veil of the company can be lifted where special circumstances exist which indicate that it is a mere facade concealing the true facts. In order to establish a facade, there must be a showing of impropriety. The impropriety must be linked to the use of the company structure to avoid or conceal liability to a third party. In this circumstance, the court, whilst recognising the separate existence of the company, may nevertheless lift the corporate veil in order to prevent the individuals involved in the illegitimate activity from escaping liability that otherwise would have been enforceable had the individual(s) concerned not sought to hide behind the company's separate status.[103]A facade will also exist where in a group situation, the holding company controls a subsidiary company to the extent that the control amounts to an agency relationship.[104] In the case of Cape, the court found nothing wrong in the company structuring its US business through its various subsidiaries in order to reduce its tax and other liabilities.

Thirdly, the court refused to agree that agency can exist in a group as a matter of course thus setting a high and difficult standard to maintain. Consequently, agency cannot be implied by conduct in terms of group entities but by express agreement of parties.

From the above, it is clear that the *Adams* case, in applying the strict and formalistic approach of Salomon's case has narrowed the scope of veil piercing approaches in the UK thus creating more problems for creditors and other claimants such as victims of tort and employees who may have genuine claim against a company. As

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[101] *Adams v Cape Industries PLC* [1990] 1 Ch. 544

[102] G. Tweeddale & L. Flynn, 'Piercing the Corporate Veil: Cape Industries and Multinational Corporate Liability for a Toxic Hazard, 1950-2004' (2007) 8 *Enterprise Soc.(Oxford Journal)* Vol., 2, Oxford, 268 at 268.

[103] See the dictum of Lord Keith in *Woolfson v Strathcylde Regional Council* [1978] S.L.T. at 163

[104] S. Griffin, *Company Law Fundamental Principles*, 4th ed., Pearson Longman, London, 2006, 28.

Tweedale and Flynn emphasized,[105] the case shows how corporate strategy can be closely intertwined with international corporate law and occupational health and safety issues. It also highlights how limited liability law and separate personality can result in significant injustices to claimants against group enterprises and multinational corporations.[106]

Notwithstanding the perceived set back occasioned in *Adams*, there appears to be a gradual but slow positive resurgence on issues of the corporate veil in view of the decisions in *Beckett Investment Management Group v. Hall*[107] and *Stone & Rolls v. Stephens*[108] where on various occasions, the Court of Appeal and the House of Lords lifted the veil of the corporation. In respect of the former, the veil of the parent company and its subsidiaries was lifted in order to give effect to a covenant not to compete in an employment contract. In the latter case, the court upheld the defence of ex *turpi causa*[109] by the defendant so as to deny the claim of the claimants. It set aside the separate personality of the company whilst attributing the fraudulent actions of its controlling shareholders to it.

Following the decisions in *Beckett and Moore Stephens*, it is arguable the courts have added a renewed impetus to contract claims notwithstanding the separate personality of the company. For tort claims, it is possible to see from *Adams* that there will be inherent difficulties that any claimant will face in pursuing such claims. It is submitted that, with the current state of the law, such tort claims appear impossible to recover under UK laws. Nonetheless, the recent Court of Appeal decision in *Chandler v Cape plc*[110] demonstrates the availability of damages for a tort victim from a parent company in circumstances where the victim suffered industrial injury during employment by a subsidiary company. The decision is significant because it represents the first time an injured employee of a subsidiary company has established that his employer's parent company owed him a duty of care in health and safety matters. Given the circumstances of the case, the Court of Appeal reasoning is that Cape had superior knowledge about the nature and

[105] Tweedale and Flynn, n.102 above.
[106] Ibid.
[107] [2007] I.C.R. 1539 (CA)
[108] [2009] 3 W.L.R. 455 (HL)
[109] Under the principle of ex *turpi causa*, the court will not assist a claimant to recover compensation for consequences of his own illegal conduct.
[110] [2012] EWCA Civ 525

management of asbestos risks, knew (or ought to have known) that the subsidiary's system of work was unsafe and therefore should have provided them with a safe system of work or ensured that appropriate steps were taken in the light of the knowledge available to it.

Although the judgment is not concerned with the piercing of the corporate veil, it practically gives the equivalent effect of imposing liability on a parent company despite the fact that it is considered a separate legal entity from its subsidiary. However, the four-path test set out in *Chandler* for ascertaining responsibility on the parent company for the health and safety of its subsidiary's employees highlights key elements including questions of control and the assumption of responsibility which remain unclear and problematic.[111] The case did not discuss nor mention unjust enrichment and constructive trust on the part of the controlling shareholders and directors who benefitted at that time from the fraudulent activity of the parent company and whose actions and negligence gave rise to the breach of duty of care complained about.

Arguably, Chandler's case does not depart fundamentally from the present orthodoxy of the corporate form. Chandler demonstrates clearly that a parent company will not be held liable simply because it owned, or could control, or had shared directors with a subsidiary company. Liability was attached to Cape because of its assumption of a responsibility to the subsidiary's employees in relation to their health and safety. Cape was in breach of that duty of care by failing adequately to discharge that burden. The court's concern was the relationship between the parties and whether that gives rise to a duty of care. Its wider implication is that there is no general duty to prevent third parties causing damage to another, though the particular circumstances or relationship between the parties may give rise to an assumption or attachment of responsibility. Given this scenario, it becomes clear that the task of establishing this 'special relationship' and therefore the assumption of responsibility would rest on the claimant. This burden may be difficult for claimants to discharge given the passage of time, information assymmetary and dissolution of companies.

[111] For detailed analysis of this case, see M. Petrin, 'Assumption of Responsibility in Corporate Groups: *Chandler v Cape plc'* (2013) 76(3) *MLR* 589-619.

It is therefore submitted that, rather than the present approach, the presumption of separateness should not apply to corporate shareholders. Instead, corporate entities in a group should be treated as a collective whole. Failure to do this would promote injustice; this is the basis of enterprise law. In the alternative, there should be a revival of the much maligned single economic unit theory enunciated by Denning in *DHN*, but this time with a more defined scope, clarity and theoretical foundation based on actual or potential control of the subsidiary by the corporate parent. The presumption of control puts the parent on notice on the risk of liability in respect of its control of the subsidiary. To disprove actual control, the corporate parent must show by preponderance of evidence that the subsidiary exercises independent judgment in its daily operation or that it does not follow the dictates of the parent. This will ultimately give a formal structure to the theory whilst making it clearer with predictable application. The benefit of this approach is that liability, whether in contract or tort, will be undertaken by the group as a whole rather than leaving it to the individual companies, even when they do not have the capacity to deal with the weight of the problem that has arisen. A new jurisprudential change is required in this direction.

3.2.4 Nationality of Shareholders

The English courts have sometimes attempted to pierce the veil of the corporation particularly in times of war in order to identify the nationality of its incorporators. Although this ground may not explicitly be regarded as a challenge to the separate legal personality of a company as it involves issues of statutory or common law legal questions, it has nevertheless been applied to lift the veil of incorporation. A case which appears very relevant on this ground is *Daimler Co Ltd v Continental Tyre and Rubber Co Ltd*.[112] Here, the defendant was a UK company but with greater control and majority shareholding held by Germans. The company supplied tyres to Daimler, but Daimler was concerned that it might act in contravention of the prevailing common law offence of trading with an enemy, as well as the proclamation issued under s.1 (2) Trading with the Enemy Act 1914 if it made payments to the company. It thus brought an action to determine the propriety of making such payments, given that it was the First World War. Both the court of first instance and the Court of Appeal saw no basis for refusing to make the payments.

[112] [1916] 2 AC 307

However, the House of Lords unanimously reversed the decisions of the courts below. It came to the conclusion that the company, as presently constituted and controlled, had an enemy character and therefore payment ought to be denied. This case demonstrates that the courts in the post Salomon era are prepared to pierce the corporate veil notwithstanding its separate personality, in order to see who the controllers of the company are, particularly in times of war. This is analogous to lifting the corporate veil with paramount public interest in mind.

3.3 Statutory Exceptions

Apart from judicial action, there are few instances when the legislature has intervened to temper the effects of the Salomon's case and impose liability on members and corporate controllers. Some of these interventions are intended to ensure that the corporate form is not misused, that there is some degree of transparency and accountability and that the right of third parties are not abused. Statutory provisions tend to clarify the prevailing or indeed changing state policy and reduce judicial discretion.[113] This is particularly important because judges are required to comply with the provisions of the statute even when the outcome was not contemplated.[114]

Before the coming into force of the Companies Act 2006, there had been attempts by the legislature to impose liability on the members personally notwithstanding the privilege of the corporate form. This is most evident in section 24 of the Companies Act 1985 regarding a company trading below its minimum membership over a certain period of time, in the case of a public company. Under the provision of this law, a member alongside the company can incur joint and several liability for company debts where a company, other than a private company limited by shares or by guarantee, carries on business without having at least two members and does so for more than six months with their knowledge for the whole or any part of the period that it so carries on business after those six months. This provision affects not only the controlling shareholder but all shareholders of the company. However,

[113] This is evident from most of the changes made under the Companies Act 2006 from the previous Companies Act 1985.
[114] See Jianlin Chen, (2008) 38 *Hong Kong Law Journal* 425 at 439; See also the views of Lord MacNaghten and Lord Halsbury in *Salomon v Salomon [1897] AC 22*.

following the Twelfth Company Law Directive,[115] which excluded private companies limited by shares or guarantee from the provisions of section 24, the section was not replicated in the Companies Act 2006. The provision was further weakened by the fact that it is possible to satisfy the two member requirement by simply issuing one share to a person who will then hold that share as a nominee for the other member. Although this provision is no longer applicable in the UK by virtue of the fact that under the current law, a company (whether private or public) can a have single member, it provides an example of the imposition of liability on shareholders in spite of the shield of separate personality and limitation of liabilities of members. That section is also important for purposes of comparison, because as we shall see in the course of this work, a similar provision of this law exist under the Nigerian Companies and Allied Matters Act 2004.

As with the provision regarding reduction of number of members above, the Companies Act 1985 also imposed personal liability on officers of the company in the event of misdescription of the company's name.[116] This provision operated where an officer or a person acting on behalf of the company signs a bill of exchange, cheque or similar instrument for any transaction or purchases for goods on behalf of the company, in which the company's name is not mentioned.[117] Again this provision was not replicated in the Companies Act 2006. It therefore no longer operates as a law in the UK, though it still exists as part of Nigerian laws.

Notwithstanding the non retention of the provisions above, there are far reaching provisions in the Companies Act 2006, Companies Directors Disqualification Act 1986 and the Insolvency Act 1986 delineating exceptions to the rule on separate personal liability of members and corporate controllers of companies in the UK. These exceptions can be seen in the following ways.

3.3.1 Premature Trading

The corporate veil can be pierced and personal liability imposed if a public company commences business or exercise any of its borrowing powers, without first obtaining from the Registrar of Companies a certificate of compliance signifying compliance

[115] See for instance EC Council Directive 89/667, implemented in Britain by the Companies (Single Member Private Limited Companies) Regulations 1992 (SI 1992/1699).
[116] See s.349(4) of the CA 1985.
[117] See s.349 (1) (c) of CA 1985

with the relevant provisions of the Act regarding share capital requirements unless it has re-registered as a private company. This is contained in section 761 of the Companies Act 2006 which is in *pari materia* with section 117 of the Companies Act 1985. Thus if, a company operates or transacts any business in contravention of that law, the company and its officers will be fined for default. The imposition of liability is further extended where the company in that connection fails to comply with its obligation under the transaction within 21 days upon being called upon to do so. In that case, the directors of the company are jointly and severally liable to indemnify the other party to the transaction in respect of any loss or damages suffered by him by reason of the company's failure to comply with those obligations.

What is obvious from that provision is that whereas it exculpates directors from liability of company's debt, it nevertheless penalises them for any loss suffered by third parties following the company's default in complying with the section breached. To this extent, section 761 of the Companies Act 2006 seeks to protect the creditors of publicly held companies in the event of the company violating its share capital requirement. Arguably, without reaching the share capital requirement in publicly-held company, limited liability can be abused. Lack of adequate share capital guarantee can also lead to stock market disorder or fraud. It may also result in inefficiency, poor economic development as well as social wealth maximization. The provision relating to premature trading is rarely invoked largely because of the changing processes of companies converting from private companies to public companies; companies may originally be formed as private company and later apply the procedure of re-registration for conversion into a public status .[118] This process can further erode the application of the law, though it can still be checked if obtaining the minimum capital requirement is made a pre-condition for conversion through re-registration.

3.3.2 Fradulent Trading Provision

A fraudulent controller cannot use the corporate form to commit fraud or defraud creditors and escape liability in respect to the company's debt if the company goes into liquidation. This is the basis of the fraudulent trading provision contained in section 213 of the Insolvency Act 1986. The provision, which is a clear departure

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[118] Davies & Worthinghton, n.12, at 226-227

from the decision in *Salomon's* case, relates to the fact that during the winding up of a company it appears to the court that any business of the company has been carried on with intent to defraud creditors of the company or creditors of any other person, or for any fraudulent purpose, the person or persons involved shall be called upon to contribute to the debt of the company. This involves making such contributions to the company's assets as the court may deem fit and proper in the circumstance of the case. [119] The court's intervention is compensatory in nature. In making any declaration, the court ultimately takes into account the extent of loss made by the company during the period of the fraudulent trading. [120] At times the courts declaration may be punitive in nature. Section 213 of the Insolvency Act only empowers the liquidator to initiate civil proceedings on behalf of the company. This tends to exclude applications from individual creditors and also the possibility of multiplicity of individual actions.

Section 213 of the Insolvency Act provides the civil liability against fraudulent trading and operates to lift the corporate veil. Essentially, the provision covers anyone involved in the carrying on of the business. In small companies, directors are often also members of the company and so their limitation of liability is indirectly affected. In large or holding companies, the holding company can only be held liable as a party to the fraudulent trading of a subsidiary if it is shown in evidence that the holding company is an active participant in running the subsidiary business and the degree of control is substantial. However, this appears impossible in practice as the holding company is clothed with separate personality and is therefore responsible for its own actions.[121]

The criminal liability of the fraudulent trading provision can be found in section 993 of the Companies Act 2006. Unlike the provision in the Insolvency Act, it need not operate in the course of winding up.[122] This provision carries a deterrent measure of criminal liability of ten years, or a fine, or both on conviction for any person who knowingly commits this crime.[123] The provision of section 993 of the Companies Act 2006 has had a chequered history in successive company laws. Indeed the notion

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[119] See *Re William C Leitch Bros* [1932] 2 Ch 71, at 77-79
[120] See *Re a Company* (No 001418 of 1988) [1991] BCLC 197. The case involved the application of CA 1985, s. 630, the statutory predecessor of IA 1986 s.213.
[121] See *Adams v Cape Industries* [1990] Ch 433
[122] Davies & Worthington, n.12, at 227
[123] See Companies Act 2006, s.993 (3) (a)

of the fraudulent trading became known under English law in the Companies Act of 1928 following the recommendations of the Green Committee and was re-enacted in the Companies Act 1929,[124] followed by the Companies Act 1948.

The fraudulent trading provision is intended primarily to protect the interests of corporate creditors. However, it has been suggested that carrying on a company's business "for any fraudulent purpose" may extend the effect of the provision on persons other than creditors of a company in its strict sense. An instance of this could be seen in Lord Denning's comments in *Re Cyona Distributors Ltd*[125] where he asserted that the word "for any fraudulent purpose" were composed deliberately in wide terms to enable the courts to bring fraudulent persons to book, and that they should be given their full width. Following this dictum of Denning, some later authorities have classified customers as persons who are potential / contingent creditors of a company with an existing right to the payment of a debt at some future date.[126] Though the argument of inclusion of a customer as a creditor appears unnecessary following the varied misconception of the provision, viewed within the context and the potential width of the term "for any other purpose", the fraudulent trading provision has now been applied to bring the customer of a company within the ambit of the creditor.[127]

Dishonesty is a fundamental element of fraudulent trading.[128] Proof of fraud requires that the directors not only acted unreasonably but that they acted dishonestly.[129] This requirement however poses a difficulty which tends to make the remedy of little use.[130] The result has been the paucity of cases in relation to director liability for fraudulent trading[131] and calls for reforms in this area of the law.

The fraudulent trading provision has also been difficult to operate in practice. This is largely because the provision contains both criminal and civil elements. The fraud

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[124] See Companies Act 1929, s.275. This provision only covers fraudulent trading by directors.
[125] [1967] Ch 889, at 902
[126] See *Re Sarfax Ltd* [1979] 1 Ch 592, where Oliver J. treated a customer as potential creditor of the company notwithstanding that the customer had no legal entitlement to be paid during the relevant trading period. See also *R v Kemp* [1988] QB 645, where the Court of Appeal interpreted the term "for any fraudulent purpose", as being applicable to potential creditors.
[127] See the recent Court of Appeal decision in *R v Smith* [1996] 2 BCLC 109, at 119-122
[128] See *R v Cox* [1983] BCLC 169
[129] *Re L. Todd (Swanscombe) Ltd*, (1990) BCC 125
[130] J. Dine, 'Punishing Directors', (1994) *J.B.L* 325 at 333
[131] B.R Cheffins, *Company Law Theory, Structure & Operation*, Clarendon Press, Oxford, 1997, 547

element in the provision requires that the standard of proof beyond reasonable doubt, which is very high. In *Re Patrick and Lyon Ltd*,[132] a case involving a company which had never made a trading profit and in which the directors secured money that was owed to them from the company by causing the company to issue debenture to them, the court was of the opinion that actual dishonesty involving current notions of fair trading among commercial men, real moral blame be proved. However, in *Re Gerald Cooper Chemicals Ltd*[133] an insolvent company which accepted an advance payment for the supply of goods in a manner which presupposes that the directors knew that there was no prospect of the goods being supplied or that the payment made would not be repaid was held to be carrying on business fraudulently.

The fraudulent trading provision does not appear to help tort victims. This is because the kind of creditors contemplated by the provision with respect to declaration to be made by the court for liability "against any person in any business of the company which has carried on with intent to defraud creditors of the company or creditors of any other person or for any other fraudulent purpose" tends to relate contractual creditors in contractual relationship with the company who may be defrauded. Tort victims have no related contract with the company capable of being defrauded. In addition, even if creditors have not been defrauded, section 213 of the Insolvency Act 1986 still requires that there must have been some fraudulent purpose on the part of the company, which apparently excludes the protection of tort victims.

With the fraudulent trading provision failing to curb director's excesses in running up losses when their companies are in deep financial difficulty,[134] a new section with a lesser burden of proof which seeks to stop directors externalising the cost of their companies' debts and placing all of the risks of further trading on the creditors, becomes expedient. This new section as we shall see below turns attention away from any person (shareholders) to directors of companies.

[132] [1993] Ch 786, at790. See also *R v Cox and Hodges* [1982] 75 Cr. App R. 291
[133] [1978] Ch 262
[134] F. Tolmie, *Introduction to Corporate and Personal Insolvency Law*, Sweet & Maxwell, 1998, 358. Unlike section 214 of the Insolvency Act 1986 which imposes objective standard of reasonable conduct, the fraudulent trading provision applies the subjective test.

3.3.3 Wrongful Trading

The wrongful trading provision found in section 214 of the Insolvency Act 1986 remains another major attempt by the legislature in the UK to deal with the abuse of the corporate form. It is as a leading commentator pointed out, an "extreme departure" from the rule in *Salomon's* case so far achieved in the United Kingdom.[135] The section is intended to deal with situations where directors who seeing that their company is facing imminent collapse fail to do something to protect creditors interests. The introduction of section 214 of the Insolvency Act became apparent when it emerged that the existing fraudulent trading provision was unable to stem the prevalence of directors running up losses in periods when their companies were deeply in financial difficulty.[136]

The inclusion of the section in the Insolvency Act appears to be the Government response to the recommendations of the Cork Report[137] which had endorsed for the creation of a wrongful trading provision having in mind the need to ensure stricter controls to curb the reckless trading activities of persons involved in the management of insolvent companies.[138] The committee thought that the wrongful trading provision would provide a balance between the need for economic growth and the need to discourage abuse of the privilege of limited liability.[139]

The wrongful trading provision focuses attention on a civil remedy for those who have suffered financial loss and compensation to be available to those who suffer foreseeable loss as a result of unreasonable behaviour.[140] Thus, the major advance brought about by the introduction of wrongful trading is that considerable personal

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[135] Davies & Worthington, n.12, at 230

[136] Insolvency Law Review Committee, Insolvency Law and Practice (generally referred to as "the Cork Report") Cmnd 858, HMSO, 1982, at paras 1776-1778

[137] See the Report of the Insolvency Law Committee, Insolvency Law and Practice, CMND , 8558 ,1982; Cmnd 9175 para. 52.

[138] Ibid, at 1805

[139] Ibid. [139] See also F. Tolmie, n.130 above. Unlike section 214 of the Insolvency Act 1986 which imposes objective standard of reasonable conduct, the fraudulent trading provision applies the subjective test.

[139] Davies & Worthington, n.12, at 230-232

[139] Insolvency Law Review Committee, Insolvency Law and Practice (generally referred to as "the Cork Report") Cmnd 858, HMSO, 1982, at paras 1776-1778

[139] See the Report of the Insolvency Law Committee, Insolvency Law and Practice, CMND , 8558 ,1982; Cmnd 9175 para. 52.

[139] Ibid, at 1805

[139] Ibid.

[140] See n.136 above, at para. 1777

liabilities can be imposed on those persons who have run a company where the company has gone into insolvent liquidation, even where those persons have not acted dishonestly. This is particularly important because the person entrusted to manage the company failed to take any necessary action to stop further transaction when it is apparent that the company is insolvent and can no longer pay its debt. The consequence of this negligence is two- fold. First, it can result in further economic loss with regard to the fact that the company may be incapable of taking regular responsibilities when it is insolvent. Second, and by far more importantly, the transaction could possibly increase market immorality by bringing more transaction risk to outsiders.

The wrongful trading provision as a regulatory framework shifts attention of directors from shareholders to creditors. Directors are required by the provision to take action to minimise losses to creditors since the latter have a residual claim over company assets when the company is proceeding to insolvent liquidation.[141]

Section 214 of the Insolvency Act has a very wide scope and extends to a shadow director for purposes of liability. A shadow director under the Insolvency Act is:

> ...a person in accordance with those instructions the directors of the company are accustomed to act (but so that a person is not deemed a shadow director by reason only that the directors act on advice given by him in a professional capacity.[142]

There has also been further extension of liability under section 214 to those regarded as *de facto director*. In *Re Hydrodam (Corby) Ltd*,[143] a de facto director was defined thus:

> ...a person who assumes to act as a director. He is held out as a director by the company, and claims and purports to be a director, although never actually or validly appointed as such. To establish that a person was a de facto director of a company it is necessary to plead and prove that he undertook functions in relation to the company which could properly be discharged only by a director.[144]

[141]See ss.214 (1), 214(2) and 214(3) of the Insolvency Act 1986. See also S.Schwarcz in 'Rethinking a Corporation's Obligations to Creditors' (1996) 17 *Cardozo Law Review* 647, 668
[142] Section 251
[143] [1994] 2 BCLC 180
[144] Ibid, at 183

The definition of a de facto director is a marked contrast to a shadow director who claims not to be director but is he held out by the company as a director.

Thus the meaning of a shadow director may seem to be a person who having retired from a company which he helped to build up over so many years continues to have influence over the directors. A parent company which is directing the affairs of a subsidiary may come within the purview of a shadow director.[145]

The wrongful trading provision, unlike the fraudulent trading provision in section 213 of the Insolvency Act, does not require proof of intent to defraud or dishonesty. Section 214 of the Insolvency Act attempts to deal specifically with the civil sanction associated with the negligent conduct of a director of the company or persons in that category who fail to take appropriate steps where the avoidance of insolvent liquidation was not a reasonable prospect.[146] The section does not avail corporate controllers the protection of limited liability, on threat of insolvency, unless their conduct meets an objective standard required of a person occupying such position.[147] Thus the courts shall not proceed to make the order against the director unless it is satisfied that the director, having known that there was no reasonable prospect of the company going into insolvent liquidation, took no steps with a view to minimising the potential loss to the company's creditors.[148] The conclusion a director ought to reach are those which would be known or ascertained by a reasonably diligent person having both the general knowledge, skill and experience that may reasonably be expected of a person carrying out the same functions as carried out by the director in relation to the company, and the general knowledge, skill and experience that the director personally possesses.[149] The standard of knowledge and skill required is therefore a cumulative blend of subjective and objective standards.

The defence which suggests that the director must take 'every step' in order to avoid liability appears to be quite herculean, and going by its strict interpretation, and

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[145] Davies & Worthington, n.12, at 219. See also the comments of Miller J. in *Re Hydrodam (Corby)* Ltd [1994] 2 BCLC 180, at 182-183; Tomlie, n.130 at 360

[146] See section 214 (2) of the Insolvency Act 1986. See also *The Earp v Stevenson* [2011] EWHC 1436 (Ch); *Roberts v Frohlich* [2011] EWHC 257 (Ch); *Singla v Heman* [2010] EWHC 902 (Ch); Ward Perks, Re Hawkes *Hill Publishing Company (in Liquidation)* [2007] BCC 937

[147] Ibid.

[148] See section 214 (3)

[149] Section 214 (4)

except in few cases, it is almost impossible to establish.[150] The lack of legislative guidance or judicial pronouncement on what constitute 'every step' for purposes of establishing the defence have not helped matters. It has become increasingly difficult to make application for this defence for purposes of satisfying the requirements of section 214(3).[151]

A number of suggestions has, however, been made as to how a director, following this lack of clarity, can establish the defence. This includes regular attendance of board meetings where he will ensure that measures taken by him are recorded and keeping of, up to date books detailing the company's accounts, records and efforts made to minimise loss to creditors. It is logical at this stage, when a company is nearing insolvency, for the director to present to the board the critical financial position the company has found itself in, allowing it to be discussed and supporting any measure aimed at assessing the company's capacity to stop trading. If it means that the company should stop trading at this juncture, the director should equally support it.[152]

There have been alternative suggestions that where it becomes evident that there was no reasonable prospect of the company's debt and liabilities being reduced by the continued trading, the director should support the appointment of an administrator or have the company put into receivership.[153] In exceptional cases, when the company has reached a point of no return, the director may consider resigning his appointment. However, the latter option has been seen as a sign of capitulation and failure on the part of the director to take every step to minimise potential loss to creditors than finding solution to the problems of the company which could have exculpated him from liability.[154] In effect, this may be viewed as a step designed by the director to protect his personal interest and integrity.

3.3.3.1 Compensation

The power to make compensation under section 214 of the Insolvency Act 1986 lie at the discretion of the court. Usually, the courts approach is to determine the actual

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[150] Griffin, n.104 at 74.
[151] Davies & Worthington, n.12, at 230-237
[152] S. Griffin, *Personal Liability and Disqualification of Company Directors*, Hart Publishing, Oxford, 1999, 75
[153] Ibid.
[154] Ibid, at 75-76

date the insolvency was triggered by way of its balance sheet. Thus under section 214, compensation that may be made by the court is the amount by which the net deficiency of the company increased between the two dates. The first date is when the directors knew or ought to know that the insolvent trading is inevitable. The second date is the one involving the start of liquidation.[155] The judge's discretion in making orders under section 214 is too wide. The court may not necessarily order that a director make payment, even if he or she has engaged in wrongful trading. If the judge decides to order that payment be made, it has to be the actual amount. This makes it difficult for a liquidator to determine the likely award by the court.[156]

Since the court has been given wide discretionary powers under section 214 particularly in deciding the quantum of contribution payable,[157] it could consider the culpability of the director in the wrongful trading, with the effect that an honest, naive director might be viewed with leniency whilst a reckless director might attract little sympathy. It is submitted that the exercise of courts discretion under this circumstances is questionable as the intention of section 214 is to provide compensation rather than penalise directors. In *Re Produce Marketing Consortium Ltd*[158] the court recognised that the amount of compensation is at the discretion of the courts,[159] but nevertheless upheld the fact that the jurisdiction of section 214 was compensatory in nature and not penal. To this extent, therefore, the amount of compensation is not dependent on the state of mind of directors,[160] but on the loss sustained by the company, and the ultimate prejudice to creditors. Before now, it was thought that a secured creditor which held a floating charge has priority to the proceeds of the contribution under the terms of the order.[161] This presumption has however changed following the Court of Appeal decision in *Re Oasis Merchandising Services Ltd*[162] which changed the law and held that the priority being afforded to

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155 *Re Produce Marketing Consortium Ltd* (1989) 5 BCC 569

156 A. Walters, "Enforcing Wrongful Trading- Substantive Problems and Practical Incentives" in BAK Rider (ed), *The Corporate Dimension*, Jordans, Bristol, 1998, 152.

157 S. Griffin, *Personal Liability and Disqualification of Company Directors*, Hart Publishing, Oxford, 1999, 64

158 (1989) 5 BCC 569

159 Ibid.

160 Dr Fidelis Odita has argued that absence of fraudulent intent cannot on its own constitute the basis for fixing the amount at a nominal or low figure is not, on its own, a reason for fixing. See F. Odita, 'Wrongful Trading' [1990] *LMCLQ* 205 at 215

161 See *Re Produce Marketing Consortium Ltd*, [1989] 5 BCC 569

162 [1997] 1 WLR 764

holders of floating charge is unsustainable.[163] To this extent, the benefits of the order made pursuant to section 214 are not affected by the claim of prior interest of any floating charge.[164]

3.3.3.2 Who can make an Application in Respect of Wrongful Trading

The only person empowered to make an application under the section is the liquidator. [165] By this provision, creditors are excluded from making such an application. As no opportunity is provided to creditors, this may prejudice them, particularly where the liquidator exhibits a cautious approach towards taking out proceedings against the erring directors. [166] The huge capital outlay required to initiate such proceedings may be a discouraging factor to the liquidator notwithstanding the public importance of instituting such action. Anecdotal evidence indicates that a sum in the region of £50,000 is needed, even for relatively small claims.[167] Again, as the liquidator may not be a beneficiary, he may not be concerned with the amount of money that can be obtained for the benefit of the creditors.

Putting these factors together, it becomes difficult to accept why a creditor may not be allowed to take action for recovery against the director. One possible argument weighing against it is that the proceeds of an order under section 214 is not directed for the benefit of a particular creditor but to the whole group of creditors.[168]

3.3.3.3 Assessment of the Wrongful Trading Provision

Section 214 of the Insolvency Act has been hailed as positive by a number of commentators despite the associated problems arising from it. While some have regarded it as being capable of shaping the minds of directors in the wake of the likely insolvency of companies,[169] others have variously seen it as unquestionably

[163] This also applies to contribution made under Insolvency Act 1986, s.213.
[164] Although the benefits of the fruits of s.214 is preserved for unsecured creditors, it may still concurrently extend to secured creditors for purposes of distribution if the corporate assets is insufficient to discharge its obligation to them.
[165] This follows the white paper on the Cork Report.
[166] Section 168(5) of the Insolvency Act however provides a window of opportunity for a creditor to apply to the court for a review of the inaction of the director.
[167] P. Fidler, 'Wrongful trading after Continental Assurance' (2001) 17 *Insolvency Law & Practice* 212 at 212.
[168] See *Re Purpoint* [1991] BCC 121, at 129
[169] P. Davies, 'Directors' Creditor-Regarding Duties in Respect of Trading Decisions Taken in the Vicinity of Insolvency' (2006) 7 *EBOR* 301

one of the most important developments in company law this century;[170] it has been viewed as a welcome development and additional weapon in the fight against abuse of limited liability by directors of trading companies,[171] and as offering a bright future for the provision of much needed protection to creditors.[172]

Despite the encomiums poured on the wrongful trading provision, it has in reality been seen to have failed to achieve its objective. The reasons attributed to this failure have been wide and varied. Apart from paucity of reported cases,[173] only a small number of compensation claims on behalf of creditors for wrongful trading against directors have been successful.[174] In most cases, the courts do not appear ready to impose liability on directors, and this is particularly true where the directors have sought and obtained advice from professionals. Indeed, the cases suggest that only the most irresponsible of directors have been found liable for wrongful trading by judges.[175] Further empirical research carried out by Hicks has also revealed that only on rare occasions have any actions for wrongful trading been brought against directors who are disqualified under section 6 of the Company Directors Disqualification Act 1986.[176] The provision has been fundamentally flawed as it placed no ready funds in the hands of the liquidator to pursue claims for recovery against directors. As the funds needed to pursue these claims are quite enormous, liquidators are reluctant to institute compensation claims unless there are funds available to cover not only the cost incurred by the liquidator himself, but also the costs against the liquidator himself in favour of the other party from whom recovery is sought in the event of failure in the recovery proceedings.[177] Another factor is that in many cases the directors in question have insufficient assets to make them worth

[170] D. Prentice, 'Creditors Interests and Director's Duties' (1990) 10 *OJLS* 265, at 267
[171] Odita, n.160 at 222
[172] R. Schutle, 'Enhancing wrongful trading as a standard of conduct for directors and a remedy for creditors: the special case of corporate Insolvency' (1990) 20 *The Company Lawyer* 80.
[173] L.Doyle, 'Ten Years of Wrongful Trading' [1996] *Insolvency Lawyer* 10
[174] See Hicks, Wrongful Trading-Has it been a failure?" [1993] *Insolvency Law and Practice* 133 at 134.
[175] *Re Sherborne Associates Ltd* [1995] BCC 40
[176] Disqualification of Directors: No Hiding Place for the Unfit (Chartered Association of Certified Accountants, Research Report No 59, London, 1998) at 125.
[177] *Re M.C. Bacon (No 2) [1990] B.C.L.C.* 607. Here the court held that the liquidator would incur personal liability for costs in an unsuccessful action for wrongful trading.

suing.[178] The result has been the failure to achieve a more efficient regulation of the wrongful trading activities of directors.[179]

Another major problem associated with wrongful trading provision is its inability to make specifications as to the precise action a director is required to take to meet its requirements.[180] Rather than lay down a rule to which the director must conform to in order to avoid liability, it seems to provide an across-the-board standard of every step to be taken to minimise potential loss to company's creditors in the course of insolvent liquidation.[181] Crucial at this juncture are two unanswered question: at what point can it be said that there is no reasonable prospect of the company avoiding insolvent liquidation; and what can we say constitutes "every step" taken to minimise loss to creditors? These two questions lack answers.

The wrongful trading provision in the UK appears to be at variance with similar insolvency regimes in other jurisdictions in terms of certainty and scope of liability and procedure for recovery. In Australia for instance, the point at which liability is attracted seems to be more definite. Under the Australian provision, a duty is imposed on the directors to prevent their companies from incurring debts at the time of insolvency.[182] Thus where a director incurs debts at the time of the company's insolvency, he may be liable for recovery by the liquidator to such amounts as may be equal to the amount of loss or damage suffered by the company as a result of the insolvent trading.[183] In addition, the Australian law grants the creditors the right to pursue claims against the directors for insolvent trading subject, although it requires the consent of the liquidator or the leave of the court.[184] It further imposes liability on the holding company for the insolvent trading of its subsidiary.[185] Like section 214 of the Insolvency Act, the Australia law had no provision for the insolvency of the group. In New Zealand, the reckless trading provision imposes liability against a director not merely where there is a loss, but rather where there is a substantial risk

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[178] Tolmie, n.134 at 363

[179] Ibid. See also Williams & McGhee, 'Curbing Unfit Directors –Is Personal Liability an Empty Threat' [1993] *Insolvency Lawyer* 2.

[180] Davies & Worthington, n.12, at 230-237

[181] Ibid.

[182] See section 588 G – 588Y regulating insolvent trading provision under the Australian corporation Law 2001.

[183] Ibid, at section 588 M (2)

[184] Ibid, at section 588R

[185] Ibid, at section 588Y

of serious loss to the company's creditors.[186] Thus, a director is required not to perform any obligation unless he believes, on reasonable grounds, that the company has the ability to perform the obligation when required to do so. This provision therefore requires knowledge on the part of the director concerning the incurring of the debts, which is different to Australia's insolvent trading provision and section 214 of the insolvency Act.

Following the above, it is submitted that section 214 of the Insolvency Act can be strengthened by ensuring clarity in the law as to when liability could arise against a director. It is apparent on the face of the law that the term "no reasonable prospect" in relation to when liability may arise is somewhat vague and difficult to interpret. The use of the term at the moment renders the provision vulnerable to various and contradictory interpretations. It also makes it difficult for the liquidator to ascertain when the liability of the director can be said to have started running. One way to solve this problem is by providing a time limit between when insolvency sets in and the time the director is expected to stop trading. It is suggested that a period of thirty days should be given for the director to initiate an insolvency case on reasonable ground that the company has no prospects of recovering or incuring liability thereafter.

On the issue of funding proceedings, it is submitted that the Secretary of State should be granted the powers to bring section 214 proceedings in the overall public interest.[187] Alternatively, creditors may be allowed to pursue recovery actions as a class without recourse to a liquidator. These measures will ultimately relieve the liquidator the burden of looking for funds to pursue claims against the incompetent directors.

Finally, the nature of the provision which affects the extent of the contribution that the court may order should be clarified, whilst liability of companies in a group should be dealt with by the group as whole, liable with all its assets.

[186] See sections 135-136 of the Companies Act 1993 (NZ)

[187] This is an approach that has been implemented in Australia with success in relation to its insolvent trading legislation. Here the Australian regulator of companies, the Australian Securities and Investments Commission is entitled to bring insolvent trading proceedings against directors.

3.4 Disqualification of Directors

Disqualification of directors is another mechanism deployed in the UK to deal with delinquent directors who have abused the corporate form. The Disqualification of Directors Act 1986 (CDDA 1986) aims to strengthen corporate responsibility and accountability. As pointed to by Browne Wilkinson VC in *Re Lo-Line Electric Motors Ltd,*[188] the primary purpose of disqualification provisions was "not to punish the individual but to protect the public against the future conduct of companies by persons whose past records as directors of insolvent companies have shown them to be a danger to creditors and others." A director for the purposes of disqualification includes a de jure, de facto and shadow directors.[189] However, in *Holland v Revenue and Customs & anor*[190] the Supreme Court held that merely acting as a director of a corporate director of a company and performing duties in that capacity without more is not sufficient for a de facto directorship of that company.

Thus, where a director engages in fraudulent or wrongful trading[191] or has been found guilty of other misconduct in connection with a company and is held to be unfit by the court, he may be disqualified by a court order or have a disqualification order accepted by the Secretary of State under the Directors Disqualification Act 1986 (CDDA).[192] Such a disqualification order may include periods ranging between two and fifteen years.[193]

The 'other misconduct' identified above for the purposes of a disqualification order may include persistent breaches of companies legislation,[194] where there has been fraud in relation to a company's promotion or management,[195] or where an individual was a director of a company which became insolvent and the individual's conduct with that company or another company makes him unfit to act as director in

188 [1988] B.C.L.C 698.
189 See CDDA 1986, s.22
190 [2010] UKSC 51
191 CDDA,s.10. See also *Re Brian D Pierson Contractors Ltd* [1999] B.C.C 26; *Re Idessa (UK) Ltd* [2011] EWHC 804 (Ch); [2012] B.C.C 315
192 See Company Directors Disqualification Act 1986, s.6
193 Ibid. See also F. Tolmie, n.134 at 239
194 CDDA, s.3
195 CDDA, s.4

the future. In the case of the unfit director, the Act imposes mandatory disqualification orders which must be complied with by the courts.[196]

Owing to the seriousness of imposing such an "unfitness" order or undertaking, what has to be proved is "breach of commercial morality",[197] lack of commercial probity or "gross negligence or total incompetence".[198] Commercial morality is relevant within the context of creditor protection. However, the whole concept of "unfitness" lacks clarity and can be subject to variety of interpretations that rest on questions of fact and not of law.[199] In *Cathie v Secretary of State for Business, Innovation and Skills[No.2),*[200] it was held that when considering appeals against disqualification, a court would better be guided by the use of the phrase 'extenuating circumstances' than by the phrase 'exceptional circumstances'. The court must look at the situation as a whole, to see whether a director had fallen below standards of probity and competence appropriate for directors. As Cheffins points out, the extent to which disqualification performs a screening function is very much open to debate.[201] Consequently, many individuals whose conduct does not meet the standard prescribed by the Act still operate as directors.[202] Worse still, most disqualification orders come too late to resolve problems. *Secretary of State for Business, Innovation and Skills v Gifford & Ors*[203] exemplified this. This is largely because it is only after the companies have failed and debts been incurred that action is taken. There is also little to ensure compliance even after obtaining disqualification orders and there are no schemes of arrangement to ensure that disqualified directors resign or that a director is affected for the first time.[204] The sanctions provided under CDDA 1986 ss.13 and 15 for criminal and personal liabilities for the company's debts if there is

[196] Ibid. See also R.M. Goode, *Principles of Corporate Insolvency Law*, Sweet & Maxwell, London. 143-4
[197] Re *Dawson Print Group Ltd* [1987] BCLC 601
[198] *Re Lo-Line Electric Motors Ltd* [1988] BCLC 698 at 703
[199] Unfitness has been described as a concept of "indeterminate meaning." For this see F. Fitzpatrick, 'Disqualification of a director on the ground of unfitness' (1992) *New Law Journal*, 596. See also CDDA 1986, s.9 where reference is made to schedule 1 containing matters for determining unfitness of directors.
[200] [2012] EWCA Civ 739
[201] Cheffins, n.131 at 550.
[202] Ibid.
[203] [2011] EWHC 3022 (Ch). Here Floyd J saw justification in the power of the court to extend the limitation period of two years within which the Secretary of State can make application for directors' disqualification under s.7 (2) CDDA 1986. The application for disqualication of the directors was brought even though a period of two years had elapsed since the company had become insolvent.
[204] See 'Dependent on the overdraft', *Financial Times*, 9 November, 1993.

breach of a disqualification order have not been adequately utilised because of the huge cost involved in order to obtain a disqualification order. This leaves directors in breach of a disqualification orders with no appropriate sanctions.

Following the amendments to the CDDA 1986 introduced by the Insolvency Act 2000, directors who are subject of intended disqualification proceedings are now required to give an undertaking to the Secretary of State for Business, Innovation and Skills not to act as a director for a given period.[205] This procedure does not require a court order and consequently, avoids the expense of disqualification proceedings in the courts. Milman observed that, the number of disqualifications appears to be on the decline following this new measure which has seen a high percentage of disqualifications implemented through the use of undertaking procedure. [206] However, it is not clear whether the declining numbers are due to improved managerial standards and the exclusion of those Milman referred to as 'cowboys' from managing limited liability companies or the effect of the shrink on public finance which has imposed expenditure cuts on the authorities empowered to process information made available to them by insolvency practitioners.[207] In any event, the fact that an undertaking has the same effect as a court order even though provisions exist for its variation where there is a change of circumstances signify the essence of the reform process.[208]

3.5 Phoenix Companies

The Insolvency Act 1986 allows the court to lift the corporate veil in cases of so – called "phoenix Companies", in which a new company is created with the same or similar name to an insolvent company. Section 216 of the Insolvency Act makes it an offence for anyone who was a director of the Insolvent company during 12 months before liquidation to be associated with a company with similar name as the Insolvent company or a name so similar as to suggest an association.[209] Section 217 provides that where a person is involved in the management of a company in

[205] See Insolvency Act 2000, ss 5,6 & 7

[206] D. Milman, 'Disqualification of directors: An Evaluation of Current Law, Policy and Practice in the UK' (2013), *Sweet & Maxwell Company Law Newsletter*, 342, 1-5; See also D. Milman, 'Regulating Managerial Standards- Current Developments' (2005) *Sweet & Maxwell Company Law Newsletter*, 17, 1-4.

[207] D. Milman, 'Disqualification of directors: An Evaluation of Current Law, Policy and Practice in the UK' (2013), *Sweet & Maxwell Company Law Newsletter*, 342, 1-5

[208] Ibid. See also CDDA 1986, ss.1A & 8A

[209] Unless that person is given leave by the court so as to act:see IA s.216 (3)

contravention of s.216, or where he acts, or is willing to act, on instructions given by a person whom he knows to be in contravention of that section, he is himself liable jointly and severally with the company for all the relevant debts.

A phoenix company is one which has been reborn soon after its failure. The new company which is unable to pay its debt takes on the failed company business, often using a similar name with the same managers and directors and the same assets under the guise of a new limited liability, but disclaiming any responsibility for the debt of the predecessor.[210]

Under this arrangement, a new company is formed (the "phoenix company"). Typically, before the new company is placed into liquidation, the directors of that first company transfers the profitable aspects of the first company to the new company, at under value. The directors of the first company then carry on with the second company. In sum, the meaning, scope and dimension of Phoenix Company is best captured by the Company Law Review as follows:

> The 'phoenix' problem results from the continuance of a failed company by those responsible for that failure, using the vehicle of a new company.The new company, often trading under the same or similar name, uses the old company's assets, often acquired at an undervaluation, and exploits its goodwill and business opportunities. Meanwhile the creditors of the old Company are left to prove their debts against a valueless shell and the management control their previous failure from the public.[211]

From the above, it may be argued that the phoenix is inimical to public interest being that it tends to remove the assets of the first company beyond the reach of the creditors thus depriving them payment of their debt.

In addition to the above, the phoenix syndrome allows for mistaken identity in terms of name and management and has the capability of confusing creditors and those in transaction with the two companies. The result is that the cycle of abuse will continue undetected.

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[210] Curbing the phoenix company, Law Reform Committee of the Parliament of Victoria Third Report, 1995,[1].
[211] Company Law Review Final Report, para. 15.55

Unlike the fraudulent trading provision which does not allow creditors to maintain action against the directors for recovery, claims under section 217 to enforce personal liability can be brought by individual creditors as opposed to the liquidator.[212] In order to prove liability under section 217 of the Insolvency Act, the claimant does not need to prove that he has been misled by the prohibited act. The court will be satisfied if he is able to adduce evidence showing that the two company names had a tendency to mislead.[213]

The essence of the prohibition against phoenix company is to protect public interest and safeguard the rights of corporate creditors.

3.6 Conclusion

The chapter has explored the development of the law in the UK in the light of the decision of *Salomon v Salomon* which confirmed the separate personality of the company and limited liability for members. The result drawn from the analysis reveals that legal responses to the principles of separate legal personality and limited liability in the UK since after the decision in the Salomon's case have been cautious. In most cases, the courts and the legislature have followed a strict and formalistic approach in the application of the case and have reluctantly lifted the veil of the corporation only in few, exceptional circumstances.

In the absence of clear guidelines by the legislature, the courts have had to rely on common law tests to deal with issues arising from strict application of *Salomon's* case. This has however resulted in conflicting judgments from various courts on similar subjects. A measure of clarity appears to have been laid in *Adams v Cape Industries Ltd.* Although this landmark case sets out the current law on judicial attitude to Salomon's case, it came with its own confusions and apparent injustices. The case has effectively foreclosed tort victims from making claims against parent companies in the UK in respect of wrongs done to them by the action of their subsidiaries in a group situation. It further recognised the distinctiveness and separate personality of each company in the group. The case merely reiterated the decision in *Salomon* and narrowed the scope under which the corporate veil can be lifted in the UK. The result is that, except in cases of fraud or sham or where the

[212] Davies & Worthington, n.12, at 238-240
[213] Ibid., See also *Revenue and Custom Commissioners v Walsh,* [2005] 2 B.C.L.C. 293 CA.

company is a mere facade, the corporate veil cannot be pierced. The effect is that lifting of the corporate veil can only be founded in contract as opposed to tort and only in the limited circumstances highlighted above.

There seems to be nothing in the cases to suggest that liability has been imposed on the corporate shareholders for corporate abuse or that the corporate veil has been lifted to reach the assets of shareholders or the parent companies. This is a major lacuna in the UK corporate veil doctrine. It is therefore submitted that a well thought out corporate veil lifting, unlike the present approaches, should emphasize not only imposing liabilities on shareholders and directors but in engaging in the whole programme of activities that will aim at tracing and recovering the gains of these shareholders following their improper use or abuse of the corporate form. In this regard, there is need for equitable intervention in this area of the law.

Although the legislature has moved more rapidly than the courts to impose liabilities on corporate controllers, the provisions considered reveals problems of adequacy of the laws, procedural defects and difficulties in implementation. It has been found that it is extremely difficult to make claims under fraudulent trading provision owing to the high standard of proof required largely because it contained elements of criminal and civil intent. On the other hand, the wrongful trading provision has also been found inadequate owing to the fact that it placed commencement of proceedings in the hand of liquidators, thus effectively denying creditors the right to maintain such action.

Given the foregoing analysis, it is submitted that the existing law in the UK both at common law and under statute for lifting the corporate veil are far from being satisfactory. A more functional, flexible and equitable approach should be adopted in veil piercing claims. This will enable the courts to incorporate notions of justice and policy and widen the scope of categories based on the merits of each case. With this in place, the courts can and should impose liability on a shareholder or director that induces a corporation to generate mass risk with negative value or abuse of the corporate form. His personal assets should equally be reached in order to recover any gain made by him through the improper use of the corporate form. Furthermore, it is proposed that the single economic unit theory based on actual or potential control of the parent company over the subsidiary be revived. This will obviate the apparent injustices associated with veil piercing claims within the context of corporate groups and restore certainty in this area of law in the UK.

Section 214 of the Insolvency Act 1986 needs to be redrafted to settle the issues of funding, liability of directors and the precise time the company's insolvency could be said to have set in. The introduction of a detailed scheme consisting of a precise set of measures is required for action in dealing with these problems. One such measure could be to give the Secretary of State for Trade and Industry the power to bring action for wrongful trading on his own initiative or to allow creditors to bring such action in the form of a class. This will remove the burden from the liquidator in terms of cost to bring an action. Further to this, there should be clarity on the precise time the liability of a director commences under the law within the meaning of "every steps". Timing is an important ambiguity within section 214. It is proposed that instead of speculation by the director or leaving the timing within the discretion of the courts, a period of thirty days be given to the director between the time insolvency sets in and the time he should stop trading. In addition, it is proposed that there should be a specific provision which particularly makes directors personally accountable for corporate debts. This will make them more responsive to creditor's interest and minimise uncertainty that surrounds this area of the law.

The importance of examining the state of law in the UK in the wake of Salomon's case is particularly pertinent in light of the fact that the entire gamut of the corporate law and the corporate form was transplanted from the UK to Nigeria. The huge impact made by the UK corporate law on Nigeria, particularly in terms of the application of the corporate form, will be looked into below with a view to drawing appropriate comparisons.

CHAPTER 4 RECOGNITION, INTERPRETATION AND APPLICATION: DOCTRINE OF CORPORATE PERSONALITY IN NIGERIA

4.1 Introduction

The separate legal personality of the company as encapsulated in the case of *Salomon v Salomon*[1] is an often neglected, confused and somewhat misapplied area of corporate law in Nigeria. While it is difficult for some people in Nigeria to distinguish between a company and its owners, others see it as a fiction and imaginary thing existing only in the minds of lawyers. Yet a third group, including controlling shareholders and directors, who appears to know what it means has misapplied its use.

Salomon's case remains one of the most frequently cited cases in British Commonwealth, applied and interpreted in a many different circumstances. This has wide and varied implications on the evolution and practice of company law in Nigeria, particularly in terms of corporate fraud and abuses, the effectiveness of the laws in dealing with the problem arising from its application as well as probable solutions.

This chapter examines the operation of corporate personality in Nigeria and the inherent problems associated with its application. It begins with a brief analysis of the evolution of company law in Nigeria, the recognition, interpretation and application of Salomon's principles in Nigeria and the grounds upon which the veil of the corporation can be lifted under various statutes and by the courts in Nigeria to find liability against corporate controllers. Whilst it will be demonstrated that there are areas where Nigerian corporate law can learn lessons from the UK experience, this chapter will demonstrate that Nigeria as a developing country is in dire need of an equitable approach to dealing with the abuses of the corporate form. This is particularly important because the existing common law approach, with its rigid application of the *Salomon* principles, appears inadequate to deal with the scourge of the abuse of corporate form. It is on this score that the chapter seeks to contribute to the meagre literature on corporate personality and the limited liability of members of

[1] [1897] AC 22

corporation in developing economies by bringing a Nigerian perspective to the application of corporate personality.

4.2 Development of Company Law in Nigeria

Nigeria's contact with the British, first through trading and later through colonialism in the 19th century, had the effect of creating and changing the existing structures and legal mechanism of what later became the country called Nigeria. This included the development of company law.[2]

Prior to contact with the British, the people today known as Nigerians were mainly agriculturists who practiced farming at the subsistence level. There was no commercial activity until the abolition of the slave trade and its replacement with legitimate trade in the second half of the 19th century.[3] The emergence of legitimate trade saw increased ascendancy of British trading activities in the area called the Niger Delta Basin.[4] To benefit from these trading activities in the Niger Delta Basin, the United African Company was established by George Goldie.[5] In line with the charter activities of the time, the company received concession for the areas surrounding the Niger River under the charter of the Royal Niger Company in 1886.[6] The company faced stiff competition from a number of equally 'rough-hewn British' merchants who were originally slave traders but later became engaged with mercantilist trading activities following the abolition of the obnoxious slave trade.[7] With these rapidly developing trading activities and stiff competition from the traders, ground rules had to be laid. This was achieved with the establishment of a formal British Authority in the second half of nineteenth century.

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[2] See K.D. Barnes, *Cases and Materials on Nigerian Company Law*, Obafemi Awolowo University Press Limited, Ile-Ife, Nigeria, 1992, 63; See also *Motosho v Registered Trustees of Diocese of Ibadan*, (1966) 1 All N.L.R. 287, per Brett, J.S.C. at 293 and A. Alliot, *The Limits of Law*, Butterworths, London, 1980, 170.
[3] J.O Orojo, *Nigerian Company Law and Practice*, Mbeyi & Associates (Nig.) Ltd, Lagos-Nigeria, 1976, 1
[4] Ibid.
[5] See the history of United African Company (UAC) in http://www.uacplc/company/history.htn, accessed on 18 July, 2012.
[6] The Royal Niger Company was a mercantile company chartered by the British Government in the Nineteenth century. It formed the basis of the modern state of Nigeria. For detailed information of the activities of the Royal Niger Company, see Obaro Ikime, *Groundwork on Nigerian History*, Ibadan University Press, Ibadan-Nigeria, 2000, 23.
[7] See R.Law (ed.), F*rom Slave Trade to Legitimate Commerce: The commercial Transition in Nineteenth-Century West Africa*, London, 1995,278; See also K.M Amaeshi, et al, 'Corporate Social Responsibility (CSR) in Nigeria: Western Mimicry or Indigenous Practices?' in http://hdl.handle.net/123456789/1091, accessed on 19 July, 2012

The establishment of colonial rule meant that certain laws were introduced in order to maintain peace and order in the territory; these were coupled with the common law, doctrines of equity and other British legislations which were received as part of statute of general application that had come into force in England on 1st January, 1900 and were altogether called received laws. With the amalgamation of Northern and Southern protectorates and with the Colony of Lagos, these laws were made to cover the whole of the country. This became effective by virtue of section 14 of the Supreme Court ordinance 1914 which provides as follows:

> Subject to the terms of this or any other ordinance, the common law, the doctrines of equity, and the statutes of general application in England on the 1st day of January, 1900 shall be in force within the jurisdiction of the Court.

Interestingly, it was during this period that the famous case of *Salomon v Salomon* was decided. The effect of this on company law was that the English common law and the doctrine of equity applicable to company law in England were both made applicable to Nigeria, albeit subject to any later relevant local statutes. It was in this connection that the concept of the separate and independent legal personality of the company as stated in *Salomon v Salomon* was so received and has since become part of Nigerian law. Similarly, other English laws relating to company affairs such as the doctrine of *ultra vires* and the English Companies Act 1862 which consolidated the Joint Stock Companies Act 1856[8] and subsequent amendments providing for limited liability, the introduction of the modern form of the memorandum and articles of association in place of deeds of settlement, and contained provision for winding up, were all made applicable as part of the pre-1900 English statute of general application. In the absence of indigenous corporations and local laws requiring incorporation during this period, foreign companies operating in the colony of Lagos were governed by the laws of their respective countries. As most of the companies were English corporations, they enjoyed advantages of limitation of liability as long as they were registered in England.[9]

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[8] 19 & 26 Vict. C. 89; Great Britain Pub. Gen. Stats, 277, 1856. The Act was the first English enactment relevant to Nigeria.

[9] Orojo, n.3 above.

Thus with the reception of English laws into Nigeria and the growth of legitimate trade which developed rapidly in the 19th century and continued into the early 20th century, attempts were made to enact laws which would reduce the tendency of having to go to England to ascertain the position of the law on controversial company issues.[10] The first of these laws was the Companies ordinance of 1912[11] which was in force only in the colony of Lagos but was later extended to the entire country following the amalgamation of Southern and Northern Nigeria in 1914. Progressively, the country made successive company laws beginning with the Companies Decree 1922 which repealed both the 1912 and 1917 ordinances and the 1968 Companies Decree which was fashioned along the lines of the United Kingdom Companies Act 1948 as part of the recommendations of the Jenkins committee[12] and was listed in the Exclusive Legislative list of the 1979 constitution. To boost the innovations of the Companies Act 1968, the Nigerian Enterprises Promotion Act 1977[13] and the 1968 Act made copious provisions for the first time on matters such as mandatory provisions for accounts and greater accountability of directors, while part X made inputs towards checking the excesses of company officers.

However, the 1968 Act was criticised as being inadequate to deal with the rapid economic and commercial developments of the country particularly with the introduction of the Nigerian Enterprises Promotion Acts, intended to promote indigenous enterprises.[14] One of the major defects of the Act, as with most colonial company statutes, was the failure to state the law in a systematic, comprehensive and chronological form. As pointed out by Orojo,[15] the 1968 Act was little more than the putting together of some of the sections of the repealed 1922 Ordinance re-designated Companies Act 1963, and some sections of the English Companies Act 1948. A clear example of the failure of the 1968 Act was its inability to provide a legal framework to regulate the activities of companies in Nigeria through effective

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[10] Ibid.
[11] Ibid. See also the Southern Nigeria Ordinance 1910-1912.
[12] See the preamble to the 1968 Companies Act.
[13] Now Cap No 117 Laws of the Federation 2004.
[14] See the Nigerian Enterprises Promotions (Indigenisation) Decree (NEPD) of 1972 which puts in place a framework for the varied transfer of majority equity ownership of expatriate businesses to Nigerians. See also Federal Republic of Nigeria, *Second National Development Plan 1970-74*: Programme of Post-War Reconstruction and Development, 1970 at 239. Prior to indigenization, the Nigerian economy was dominated by foreign businesses; F. Odufalu, Indigenous Enterprises in Nigerian Manufacturing, *The Journal of Modern African Studies* 9, 1971, 599.
[15] See Orojo, n.3, at 20

registration, control and monitoring in the absence of a separate commission from the Ministry of Trade. It therefore became expedient to repeal the Act, allow for consultation and review, and eventually replace it with a new Act able to take cognisance of the country's developmental activities as well as protect the interests of the investors, the public and that of the nation as a whole.[16] This gave birth to the Law Reform Commission set up in 1987 by the Federal Government and headed by Justice Orojo whose work ushered in the present Companies and Allied Matters Act 1990[17] (hereinafter referred to as CAMA) and other amendments such as the Investment and Securities Act 2007.[18]

4.3 Nigerian Approach

The doctrine of corporate personality established very early in *Salomon's* case[19] applies in Nigeria. Section 37 of the Companies and Allied Matters Act 2004 (CAMA)[20] confirms that a company comes into existence as a body corporate on the day it is registered by the Corporate Affairs Commission. In doing so, the company becomes a separate legal entity - a person in law capable of enjoying rights, exercising powers, and incurring duties and responsibilities distinct from the members. It can sue and be sued whilst liability of members is limited to the amount in their shareholding. In recognising this position of the law, the Nigerian Court of Appeal in the recent decision of *N.R.I. Ltd v. Oranusi*[21] stated as follows:

> The concept of corporate personality means that once a company is incorporated under the relevant laws, it becomes a separate individual person from the individual who are its members. It has capacity to enjoy legal rights and is subjected to legal duties which do not coincide with that of its members. Such a company is said to have legal personality and is always referred to as an artificial person. It can sue and be sued in its own name. It may own property in its own right and its assets, liabilities, rights and obligation are distinct from that of its members. A registered company has perpetual succession. Thus a change of membership or death of a member does not affect the existence of the company. It acquires its capital from its members

[16] See Working papers on the Reform of Nigerian Company Law, Vol. 1, p.3, para.9.
[17] Cap 59 Laws of the Federation 1990 but later codified in 2004. The law provided for the establishment of the Corporate Affairs Commission to administer the affairs of companies, business names and incorporated trustees set up under the Act among its improvements.
[18] Investment and Securities Act Cap No 29 of 2007.
[19] *Salomon v Salomon & Co* [1897] AC 22
[20] At inception the law was called Companies and Allied Matters Act 1990 before it was codified in 2004
[21] [2011] ALL FWLR (Pt. 577) 760 at 777-778

> through the sale of shares and invariably distributes the profits in form of dividends from the utilization of the capital to its members. Companies speak or express their decisions through resolutions, which must be validly passed. No member of the company has right to unilaterally commit the company on any matter without its consent and approval.

The above decision which has been replicated in numerous decisions of Nigerian courts re-affirms the essential characteristics of companies in Nigeria and the strict adherence to the separate legal personality firmly established in *Salomon's* case.[22] It further confirms the common law prescription crystallised in what is known as the rule in *Foss v. Harbottle*[23]and codified in section 299 of CAMA that the proper plaintiff in an action in respect of a wrong alleged to be done to a company or association is the company itself. The provision of section 299 of CAMA is made subject to certain exceptions contained in section 301(2) of CAMA which seeks to protect minority shareholders not only for the enforcement of personal rights, but also corporate rights. However, problems often arise where the shareholder is seeking to enforce a right which strictly belongs to the company. There is always the question of *locus standi* in such a situation. The rationale for the rule that a company is a proper plaintiff for wrong done against it is based on the fact that it is not the duty of the court to run the affairs of the body corporate for the body.[24] The provision of section 299 of CAMA above which tends to shield majority shareholders, directors and indeed corporate controllers has given rise to all sorts of manipulation in the guise of operating through the corporate form, particularly where the derivative action, for example is premised on fraud on the company or fraud by those in control. To establish fraud as a basis for legal action, the minority shareholder must be seized of detailed information beyond what may be gleaned from the company's books of account and auditor's report. In most cases, such information is very difficult to get due a lack of effective disclosure mechanisms, particularly in a country like Nigeria.

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[22] See for example the decisions in *Saleh v B.O.N.* (2006) 6 N.W.L.R (Pt. 976) 220; *Laban-Kowa v Alkali* (1991) 9 NWLR (Pt 602); *Comet Shipping Agencies Nigeria Limited v. Babbit (Nigeria) Limited* (2001) 7 NWLR (Pt 712) 442 ratio 7.
[23] (1843) 2 Hare 461. See also *Gombe v.P.W (Nig) Ltd* (1995) 6 NWLR (Pt 402) 402; *Tanimola v. S & Mapping Geodata Ltd* (1995) 6 NWLR (PT 403) 617.
[24] *Foss v Harbottle*, (1843) 2 Hare 461

4.3.1 Insider Corporate Abuses

Insider corporate abuses have remained a dominant feature of the Nigerian corporate history in the last few decades. This is evident in the fact that incorporating a limited liability company is seen as a status symbol by an average Nigerian and as a means of maximising the wealth of the controlling shareholders or directors, even in some cases by defrauding creditors, instead of being used to promote commerce and entrepreneurship and further economic growth and development. These companies often get people to make payments without intending to supply goods and services as promised. One commentator on the Nigerian economy[25] has blamed the abuse of the corporate form on what he called "the culture of Nigerian entrepreneur as a lone ranger" which took its root from the oil boom years of the 1970s when money was readily available in Nigeria because of huge oil exports in the international oil market. During this period, it was possible for those in business to get huge loans in excess of the equity capital of their business from banks, most of which are government controlled, without collateral. Many of the loans were not repaid.[26] Under this scenario, entrepreneurship flourished from 1970 through to the early 1980's and most businesses that were sole proprietorships emerged without equity participation from others. As most of these private companies are family-run companies, there is rarely any distinction between ownership and management. Thus in these type of companies, the shareholders are also directors of the company and, in certain cases, the majority shareholder is the sole director.

While it may be disputed that oil boom alone laid the foundation for the abuse of the corporate form in Nigeria, it nonetheless brought in its wake the emergence of a corporate culture where limited liability lacked form and substance. With this culture in mind, these companies became instruments for which their incorporators used to siphon the oil wealth, engage in contrived contracts and fraud, and obtain loans from banks with little or no collaterals. With the prevalence of informality, irrationality and the almost total absence of corporate organisation such as meetings, proper

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[25] O.Odugbemi, "Business today and tomorrow: crisis and the Lone Ranger", *The African Guardian*, 7 June, 1993, 30-31

[26] See G.A. Yakasai, Corporate Governance in a Third World Country with Particular Reference to Nigeria, Corporate Governance, Vol. 9 No. 3 2001, 245. This paper was presented at the 3rd International Conference on Corporate Governance and Direction, 16-18 October 2000, at the Centre for Board Effectiveness, Henley Management College, UK.

record keeping (including accounts and the observance of rules), there emerged a negative corporate practice in Nigeria. This practice has continued through to today.

A recent feature of the abuse of the corporate form is the tendency of bank directors to establish companies without genuine business interest and activities as fronts to get loans from their banks. These directors often give loans to their children, wives, relatives and associates without securing collaterals. This practice mirrors the nature of business undertakings in Nigeria, most of which are predominantly family-owned with a propensity for being closed corporations set up, as earlier pointed out, with no genuine business intentions and lacking in form and substance. With the mask of corporate personality shielding these unscrupulous incorporators, who may be regarded as the emerging elite or business classes, the courts appear to be increasingly frustrated in dealing with them. The consequence of this situation is the distress syndrome by banks in Nigeria in the late 1980s, 1990s and 2009, which were owned by powerful individuals in the society, and the failure of most corporations with the attendant loss of depositor's funds.[27] This has attracted the attention of the regulatory agencies such as the Central bank of Nigeria (CBN) and invoked response from the Nigerian Government through various publications and regulatory activities. Indeed in one of its publications entitled "Insider Related Credit Facilities", the CBN stated as follows:

> One of the endogenous factors that caused the last generalised distress in the financial system was the magnitude of non-performing facilities granted to key shareholders and directors of banks and their related interests...however reports of routine examinations of banks by both the Central Bank of Nigeria and the Nigeria Deposit Insurance Corporation (NDIC) have indicated that many banks have continued to record huge amounts of insider-related credit facilities, many of which have been classified as either doubtful or lost.[28]

Nigeria is an interesting case to explore in terms of the application of corporate personality principles and the inherent abuses in the system. First, it is the dominant

[27] V.O Nmehielle & E.S Nwauche, External-Internal Standards in Corporate Governance in Nigeria, Paper presented at the conference of corporate governance and accountability in sub-Saharan Africa, Institute for International Corporate Governance and Accountability, George Washington University Law School, October 29, 2004. This paper can also be found in http://ssrn.com/abstract=627664

[28] The Nigerian Deposit Insurance Corporation (NDIC) is established by the Nigerian Deposit Insurance Act 1990 with the principal function of insuring the deposit liabilities of licensed banks. Pursuant to this, it has powers to inspect insured banks to ascertain their health.

and most populous black- country in the world, and its influence both within sub-Saharan Africa and indeed the global oil market makes an interesting inquiry into the conduct of business in the country and beyond. Second, unlike in the UK and other western countries, corruption both in public and private enterprises appears prominent. Whilst most businesses are set up with no real intention of providing goods and services, the majority of such endeavours are one-man companies and small and medium enterprises whose members also double as directors. They are owned by wealthy politicians and businessmen who have acquired enormous funds through corrupt means and government patronage because of their close relationship with those in government. Often, they are drawn from the erstwhile military oligarchy which ruled the country for a long time before the return of civilian democracy.[29] Third, the directors of most State corporations and even privatised companies under the bureau of public enterprises are appointed by the government as their agents and are given access to the judiciary and law enforcement agencies.

There is clear evidence that Nigerian government's response to the problem of corporate abuses through the existing laws and intensification of regulatory activities by way of new laws and regulations and increased Central Bank of Nigeria supervisory roles have failed to achieve what they set out to do. A new approach aimed at disgorging the assets of these fraudulent shareholders and directors, as well as tracing diverted funds through their agents and associates, is required through appropriate legislation by government and intervention by the courts. This approach, rather than undermining the separate personality principle, will strengthen it, particularly for a developing country like Nigeria where it is difficult to separate a company from those who run it. An examination of the various approaches adopted by the Nigerian courts and statutes to deal with the problems of corporate abuse is dealt with below.

4.4 Disregard of Corporate Personality under Nigerian Laws

Both the statute and the courts in Nigeria are prepared to lift the veil, though only in limited circumstances. These circumstances are shown below.

[29] Nigeria became an independent country on 1st October, 1960. It became a republic in 1963. In 1966, a violent change of government took place through a coup d'état. The military ruled the country from 1966 to 1979 and handed over power to an elected civilian government. The return to civilian democracy was short lived as the military again struck in 1983 and ruled the country from 1983 to 1999 before the coming into being of the present civilian administration.

4.4.1 Statutory Exceptions to the Separate Personality Doctrine

The legal framework for companies in Nigeria is set up in the Companies and Allied Matters Act (CAMA) 2004. However, there are other laws enacted by the legislature which also touches on the running of companies in Nigeria and the conduct of its controllers. These include the Central Bank of Nigeria Act [30] (CBN Act); the Investment and Securities Act,[31] the Failed Banks (Recovery of Debt) and Financial Malpractices Act,[32] the Insurance Act (IA)[33] and the Banks and other Financial Institutions Act (BOFIA).[34] It is open to the legislature to limit the effects of incorporation by a suitably worded statutory provision. These laws permit the veil of incorporation to be lifted or disregarded in the following cases:

4.4.1.1 Reduction of Members below Legal Minimum

The minimum number of memberships for the formation of a company in Nigeria, whether private or public is two.[35] Only in the case of a private company is a maximum placed at fifty persons. Thus where a company's membership falls below the prescribed minimum, the veil of incorporation will be lifted to find liability against the corporate controllers. Section 93 of CAMA, which is related to the liability for members debts, provides that if a company carries on business without having at least two members and does so for more than six months, every director or officer of the company during that time it so carries on business after those six months who knows that it is carrying on business with only one or no member is liable jointly and severally with the company for the debts of the company contracted during that period. In this case, the officers and directors will share in the liability of the company.

However, this section should be interpreted as creating an offence, but it only states the consequences that follow when a company carries on business for more than six months after the members has fallen below the legal stipulated minimum.

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[30] No. 24 of 1991
[31] No. 45 of 1999
[32] No. 18 of 1994
[33] No. 2 of 1997
[34] No. 25 of 1991
[35] See CAMA 2004, s.18

In *Iro v Park*,[36] the Supreme Court of Nigeria reiterated the fact that the section warns the directors and officers of the consequent liability to which they are exposed but it does not proscribe the company or deny its existence; what it does is to set it aside in order to strike at the members.

The liability imposed on every director or officer of the company by the section may easily be avoided, except in cases where the articles impose restrictions on the transferability of shares. This is because the liability does not attach until the membership has remained below the statutory minimum for six months and it attaches only in respect of debts contracted after that time; the directors or officers may, therefore, escape personal liability by transferring some of the shares to themselves during the six months, if they are not members, so that the number of members is restored to the statutory minimum before the expiration date.[37]

It is important to note that the wording of the section also suggests that those who remain after six months are liable only in respect of debts contracted by the company, and not in respect of claims for damages against it for breach of contract or tort or in respect of statutory claims against the company, whether liquidated or not; for instance, this might include taxation, claims by employees for redundancy payment or compensation for unfair dismissal.[38] Every director or officer of the company will not incur personal liability merely because the claimant has obtained judgment against the company. The amount payable under the judgment is a species of debt, but it is not contracted by the company as required under section 93 of the Act. Also every director or officer of the company may be sued personally if he is liable to a creditor; it is not necessary to wind up the company in order to enforce a director or officer's liability.[39] Moreover, there is no limit to a directors or officers liability for a debt for which he is personally liable under this section - his liability is not limited, as it is normally with a member of a company, to the amount unpaid on his shares.

It is submitted here that the provisions of section 93 of CAMA is designed to prevent misuse of corporate entity and limited liability to the detriment of creditors. As

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[36] (1972) 12 S.C. 93 at 102
[37] See *Pennington's Company Law*, Butterworth, London, 1985, 53.
[38] Ibid, at 53 & 54
[39] Ibid, at 54

pointed out by Akanki, if the law were to be different, a company that exists without real operation, moribund or left in the hands of an inefficient few, might be used to contract debts and liabilities which it has become incapable of discharging.[40] Section 93 of CAMA ultimately protects the interest of creditors who transacts business with a company when the latter is in breach of section 18 of CAMA in respect of a minimum number of memberships.

The essence of section 93 of the CAMA is fortified by the rule under section 408 (c) that a company may be wound up by the court if the number of the members is reduced below two. Nonetheless, it has to be borne in mind that there is no equivalent provision of section 93 of CAMA in the Companies Act 2006 as section 24 of the 1985 Act has been abolished by the Twelfth Company Law Directive on single-member private limited liability companies.[41]

4.4.1.2 Where the number of Directors falls below a certain Minimum

Where the number of directors of a company falls below two and the company carries on business after sixty days of such depletion, the corporate veil shall be lifted to make every director or member of the company who know that the company so carries on business after that period liable for all liabilities and debts incurred by the company during that period when the company so carries on business. This section appears more embracing and explicit than liability under section 93. This position is anchored on the fact that liability is not restricted to debts incurred by the company during the period but all other liabilities which are outside the ambit of the term “debt”.

4.4.1.3 Personal Liability of Directors and Officers of a Company

Although there is a clear distinction between a company and its directors and members in terms of corporate liability, there are circumstances express or implied where a director can still be personally held liable. Consequently, a director may incur liability without express assumption of liability. This could be seen where he engages in contract in his personal name without disclosing that he was doing so on

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[40] O. Akanki, ‘The Relevance of Corporate Personality Principle’ (1977-1980) 11 *N.I.J*, 27

[41] See Council Directive 89/667, implemented in Britain by the Companies (Single Member Private Limited Companies) Regulations 1992 (S1 1992/1699). See also P.L. Davies & S. Worthington, ‘*Gower and Davies’ Principles of Modern Company Law*, 9th ed., Sweet & Maxwell, 2012, 5.

behalf of an existing principal. Where such a thing happens, a third party who files an action against a director is likely to succeed.[42]

In the realm of Nigerian law particularly with regards to third party dealings with companies generally, section 290 of CAMA is very crucial. It provides that where a company receives money by way of a loan for a specific purpose; or receives money or other property by way of advance payment for the execution of a contract or other project, with intent to defraud or fails to apply the money or other property for the purpose for which it was received, every director or officers of the company who is in default shall be personally liable to the party from whom the money or property was received. They will be liable for a refund of the money or property so received and not applied for the purpose for which it was provided so that nothing in the section will affect the liability of the company itself". This type of statutory provision, it is hoped, should go a long way in checking the transgression of some types of business indicated earlier which had surfaced in Nigeria since the oil boom era and had been used to hood-wink unsuspecting business partners including creditors.[43]

In addition to the above, it can be argued that this provision is apparently designed to catch not only those who borrow money from the bank and divert it to their own use, but those who receive a mobilization fee without intending to apply them for the purpose for which they are paid.[44] In *Public Finance Securities Ltd v. Jefia*,[45] the respondent vide the undefended list procedure sued the appellants jointly and severally for the recovery of the sum of N3, 593,851.000(Three Million, five hundred and ninety three thousand, eight hundred and fifty one naira) with interest paid to the first appellant based on the assurance and warranty of the second appellant (its Managing Director) that upon maturity he would be paid. The appellants failed to fulfil their obligation to the respondent at the appropriate time.

The appellants upon service of the writ in the matter filed "Notice of Intention" to defend the suit. They thereafter filed a Notice of Preliminary Objection. Argument was taken on the preliminary objection and in a considered ruling, the court found in

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[42] See *Elkington & Co v Hunter* (1892) 2 Ch. 452
[43] Okorodudu Fubara, 'Protection of Creditors' in Akanki (ed.) *Essays on Company Law*, 1992, 181-181.
[44] See also the views of Orojo, n.3 at 87.
[45] [1998] 3 NWLR (Pt. 543) 602

favour of the respondent. The trial court proceeded to decide the matter on the undefended list and found that the appellants have no defence to the claim. It then found the appellants liable jointly and severally to pay to the respondent the sum of N3, 593,851.00 (Three Million, five hundred and ninety three thousand, eight hundred and fifty one naira) in addition to various sums of interest being made due until payment was made.

Dissatisfied with the ruling, the appellants appealed to the Court of Appeal. The Court of Appeal, while unanimously dismissing the appeal, held that by virtue of section 290 of the Companies and Allied Matters Act, 1990 (now 2004), where a company receives money by way of loan for a specific purpose, and with the intent to defraud, and fails to apply the money for the purpose for which it was received, every Director or officer of the company shall be personally liable to the person from whom the money was received. Rowland, J.C.A. delivering the judgment of the Court of Appeal noted as follows:

> The money invested by the plaintiff represents a loan to the 1st defendant for the sole purpose of yielding interest. The company is not willing to pay and says that it is in some distress and has resorted to all sorts of subterfuge in order to avoid payment of the sum appearing in the Bond certificates. I have already shown that this is a sham and fraudulent defence that is put forward. The question is what did they do with the money? It is fraud in my view to establish a Financial Institution that collects money from the general public by way of investments and turn round to disappoint their legitimate expectation under the guise of having a general decline in business proceedings. I agree with him. I also agree with him that this a proper case to invoke the provisions of section 290 of the Companies and Allied Matters Act 1990 to protect the respondent and hold the second appellant liable jointly and severally with the 1st appellant for the debt owed the respondent.[46]

Nevertheless, it does appear that a director of a company who has a good business proposition and diverts such a loan received on behalf of the company to another project in good faith and for good reason is not caught by the provision.[47] In other words, mere innocent misapplication of funds in situations honestly believed to be in the best interest of the company will not give rise to personal liability under this section. The determination of what constitutes the best interest of the company is not

[46] Ibid., at 605 ratio 5
[47] Orojo, n.3 above.

defined in the Act. It is vague and subjective. It is likely that a fraudulent director may embark on a project which does not serve the best interest of the company, yet declare it to be so. The provision of section 290 of CAMA have regularly been invoked by the courts to curb the excesses of directors who misapply their company funds for purposes other than what it was meant for.

Another instance of director's liability under the Nigerian laws is found in Banks and Other Financial Institutions Act (BOFIA). Section 18(1) of BOFIA prohibits a manager or an officer of the company from granting any advance, loan or credit facility to any person unless it is authorised in accordance with the rules and regulations of the bank. They are further required not to receive any benefit as a result of any advance, loan or credit facility granted by the bank. Contravention of this provision attracts a fine or term of imprisonment.[48]

Where a director is involved in the granting of loans or advances, he has a duty to declare his interest as well as the nature of such interest in the meeting of the board where the loan or facility would be first considered.[49] This provision is designed to avoid a conflict with the duties or interests of being a director of a bank. Any officer or director that contravenes the obligations imposed above is liable to punishment on conviction.[50] There is also a general duty imposed on directors and officers of the bank, by virtue of section 46 of BOFIA, to take all reasonable steps to ensure compliance with the provisions of BOFIA, failing which they are liable to be prosecuted. The ultimate sanction for failure to comply with the provision of BOFIA is the powers given to the Central Bank of Nigeria (CBN) pursuant to section 12(1) of BOFIA to revoke the banking license of the affected bank. Although these provisions could be said to have helped to sanitize the banking sector, it remains to be seen how effective they are in view of the continued upsurge of corporate abuse and insider corporate fraud which has led to numerous bank failures in Nigeria.

Furthermore, under the Failed Banks (Recovery of debt) and Financial Malpractice in Banks Decree (No 18 of 1994) (hereinafter referred to as the Failed Bank Decree), all directors and employees both present and past must be joined as parties to any

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[48] See section 18(2) of BOFIA
[49] See sections 18(8), 18(9) &18(10) of BOFIA.
[50] Ibid., at s. 18(10)

action for recovery which must include the debtor of the bank.[51] Section 3 (3) (b) (ii) of the Decree empowers the court to lift the corporate veil for purposes of discovering the members who may be liable jointly, or severally for the debts owed by the corporate body.[52]

The Act was a bold response from the then Nigerian Military government to the growing incidence of near collapse of the financial sector through the phenomenon of failed banks and other financial institutions in the late 1980s and 1990s. In consequence, the Act was promulgated to facilitate the prosecution of those who contributed to the failure of banks and to recover the debt owed to the failed banks. It made provision for the establishment of a Tribunal to deal with cases arising as result of bank failures as well as recover debts owed to banks.

Under section 19 of the Decree, the persons affected for purposes of liability are directors, managers, officers or employees of a bank who grant loans and other advances in a manner deemed unethical to the growth and survival of the Bank. This includes where any director , manager, officer or employee of a bank knowingly , recklessly, negligently, wilfully or otherwise grants, approves the grant, or is otherwise connected with the grant or approval of a loan, advance, guarantee or any other credit facility or financial accommodation to any person without adequate security or collateral, contrary to the accepted practice or the bank's regulations. Liability may also be imposed on the persons affected above where such loans or advances were granted without security or collateral where such collateral is normally required in accordance with bank's regulations, or with defective security or collateral or without perfecting through his negligence or otherwise, a security or collateral obtained. Apparently, because of the incessant abuse of director's position, the Decree widened the scope of the meaning of a director by defining a director to include a wife, husband, mother, father, son or daughter of a director. [53]This was designed to get at relatives who served as conduits for these directors to siphon bank funds through non- performing loans and advances.

In terms of the recovery of these loans or advances, the Decree provides that where the assets of a debtor company, whether pledged as security or not, are inadequate to

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51 See section 3(1)
52 See *Macebuh v. National Deposit Insurance Corporation*, (1997) 2 F.B.T.L 4
53 See section 29

offset the company's debt, the personal property of such a company could be sold and applied in satisfaction of the outstanding debts.[54] Where it becomes impossible to locate the security pledged for the loan, or where no security is pledged at all, or where the debtor is fictitious, the tribunal was empowered to hold liable for the outstanding debts and interests therein on the directors, shareholders, partners, managers, officers and other employees of the failed bank who in the performance of their duties were found to have been connected in any way with the granting of the loan which has become impossible to recover.[55]

The tribunal set up under the Decree was empowered to deal with matters expeditiously devoid of legal technicalities, inefficiencies, loopholes of the legal system and to deliver judgment in each case not later than 21 working days from the day of its first sitting. The Tribunal was also given powers of remand, and even bail, whilst members of the police force or armed forces were empowered to arrest offenders under the Act without any warrant;[56] -trials and sentencing of offenders, even in absentia, was also recognised.[57] Appeals under the Decree can only lie to the Appeals tribunal and no more.[58]

A number of cases that came before these tribunals indicate clear corporate abuses and insider corporate fraud by dominant shareholders and directors who use their vast personal and family resources to establish banks. In *Federal Republic of Nigeria v. Ajayi* for instance,[59] the accused person who was the founder of the now defunct Republic Bank Ltd was arraigned and convicted on a 17-count charge for failing to disclose his interest as soon as possible to the Board of Republic Bank while being a director in respect of loans and advances granted to five of his companies contrary to section 18(2) of the BOFIA. In addition, he was found liable for contravention of the provisions of section 46 of BOFIA in respect of general compliance with the Act. Similarly, in *Federal Republic of Nigeria v Mohammed Sheriff & 2 Others*,[60]the accused were found guilty as charged for using their positions to grant facilities to

[54] See section 21
[55] See section 15 & 16
[56] See section 25
[57] See section 27
[58] Persons convicted or against whom a judgment is given under the Act may, within 21 days of the conviction or the judgment appeal to the Special Appeal Tribunal established under the Recovery of Public Property (Special Military Tribunal Decree 1984 as amended).
[59] (1998) 2 F.B.T.L.R 32
[60] (1998) 2 F.B.T.L.R 109

companies which, at the time the loans were granted they were directors, contrary to the provisions of sections 18(2) and 20(1) of BOFIA which requires a disclosure of this information for such a transaction to take place. Closely related to the above cases is *Federal Republic of Nigeria v Alhaji Murnai*[61] where the tribunal made a finding of guilt and convicted the accused, a former manager of Nigeria Universal Bank, for granting facilities to customers of the bank without lawful authority and in contravention of the rules and regulations of the bank regarding the granting of credit facilities without taking security or collateral.

Although the activities of the Tribunal were hailed as laudable and curbing the menace of corporate abuse in these individual and family owned banks, it nevertheless was criticised for punishing the innocent directors, who, in the course of their duties, may have granted loans to their customers in the mistaken belief that they would pay them back. The extension of the liability to include relatives of the directors made the operation of the decree open to abuse. Finally, the decree and the tribunals set up under it did not last long before Decree No 62 of 1999 dissolved the Failed Bank Tribunals and transferred all pending part- heard matters before it to the Federal High Court following the return of civilian democracy in 1999.[62] With the transfer of the cases to regular court, most of the problems the Decree sought to avoid, such as delays, technicalities and undue interference, returned.

4.4.1.4 Reckless or Fraudulent Trading

The above provision which is similar to section 213 of the Insolvency Act 1986 is found in section 506 (1) of CAMA 2004. It seeks to protect corporate creditors by holding directors/members personally liable during winding-up proceedings. For the section to apply, the court must be satisfied that in the course of winding up a company, its business has been carried on in a reckless manner or with intent to defraud creditors of the company or creditors of any other person or for any fraudulent purpose. The court may, therefore, on the application of the official receiver or creditor or contributory of the company, declare that any persons who were knowingly parties to the carrying on of the business in that manner shall be personally responsible without any limitation of liability for all or any of the debts or

[61] (1998) 2 F.B.T.L.R 196
[62] See sections 2 & 3 of the decree. See also the Supreme Court decision in *Arewa Paper Converters Ltd v. N.I.D.C (Nigeria Universal Bank Ltd)* SC 135/2003.

other liabilities of the company as the court may direct.[63] It can be deducted from the provision that it is only operative on winding up and not before. This is also not without prejudice to such persons who knowingly participated in the carrying on of the business in such fraudulent manner being guilty of a criminal offence.

Consequently, section 644 of the Act provides that section 506 which imposes penalty for certain offences connected with fraudulent trading of a company on winding up of company shall be extended and applied to cases where fraudulent trading is discovered in circumstances other than winding up. Also, the section does not cover only fraudulent trading alone, it also extends to recklessness in carrying on the business of the company.

Section 506 of CAMA suffers the same problem identified with section 213 of the Insolvency Act in terms of difficulty to prove “intent to defraud”, which requires proof beyond reasonable doubt. Arguably, its own effect is in terms of deterrence of corporate controllers whereby, as Pennington has postulated, the separate legal personality of the company is ignored, but not its very existence.[64]

Again, it is difficult to determine judicial attitude in this area of law in Nigeria because of a dearth of case law which could have helped to clarify some of the contentious areas in the provision. This may be due to the fact that corporate insolvency practice is still evolving in Nigeria at a relatively slow rate. Worse still, Nigeria does not have a separate Insolvency Act similar to the British Insolvency Act of 1986, streamlining insolvency practice in the UK in a single statute and providing clear and certain answers to emerging issues. Even in the existing CAMA, there is no equivalent section for wrongful trading as is also the case in section 214 of the Insolvency Act, which in spite of its inadequacies, is a marked improvement on section 213 in terms of the difficulty of proof, because of its essentially civil liability nature. The result is that sections 506 of CAMA evokes confusion among practitioners and lawyers in Nigeria and appear unhelpful in dealing with creditor protection problems.

[63] See CAMA 2004, section 506 (1)
[64] See Schmitthoff, *Palmer's Company Law*, 1985, 57. His observations which were made with regards to section 458 of the Companies Act , 1985 read in conjunction with section 213 IA 1986 appear to be in tandem with the relevant provision of CAMA under discussion.

4.4.1.5 Where the Company is not mentioned on the Bill of Exchange

Under section 631(1) (c) of CAMA 2004, every company is required to have its name mentioned in legible characters, inter alia, in all bills of exchange, promissory notes, endorsements and cheques. Sub section 4 provides that if any officer of a company, or any person on its behalf, issues or authorises the issue of any bill of exchange, promissory note, endorsement, cheque or order, for money or goods without the name of the company being so mentioned, he will be liable to the holder if any such bill of exchange, promissory notes, cheques or order for the amount thereof, unless it is duly paid by the company. If an essential part of the name of the company is omitted, that will amount to a breach of the section. In *Western Nigerian Finance Corporation v. West Coast Builders Ltd*[65] the court held that the omission of the word "Limited" on a company's contract constituted a misdescription of the company which rendered the contract null and void.

It is suggested that section 631(4) be amended so that the signatory will have a defence if he can establish the holder had not been misled by the misdescription.

4.4.1.6 Taxation

Nigerian law recognises that the corporate veil can be lifted for purposes of ensuring compliance with tax liabilities under the Companies' Income Tax Act. Thus in order to ensure that a company complies with the Companies' Income Tax, it may be prudent to pierce the corporate veil in order to determine where the control and management of the company is exercised for this helps to determine whether or not a company is a "Nigerian Company" for the purpose of the Companies Income Tax Act.[66]

Ordinarily, one expects the control of a company to be where the board of directors functions, although it may not necessarily be so. In some cases, it may be where the holding company is or where the managing directors are, especially if they had the controlling shares.[67] However, the place where the management and control is exercised is a question of fact as could be seen in *Smith, Stone & Knight v.*

[65] (1971) *U.I.L.R* 316
[66] See Companies Income Tax Act 1961 now Cap 60 Laws of the Federation 2004), section 2 & 18
[67] Orojo, n.3 at 82

Birmingham Corporation[68], where the court said that this is determined by "a scrutiny of the course of business or trading".

4.4.1.7 Holding and Subsidiary Companies

The classic *Salomon v Salomon* doctrine requires that each company in a group be regarded as a separate entity - each may have its own directors and its own auditors, and its own account. It was not until 1948, as a result of the Cohen Committee in the UK, that consolidation of the balance sheet and profit and loss account of holding and subsidiary companies was required.[69]

Thus under Section 336 to 338 of CAMA 2004, and notwithstanding the concept of corporate personality, companies belonging to a group constitute in effect a single commercial unit for many purposes including preparation of a single account so as to enable not only the company's registry but also the investing public to have an accurate idea of the financial position. The section therefore provides that where, at the end of financial year, a company has subsidiaries, it must prepare group financial statements dealing with the state of affairs and the profit and loss account of the company and subsidiaries, unless otherwise permitted by the Act. Section 345 further provides that these must be laid before the company in a general meeting when the company's balance sheet and profit and loss account are displayed. These measures are designed to prevent misleading information about the financial position of a group of companies controlled by its holding company, which arise where it is possible for the controlling company to publish a positive picture of itself without reference to the gloomy state of affairs that exist in its subsidiaries.[70]

Furthermore, the significance of the provisions from the point of view of the creditor, is that the group financial statement gives the creditors a total picture of the assessing standard of the whole group, so that he will be better informed for the purposes of subsequent transaction and/ or the prospects of recovering the debt due from any of the companies.[71] Apart from the above, Orojo has rightly pointed out that the effect of such a group account is to depart from the separate independent personality of the companies and by so doing demonstrate that they are not only

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[68] (1939) 161 L.T. 371
[69] See Lord Wilberforce, 'Law and Economics' (1966) *J.B.L* 303 and 304
[70] Akanki, n.40, above
[71] Fubara, n.43 above

related but are subject to scrutiny, or indeed examination, behind the incorporation veil.[72] However, in practice, there is nothing to show that these companies have produced any account depicting the true financial state of the companies, as the external auditors of these companies merely rubber stamps figures submitted to them. This has led to a situation whereby creditors have had to deal with the company relying on such accounts only for them to realise when it is too late that the company is in a bad shape financially.

Another instance where a holding subsidiary relationship is pierced under the Act can be found in section 159. The prohibition of financial assistance for the purchase of a company's shares extends to financial assistance by any of its subsidiaries.

4.4.1.8 Investigation into Related Companies

Section 314 (1) of CAMA 2004 provides that the Corporate Affairs Commission (CAC) may appoint one or more competent inspectors to investigate the affairs of a company and to report on them. When an inspector is appointed by the Commission to investigate the affairs of any other related company, the inspector may, if he thinks it necessary for the purpose of his investigation, investigate into the affairs of any other related company and report on the affairs of the other company which may be the basis of civil[73] or criminal action[74] so far as he thinks the result of the investigation thereof are relevant to his main investigation. However, such a related company may be a corporate body or may have at any time been the company's subsidiary or holding company or a subsidiary of its holding company or a holding company of its subsidiary.[75]

It may be rightly stated that these provisions of the Act for investigation of a company and of related companies should be seen as an integral part of a developing system of governmental disregard of the corporate veil it has permitted companies to drape over themselves.[76] As Dr Barnes put it:

> It is thought that Corporate Affairs Commission's power to inspect certain companies will facilitate state intervention to make offenders subject to relevant civil or criminal liabilities. Such suspicious

[72] Orojo, n.3 above
[73] Section 312
[74] Section 321
[75] CAMA, section 316 (1)
[76] Barnes, n.2 , at 71

> situations seen in *Lasis v Registrar of Companies*...readily indicate the potential use of these provisions to uncover the real situation behind a corporate wall.[77]

In this process, the separate legal personality of the companies may be disregarded.[78]

Notwithstanding the above, there are still inherent problem with investigation of these companies. The first problem may lie with access to information as, management often may not be forthcoming with relevant information. This problem is similar to that identified in respect of the DTI (Department of Trade and Industry) charged with similar responsibilities in the United Kingdom.[79] However, in the latter case they have the power not only to order for books and papers from the company if there are good reasons to do so in their internal investigation,[80] but such power is backed by power of entry and search. Secondly, the commission may lack the necessary human and material resources to embark on the investigation. There is yet the third problem which relates to the issue of bureaucracy by the CAC who has to be convinced that the company's affairs need to be investigated. The CAC in its present state as the main agency for regulating and supervising all corporation related matters in Nigeria is weak and perfunctory in performing its duties.[81]

It is therefore submitted that there is need to improve the schemes for exercising control and surveillance over the conduct of company's affairs by the appropriate authority. This will help to put the directors/management of companies in check and obviate the likely abuse and potentiality of fraud. Even at that, this provision appears to have no impact in the Nigerian corporate scene largely because it does not extend to small and medium scale enterprises (SMEs) which constitute about 80 percent of the registered companies in Nigeria. These companies owned by a network of families of the political and business classes lack all forms of disclosure and have become the conduit to perpetuate fraud and launder their loot through legitimate corporate channels.

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[77] Ibid.See also *Lasis v Registrar of Companies,(*1976) 7 S.C.73

[78] See E. Oshio, *Modern Company Law in Nigeria*, Lulupath International Limited, Benin City, Nigeria, 1995, 40

[79] Vanessa Finch, "Company Directors: Who cares about Skill and Care', (1992) 55 *MLR* 179, at 195

[80] See the comment 'Company Investigations', (1990) Vol. 11 no.11 Co Law 202

[81] E.N.M. Okike, 'Corporate Governance in Nigeria: The Status quo', *Corporate Governance* (15) 2 173-193

4.5 Under Case Law

Having discussed the express provisions of the Act relating to circumstances under which the veil of incorporation may be lifted, it is necessary also to examine the judicial in-roads into this field under the Nigerian law.

Since the decision in *Salomon v Salomon,* efforts by the judges to lift the corporate veil have in general been hamstrung and penetration into the corporate person of companies has been extremely difficult. Nevertheless, the Salomon doctrine is not an immutable one.

Like in England and other jurisdictions, courts in Nigeria have refused the use of corporate personality for the commission of fraud, improper conduct or to defeat the aim of the law. Whenever the use of the doctrine for some certain purposes are challenged, the courts look at the intention and activities of the individuals composing it to see if the advantages of separate personality of companies are being applied to protect interest. In looking at the human instead of the corporate entity when it is considered necessary, Nigerian courts do call in aid general principles of law and more often allow themselves to be assisted by English authorities. The influences of English law on Nigeria remain steadfast, although the decisions by English courts are only persuasive and not binding. In addition, English commercial law will be applicable in Nigeria, provided there is a lacuna in the law and so long as the law is appropriate to local circumstances.[82]

Efforts will be made to see how the courts, in recent years and in exceptional cases lifted the corporate veil in order to look at the realities behind the facade. Courts in Nigeria tend to take a fact-based approach to questions of piercing the corporate veil, and no particular trend is readily discernible from an overview of the cases. This may be attributable to the intensely factual nature of the issues in the cases[83] or the preference to judge each case on its merit.[84] Review of the cases dealing with this issue decided in Nigeria, however, establishes certain broad principles and it is appropriate to consider these principles in turn.

[82] See Section 17 of the Supreme Court Ordinance, 1874.
[83] H.Gelb, 'Piercing the Corporate Veil- The Undercapitalization Factor' (1982) 59 *Chicago Kent Law Review*1, 2
[84] C. Mitchell, 'Lifting the Corporate Veil in the English Courts: An Empirical Study' (1999) 3 *Company Financial and Insolvency Law Review* 15.

4.5.1 Fraudulent Use of the Corporate Form

As is prevalent in the UK, Nigerian courts denote fraud as an important exception to the separate personality principle of the company. Consequently, where a company is used to perpetrate a fraudulent act, the courts will treat the company and those behind it as one and the same. Thus, if a company has been incorporated to defraud innocent investors, the courts may hold the promoter liable even though the promoter and company are separate persons.[85] In *FDB Financial Services Ltd v Adesola*,[86] the Nigerian Court of Appeal reiterated the fact that once there is clear evidence of fraud or illegality the veil will be lifted. Manifestation of fraud, as pointed out by Singh, could be seen in false accounting, misrepresentation, tax evasion, siphoning off corporate finances, money laundering, etc.[87]Whilst the misuse of a corporate entity structure depicts the failure of the regulatory system, it may also be attributable as a phenomenon embedded in the social system.[88]

In the case of Nigeria, the fraudulent attitude of incorporators appears more prevalent in private limited liability companies than in public limited companies.[89] This is largely because the private limited company discloses lesser information in the process of its incorporation, operations and activities, vis-a-vis public limited companies which have stricter disclosure norms and are under tighter regulations. Moreover, a private limited company with minimal subscription is the most economical structure for such fraudulent promoters to design a structure, which is also, legally, a distinct entity separate from its promoters.[90] It is arguable whether or not this position is completely right in view of numerous bank distresses in Nigeria though most of the banks do have top businessmen and politicians as their dominant shareholders.[91] Nonetheless, a survey of the cases in the law reports giveS credence

[85] See *Re Darby* [1911] 1 KB 95
[86] [2000] 8 NWLR (Pt 668) 170
[87] D. Singh, 'Incorporating with fraudulent intentions: A Study of differentiating attributes of Shell Companies in India' (2010) 17:4, Journal of Financial Crime, 459.
[88] Ibid
[89] See *Alade v. Alic (Nig) Ltd*, [2010] 19 NWLR, (PT 1226) 111
[90] Incorporation of private limited companies in Nigeria does not require any publicity compared to Public companies that require diverse shareholdings and equity participation which may be quoted in the Nigerian Stock Exchange,.
[91] Most banks in Nigeria are floated by powerful and very few wealthy individuals who are also its controlling shareholders even though in theory they tend to advertise for subscription of shares from members of the public who are oblivious of the undercurrents of the promoters and their directors.

to the preponderance of fraudulent and sharp business practices among private limited liability companies than public companies.

In all these illuminating line of cases, Nigerian courts have refused to be tied down by the entity theory and have shown marked impatience with all attempts to hamper, delay or defraud creditors by means of "dummy" of fraudulent incorporations. In all such instances, the courts did not hesitate to penetrate the veil and to look beyond the juristic entity at the actual and substantial beneficiaries. The decision of the Supreme Court in *Alade v. Alic (Nig) Ltd*[92] is very important on this point. A summary of the plaintiff's case, as can be gleaned from his pleadings, is that he entered into a partnership agreement with the 1st respondent which is a registered company for trading on produce that is cocoa beans, palm kernel and other produce generally for the 1987/88 season. The 2nd respondent was the Managing director and major subscriber of the 1st respondent. Based on the agreement, the appellant raised a loan of N240, 000.00 for the take off of the business with the profit accruing from the partnership to be shared between the appellant and the respondent on a 40% and 60% basis, respectively. The appellant obtained the loan from the International Bank for West Africa Ltd. (IBWA). The loan was guaranteed by the Marine and General Insurance Company upon an indemnity given by the appellant to the Insurance Company. It was the appellant's case that the 2nd respondent thereafter fraudulently failed to disclose the 1st respondent's prior indebtedness to the International Bank for West Africa and this consequently resulted in a substantial sum of the loan procured to be deducted from the 1st respondent's account once deposited to off-set the indebtedness of the 1st respondent leaving only a credit balance of N71, 000.00. There was a further diversion by the respondents of the sum of N453, 584.50 into the 2nd respondent's account and non-disclosure of the sum of N165, 000.00 from a major trading customer of the 1st respondent Kopak Ltd. The 2nd respondent kept the appellant in the dark of all the transactions of the 1st respondent and refused to render account of its trading activities under the partnership. The appellant further claimed that the profit, which occurred to the partnership, was over N1, 000,000.00 (One Million Naira) and that his 40% share of the profit was therefore N436, 649.44.

[92] [2010] 19 NWLR (Pt1226)111

Due to the above facts and the inability of the appellant to realize anticipated profit, the appellant instituted this action against the 1st and 2nd respondents claiming the sum of N3,296,528.08 (Three Million, Two Hundred and Ninety-six Thousand, Five Hundred and Twenty Eight Naira, Eight Kobo) as particularised being damages suffered as a result of the 1st defendant's breach about March, 1988 of partnership agreement entered into at Ibadan between the plaintiff on 1st July, 1987, and which breach was masterminded, procured and instigated by the 2nd defendant as agent of the 1st defendant in fraud of the plaintiff.

At the conclusion of evidence, the trial court gave judgment in favour of the appellant.

Being dissatisfied, the respondents appealed to the Court of Appeal which allowed the appeal in part but nevertheless set aside the entire damages awarded in favour of the appellant by the trial court notwithstanding that it found that the appellant proved the special damages awarded him as loss of profits due to him in the partnership business. On the appellant's further appeal against the decision of the Court of Appeal, the Supreme Court unanimously allowing the appeal held that it was wrong for the Court of Appeal to have dismissed the appellant's entire claim after having held that he proved the special damages awarded by the trial court. The court stated clearly that one of the occasions when the veil of incorporation will be lifted is when the company is liable for fraud. In fact, the Justices of the Supreme Court in turns condemned unequivocally the failure of the business transaction. As for Onnoghen, JSC:

> The facts of this case is a clear pointer to the dilemma of the small scale business community of this nation such as partnerships. It brings to the fore the total absence of honesty and trust between business partners and the fraud being perpetrated by some of them. The situation revealed by the facts of this case ought not to be encouraged by the deployment of legal technicalities irrespective of the case pleaded by the plaintiff.[93]

Muntaka-Commassie, J.S.C echoed his own views in the following words:

> It must be stated unequivocally that this court, as the last court of the land, will not allow a party to use his company as a cover to dupe,

[93] Ibid., at 117

> cheat and or defraud an innocent citizen who entered into lawful contract with the company, only to be confronted with the defence of the company's legal entity as distinct from its directors. Most companies in this country are owned and managed soley by an individual, while registering the members of his family as shareholders. Such companies are nothing more than one-man business. Thence, the tendency is there to enter into contract in such company name and later turn around to claim that he was not party to the agreement since the company is a legal entity.[94]

On his own part, Rhodes-Vibour, J.S.C stated his opinion on the case as follows:

> The Court of Appeal was of the view that the respondents cannot be jointly and severally liable. When an individual (the 2nd respondent) used the 1st respondent (the 1st respondent is inanimate) in conducting his personal business in the pretence that he was acting on behalf of the 1st respondent in the partnership agreement between the 1st respondent and the appellant the court is left with the only option, and that is to liftthe veil of incorporation of the 1st respondent to reveal fraud. The court will readily impose liability on the 2nd respondent and that liability is joint and several. In this situation, it is necessary for justice to be seen to have been done. In my view, I think the Court of Appeal missed the point completely. This is not a question of reading anything into exhibit P.5. It has to do with lifting the veil of incorporation of the 1st respondent in order for the learned trial judge to see the fraud perpetrated by the 1st respondent on the appellant....The breach of the partnership agreement was masterminded, procured and instigated by the 2nd respondent as agent of the 1st respondent in fraud of the appellant.[95]

The views of the learned justices of the Supreme Court clearly demonstrate the abuse of the corporate form by corporate controllers on the guise of the separate personality of the company. There are yet other cases on fraud where the Nigerian courts have risen up to the occasion to lift the veil of incorporation in order to get at the corporate controllers.

One other case will serve to make it clear that the courts ignore the concept of legal corporate entity when used as a shield for fraudulent attempts to swindle creditors. In *Adeyemi v. Lan & Baker (Nig) Ltd & Anor*,[96] the respondent sued the appellant and the 2nd respondent jointly and severally claiming a total sum of N132, 500 for a

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[94] Ibid., at 117-118
[95] Ibid., at 118
[96] [2000] 7 NWLR (Pt 663] 33

consideration that wholly failed. The 1st respondent also made an alternate claim against the appellant alone for the same amount of money and compound interest thereon in the rate of 14% from September 1984 until payment or judgment whichever is earlier.

In support of his claim, the 1st respondent pleaded that the appellant introduced himself to the 1st respondent as the Managing Director and Chief Executive of the 2nd respondent and purportedly acting as such and for himself offered to sell some bags of rice which he had at the ports to the 1st respondent which rice the 1st respondent could in turn sell to the third party whom the appellant also introduced to the 1st respondent as a prospective purchaser. The appellant also showed the 1st respondent certain documentative materials to the business in a bid to convince him to embark on the transaction. The 1st respondent then gave a total sum of N106, 000 in three instalments for the rice to the 1st respondent, who received it but failed to issue receipts despite his promise to do so. In defence of the suit, the appellant filed a statement of defence.

In proof of his case, the 1st respondent called three witnesses namely the Managing Director of the 1st respondent company, his solicitor and the 1st respondent's accountant through whom two of the instalment payments were made to the appellant. All the three witnesses corroborated the case of the 1st respondent that the money in dispute was actually paid to the appellant in their presence. At the conclusion of trial, the court found for the 1st respondent and held the appellant personally liable for the money received from the 1st respondent.

The appellant's contention at the Court of Appeal that he was an agent for a disclosed principal and the 2nd respondent was dismissed. The court held that, although an incorporated company is a distinct person from its members, where it is proved that it is a mere sham, device or mask being used to cover the true state of things in the eyes of equity the court must open the veil. It thus came to the conclusion that the 2nd respondent was a mere puppet of the appellant and the veil of incorporation ought to be lifted on grounds of equity.[97]

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[97] Ibid., at 51

While arriving at its decision, the Court of Appeal noted that the decision in *Salomon v. Salomon* must not bind one to the essential acts of dependency and neither must it compel a court to engage in an exercise of finding of fact which is contrary to the true intentions or positions of parties voluntarily created by the parties as distinct from an artificial or fictitious one. It then concluded that once a company is discovered to be a cloak of a biological creature, whoever he might be, the veil of incorporation must be lifted.[98]

Whilst the Court of Appeal should be commended for its position to lift the corporate veil in the above cases, later decisions by the same court demonstrated the lack of consistency in this area of law in Nigeria, which is not that different from what is prevalent in the UK and other common law jurisdictions. A case in point is *FDB Financial Services Ltd v. Adesola*[99] where the court, in refusing to lift the corporate veil on similar facts, stated as follows:

> Even if fraud and / or illegality is discernible in the conduct of the affairs of a company, this in itself does not disregard the company's separate personality since the court often imposes liability on the company as well. There must be clear evidence of illegality or fraud for the veil to be lifted. In the instant case, it was not necessary to join the second appellant (Managing Director of the 1st appellant) as a party to the suit since there was no evidence of fraud and he was merely an agent of the company.

It is difficult to comprehend the views of the Court of Appeal in this case in view of the fact that the appellants evinced a clear intention to deny the respondents the fruits of their investments even when it had become due. It is submitted that fraud *simplicite*r should not only be the basis for lifting the veil even when there are surrounding circumstances leading to it. Thus, once fraud is discernable in the affairs of the company or is shown to be the sole reason for the establishment of the company, as in this case, the veil ought to be lifted. This proposition in itself raises a problem in terms of the determination of what constitutes fraud or when it can be deemed that a company is a mere facade. In this connection, the motive of the incorporators becomes pertinent. To this extent, where a company is incorporated with a deceptive motive or intention, it is more likely that the court will lift the veil

[98] Ibid. The views of Aderemi, JCA one of the Justices of the Court of Appeal in this case is very important.

[99] (2000) 8 NWLR (Pt 668) 170

of incorporation. The determination of deceptive motive should be at the time of transaction and not before it.[100]

In yet another case, Dosunmu, J. of the High Court of Lagos, Nigeria in *Bank of America National and Savings Association v. Niger International Development Corporation Ltd*,[101] refused to accede to the interpleaded claim of the claimant as it was found to be a fraud to deprive the judgment creditor of the fruits of his litigation. The subject matter of this action relates to a Volkswagen saloon car which was attached in pursuance of the writ of attachment taken out at the instance of the plaintiff. The plaintiff had obtained judgment against the defendant in the sum of £1,424, in addition to some costs. Only £50 was paid out of the judgment debt. The plaintiff subsequently took out a writ of *fi.fa* whereupon the vehicle was attached. While the writ was waiting to be executed, the claimant interpleaded and claimed to have bought the vehicle from the defendant *bona fide* and without knowledge of any action at the price of £300.

The question that came for determination was whether the purchase was one made for value and without notice or was made in fraud of creditors under the Fraudulent Conveyances Act, 1571. At the hearing, the claimant called one witness, Alhaji Rufus Adeshina who swore to the affidavit on behalf of the defendant in his earlier bid to have an order for instalment payments in respect of the judgment debt. The witness was also found to be the agent of both the defendants and claimants company being both a manager and general manager of the two companies respectively. It was also established that the owners of the two companies were the same, having the same shareholders and directors. The court did not hesitate to come to the conclusion that the transaction between the defendant and the claimant was juggled after the latter had failed to secure instalmental payments of the judgment debt, in order to defeat the judgment creditor in pursuit of its remedy. Citing with approval the decision in the English case of *re Hirth*,[102] the court dismissed the claim and held that where an alienation is made by a debtor with intent to defraud his creditors to a company practically identical with himself, the company must be taken

[100] See *Creasy v Breachwood Motors Ltd* [1993] BCLC 480
[101] (1969) N.C.L.R. 268
[102] [1899] 1 Q.B. 612

to have full notice of the true nature of the transaction and so be unable to avail itself of the protection (of the Fraudulent Conveyances Act, 1571, s.5).

More recently in *Access Bank PLC v. Erastus Akingbola and others*,[103] an English court sitting in London, whilst dealing with a monumental case of insider corporate fraud and cross border related issues of abuse of the corporate form, departed from the Salomon's principles and found the defendant guilty of misappropriating and diverting billions of depositors funds to buy properties in the United Kingdom. The defendant was also found to be taking his company's money to make illegal shares purchases for himself in order to manipulate its share price in the Stock Exchange. He was found guilty of diverting or siphoning his banks money to five other companies named as co-defendants controlled by him and some of his family members, including his wife, in order to help them pay off "substantial debts".

The facts leading to this case were that the defendant, who was a former Managing director of Intercontinental Bank PLC before its merger with the claimant, had fled Nigeria to the UK in 2009 to escape justice after he was removed by the Governor of Central Bank of Nigeria (CBN) in exercise of his statutory powers under Section 35(2) of the Banks and Other Financial Institutions Act 1991("BOFIA"), and following an investigation into the affairs of Intercontinental Bank. The consequences of events material to the proceedings, as the claimants asserts, was the collapse of the bank which before then, was one of Nigeria's top four banks, employing over 20,000 people and having some 350 branches. Following his flight from Nigeria, the bank pursued him to the UK and commenced this action largely because the Fulgers claim related to properties (proceeds of the fraud) in the UK and at the time of service of the proceedings, he was resident in London.

There were three areas of claims in the proceedings: the unlawful share purchase claim, the tropics payments claim, and the Fulgers claim. In respect of the unlawful purchase claim, the claimants challenge was that between April 2007 and August 2009, the defendant procured, operated, approved and/or orchestrated a share purchase or support scheme by which under his direction, the Claimant was caused to purchase or acquire with its own funds shares issued by it contrary to sections 159 and 160 of CAMA 2004. Whilst section 159 of CAMA prohibits financial assistance

[103] [2012] EHWC 2148 (Comm.) 1680

by a company for acquisition of its shares except the lending of the money is part of the ordinary business of a company, section 160 makes it clear that a company may not purchase or otherwise acquire shares issued by it. The shares as it turned out were purchased for the benefit of the defendant.

The second heading of claim the Tropics payments claim relates to a total sum of N18, 684,500, 000 (approximately £68m) in respect of monies paid away by the claimant to, or to the benefit of, various companies in the Tropics Group, of which, as set out in the claim, the Defendant was a director, and which he, and /or his wife or family, directly or indirectly owned, between 11 May and 26 June 2009.

The third head of claims otherwise referred to as the Fulgers claim relates to two transfers caused or directed by the Defendant to be made by Intercontinental Bank to the client account of Messrs Fulgers (in association with David Berens & Co) LLP, London solicitors, in the sum of £8,540,134.58 on 11 March 2009 and £1.3m on 13 July 2009, which were used for the purchase of property to or to the order of the Defendant (and variously involving other defendant companies named in the claim).

At the end of trial for which relevant witnesses were called, including experts on Nigerian law agreed by both parties, the court agreed with the claimant that the defendant’s actions were inconsistent with the provisions of sections 159 and 160 CAMA and that he breached his duty as director of the company under section 283 of CAMA which provides that:

> Directors are trustees of the company’s moneys, properties and their powers and as such must account for all the moneys over which they exercise control and shall refund any moneys improperly paid away, and shall exercise their powers honestly in the company and all shareholders, and not in their own or sectional interest.

Accordingly, the court held that the claimant is not only entitled to all the three heads of claim but also a tracing claim into the properties or their proceeds of sale. Burton, J, made the following observations:

> As for his strategy for the company to buy its own shares into the box, quite apart from being contrary to Nigerian law, it was simply wrong-headed and was plainly a substantial contributing factor to the collapse of the bank.

Burton, J, further observed that it was certain that the defendant paid out the banks money to buy properties for his companies. In his own words, he said as follows:

> But I can simply rest my decision on the basis that in fact the bank's money was paid out to buy properties for the defendant's companies. As it happens I am satisfied that they were never repaid, but in any event they were caused to be paid out by the defendant in breach of duty and consequently of trust, and the claimant has a tracing claim into the properties or their proceeds of sale.

The irony of this case is that whilst the court in the UK has quickly dispensed of the bank's claim, its sister case in Nigeria bordering on allegation of crime in the Lagos High Court, is yet to be heard and determined to date. The case has suffered from so many interlocutory applications and adjournments, thus exposing the weak Nigerian judicial and regulatory system as well as enforcement mechanisms of Nigerian laws. This is obviously a lesson Nigeria must learn from the UK.

However, before leaving this point it is necessary to point out that in the Nigerian case of *Adeniji v. The State*,[104] the Court of Appeal had to consider whether it was proper to lift the veil of incorporation in order to hold the managing director of a company criminally responsible for conversion by the company of money paid to it by a third party. The Court of Appeal in allowing the appeal held inter alia that the doctrine of lifting the veil applies invariably to civil matters and not to criminal matters.

It is arguable if this decision is correct in view of similar English authorities and the common law position that the agent is always personally liable for his or her own crime. It is therefore respectively submitted that the veil of incorporation may be lifted for the purpose of Civil law as well as for Criminal Law. It is not restricted to the civil law as the Court of Appeal would assume in the case. Lifting the veil of incorporation was involved in the following criminal cases *R. v. McDonnel*,[105] *R. v. Pearlberg and O'Brien*,[106] *R. v Arthur*,[107] and *R. v. Gillet*.[108]

[104] (1992) 4 N.W.L.R.(Pt 234) 248 at 261
[105] (1966) 1 Q.B. 233. See also the views of C. Okoli, 'Criminal Liability of Corporations in Nigeria: A Current Perspective, (1994) *Journal of African Law*, Vol. 38, No 1,35 at 42
[106] (1982) Crim. L.R 829
[107] (1967) Crim. L.R. 298
[108] (1929) AD 365

4.5.1.2 An Assessment

In all the above cases, the court demonstrated its willingness to lift the corporate veil on grounds of fraud whenever invited to do so. However, the nature of the decisions leaves much to be desired. Most of the judgments following common law approaches seem to be declaratory in nature, merely determining the rights of the parties, without making any consequential order which could have allowed for the equitable recovery of ill-gotten gain from the corporate controllers. This ultimately makes it difficult for the attainment of satisfactory remedy to restore the injured party to his former position whilst denying him compensation for that which was forfeited or denied as a result of the abuse. The result is that a victorious party pursuant to the lifting of the corporate veil is faced with the herculean task of making recovery from the corporate controller through another claim.

This is nevertheless an arduous task for a litigant in a developing country like Nigeria considering the cost of litigation, delay and the length of time it takes before cases are determined. It is therefore submitted that the courts should adopt a more equitable approach which tends to disgorge the assets of the corporate controller in the principal judgment, thus making recovery and compensation to the injured party less difficult or cumbersome.

4.5.2 Where a Company is used by the Shareholders as an Agent

Nigerian corporate laws follow the principle enunciated in *Salomon* that the company is not an agent of its subscribers. However, the question whether the court will ascribe liability under the agency construction is a question of fact depending on circumstances. Thus, where there is an express agreement of agency between the company and its shareholders, or where a controlling personality be it corporate or natural, dominates a company, the veil may be disregarded to that extent on the general principle of agency. In *Marina Nominees Ltd v. Federal Board of Internal Revenue*[109] the Supreme Court refused to lift the veil on the suggested agency construction that the appellant was set up to perform secretarial duties on behalf of Peat Marwick & Co which would have enabled it to avoid payment of tax to the respondent. In coming to this conclusion, the court found no proof that the company

[109] (1986) 2 N.W.L.R. (Pt 20) 40

was set up strictly to perform secretarial functions for Peat Marwick, there being other functions performed by the company in its memorandum of association.

Unlike the UK where agency has been widely used for so many years, the case above represents the first widely known instance of the use of agency in company law reported in Nigerian case law.[110] What had existed before it were mere divisions of existing companies which does not translate to separate legal personalities as they are not independent companies. It is however hoped that, what- with the influence which multinational companies exert in the country, it is highly probable the forms in use in the UK may be employed in Nigeria.

4.5.3 Interest of Justice

Nigerian courts permit exceptions to separate personality and limited liability in the interest of justice. This is unlike in the UK where the interest of justice seems less important.[111]In *FDB Financial Services Ltd v. Adesola*[112], for instance, the Court of Appeal ordered for specific performance of the contract between the appellant and the respondent whilst reiterating that the veil of incorporation can be lifted as the justice of the case demands so. The interest of justice exception was also applied by the Nigerian Supreme Court in *Edokpolo v Sem-Edo Wire Industries*[113] and yet again by the Nigerian Court of Appeal in *First African Trust Bank v Ezegbu*.[114] However, the courts did not clarify in vivid terms the circumstances in which the interest of justice will apply. This tends to leave each case to be determined at the discretion of the court in the absence of coherent and rationalised principles. Notwithstanding the above, it is apparent that with the combination of interest of justice exception and the provisions of the 1999 Constitution of Nigeria,[115] which grants individuals access to courts for a redress of their grievances, an aggrieved person can pursue a claim against the company and its erring director/ or controlling shareholder based on this ground.

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[110] O.A. Osunbor, 'The Agent-only Subsidiary Company and the Control of Multinational groups', (1989) *I.CL.Q.*, 377
[111] See *Adams v. Cape Industries Plc*, [1990] Ch 433
[112] [2000] 8 NWLR 170 at 173
[113] (1984) 15 NSCC 533
[114](1990) 2 NWLR (pt. 130) 1
[115] See section 6(6) of the Constitution of the Federal Republic of Nigeria, 1999.

4.6 Conclusion

The primary principle in relation to the status of corporate entities is that they are separate from their corporators and other controllers, and as a general rule the corporate veil will be maintained. Nigeria has followed the UK in applying this principle. However, the doctrine of corporate personality is not immutable.

Beyond the common law exceptions such as fraud, incompatibility with public policy, avoidance of legal obligations and perhaps where the justice of the case demands, it is difficult to hazard any principled approach requiring the circumstances in which the veil of the corporation can be lifted. This is largely due to the rigid and formalistic approach adopted in *Salomon's* case, and which has been applied vigorously by Nigerian courts.

In any event, Nigeria's peculiar circumstances as a developing country with diverse sociological and different level of development than the UK appear to need a more radical approach towards dealing with the abuse of the corporate form in order to accelerate its social and economic development. One means of doing this is to deny the incorporators the benefit of the advantages gained through the abuse of the corporate form. An attempt to this was evident in the promulgation of the Failed Banks (Recovery of Debts and Financial Malpractices Act) 1994 to hold corporate controllers and sundry debtors of failed banks liable for the failure. This Act was short lived as the inevitability of transfer of power from military to civilians in 1999 led to its eventual demise.

Again, a close study of the chapter reveals deep institutional problems in tackling the abuse of the corporate form as could be seen in the weak judicial system, inadequacy of laws and regulatory activities of the Corporate Affairs Commission-the main agency for regulating and supervising all corporation related matters in Nigeria. The judicial system and the administrative apparatuses of the commission desire immediate strengthening to enable them meet with the changing times in the modern world.

Furthermore, there are obvious lessons Nigeria has to learn from the UK in terms of improvement of its laws and effective judicial system. There is need in Nigeria for an Insolvency Act, similar to the British Insolvency Act of 1986 and effective disclosure mechanism. This will help protect creditors and make access to information about a company readily available. In addition, the technology available to investors and creditors should be improved through easy and accessible websites on company matters.

More discussions on the comparative analysis of the state of the law in the UK and Nigeria in relation to the operation of corporate personality principles in the two jurisdictions, as well as suggestions on how to tackle the above problems, shall be dealt with in subsequent chapters.

CHAPTER 5 LIFTING THE CORPORATE VEIL: AN ANALYSIS OF THE UK AND NIGERIAN PERSPECTIVES

5.1 Introduction

The concept of the corporation as a separate personality with limited liability has long been fully entrenched as part of the laws of the UK and Nigeria. A comparative analysis of the laws of these two countries in relation to the application of the doctrine has become imperative in view of the globalisation of business. This is particularly pertinent because there is a growing business relationship between the developing countries and the developed countries. In particular, the UK and Nigeria are the two most important common law jurisdictions in the developed and developing countries of the world with trading activities spanning well over a century. The UK is the most significant trading partner to Nigeria whilst most of the latter's institutions are shaped on the innovations and improvements found in the UK, including in the area of company law.

One area of concern which has tended to undermine healthy trade and investment in businesses both at the domestic and international level is the whole question of the abuse of the corporate form. The trend and scale of this abuse has been well documented in previous chapters. What is relevant to us in this chapter is the fact both UK and Nigerian company laws recognise the fact that in spite of the generally strict application of the doctrine of corporate personality, the doctrine is not immutable. Thus, in appropriate circumstances involving the abuse of the corporate form, the corporate veil will be disregarded to find liability against the corporate controllers.

A review of the approaches adopted by the UK and Nigeria to deal with the abuses of the corporate form reveals certain commonalities and differences. This may perhaps be attributed to the common law doctrine which pervades the two jurisdictions and the diverse nature of the peoples, levels of development and corporate behaviour between the nations. In the light of the growth of veil-piercing jurisprudence in the UK coupled with the improvement of insolvency laws and disclosure mechanisms aimed at ensuring corporate rescue and protecting creditors, it is expected that Nigeria, as a developing country, will learn lessons that could help it fill the vacuum in its laws in the absence of existing legislations. Furthermore, an understanding of the different approaches adopted by the two countries, particularly where there are gaps, will help to fashion new ways and strategies to tackle the problem of the abuse of the corporate form.

In the light of the above, this chapter builds on the findings in chapters three and four and critically examines and discusses the approaches adopted by the UK and Nigeria with regards to the lifting of the corporate veil. The chapter engages in an in-depth comparative study by looking into the substantive rules and legislation as well as the underlying jurisprudential basis of the approaches adopted. The respective gains and limitations of the approaches are then identified. The aim is to provide the foundation or guidance for reforms or new jurisprudential approach towards corporate personality in Nigeria in chapter six, drawing on the strength of the two approaches, while simultaneously avoiding their pitfalls.

The chapter is divided into four parts. Part I briefly explains the corporate formations found in the UK and Nigeria whilst highlighting the issue of undercapitalisation resulting from lack of, or a low threshold of, capital requirement for private companies operating in the UK and Nigeria as well as the attendant consequences it has on creditors in these jurisdictions. Part II proceeds to analyse the measures aimed at protecting creditors in the UK and Nigeria including insolvency laws and disclosure mechanisms, explaining the differences in approach between the two jurisdictions. Part III provides a comparison between the UK's and Nigeria's corporate veil doctrines. From the comparisons in relation to their jurisprudential approaches, some broader inferences will be drawn about the UK and Nigerian legislative and judicial reasoning on the issue. Part 1V, while drawing on the strengths of the existing regime, nevertheless proposes the need for a new approach to the identified inadequacies of the present approach.

5.2 Corporate Formations

Effective operation of the corporate personality principle would mean in effect that a company at inception should have adequate capital for its business. Unfortunately, corporate law jurisprudence in the UK and Nigeria allows for the existence of companies with little or no capital requirements. In the UK for instance, the company law allows for the setting up of a single-member private company.[1] There is no minimum capital requirement for private companies in the UK and public share subscription is not allowed.[2] This has the potential of reducing the amount such companies may have for their operations, resulting in a weak asset base as they are unable to pool resources together from a wide spectrum of investors.[3] The problem is also worsened by the fact that financial institutions avoid lending to small businesses unless there is personal guarantee by the controlling shareholder or directors. As pointed out by Davies, of about 2,000,000 registered companies in the UK, only about 11,500 are public companies.[4] In the case of public companies, a minimum capital requirement of £50,000 is provided in the Companies Act.[5]

The lack of minimum capital requirement for private companies in the UK may also create opportunity for business failure and the existence of undercapitalised companies which may be unable to fulfil their obligations to creditors. Although a low capital threshold may not be peculiar to small companies, as it also exist in companies with more than one member (depending on the investment capacity), the likelihood of its occurring, and the problems associated with it, appear to be greater in small companies. This raises concerns of potential fraud about the one member company because at the time when advances are made to the firm, the shareholder with fixed caps on possible losses made possible by limited liability, knew it could not have borrowed a similar amount of money from an informed outside source.[6] Moreover, if a creditor requested financial information, and the controlling shareholder lied in response, there would be fraud and grounds to pierce without the need to discuss capital itself. The owner who promises corporate performance

[1] See Companies Act 2006, section 7. The foundation for the operation of one-man company was laid in the leading case of *Salomon v Salomon* [1897]AC 22

[2] See CA 2006, s755. See also D. Milman, 'Promoting Distributional Justice on Corporate Insolvency in the 21st Century' in J. Steele & W.H.Van Boom (eds), *Mass Justice Challenges of Representation and Distribution*, Edward Elgar Publishing Limited, Cheltenham, 2011, 170

[3] P. Davies & S. Worthington, *Gower and Davies' Principles of Modern Company Law*, 9th ed., Sweet & Maxwell, London, 2012, 14.

[4] Ibid, at 16.

[5] See CA 2006, s.763

[6]. See Chen Jianlin, 'Clash of Corporate Personality Theories: A Comparative Study of One-Member Companies in Singapore and China, (2008) 38 *H.L.J* 425; J.M Dobson, 'Lifting the Veil in Four Countries: The Law of Argentina, England, France and the United States, (1986), *I.C.L.Q* 839 at 850. See the English Jenkins Report-Report of the Company Reform Committee (Cmnd) 1962, 5; See also W.P. Williams & T.G. Benson, 'Shareholder Liability for Inadequate Capital', 43 *U. PITT. L. REV*, 837 at 859, 888

knowing that, at the time, the corporation will never be able to perform, has obtained limited liability by fraud.[7]

Analysing a study by the German credit rating agency,[8] Hurley has noted, following an analysis of financial statements of around 4.3 European companies, that UK businesses are among the most over reliant on debt finance in Europe.[9] The research also revealed that UK companies are some of the continent's most undercapitalised. As pointed out by Williams, of Credit Agency Graydon, the research showed that UK businesses followed the same pattern as individuals, relying too much on debt to finance their activities, and that they were not ready for the recession when it hit because they were not able to get hold of more debt.[10] For Williams, the problem in the UK is particularly pronounced among small, private companies because of a lack of understanding of balance sheet quality as well as unwillingness of directors to invest start-up capital or retain profits in the business. The study further revealed that many UK small businesses opted for just £2 of issued share capital at start-up stage. The implication of this study is that corporate owners are risking relatively little of their own capital or else failing to maintain or preserve their stated capital, while the company's debts grow vastly out of proportion to its capitalization. Such gross under-capitalization in the private corporate sector heightens the risk of corporate insolvencies as owners of business will be increasingly willing to engage in risky activities because they have little to lose. [11]

From the legal standpoint, the basic idea behind undercapitalization is that shareholders are engaging in an abuse of the corporate privilege for deliberately incorporating with initial capital they know to be inadequate to meet the expected liabilities of the business.[12] In other words, shareholders should not be entitled to personal immunity if they fail to provide the *quid pro quo* for such immunity, which, specifically, would mean failing to provide a reasonably adequate length of capital at

[7] Franklin A. Gevurtz, Piercing Piercing: An Attempt to Lift the Veil of Confusion Surrounding the Doctrine of Piercing the Corporate Veil, (1997) 76 Or. L. Rev. 853

[8] James Hurley, UK Companies are undercapitalised and 'addicted to debt' in http://www.telegraph.co.uk/finance/business club/8459418/UK-Companies are undercapitalized and 'addicted to debt', accessed 20/1/2013.

[9] Ibid.

[10] Ibid.

[11] Steven C. Bahls, 'Application of Corporate Common Law Doctrines to Limited Liability Companies', (1994) 55 *Mont. L. REV*. 43, 56.

[12] S.B. Presser, *Piercing the corporate Veil*, Clark Boardman, Minnnesota, United States, 1995, 1-54

incorporation to which creditors may resort.[13] However, notwithstanding the basic problem posed by undercapitalisation, it has not been made an issue in the UK as a ground of lifting the corporate veil as no case has been reported in this study on the subject. This may be attributed to the difficulty faced by the courts in developing a workable standard that can be meaningfully and fairly applied to all shapes and sizes of business as well as the obvious economic reason that raising a barrier in the form of high capitalisation may discourage small business development.

Another difficulty is the fact that the UK is subject to EU legislation and competition rules.[14] These rules have opened competition among member states so that a business established in one state has freedom to operate in any member state or have branches elsewhere.[15] The rationale behind this is that the citizens of the EU can move freely everywhere as legal persons in the EU and do business. The citizens also have legal right to take up cases or seek redress in courts. The effect of this is that some of these businesses which may have little or no capital or whose asset base can hardly be determined are allowed freedom to operate unhindered in spite of the problems they pose to creditors.

Unlike the UK, Nigeria maintains a requirement to have a minimum share capital of N10, 000 (Ten thousand Naira) in order to set up a private company.[16] However, this amount is too small to effectively run a company though given the widely divergent needs of businesses, it is difficult to determine what level of capitalization is sufficient. This is coupled with the problem of assessing the level of risk a particular business proprietor should be willing to accept.[17] With this in view, it seems unlikely that a uniform test for inadequate capitalization may be fashioned to account for different business sizes and types and the expected and unexpected liabilities attributable to each particular area of business.[18]Even at that, it is clear that the

[13] See Solomon R.B. Castro, 'Undercapitalization as a Factor in Piercing the Corporate Veil in Contract Cases: Balancing Risks and Incentives', *Phillpine Law Journal,* Vol. 74, 6333 at 640.
[14] See Mads Andenas & Frank Wooldridge, *European Comparative Law*, Cambridge University Press, 2009, 10, 31; See also S.Grundmann, European Company Law, (2003) Antwerp/Oxford; Intersentia, 119 *LQR* 221
[15] Adenas, n.14 above. See also Articles 43(2) and 48(1) EC which provides that companies established in the EC may create secondary establishments in other member states and thus set up agencies, branches or subsidiaries there.
[16] See CAMA 2004, s.27(2) & (a)
[17] R.B Huss, 'Revamping Veil Piercing for All Limited Liability Entities: Forcing the Common Law Doctrine into the Statutory Age', (2001) 70 *U. Cin. L. Rev.* 95, 114-115.
[18] Ibid.

amount which is merely stated in the form in order to satisfy the requirement of the law is rarely paid by the incorporators at the time of incorporation of the company. Consequently, the same problem of undercapitalisation and its attendant effect of risk to creditors which befalls the UK system are still prevalent in Nigeria. As is also the case with the UK, undercapitalization has not been made a subject of veil lifting for purposes of holding fraudulent members or directors liable for corporate abuse.[19] Indeed, there is no authority in Nigeria allowing the courts to pierce the corporate veil in circumstances where a company is incorporated with insufficient funds to satisfy creditors if debts become due and payable.

Given the risk posed by undercapitalisation among private companies in Nigeria[20] and the fact that most of them do not observe corporate formalities[21] and are characterised by lack of accounting records, misleading documentation on incorporation and non-filing of returns, the lack of consideration of undercapitalisation as a factor for lifting the veil of the company in this jurisdiction is obviously a major lacuna which needs to be filled in view of the massive problem it poses to potential creditors.

In the light of the problem posed by undercapitalisation and the fact that private companies cannot invite the public to subscribe for shares or debentures in order to raise capital for its business, it becomes doubtful whether the small corporate enterprise was ever intended or designed to embrace the institution of the corporate form with regard to widespread abuses inherent in it.[22] Nevertheless the single-member company and family corporation have become familiar modes of business

[19] See J.O. Orojo, *Nigerian Company Law and Practice*, Mbeyi & Associates (Nig) Ltd, Lagos-Nigeria, 1976, 79-90.
[20] See the index of statistics from the Corporate Affairs Commission (CAC) on the number of companies who have failed to submit their annual returns. The report indicated that the work of the commission is made difficult by the fact that most of the companies registered are not doing business in actual fact and this makes it difficult for the commission to apply and enforce certain corporate rules. See also n.115. Most of the facts that emerged from that case is that no actual business was done by some of the companies who claim to be so doing.
[21] A company is required by law to follow corporate formalities for instance in terms of maintaining stock ledgers properly, keeping corporate minutes and corporate resolutions up- to- date among other things.
[22] See W. Rutledge, 'Significant Trends in Modern Incorporation Statutes, (1937) 22 *WASH. U.L.Q* 305 where it was suggested that there is need to have a study to determine the advisability of having three types of corporation statutes: one for extensive business, another for the small or moderate size business, another for the one-man company. See also I. Israels, 'The Close Corporation and the Law',(1948) 33 *CORNELL L.Q*. 488.

enterprise and, despite occasional questioning by the court[23] and some writers,[24] have generally received judicial sanction and approval.[25] The usual argument advanced by the courts is that limited liability is a privilege held out by the corporation law of the state and where a person incorporates a single-member or family corporation in compliance with the formalities of the law, for purposes of taking advantage of the corporate form in a commercial venture, he is merely taking advantage of the privilege conferred by law.[26] There is always a temptation to question both the logic and the historical realities in this judicially tailored reasoning. What is important however, at least for the purposes of this study, is that this and similar reasoning indicates clearly a judicial proclivity following the legislation, allowing the existence of a single-member company and family corporations on top of the risk it poses to the society.

There is therefore the need to ensure an adequate capital ratio for small businesses on incorporation if they must be allowed to function in order to avert the potential risk they pose to creditors. If the courts at least set minimum standards that creditors would be sufficiently covered, it would surely operate as a bar to those who may want to join the market without capital.[27] In the United States, the courts have always pierced the veil where the company is incorporated with insufficient funds to satisfy creditors if debts become due and payable.[28] The UK and Nigeria can follow this US example, although it may not be uncommon for a company to have insufficient assets to cover all of its debts at the inception of its operation. To this end, a balance needs to be struck between ensuring a business environment that facilitates economic growth, and also the one that protects the rights of participants such as creditors. This will bring harmony among all participants in the corporate field whilst reducing the tendency of fraudulent shareholders and directors to abuse the corporate form through the use of undercapitalised companies.

[23] See *Dollar Cleaners & Dyers, Inc. v MacGregor*,(1932) 163 Md. 105, 161

[24] W. Fuller, 'The Incorporated Individual: A Study of the One-Man Company', (1938) 51 *Harv. L. Rev.* 1373.

[25] See the landmark case of *Salomon v Salomon* [1897] A.C. 22

[26] Ibid.

[27] H.G. Manne, 'Our Two Corporation Systems: Law and Economics' (1967) 53 *Va. L. Rev*. 259 at 176.

[28] S.B. Presser, 'Thwarting the Killing of the Corporation: Limited Liability, Democracy and Economics', (1992) *87 Nw. U.L. Rev*. 148 at 180.

5.3 Directors Duties and Creditors' Interest

A fundamental question that has resonated in various company law debates over a long period of time is whether the director's duty should or ought to extend to creditors. Some commentators have answered the question in the affirmative[29] while others simply believe that the existing common law duties of directors are sufficient.[30] They have also raised conceptual issues and policy concerns and questioned the practical implementation of such an extended duty.[31] Implicit in this fear is the fact that extension of directors' duties to creditors will amount to an erosion of the principle of limited liability. There is also the argument that such extension of duty to directors in favour of creditors is likely to restrict directors from risk taking which is commonly associated with businesses.[32] If this is allowed to happen, it is contended, directors are likely to adopt defensive measures in order to protect themselves from liability.[33] This argument is largely based on the idea that the contractual paradigm[34] appears flawed as the conceptual basis of protecting shareholders and directors because it must be matched with accountability in the performance of their duty. Such design will facilitate the protection of deserving directors while punishing the delinquent ones.[35]

Under the common law, directors owe their duty to the company. The Jenkins Committee while appraising the issue in the wake of *Percival v Wright*,[36] restated the fact that "no fiduciary duty is owed by a director to individual members of his company, but only to the company itself, and *a fortiori* that none is owed to a person who is not a member".[37] In doing so, the director shall exercise that degree of care, diligence and skill, which a reasonably prudent director would exercise in a

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[29] S. Schwarcz, 'Rethinking a Corporation's Obligations to Creditors' (1996) 17 *Cardozo Law Review* 647, at t 668; M.E. Van der Weide, 'Against to Corporate Stakeholders' (1996) 21 *Delaware Journal of Corporate Law* 27, 43.
[30] See CAMA., section 279(3); Keay, n.34 below at 672.
[31] See F. Dawson, 'Acting in the Best Interests of the Company-For whom are Directors "Trustees"? (1984)11 *NZLR* 68. See also *Nurcombe v. Nurcombe* [1985] 1 WLR 370; *Re Gray's Inn Construction Ltd* [1980] 1 *WLR* 711, at 718.
[32] A.Keay, *Company Directors' Responsibilities to Creditors*, Routledge-Cavendish, London, 2007. 310-310.
[33] Ibid.
[34] See A. Keay, 'Directors' Duties to Creditors: Contractarian Concerns Relating to Efficiency and Over Protection of Creditors', (2003), *The Modern Law Review*, Vol. 66, No. 5, 665 at 666.
[35] See D. Millon, 'New Directions in Corporate Law: Communitarians, Contractarians and Crisis in Corporate Law' (1993) 50 *Washington and Lee Law Review* 1373.
[36] [1902] 2 Ch. 421
[37] Cmnd 1749 (1962), at para. 89.

comparable circumstance.[38] The courts in Nigeria have upheld these common law principles. Thus in *Okeowo v. Milgore*[39] the Nigerian Supreme Court held that the directors' fiduciary duty is not for any individual director's advantage but for the advantage of the company. It is settled law that directors, in exercising their powers must do so bona fide and in the best interest of the company.[40] However, what constitutes the 'interest of the company' has assumed a wide and varied interpretation. Often, the interest of the company is indeterminate and somewhat incoherent.[41] Some commentators have even questioned why a director should owe any duty to the company when he is acting as the agent of a shareholder.[42] On equitable grounds, it would appear that the interest of the company is that of the shareholders or investors acting as a whole. In *Greenhalgh v. Aderne Cinema Ltd*[43] it was held that the company as a whole does not mean the company as a commercial entity, distinct from its incorporators. It means the corporators as a general body. Notwithstanding this position, the prevalent company legislations in the UK and in Nigeria still maintain the position that directors owe their duty to the company. In relation to whom the duty extends to, it has been pointed out that statute has now given some form of recognition to the interests of employees to whom directors in the discharge of their duty should have regard to.[44] This duty is still owed to the company and is also enforceable in the same manner as other duties to the company are enforced, namely by the shareholders.

Both the Companies Act in the UK[45] and the Companies and Allied Matters Act in Nigeria[46] failed to provide any duty of the directors to creditors. However, section 172 (3) of the Companies Act 2006 is subject to any enactment or rule of law requiring directors, in certain circumstances, to consider or act in the interest of the company. This proviso tends to give credence, as will be discussed later, for the accommodation of certain insolvency legislation aimed at protecting the interest of

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[38] See CAMA 2004, s.282; CA 2006, ss. 174 (1) & (2).
[39] [1979] NSCC, 210 at 263.
[40] See CA 2006, ss. 170(1) &171-177; CAMA 2004, s. 273 (3).
[41] See *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] AC 821; *Peter's American Delicacy Co Ltd v Heath* (1938) 61 CLR 457, at 481.
[42] O. Osunbor, *The Company Directors: Its Appointment, Powers and Duties in Essays on Company Law*, University of Lagos Press, 1992, 407.
[43] (1951) Ch. 286 per Evashea M.R.
[44] See CA 2006, s.172 (1) (b); See also CAMA 2004, s.279 (4).
[45] CA 2006, s.172
[46] CAMA 2004, s.279

creditors.[47] The courts have also been faced with the controversy of whether the interest of the company should be interpreted to incorporate the interest of creditors. This question tended to be answered in the affirmative, as it has been held that the interest of the company can include the interests of a company's creditors in certain circumstances and this gives credence to the fact that directors owe some indirect duties to a company's creditors.[48] Indubitably, whilst such duties are not imposed when the company is a going concern and solvent, it is automatically altered in favour of the creditors as soon as the company becomes insolvent or is approaching insolvency.

Further to the above, there are a number of cases in the UK which support the view that directors owe some duty to the creditors. This can be found, for example, in *Winkworth v. Edward Baron Development Co Ltd*[49] where the House of Lords approved that the directors owe some duties to its creditors both present and future. Explaining the views of the court, Lord Templeman asserted as follows:

> A company owes a duty to its creditors, present and future. The company is not bound to pay off every debt as soon as it is incurred and the company is not obliged to avoid all ventures which involve an element of risk, but the company owes a duty to its creditors to keep its property inviolate and available for the repayment of its debts... A duty is owed by the directors to the company and to the creditors of the company to ensure that the property is not dissipated or exploited for the benefit of directors themselves to the prejudice of the creditors.[50]

From the above, it can safely be said that the courts have countenanced the view that directors owe a duty to the company and to the creditors.

The fact that directors owe some duty to the creditors was driven home more forcefully in *West Mercia Safetywear Ltd v. Dodd*[51] where the Court of Appeal, citing with approval the decision of the New South Wales Court of Appeal in *Kinsela v. Russel Kinsela Pty Ltd*[52] held that shareholders cannot absolve directors

[47] See Insolvency Act 1986, s.214.
[48] See *Dawson International plc v Coats Paton Plc* [1989] BCLC 233. The courts seem more guarded and uncertain as to whether directors owe duties to shareholders.
[49] [1986] [1987] 1 WLR 1512; 1 All ER 114
[50] Ibid, at 1516; 118
[51] [1988] BCLC 250
[52] (1986) 10 ACLR 395

from a breach of duty to creditors so as to bar the liquidators claim. In coming to this conclusion, Dillon LJ who gave a different view in *Lonrho Ltd v. Shell Petroleum*[53] quoted the statement of Street CJ as follows:

> In a solvent company the proprietary interests of the shareholders entitle them as a general body to be regarded as the company when questions of the duty of directors arise...But where a company is insolvent the interests of the creditors intrude. They become prospectively entitled, through the mechanism of liquidation, to displace the powers of shareholders and directors to deal with the company's assets. It is in a practical sense their assets and not the shareholders' assets, through the medium of the company, are under the management of the directors pending liquidation, return to solvency, or the imposition of some alternative administration.

The implication of the cases discussed above is that directors owe an indirect duty to the creditors which is dependent on the occurrence of a particular or series of events in respect of the financial health of the company. Consequently, as soon as the company moves into insolvency or some form of triggering effect of financial or economic distress, the human equivalent of the company for purposes of director's duties becomes the creditors as whole, namely its general creditors. The corollary in the circumstance would therefore be that so long as the director's act in the interests of the general creditors and not with a section of it, it is within its bounds of duty and no breach of duty can be said to have occurred.[54] This, it is submitted, has to be done through the medium of the company and not to individual creditors directly.[55] The underlying reason for this position is that it will eliminate problems of double recovery, allow for equal treatment of creditors in order to preserve the firmly entrenched principle of insolvency law (i.e. the *pari pasu* principle)[56] and preserves the company's monopoly of liquidation proceedings.[57] It has to be pointed out that a key limitation exists with respect to this duty owed by the directors to the creditors.

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[53] [1980] 1 *WLR* 627

[54] See R.M. Goode, *Principles of Corporate Insolvency Law Student Edition*, Sweet & Maxwell, London, 2005; See also J. Armour & H Bennett (ed.,), *Vulnerable Transactions in Corporate Insolvency*, Hart Publishing, Oxford, Chapter 1.

[55] See *Yukong Lines of Korea v. Rendsburg Investments Corp. (No 2)* [1998] 4 All ER 82 where it was restated that the duty owed by the directors is a duty owed to the creditors as a whole, not to individual creditors.

[56] See *Re Gray's Inn Construction Ltd* [1980] 1 *WLR* 711, at 718: the policy of the law is to preserve so far as is practicable rateable payments of the unsecured creditors' claims. *Pari pasu* principle presupposes that all creditors should be treated equally to avoid a situation where one creditor will have an upper hand against the others.

[57] D.Prentice, 'Effect of Insolvency on Pre-liquidation Transactions' in B. Pettet (ed.,) *Company in Change*, Stevens & Sons, London, 1987, 39

The limitation is to the extent that a creditor does not have the standing to litigate on behalf of the company.[58] As pointed out by Cheffins,[59] it is only when the company is in liquidation that the situation changes allowing the liquidator to exercise his powers by proceeding against the responsible officials in court to recover damages for distribution to the creditors as part of the liquidation proceeds. This situation, which allows only the liquidator to maintain such action, can be remedied if creditors are allowed to make a claim as a class and not as individuals.

In Nigeria, and except for the traditional cases dealing with directors duties generally, there is no reported authority in relation to director's duties to creditors as found in the UK case. Indeed, that approach has not been taken at all in Nigeria yet. The courts are still adhering strictly to the old common law principle of director's duties. This may be attributable to the low level of knowledge about creditors' rights in other jurisdictions and the fact that commercial litigation is still evolving. Nevertheless, the cases discussed above are of high persuasive value to Nigeria in the absence of local case law on the subject.

It is clear from the discussion above that courts in the UK are beginning to widen the scope of director's duties to consider creditors' interests and are willing to lift the corporate veil in order to hold that directors who fail to protect creditors during or near insolvency of the company have breached their duty, and hence are liable for their actions. This does not connote that courts have discountenanced the age-long principle of corporate personality enunciated in *Salomon v Salomon*[60] on account of the exception allowed in the cases.

5.4 Disclosure Mechanisms

Corporate disclosure of relevant and reliable information is critical for the effective operation of corporate personality and protection of creditors. As a regulatory device in company law, its importance has also been widely recognised.[61]However, in the UK and more particularly in Nigeria, disclosure requirements for private companies

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[58] G. Phillips, *Personal Remedies for Corporate Injuries*, Carswell, Scarborough, Ontario, 1992, at 173-7 wherein *Lawrence v. West Somerset Mineral Rwy*. [1918] 2 Ch. 250 (Ch. D) was cited as authority for the position.

[59]See B.R. Cheffins, *Company Law Theory, Structure and Operation*, Clarendon Press, Oxford, 1997, at 539.

[60] [1897] A.C. 22

[61] C.Villiers, Corporate Reporting and Company Law, Cambridge Studies in Corporate Law (No 5), June 2006.

are remarkably low. This is significant because private companies constitute about eighty percent of all registered companies in the UK.[62] Instead, most of the disclosure processes have been centred on public companies. The reason may be explained by the low capital structure of private companies and the issue of equity participation which is built around a small number of people as opposed to the large number of people engaged in public companies. Notwithstanding this, disclosure is important both for private and public companies because both types of companies are engaged in business with third parties who rely on information gathered through this process to make decisions in their transactions with them.

A clear example that disclosure is important for companies of all types was demonstrated in the landmark case of *Salomon v. Salomon*.[63] In that case, both the Court of Appeal and the House of Lords agreed that the existence of a publicly available register of debentures containing information about the first priority debenture held by Mr Salomon was an important consideration. Following this consideration, the House of Lords was of the firm view that the public availability of this information allowed trade to incorporate the fact of the existence of the debenture into their decision as to whether or not to do business with the company and enter into the terms of the trade. This position has been statutorily recognised in the Companies Act 2006. Thus, under section 743 of the Act, the public is allowed to inspect the register of debentures kept by a company.[64] On the other hand, section 876 of the 2006 Act requires that companies maintain a register of charges which is available for inspection to any person on the payment of a nominal fee.[65] If a company does not comply with disclosure in the UK, it is clear from legislation that it can be struck off.[66]

Disclosure essentially concerns issues of transparency in the activities for which companies are accountable, namely, the results of their activities.[67] As pointed out by Kershaw, the primary function of corporate disclosure is to facilitate a third party's assessment of the risks associated with entering into a transaction with the company

[62] P.L. Davies & S. Worthington, n. 3 at 16
[63] [1897] A.C. 22
[64] See CA 2006, s.743
[65] See CA ss.744 and 877. Members and existing creditors have access to the register without charge.
[66] CA 2006, s.1000
[67] C. Leuz & R.E Verreclia, 'The Economic Consequences of Increased Disclosure', (2000), *The Journal of Accounting Research*, Vol. 38, 91-124.

and his determination of the terms upon which he would be willing to enter into the transaction. Companies provide disclosure through regulated financial reports, including their annual audited financial statements, directors, management discussion and analysis and other regulated fillings.[68]

In the UK, mandatory disclosure is a significant requirement for all companies regardless of whether they are public or private, large or small. However, it is evident that the level of disclosure obligations for listed companies are more onerous than those of private companies or public companies that are not listed as can be seen in the variation of financial and narrative reporting obligations, which are dependent on company type. Nonetheless, all companies in the UK regardless of size are required by the 2006 Act to keep and maintain accounting records.[69] Failure to comply with these obligations is a criminal offence.[70] In addition, all companies are required to produce a narrative report, namely, a directors report which serves to provide narrative information about the development of the company's business and its performance for the prior financial year. The extent and scope of such report varies depending on type and size of the company. The directors' report must contain the names of the directors of the company and the company's principle business activities.[71]

Furthermore, the disclosure obligation also requires that all private companies must file its accounts and reports with the Companies Registrar within nine months from the accounts reference date i.e. the financial year.[72] For public companies, it is within six months of the account reference date.[73] It has to be noted that a benefit of qualifying as a small or medium –sized company is that such a company only need to file a balance sheet account to the Company House and do not need to file a profit and loss account unless they elect to do so.[74]

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[68] P.M Healy & K.G Palepu, 'Information asymmetry, Corporate Disclosure and the Capital Markets: A Review of the Empirical Literature', (2001), *Journal of Accounting and Economics*, 31, 405-440.
[69] The length of such accounting records that must be kept vary depending on company type. Three years is required for a private company and six years for a public company respectively. See section CA 2006, s.388
[70] See CA 2006 ss.387 & 389
[71] See CA 2006, s.415 (1); See also Davies, n.3, at 735.
[72] See CA 2006, S.441. See also CA 2006, s.451 which provides for an offence for failure to comply with the Act's filing requirements.
[73] See CA 2006, s.442. Failure to file in accordance with the Act's provisions is a criminal offence.
[74] See CA 2006, s.445(3)

In all situations, the account submitted must provide a true and fair view of the company's financial position.[75] What constitutes a 'true and fair view' was not defined by the Act. However, both legal commentaries and case law suggest that compliance with relevant accounting standard or principles is a prima facie evidence of compliance.[76]

In Nigeria, the Companies and Allied Matters Act 2004 similarly to the provisions of the Companies Act highlighted, provides that every company must maintain accounting records which must be sufficient to show and explain the transactions of the company.[77] Such accounting records in cases of business involving dealing in goods, must show a statement of stocks held by the company.[78] In addition, directors are required to prepare financial statements reflecting a true and fair view of the company for the financial year, the balance sheet, and a profit and loss account which must be laid before the company in a general meeting and delivered to the commission. Curiously, the financial statement required of a private company excludes a statement of the source and application of funds.[79] Section 340 of CAMA dealt with disclosure of loans in favour of directors and connected persons as defined in section 286(8) of CAMA. The connected person includes the director's spouse, child or step-child, including any illegitimate child.[80] There is also a provision in section 277 of CAMA on disclosure relating to director's interest in contracts, or other officers. Sub-section 277(4) provides that any director who fails to comply with the provisions of this section shall be guilty of an offence and liable to a fine of N100.[81]

From the above provisions of CAMA, it is clear that little or nothing was provided for disclosure by private companies, yet they constitute almost ninety-eight percent of the total number of companies in Nigeria. It is also doubtful if any private company has ever delivered its financial statement to the Corporate Affairs

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[75] See CA 2006, S.393.
[76] *Bairstow v. Queens Moat House Plc*, (unreported) where Nelson J. quoted M. Moore QC's opinion: 'The true and Fair View Requirement Revisited' (21 April 2008), para. 15. See also D. Kershaw, *Company Law in Context Text and Materials*, Oxford University Press, 2009, 459-462.
[77] See CAMA, s.331 (1)
[78] CAMA, s.331(4)
[79] CAMA, s.334 (3) (2) (a)
[80] CAMA,s.286 (8) (a)
[81] Note that N100 is not up to £1 in equivalence.

Commission. Even when it has been done, the document, in the absence of income and expenditure excluded in the Act, is virtually meaningless.

In comparative terms, therefore, disclosure mechanisms in the UK appear to be stronger than that of Nigeria with regard to the provisions of the law and policies put in place to ensure compliance and eventual sanctions.

5.5 Creditors Rights in Insolvency

The protection provided to creditors in case law is strengthened further by legislation in the UK, in particular as shown in the Insolvency Act 1986. Compared to the UK, Nigeria has no general elaborate insolvency regime aimed at protecting creditors or dealing with erring directors. It is still relying on some provisions of the Companies and Allied Matters Act (CAMA) which is now rather obsolete and has failed to in many respects to curb the activities of directors who continue trading to the detriment of creditors, even when they knew that their companies' financial capacity cannot sustain such endeavour. CAMA, in its present state only deals with issues arising from the direct holding system of company securities, winding-up and arrangement and compromise respectively[82] while falling short of new areas of insolvency practices found in the UK such as wrongful trading. The result is that the UK and Nigeria follow different paths in protecting creditors and finding liability against directors during insolvency. While the UK has made significant improvement in this area of the law, Nigeria's corporate insolvency is still in its infancy.

The inadequacies of the Nigerian law on Insolvency matters can easily be seen when consideration is made in relation to the definition of insolvency in CAMA. Section 650 of CAMA defines corporate insolvency in the following terms:

> 'insolvent person' where used in this Decree means any person in Nigeria who, in respect of any judgment, decree or court order against him, is unable to satisfy execution or other process issued thereon in favour of a creditor, and the execution or other process remains unsatisfied for not less than six weeks.

This definition requires the grant of court order as the only means to establish insolvency. This, it is submitted, is not legally correct or appropriate in real terms.

[82] See Part XIV, XV and XVI of CAMA, 2004.

For purposes of clarity, corporate insolvency can also occur if the company is unable to meet its commercial commitments or debts[83] and in particular, financial and other transactions arising from trade with third parties or secured lending. The test employed in most cases to determine the insolvency of a company is that of the balance sheet of the company.[84] Where such balance sheet signifies more liabilities in excess of the company's assets, insolvency is said to have resulted.[85] The term liability is all encompassing and far broader than debt. It includes all forms of liability, whether liquidated or unliquidated and whether arising in contract or in tort or by restitution or for damages for breach of statutory duty.[86] It therefore follows, that the definition of corporate insolvency in CAMA is not only inadequate but inefficient. The creditors' main concern after giving a loan or supplying goods and services to the company is whether they will be paid on time.[87] Once payment is due and the company is unable to pay as agreed, insolvency could be said to have resulted. The implication therefore is that once insolvency encroaches, the director (in technical terms) is now using the creditor's money which could have been used to pay off its debt to trade. The common law has now imposed a duty on the directors to consider the interests of creditors when the company is insolvent.

It is therefore submitted that the wrongful trading provision will serve to enhance and strengthen creditors' interest in Nigeria if it is incorporated into the Nigerian laws. Choosing section 214 as a model for import into corporate business in Nigeria, as the arguments above have shown, will be the most efficient way both to implement stricter rules on civil liability of company directors for continuing to trade contrary to the interests of creditors, as well as to impose such liability at an earlier point in time, which can be assessed more accurately. Further, it would reduce the burden of the liquidator since there would be an alternative procedure against a director, instead of relying on section 506 of CAMA, which has proved to be cumbersome. In doing so, however, efforts should be made to exercise due care by ensuring that some of the identified problems of the section, such as the basis of any liability, persons potentially liable under the section, persons entitled to bring

[83] The Oxford English Dictionary defines 'solvent' as 'able' to pay all one's debts or liabilities' and conversely 'insolvent' as 'unable' to pay one's debt or discharge one's liabilities.
[84] R. Goode, n. 54 at 4-24.
[85] Ibid.
[86] Ibid.
[87] See R.P. Austin and I.M Ramsay, *Fords Principles of Corporation Law*, 14th ed., Lexis Nexis Butterworth, NSW, 2010, 20, 60.

proceedings, defences to be relied upon by the director and the standard upon which directors' conduct is judged, issue of funding and enforcement are clearly clarified and streamlined. Indeed, section 214, being one of the key findings in this study, provides a strong foundation and basis for future reforms of Nigerian laws, especially in the area of creditor protection.

As with the imposition of contribution on directors pursuant to section 214 of the Companies Act, directors who fail to protect the interest of creditors face the risk of other sanctions in the UK. Thus under the Directors Disqualification Act 1986 (CDDA) directors found to be unfit by the courts or whose conduct is inimical to the interest of the creditors pursuant to the wrongful trading provisions may be liable to disqualification orders. The effectiveness of this measure is still not clear as many unfit directors still superintend the affairs of companies.[88] For as Davies pointed out, the disqualification provisions of the successive Companies Act seemed to make little impact.[89] He further argued that notwithstanding the importance of the disqualification provisions for dealing with corporate wrongdoings of different nature, especially as it concerns directors, its consequences in practice were limited.[90]

Similarly in Nigeria, it is uncertain whether directors' disqualification is an effective remedy for creditors. Although, there is no separate legislation like the Company Directors Disqualification Act,[91] section 257 of CAMA contains provisions dealing with disqualification of directors. Section 257 states as follows:-

> (1) The following persons shall be disqualified from being directors-
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> (a) an infant, that is , a person under the age of 18years;
>
> (b) a lunatic or person of unsound mind;
>
> (c) a person disqualified under sections 253, 254 and 258 of this Act;
>
> (d) a corporation other than its representative appointed to the board for a given term.

[88] See B.R. Cheffins, n.59, at 550.
[89] See Davies & Worthington, n.3 at 254
[90] Ibid.
[91] See J.O. Orojo, n.19 at 322

There is also disqualification of a director in section 258 in relation to such director becoming bankrupt or ceasing to be a director by virtue of share qualification as provided in section 251.

Whilst most of these provisions are general in nature, and do not really touch on issues relating to creditors protection or substantive questions on the conduct of directors while performing their duties, only the disqualification imposed in section 254 appears to be relevant. That section pertains to conviction by the High Court of a person occupying the position of a director pursuant to section 506 of CAMA on fraudulent trading. Thus if in the course of winding up of a company it appears that a person has been found guilty of any offence for which he is liable, whether he has been convicted or not under section 506 of the Act or has otherwise been found guilty while an officer of the company, or whether he has committed fraud in relation to the company or is in any breach of his duty to the company, the court shall make an order disqualifying that person for a period not exceeding 10 years from holding the position of director in any way, whether directly or indirectly.[92] The specified offences are in connection with the promotion, formation or management of a company. A breach of an order made under this section is an offence which may attract on conviction, a fine of N500 or imprisonment for a term of not less than six months or more than two years, or both.[93]

It can be argued that the disqualification provisions under CAMA are not punitive, but rather they are intended to protect the public and to prevent the corporate structure from being used to the financial detriment of investors, shareholders, creditors and persons dealing with the companies. However, the effectiveness of these provisions remains to be seen in view of the problem of proof associated with the criminal intent of fraud. Apart from that, Nigeria does not have any specific legislation like the CDDA in the UK dealing with the disqualification of directors. Consequently, the manner and procedure involved in deciding problems arising thereon would therefore emanate from case law, which is lacking, and probably from

[92] See CAMA, s.254 (1) (a) & (b) (i) & (ii).
[93] CAMA, S.254 (6). Note that N500 which is the fine imposed under this sub-section is the equivalent of £2 in UK currency.

the articles of association of individual companies that are different from one another.[94]

The finding from this discussion is that the CDDA appears to be a more useful and effective tool in minimising the abuse of directors of limited liability companies than the provision in CAMA which lacks clarity both in definition and procedure. If anything, the deterrent effect of CDDA makes it imperative that directors should exercise caution when dealing with company affairs. This is obviously an area of law that calls for reflection and reforms in Nigeria.

Having considered aspects of the legislation in the two jurisdictions, discussion now focusses on the approaches of the courts in the UK and Nigeria.

5.6 Common Situations for Lifting the Corporate Veil

Veil-piercing jurisprudence in the UK and in Nigeria is largely based on facts and circumstances and tends to defy neat categorisations.[95] However, generalisations may be useful to give an insight on the operation of the doctrine in these jurisdictions. A number of factual situations illustrate the problem of lifting the corporate veil in the UK. These include where the company is formed or used to avoid contractual obligation to third parties or is a sham or used as a device to perpetuate fraud.[96] The corporate veil can also be lifted where an agency situation arises. Other conduct of a misleading nature that creates an injustice could also trigger veil piercing.[97]

The veil-piercing test in Nigerian law is phrased similarly to that in the UK and at first glance appears nearly identical. Under the Nigerian law, the corporate veil will be pierced if it is necessary to achieve justice.[98] However, the courts in Nigeria, as those of the UK, also exhibit reluctance to disregard the corporate form. English courts in particular have remained distinctively conservative in their approach and in most cases have tended to preserve the corporate veil. Nonetheless, the concept of

[94] Unlike in the UK, Nigeria's Companies and Allied Matters Act 2004 (hereafter CAMA) does not contain any provisions articulating the criteria or grounds upon which a director may be disqualified. This creates a lot of confusion and problems which may make it difficult to find erring directors liable.
[95] F.B Palmer & G.Morse, *Palmer's Company law*, Sweet & Maxwell, London, 2007. 33
[96] See *Jones v Lipman* [1962] 1 WLR 832
[97] See *Creasey v Breachwood Motors Ltd* [1993] B.C.L.C. 480
[98] See *FDB Financial Services Ltd v Adesola* [2000] 8 NWLR 170; *Edokpolo v Sem-Edo WireIndustries* (1984) 15 NSCC 533; *First African Trust Bank v Ezegbu* (1990) 2 NWLR (Pt 130) 1

corporate personality will be sustained only so long as it is invoked and employed for legitimate purposes. The courts in the UK and Nigeria will not sanction a perversion of the concept to improper uses and dishonest ends.

Whilst the starting point for discussion on corporate personality is obviously the case of *Salomon v Salomon*, any analysis of the veil piercing approaches in the UK and Nigeria must begin with an examination of fraud which has been recognised by the two jurisdictions as key justification for the disregard of the corporate form.

5.6.1 Fraud

Fraud is relevant to both the UK and Nigeria in their veil piercing approaches. The importance of fraud as basis for piercing the corporate veil is underscored by the fact that most of the decisions examined make direct or indirect reference to fraud. Indeed, fraud is the only predictive category within the English corporate veil cases as is in most of the commonwealth. In most cases, the courts have used the terms 'device', 'facade', 'sham',[99] 'mask', 'cloak', or 'simulacrum',[100] to describe the abuse of the corporate form through fraudulent practices. These common law usages have been described by Farrar as question begging, as a category of illusory or as circular reference.[101]

As a piercing factor, fraud has been left generally undefined and unrestricted by the courts; nevertheless, a few generalisations have been made. Apart from the evasion of contractual obligations, most of the English cases that fall within the fraud category have generally involved misappropriation of corporate assets or other outright fraudulent conduct.[102] The courts have also expanded on a few occasions the scope of fraud to encompass misrepresentation. This is evident in the case of *Re Darby, ex p Brougham*[103] involving two notorious fraudsters in the UK at the time called Darby and Gyde, who had set up an elaborate scheme to defraud public

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[99] See for example *Re H* (Restraint order: realisable property) [1996] 2 BCLC 500.
[100] See Davies & Worthinghton, n.3 above. See also J.H Farrar & B.M. Hannigan, *Farrar's Company Law*, Butterworths, London, 1998, 72.
[101] Farrar, n.100 above.
[102] See *Gencor ACP v. Glenn Bryan Dalby*, [2000] 2 BCLC 734 (Ch D). Here the conduct involved dishonest misapplication of corporate funds and diversion of business opportunities away from the company either to themselves or to companies controlled by them. In *Wallersteiner v. Moir* [1974] the financier acquired a company through circular check transactions thereby defrauding the company's other shareholders and creditors in the process. There was also the case of misappropriation of corporate funds by one of the officers in *Trustor AB v. Smallbone* [2001] 1 W.L.R 1177.
[103] [1911] 1 KB 95 (KBD).

investors through concealment of their identity. Indubitably, the two classic examples of the fraud exception in the UK are *Gilford Motor Company Ltd v. Horne*[104] and *Jones v. Lipman*.[105] The facts of these two cases have been elaborated in chapter 3. What is important is that the courts in the case of *Gilford Motors* described the company set up to avoid a legal obligation as a sham and therefore refused to recognise the separate legal personality of the company whilst granting Gilford the injunction it sought against both Mr Horne and the defendant company. On the other hand, the court awarded specific performance against both Mr Lipman and the company following their attempt to deny the plaintiff their remedy.

Similarly to the UK, some of the cases of fraud in Nigeria involve evasion of contractual liability. Nigerian courts have lifted the corporate veil where such conduct is brought before it for scrutiny.[106] However, there exist differences in the systems in terms of what fraud consists of. Courts have discussed and applied the idea of fraud in the two jurisdictions in different ways because of their peculiar commercial environments. Indeed, the trend in the UK and in other developed nations differed from that of Nigeria, at least in few cases wherein in the latter private limited companies were incorporated with fraudulent intentions, such as scams which are contrary to accepted business practices. As could be seen above and in chapter three, UK courts have taken a narrow and conservative approach to questions relating to lifting the veil on grounds of fraud, limiting themselves to matters of contract whilst ignoring fraudulent conduct arising from tort. On the other hand, Nigerian courts take a broader view of fraud in terms of lifting the veil of the corporation which the UK could consider applying.

Within the Nigerian context, most of the issues constituting fraud not only concern contract but relates to matters denoting deceit, misrepresentation, commingling of company's assets and outright misappropriation of company funds.[107] This is evident in the cases of misappropriation and diversion of company funds as well as cross border transfer of corporate funds to satisfy the interest of the corporate controller.

[104] [1962] 1 W.L.R. 832, 836
[105] [1933] Ch. 935, 936 (Lord Hanworth M.R.)
[106] See the following cases: *Alade v. Alic (Nig) Ltd* [2010] 19 NWLR (Pt. 1226) 111; *FDB Financial Services Ltd v. Adesola* [2000] 8 NWLR (Pt. 668) 170; *Adeyemi v. Lan Baker (Nig) Ltd & Anor* [2000] 7 NWLR (Pt. 663) 33
[107] See *Chief Nye D. Georgewill v Madam Grace Ekene*, (1998) NWLR (Pt. 562) 454

The latter was clearly manifest in *Access Bank PLC v. Erastus Akingbola and others,*[108] where the managing director transferred huge sums of money from his company account to his solicitors in the UK to enable them buy choice properties for him. Of course, the court rose to the occasion and lifted the veil in order to find him personally liable for such misconduct. In both *Federal Republic of Nigeria v. Mohammed Sheriff & 2 others*[109] and *Federal Republic of Nigeria v. Alhaji Murnai & Another,*[110] the respondents who were at various times managers and directors of their respective banks were found personally liable for granting credit facilities and diverting their banks funds to companies which they had substantial interest in violation of relevant banking regulations.

Fraud of corporate controllers in Nigeria particularly of these private companies also involves deceptive conduct that has emerged domestically and internationally and has been carried out on a wide scale. This scheme, known as '419' scam or fraud named after section 419 of the Nigerian criminal code,[111] involves the use of the corporate form to engage in advance -fee – fraud, in which a victim is persuaded to pay money upfront for financial reward or for the supply of goods or services which never materialise from the sham company. Through cross border contact and series of correspondences with the 'corporate controllers' and their companies and false letters of credit, victims are meant to pay some money through the western union money market or special bank accounts in the mistaken belief that the business deal or transaction is legitimate. Once the money is paid, the corporate controller disappears.[112]

One of the victims of this scam, a prosperous business woman, received a letter purportedly written from her relation in London introducing her to a business partner

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[108] [2012] EWHC 2148 (Comm) 1680; See also the details of this case in chapter 4.
[109] (1998) 2 FBTLR 109
[110] (1998) 2 FBTLR 196
[111] Section 419 of the Nigerian criminal code states as follows: "Any person who by any false pretence, and with intent to defraud, obtains from any other person anything capable of being stolen, or induces any other person to deliver to any person anything capable of being stolen, is guilty of a felony, and is liable to imprisonment for three years. If the thing is of the value of one thousand naira or upwards, he is liable to imprisonment for seven years. It is immaterial that the thing is obtained or its delivery is induced through the medium of a contract induced by the false pretence..."
[112] Russel G. Smith, et al, Nigerian Advance Fee Fraud in http://Caballonm.com/ti/21.pdf, accessed 2/1/12. See also I. Oshimiri, 'Appraisal of Nigerian Advance Fee Fraud Legislation, 1995', (2002) *Journal of Financial Crime,* No 3, 287.

who will help her import some goods at a cheap rate from Italy. Relying on the strength of the letter and without confirming its contents from the said relations, she met the 'business partner' at a designated address claimed to be the company's place of business. Following discussions with the said business partner, an offer was made to her for the purchase of goods from Italy through his company at a highly discounted rate on the condition that she pays for the purchase of the goods in advance. The woman promptly complied in the mistaken belief that as soon as the goods arrive in three weeks promised, she would make huge profits from the sales. One week after, she received a letter by post containing the bill of lading and other documents that would enable her facilitate the clearing of the goods at the Lagos port. On the expected date of arrival of the goods, she went to the port with her clearing agent to clear the goods but was shocked to hear from the custom officials that all the documents given to her were forged and that no goods arrived at the port on her behalf. She fainted. After being resuscitated, she reported the matter to the police. On investigation, it was discovered the 'business partner' introduced to her was fake and could not be traced; the address purportedly used for the transaction had no company domiciled there under the name used even though the company was duly registered with that address.

In yet another incident, one Maurice Ibekwe, owner of the company called Okwelle holdings Nigeria Limited was eventually arrested by the Economic and Financial Crimes Commission[113] after several failed attempts for allegedly obtaining the sum of three hundred thousand dollars (US S 300,000) from one Munch Klause, a German national and head of Munch Systemorganisation company, following a business transaction which never materialised. [114]

[113] The Economic and Financial Crimes Commission (EFCC) is a Nigerian law enforcement agency that investigates financial crimes such as advance fee fraud (419 fraud) and money laundering. Established pursuant to the Economic and Financial Crimes Commission Establishment Act 2002, the commission was also empowered charged with the responsibility of enforcing the provisions of other laws relating to economic and financial crimes such as the Money Laundering (Prohibition) Act 2004 and the Advanced Fee Fraud and other Fraud Related Act 1995 among others. For detailed information about the EFCC see: http://www.efccnigeria.org/efcc/index.php/abo accessed 2 January 2013.

[114] See Nigerian Thisday Newspaper 30 October 2003. See also http/home.rica.net/alphae/419coal/news2003.ht, accessed 2 December, 2012.

Other examples may also suffice. In *Federal Republic of Nigeria v. Adedeji*,[115] an Ikeja High Court sitting in Lagos-Nigeria sentenced a Lagos businessman, Mr Adedeji Alumile alias Ade Bendel to six years imprisonment for obtaining the sum of $600,000.00 under false pretence from an Egyptian General in 2003. Justice Muniru Olokoba who handed down the verdict while delivering judgment in a one count charge preferred against the accused person also ordered Ade Bendel to refund the Egyptian. According to the charge preferred against him by the Economic and Financial Crimes Commission, Adedeji who claimed to be the owner of a company called Worldwide, had, alongside with one Olufemi Ajayi gone to the Egyptian's office to deceive him to part with the sum to enable them to buy chemicals that could be used to clean some paper notes.

It turned out that the company called Worldwide never existed and no chemicals were ever bought. By the time the Egyptian realised himself, the duo of Adedeji and Ajayi had run away, a situation which prompted the Egyptian to lodge a complaint to the EFCC that culminated in the charge against Akindele and the company Worldwide. Adedeji had pleaded not liable to the charge, arguing that the company Worldwide, which had dealt with the Egyptian should rather be held accountable. The court did not agree with this view as it went ahead to personally find him liable for the offence. The company Worldwide charged alongside Akindele, was therefore discharged.

In his judgment, Justice Muniru Olokoba said "the offence is an international embarrassment to the nation and the court does not have mercy with such offence. To serve as a deterrent to the present and the upcoming generation not giving the accused a full weight of the law is inappropriate..." [116]

What has emerged from the case of Ibekwe and Akindele above is that notwithstanding the fact that the accused persons used their companies (namely Okwelle Holdings Nigeria Limited and Worldwide) named as parties in the cases to defraud their victims, the court still went behind the veil of the corporation to find

[115] See LD/38/2003 (unreported). See also Nigerian Vanguard Newspaper 19 December 2007 for full report of the case.
[116] Ibid.

them personally liable for the various fraudulent acts. These are clear examples of lifting the corporate veil whilst demonstrating the distinctiveness of the nature of corporate fraud in Nigeria where corporate controllers in a bid to escape liability, set up companies for the purposes of carrying out a scam.

With a lack of effective disclosure and weak regulatory activities of the Corporate Affairs Commission, it becomes difficult to trace these fraudsters. Even where they are caught and charged to court for trial, the prevalent criminal justice system characterised by proof beyond reasonable doubt and attendant delays are too weak to support efficient and prompt delivery of justice. For instance, in Adedeji's case, which was one of the very few that conviction was secured, it took a period of four years to conclude, and this was only after many interlocutory applications and appeals. Civil claims against such corporate controllers and their sham companies suffer the same fate largely because of the ready defence that the company is different from the person who controls it. Following this scenario, the chances of resolving the dispute appear far-fetched. This ultimately results in a lack of investors' confidence in the corporate form whilst reducing foreign direct investment in Nigeria.

The shape and form of the fraud exception, in spite of its acceptability as a strong ground for lifting the corporate veil in the UK , seems to have become confused and this is demonstrated in the decision of *Creasey v Breachwood Motors Ltd*[117] where opportunity for the court to utilise the fraud exception was raised. Yet the court refused to accept it and instead went ahead to lift the corporate veil on the basis that to do so was necessary in order to achieve justice. This was without regard to the unambiguous statement of the Court of *Appeal in Adams v. Cape Industries Plc* that "...save in cases of which turn on the wording of particular statutes or contracts, the court is not free to disregard the principle of *Salomon v Salomon* merely because it considers that justice so requires."[118] It is submitted that the failure to apply the fraud exception in *Creasey* resulted from a misunderstanding of the fraud exception. The reason for the failure of the fraud exception argument in the case turned merely on the timing of the incorporation of the sham company.

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[117] [1993] B.C.L.C. 480.
[118] [1990] Ch. 433.

From the discussions above, it can be argued that questions about what constitutes fraudulent conduct and how it can be proved in the UK and Nigeria appears to be somewhat different and problematic. The same applies to when and how the company and its officers can or should be made liable for such conduct. Of course, fraud is a vague concept. Within the company law context, as elsewhere, fraud is a difficult expression to define. [119] Certainly, fraudulent conduct goes far beyond deliberate attempts to deceive and extends to many transactions which are, strictly speaking within the law but may nonetheless be condemned as sharp practices.[120] Since we have seen that the doctrine of separate legal personality when combined with limited liability offers considerable scope for fraudulent behaviour, a finding of fraud should be made once the elements are seen to exist. It should therefore be irrelevant that the company is an existing company with its own business, as long as it has been used as a tool to effect the fraud. The UK could well consider applying the expanded notion of fraud prevalent in Nigeria as the analysis has shown.

5.6.2 Contract and Tort Claims

In the UK, the general view is that the door to tort claimants appears to have been closed in view of the Court of Appeal decision in *Adams v. Cape Industries PLC*[121] denying liability for such claims.[122] In the case of Nigeria, no distinctive authority like *Adams* foreclosing tort claims exists. However, most tort victims prefer out of court settlement instead of embarking on lengthy litigation and incurring further legal cost to no end amidst the uncertainty of the outcome of such suits. This is particularly important as tort cases involving the piercing doctrine provides the victim no direct relationship with the company unlike the parties involved in contract cases. To this extent, courts treat the cases differently because the categories of persons involved are not the same. However, the fundamental difference between the two are often misunderstood and misapplied by the courts with the result that they indiscriminately cite and purport to apply, tort precedents in contract and vice versa leading to unjust results.[123] In any event, it is submitted that there is the need to

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[119] M. Whincup, ‘Inequitable Incorporation –The Abuse of a Privelege’(1981) 2 *Co law* 158, at 164
[120] Ibid.
[121] [1990] 1 Ch. 433
[122] R.B. Thompson, ‘Piercing the Corporate Veil: An Empirical Study’, 76 *Cornell L. Rev.* 1036, at 1058.
[123] R.W. Hamilton & J.R. Macey, *Cases and Materials on Corporations including Partnerships and Limited Companies*, West Publishers, 2005 at 266-267.

maintain adequate insurance to cover a foreseeable extent of damages for tort creditors particularly as the tort victim did not choose to deal with a corporation and accept the consequences of limited liability.

With respect to contract creditors, the analysis that can be drawn from chapter two in respect to the UK and Nigeria is that they deserve less sympathy from a court when asking it to pierce. After all, they chose to do business with the company whose owners have, as a rule, limited liability. Ultimately, if the contract creditor wanted to look to the owner for repayment, it could have bargained for personal guarantee. However, as we have seen above and in previous chapters, limited liability can be denied to a corporate controller if the agreement is voided on grounds of fraud. Therefore, a corporate controller is liable to pay and indemnify the contract creditor in such circumstances. Beyond that, it is submitted that in view of the manifest abuse of the corporate form by small private companies, particularly in Nigeria, shareholders of such companies should in the course of their operation, be mandatorily required to set up an endowment fund within the company from a percentage of its profit in order to satisfy default in contractual obligation, instead of the current regime where the creditors are compelled to pursue their claims through the non-existent or empty assets of some of these companies. This would certainly make shareholders more responsible and make it difficult to increase shareholders wealth at the expense of the creditors.

Further to the above, it has been suggested by Anderson that creditors can also be protected in general by forcing companies to obtain what she called 'mandatory debt insurance' for their creditors against losses.[124] However, it has to be pointed out that mandatory insurance against creditor losses by companies in general may be hard to implement. While it may be easy to set up such a scheme for professional businesses such as auditors[125] or lawyers, doing so for other types of businesses is not easy considering its significant cost. Fixing the appropriate level of insurance and ensuring that it is obtained are problematic because of the fear of the insurer that it may expose him to unnecessary losses to risk, particularly where he stands unaware.

[124] Helen Anderson, 'Directors Liability to Creditors- What are the Alternatives?,"(2006) *Bond Law Review*: Vol. 18: Issue 2, Article 1, 20.
[125] Ibid.

Finally, imposing such mandatory debt insurance may result in small traders being forced out of business,[126] stifling economic development.

This brings us back to the same position that a cheaper and perhaps more efficient way to provide security to creditors is by way of charges over company property or personal guarantees by directors.

5.7 Administration and Judicial Systems

The operation of corporate personality in Nigeria compared to the UK suffers from administrative and judicial problems. As seen above, there is an effective and efficient system of corporate regulation in the UK accompanied by appropriate sanctions. The UK Companies House maintains a dedicated website enabling a person or persons to check the existence and details of any company and to report to the appropriate authority of any act of misconduct ranging from causing harm to customers or suppliers as well as breaking the law (e.g. fraud or any significant irregularity on the part of the company or corporate controller).[127] With this in place, it is easier for a person dealing with a company to obtain information about the company from the Companies House and to report any act of misconduct observed without delay.

The situation seems to be different in Nigeria. The Corporate Affairs Commission (CAC) set up under section 1 of CAMA to administer the Act, including the regulation and supervision of the formation, incorporation, registration, management, and winding up of companies under or pursuant to the Act, is very weak and ineffective. The only visible function carried out by the commission is the registration of companies. Issues pertaining to monitoring, supervision and compliance with the requirements of the Act are left undone. The Commission lacks the necessary staffing and technology to effectively carry out its assignment. Unlike the UK, there is no dedicated website listing the companies registered by the Commission for reference by persons wishing to deal with companies in Nigeria either as a creditor or an investor. Most of the members of the Commission are

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[126] See Ross Grantham, 'Directors' Duties and Insolvent Companies' (1991) 54 *Modern Law Review*, 576, 579. See also Frank Easterbrook and Daniel Fischel, The Economic Structure of Corporate Law, (1991) 50.

[127] This information can be sourced in http://www.gov.uk/companies-house, accessed 10 January 2013

political appointees and lack the necessary will, capacity and independence to deal with issues or problems arising from the performance of their duty. This can be explained by the fact that the Act gives the President of the Federal Republic of Nigeria the powers to appoint the chairman as well as the members of the board of the Commission.[128] Following the prevailing practice in Nigeria, such appointments are done more for political patronage and not on merit. The result is that such appointees see their appointments as a measure of deriving benefit from the system and protecting their members, most of whom are company owners and part of the fraudulent abuses complained of.

Again, the Commission runs a centralised administration in terms of policy directive and execution even when it has offices in the thirty six states of the Federation. Having a high level of bureaucracy, coupled with manual operation through numerous files, a simple enquiry either for registration of a company or issues relating to an existing company takes weeks and months before an outcome will emerge.[129]

Finally, there is no doubt that the existence of an efficient judicial system is an essential requirement to the success of any corporate regime. Unfortunately, in Nigeria this has not been the case. Under section 251 of the Constitution of the Federal Republic of Nigeria 1999, only the Federal High Court is vested with the jurisdiction to handle issues relating to Company matters. Such cases may proceed from this court to the Court of Appeal and then to the Supreme Court. From findings,[130] the court has not done well in dealing with cases that come before it.

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[128] See CAMA 2004, S.2 (a).

[129] As a solicitor in Nigeria, I undertook the preparation of filing and registration of companies for my clients. The experience is very frustrating. To check availability alone, the commission will ask you to come back in three weeks time to get the result. Other filing processes take far longer time to be completed. On the whole, the minimum period to register a company is three months and that would be if the system is functioning properly.

[130] See K.C. Uzoechi, ‘Civil Justice System and the Application of Alternative Dispute Resolution Mechanisms: A Case Study of Nigeria and England and Wales’, An unpublished LL.M dissertation submitted to the University of London (Queen Mary and Westfield College) June 2010. I attended various sessions at the offices of the Registrars of Federal High Courts and Court of Appeal in Lagos, Abuja and Owerri to inspect court records and quarterly and annual returns of cases sent to the Chief Justice of Nigeria in respect of cases filed and disposed. It was found on the average in respect of the Federal High Court that a total of 14,000 cases are filed annually and the rate of disposal remains less than 50%. For the Court of Appeal, about 1601 cases were filed with disposal rate less than 10%. In both the Federal High Court and the Court of Appeal, it was found on the average that three motions were filed in each case and the records in the courts indicate that some of the motions take about three years to be determined in view of several adjournments.

There have been delays arising from the congestion of cases, while most judges still write in long hand and the institutionalised corruption[131] in the system has not allowed judges to decide cases purely on the merit. This has resulted in cases lasting for many years in court with many frivolous applications and acquittals which are difficult to comprehend. In *Ariori v. Elemo*[132] for instance, proceedings commenced in 1960 and took 23 years to reach the Supreme Court. The need to overhaul the machinery of justice in Nigeria to deal with these issues is therefore imperative.

In *Federal Republic of Nigeria v. Dr (Mrs) Cecilia Ibru*,[133] the accused person who was a former Managing director of Oceanic bank of Nigeria owned by the Ibru family, was arraigned in court by the EFCC for manipulation of credit facilities and for using a company, Waves Project Nigeria Limited owned initially by her children and later transferred to her domestic aide to launder N15 billion which was taken out off the bank coffers and taken abroad. Following a plea bargaining arrangement entered with the EFCC and accepted by the court, she was given a lenient sentence of 18 months in prison on a three-count charge which will run concurrently, making the effective time she will spend in prison to six months. The presiding judge, Dan Abutu, J., further ordered that she be returned to the hospital from where she was coming to court. The consequence of the order of the court was that she ended up serving no sentence as she remained in the hospital throughout the six months period.

Ibru’s case no doubt exposes the weakness of Nigerian Judiciary. Nonetheless, her conviction and subsequent loss of assets following the plea bargain she entered with EFCC confirmed the fact that the courts in Nigeria can lift the corporate veil to find the corporate controller liable even when, on the facts, the fraudulent misconduct was committed in the performance of official duty and deemed to be the ostensible act of the company.

Another case illustrating the pervasive corruption and weakness in the Nigerian judicial system is *Federal Republic of Nigeria v. James Onanefe Ibori and*

[131] A.A. Adekoya, Corporate Governance Reforms in Nigeria: Challenges and Suggested Solutions, (2011) *Journal of Business Systems and Ethics*, Vol. 6, No 1., 42

[132] (1983) 1 SCNLR 1

[133] See FHC/L/CS/297C/2009 (Unreported). Plea bargaining is the process whereby a criminal defendant and prosecutor reach a mutually satisfactory disposition of a criminal case, subject to court approval. On this see; http://legal-dictionary.the free dictionary.com/pl. It is however important to note that plea bargaining is unknown to Nigeria law, yet the judge relied on it to determine the case.

others.[134]Here, the first accused a former governor of Delta State of Nigeria and five others, three of whom are limited liability companies namely Mer Engineering Nigeria Limited, Bainenox Nigeria Limited and Sagicon Nigeria Limited were discharged and acquitted on the grounds that the prosecution failed to make out a prima facie case against any of the accused persons in respect of all the 170-count charge of corruption preferred against them by the Economic and Financial Crimes Commission (EFCC). Justice Marcel Awokulehim who delivered the ruling did not even allow the case to proceed to trial in spite of the enormity of the charges against the accused persons and his companies as well as the public outcry over the colossal sum of money involved. With respect to the first accused (Ibori) in particular, he was charged with allegedly transferring various sums to a company, Silhouttte Travels Limited in which he had substantial interest. These sums formed part of funds allegedly withdrawn from the account of oil-rich Delta State Government of Nigeria and which were derived from an illegal act with the aim of concealing the origin of the money and thereby committed an offence punishable under section 14(3) of the Money Laundering (Prohibition) Act 2004.

Unfortunately for Ibori, it did not take long for him to be caught. Following collaborative efforts of the EFCC and the British government, he was arrested in Dubai, where he had fled after his acquittal to avoid re-arraignment for fresh charges by EFCC and brought to London to face trial on money laundering charges in the UK on similar facts. Thus in *Queen v.James Onanefe Ibori & ors*[135] Ibori pleaded guilty to the ten offences relating to conspiracy to launder funds from the state, substantive counts of money laundering and one count of money transfer by deception and fraud and was sentenced to 13 years in prison by the Southwark Crown Court.[136] He was also asked to forfeit properties in the UK which were bought from the proceeds of the laundered funds. According to Pitts, J. of the Southwark Crown Court, "the confiscation proceedings may shed light on the

[134] FHC/ASB/1C/09 (Unreported)
[135] Case No. T20117192 (Unreported)
[136] See 'former Nigeria State governor James Ibori receives 13-year sentence' in http:/www.guardian.co.uk/global-development, accessed 20 May 2012; See also 'Ibori bags 13 years jail term in UK, in http://www.thisdaylive.com/articles/ibori-bags-jail-term-in uk-/113990/ accessed 25 May 2012.

enormity of the sums involved." [137]According to the metropolitan police, the amount involved is about $250m (£157m) of Nigerian public funds.[138]

The sentence of Ibori in London on corruption charges puts a question mark on the corruptibility of Nigeria's legal personnel and its justice system as well as the attitude of its government in comparison to that of the UK. As pointed out by Andrew Mitchell:

> James Ibori's sentence sends a strong and important message to those who seek to use Britain as a refuge for their crimes. Corruption is a cancer in developing countries and the [UK] coalition government has a zero tolerance approach to it. We are committed to rooting out corruption wherever it is undermining development and will help its perpetrators like Ibori to justice and return stolen funds to help the world's poorest.[139]

The above demonstrates that the courts in the UK are more efficient and speedier than Nigerian courts. This position is further epitomised in *Akingbola's* case [140] cited in chapter four. But what is relevant to this study is the fact that even though Ibori transacted through agents and companies under his control some of which were joined as parties in this case, the court in the UK did not hesitate to impose personal liability against him. This the Nigerian court failed to do in spite of the fact the case lasted longer there than the one heard in the UK.

Moreover, while the UK courts have put in place alternative dispute resolution (ADR) [141] mechanisms as a means of resolving civil and commercial disputes without resorting to lengthy litigations, the civil procedure rules in Nigeria follow the old method which encourages adjudication thereby wasting time and money.

5.8 Conclusion

The chapter has revealed significant commonalities and differences in terms of lifting the corporate veil in the UK and in Nigeria. In relation to common grounds,

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[137] Ibid.
[138] Ibid. The Ibori's case in London was fully reported in the two sources cited above.
[139] Mark Tran, 'Former Nigeria State governor James Ibori receives 13-year sentence, in The Guardian.com, http://www.theguardian.com/global-development/2012/apr/17/nigeria-governor-james-ibori-sentenced, accessed on 26 May, 2012.
[140] [2012] EWHC 2148 (Comm.) 1680.
[141] See Civil Procedure Rules (CPR r.1.1(2). See also Access to Justice Final Report by Lord Woolf; P. Adler,et al., 'The Ideologies of Mediation: The Movement's own Story' (1988) 19 (4) *Law and Policy*, 317; H.Glenn, *Mediation in Action: Resolving Court Disputes Without Trial*, Louste Gulbenkian Foundation, London, 1999, 20.

fraudulent, illegal or improper conduct are important factors. For the fraud exception to apply, it must be shown that the corporate form is being used in such a way as to deny the plaintiff some pre-existing right. However, there still exist some measures of differences on what constitute fraud, and the way and manner that courts in the UK and Nigeria deal with corporate fraud. Courts in Nigeria appear to be broader and expansive in dealing with issues of fraud than the UK as it considers cases arising from fraudulent companies operating to defraud creditors through scam related activities, deception and misappropriation of company funds by corporate controllers. The UK may well consider expanding the scope of what constitutes fraud exception in its jurisdiction to include some of these issues.

From the findings of the study, it would appear that the UK has some significant measure of improvement and greater dynamism than Nigeria in the area of creditor protection and disqualification of directors. Through case law and legislations, it has now become clear that directors' duties have been expanded to include those to the creditors of companies, particularly when the company is insolvent or approaching insolvency. The wrongful trading provision in the Insolvency Act is a pointer to this development. It appears that the dynamic approach of English law in this regard allows for a more fact-specific assessment of the situation, and may result in the imposition of civil liability on company directors at an earlier point in time. Nigeria does not have any separate insolvency legislation different from the Companies Act, as found in the UK. However, it has a provision in the Companies and Allied Matters Act dealing with something akin to the fraudulent trading provision in the UK Insolvency Act as was discussed in chapter four. However, there has been no case reported on that referring or utilising the section to date. The implication is that while the UK has moved a step higher in its pursuit of creditor's protection through the wrongful trading provision, Nigeria seems to be lagging behind.

Should Nigeria seek to improve its laws with a view to strengthening creditors' protection and directors liability, as this work would suggest, the wrongful trading provision obviously may constitute a good model for import. The wrongful trading provision when added to the UK strategies to disqualify or impose civil liability upon unfit directors moderates the risks creditors face when the company experiences financial difficulty.

Disclosure mechanisms for private companies in both the UK and Nigeria appear weak. However, the existing regulatory and judicial enforcement schemes in the UK are more effective than those found in Nigeria. It is therefore important that Nigeria takes urgent action in these areas in order to ensure effectiveness and efficiency in the operation of the corporate personality principle in its jurisdiction.

On the whole, the benefits attached to corporate form should be matched with commensurate personal liability on those who manage and run the company to the detriment of creditors' particularly in cases of fraud and mismanagement of the company. This calls for reform in this area of the law.

Although Nigeria has a lot to learn from the UK in terms of improvement of its laws, there is still a lot to be done. The next chapter will discuss further recommendations on how to deal with the issues of corporate fraud and abuses by corporate controllers. Of immense concern in this regard is the need to apply equitable measures to trace and disgorge the assets of fraudulent corporate controllers and thereby satisfy the claims of creditors. This is particularly important in a developing country such as Nigeria where the assets of corporate controllers are easily placed beyond the reach of creditors.

CHAPTER 6 THE INTRODUCTION OF THE 'RESPONSIBLE CORPORATE PERSONALITY MODEL'

6.1 Introduction

The concept of the company as a separate legal person, which is a legal fiction, can only be justified to the extent that it serves social and economic aims. However, the pervasive influence of the concept of corporate personality, the effect of its application, and the way in which it reflects the intention of parliament, all point to the need for its re-examination. Veil piercing approaches so far have remained flawed. This is because they have failed adequately to protect the interest of creditors.

Although the courts have utilised various veil piercing approaches to extend liability to shareholders and directors, such approaches cannot serve as a vehicle for meaningful reform. The reason, as pointed out in Chapter 3, is because commentators and judges have stuck to the English common law methods of formulating a wide range of categories under which cases are classified for purposes of veil lifting. The categorisation approach, as was submitted in chapter 3, lacks the flexibility of concepts that would have enabled the courts to deal with matters dispassionately, based on the facts of each case without following exactly the same pattern.[1] This is also true of other proposals for imposing liability on corporate controllers. While some of these proposals have remained persuasive and influence scholarly debate, comparative analysis suggests, that the existing approaches to the problem of corporate fraud and abuses are neither adequate nor capable of confronting the complex nature of abuse of corporate form in Nigeria. A major gap still exists in the recovery of the proceeds of fraud and abuses from controlling shareholders and directors who use the corporate form for illegitimate ends.

This chapter therefore attempts to fill the gap by proposing the adoption of the responsible corporate personality model in Nigeria. Responsible corporate

[1] See M.A. Pickering, 'The Company as a Separate Legal Entity', (1968) 5 *M.L.R*, Vol. 31, 481 at 503; S.Ottolenghi, 'From Peeping Behind the Corporate Veil, to Ignoring it Completely' (1990) 53 *Mod. L.R*. 338; L. Gallagher and P. Ziegler, 'Lifting the Corporate Veil in the Pursuit of Justice' (1990) *JBL* 292; C.L. Schmitthoff, 'Salomon in the Shadow' [1976] *JBL*, 305, at 307

personality aims at forcing corporate controllers to disgorge their ill-gotten gains and the proceeds of corporate abuse and fraud, by applying the equitable doctrine of constructive trust, which Cardozo has described as "the formula through which the conscience of equity finds expression".[2] The essence of applying this model is not only to strip away the gain made by the defendant, but to put the plaintiff in the position he would have been in had the wrong not been done by denying corporate controllers the benefit of misappropriated assets through unjust enrichment. The imposed obligation does not seek to institute a new state of affairs between the parties or to facilitate a transformation of their rights. It seeks simply to restore the state of affairs that formerly existed between them.[3] This is the essence of the law of restitution which is epitomised by the equitable doctrine of constructive trust. This novel approach which departs from the conventional methods of veil piercing appears more efficient and realistic for a developing country such as Nigeria, because it offers the potential to reach the assets of corporate controllers and those transferred to third parties.

Whilst the model may not be capable of eliminating corporate fraud and abuses entirely, its effect would be to deny corporate controllers the benefits of fraud through the application of equitable measures is a massive deterrent measure to curb the malaise of fraud in corporations. The proposed model would radically change the jurisprudence of piercing law in Nigeria from the orthodox approach, which is weak and inadequate, to a more functional standard, which would waive statutory limited liability, whenever the corporate controller participated in fraud, deception, or the transfer of company assets, either to himself or to entities with which he has interest, or whenever he had misled creditors as to the assets which were available to satisfy the debts of the business.

The chapter is divided into three parts. The first part deals with the rationale for the adoption of the 'responsible corporate personality' model. The second part concerns itself with the components of the model. The third part examines its implications for tackling corporate fraud and abuses in Nigeria.

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[2] See *Beatty v. Guggenheim Exploration Co.*, 225 N.Y. 380 (1919).
[3] R.B Grantham & C.E.F Rickett, 'Disgorgement for Unjust enrichment' (2003) 62 *Cambridge L.J* 159 at 160.

6.2 Flawed Veil Piercing

Corporate fraud and abuses constitute an anathema to company law.[4] The problem affects all jurisdictions in a variety of ways.[5] However, there seem to be differing opinions on how to deal with the problem. Veil piercing, an equitable remedy used by the courts to make corporate controllers account for their actions, has been lost over time. This is because courts have reached different conclusions about whether veil-piercing affords legal and/or equitable relief. As early as the turn of the 20th Century, Wormser observed that this apparent confusion stemmed from the fact that courts, whether of law, equity or bankruptcy, do not hesitate to penetrate the veil and to look beyond the juristic entity at the actual and substantial beneficiaries.[6] Yet under the common law courts, veil piercing has been characterised by controversies, ambiguities, and even a seeming degree of randomness because claims to the court will often be futile or achieve no result due to rigidity in doctrinal standards.

To date, no uniform test has emerged on how to hold the corporate controller liable for his actions whether for perpetrating a fraud, wrong or injustice that caused wrong or injury to the claimant. In most cases, the decisions of courts on veil piercing issues are merely declaratory in nature with no consequential orders on how to deal with the substantive problem, i.e., reaching the assets of these corporate controllers and recovering the gains of the fraud and abuse from them. The courts have refused to stray very far from the traditional principles of corporate common law in analysing claims to pierce the veil of limited liability companies. There is also the question of a lack of coherence in the approaches leading to calls for the abolition of limited liability.[7]

The piercing doctrine has been obscured to the point where as one commentator has pointed out, "it is now lost in a fog." [8] This is unfortunate, considering the

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[4] *In Re Forest Dean Coal Mining Co* (1879) 315 per Jessel MR.

[5] See Roskill Report (1986) Para. 1.6 published in Criminal Law Revision Committee, Eighteenth Report, Conspiracy to Defraud (1986) Cmnd 9873; See also Roderick Munday, (1986) The Roskell Report on Fraud Trials, *The Cambridge Law Journal*, 45, 175-179.

[6] I.Maurice Wormser, 'Piercing the Veil of Corporate Entity',(1912)12 *COLUM. L. REV.* 496, 513-14.

[7] Stephen M. Bainbridge, 'Abolishing Veil Piercing', (2001) 26 *J. CORP. L.* 479, 507; See also Douglas C. Michael, 'To Know a Veil', (2001) 26 *J. Corp. L.* 41

[8] J. Matheson & R. Eby, 'The Doctrine of Piercing the Veil in an Era of Multiple Limited Liability Entities: An Opportunity to Codify the Test for Waiving Owners' Limited Liability Protection', (2000) 75. *L. REV.* 147, 150.

tremendous advancements that have taken place in business law since the unveiling of the limited liability company.

As an exception to limited liability, veil piercing has been misapplied as well as being misconceived. Depending on one's approach, veil piercing has been applied only as a means of discarding limited liability. The reason for this is not farfetched. Limited liability has been framed as loss allocation, and that path seems to have been followed by subsequent empirical studies on veil-piercing.[9] Under this scenario, the orthodox approach defines the scope of shareholder liability, based on the extent of its distributive impact on various types of creditors/claims, corporations, and shareholders.[10] This efficiency-based rationale for limited liability, which tends to govern veil piercing with primary focus on contract and tort creditors, appears to have lost sight of other fundamental aspects of private law, such as property and unjust enrichment.[11] This perception is deeply flawed when one considers the fact that veil piercing emerged as an equitable procedure to remedy the problem of unenforceable judgments. The earliest forms of shareholder liability appeared designed as incidental provisional relief available only in the absence of other reliefs.[12] Imposition of liability on a shareholder did not ultimately depend on whether an initial claim lay in contract, property, tort, or unjust enrichment against a corporation.[13] Therefore, veil piercing was not originally linked to corporate liability.

6.2.1 Scholarly Patches of Veil-Piercing

Amidst the problems identified above, various proposals, as indicated earlier, have been put forward to rehabilitate the veil piercing doctrine. These proposals have offered several different adaptations of the traditional veil piercing standards in an effort to rectify the apparent problems. A careful analysis of these proposals reveals two diametrically opposing views, namely, those offering suggestions on how to mitigate the veil doctrine problem, and those calling for its outright abolition.

For Huss, codifying the common law test as identified in chapter three might serve as a useful legislative guidance and offer better statutory interpretation to constrain

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[9] C.L. Boyd & D.A. Hoffman, 'Disputing Limited Liability' (2010) *NW. U. L. Rev*.853
[10] Ibid.
[11] See James Gordley, *Foundations of Private Law, Property, Tort, Contract, Unjust Enrichment,* Oxford University Press Inc., New York, 2006, 3
[12] Ibid., 226
[13] Peter B. Oh, 'Veil – Piercing Unbound' (2013) 93 *Boston University Law Review*, No 1, 89 at 93

the courts with a view to applying the veil doctrine in a consistent manner.[14] Though advocating for the abolition of the doctrine as being unprincipled and uncontrollable with predictability costs serving no policy goals, Bainbridge nevertheless supported the simplification of the test, by distilling the totality of existing factors into their essential ingredients.[15] However, it will be difficult to suggest that piercing serves no policy goals as suggested by Bainbridge. Piercing may at least serve as a deterrent in the minds of corporate controllers who risk exposing their assets to personal judgment.[16] As argued by Marcantel, shareholders of close corporations have greater incentive to watch each other to prevent fraud and they may also less frequently undercapitalise than they would otherwise, for fear of exposure to piercing.[17] In any event, it is here argued that the deterrent effect could only be enhanced through making application of the piercing doctrine more predictable. The present doctrine lacks this quality.

Nonetheless, John Matheson and Raymond Eby (hereafter Matheson-Eby model standard), and in an attempt to create predictability and consistency, have advocated the creation of a conjunctive test which limits judicial discretion to the waiver of limited liability, based on the wrongful conduct of the corporate controller. [18]The crucial elements of the Matheson - Eby proposal is that a plaintiff in a veil piercing proceeding should first demonstrate that the member used the company to commit fraud or was siphoning corporate funds or assets.[19] Secondly, the member must have caused the company to transfer assets or incur obligations to the member or entity in which the owner has a material interest for less than reasonably equivalent value.[20]Under this scenario, a member engaging in such a transfer is liable to the creditors for the amount transferred in excess of a reasonably equivalent amount.[21] Finally, the third test involves what Matheson and Eby call insolvency distribution.[22]

[14] Rebecca J. Huss, 'Revamping Veil piercing for All Limited Liability Entities: Forcing the Common Law Doctrine into the Statutory Age', (2001) 70 *U. CIN. L. REV*. 95, 96
[15] Bainbridge, n.7., at 481-535.
[16] S.B. Presser,'The Bogaalusa Explosion,"Single Business Enterprise" "Alter Ego", and Other Errors: Economics, Democracy, and Shareholder Limited Liability: Back Towards a Unitary "Abuse" Theory of Piercing the Corporate Veil', (2006) 100 *NW. U. L. REV*. 405, 411.
[17] J.B. Marcantel, 'Because Judges Are Not Angels Either: Limiting Judicial Discretion by Introducing Objectivity into Piercing Doctrine', (2008) *Kansas Law Review*, Vol. 59. No.2. 2011
[18] See Matheson and Eby, n.8 above.
[19] Ibid., at 184
[20] Ibid.
[21] Ibid., at 183-185
[22] Ibid.

To demonstrate insolvency, which is a crucial element of the test, it must be shown that the company made a distribution of assets to a member, in recognition of and as a return on the member's membership interest and the distribution caused the subsequent insolvency of the company that the member knew or must have reasonably foreseen.[23]

Thus, the test identifies the owner's own wrongful actions as the source of the owner's loss of limited-liability protection in the circumstances discussed above.[24] In this case, the owner shall be responsible for all of the company's debt.

However, this model runs into problems with its narrow definition of fraud. The standard limits fraud to a demonstration of a member's material misrepresentations of the assets of the enterprise. The definition of fraud under this model therefore falls short of accommodating other cases or forms of fraud. The result is that too many injured parties, such as victims of the advanced fee fraud cases in Nigeria (aka 419) discussed in chapter 5, misrepresentation involving contract claims,[25] misrepresentations relating to the company's performance and misrepresentation that someone besides the company will guarantee the debt,[26] as well as outright misappropriation of company's funds to defeat creditor's claims will all be left without a remedy. Fraud has also been found when a company was organised merely to protect shareholders from the claims of creditors.[27]

The model also makes no mention of non-fraudulent cases resulting in a wrong or injustice; neither does it preserve the equitable nature of the veil piercing remedy by permitting adequate flexibility. Even in terms of fraud itself, the model fails to provide a remedy for injured parties who are victims of constructive fraud and have suffered a wrong or injustice, but are unable to prove actual fraud. Constructive fraud for instance, would apply where a conduct though not actually fraudulent, has all the actual consequences and all the legal effects of actual fraud.[28] Species of constructive fraud may include representations made by a member by his words or

[23] Ibid.
[24] Ibid., at 181
[25] See Huss, n.14 above at 112
[26] Ibid.
[27] J.K. Vandervoort, 'Piercing the Veil of Limited Liability Companies: The Need for a Better Standard', (2004) *DePaul Business and Commercial Law Journal*, 51 at 93.
[28] See Shaun M. Klein, 'Piercing the Veil of the Limited Liability Company, From Sure Bet to Long Shot: Gallinger v. North Star Hospital Mutual Assurance, Ltd', (1996) 22 *J. CORP. L.* 131 at 145.

conduct, either directly or through the limited liability company, which cause injury to an individual or entity following reliance thereon by the injured party. In the case of *Williams v Natural Life Foods Ltd*.[29] the main question before the court was whether or not the director of a company could be held personally liable for the financial loss caused by the negligent advice of 'the company' in which he was a director. The loss occasioned in this case emanated from a defective franchisee prospectus that promised higher returns than were actually enjoyed by the appellants. The House of Lords, relying on the 'legal person' doctrine concluded that since there was no assumption of responsibility by the director for the advice of his company, the director could not be held personally liable. The aggrieved party was advised to look solely to the company for the satisfaction of his claim. The outcome could have been different if the director had assumed personal responsibility to the appellants. Before *Williams*, the New Zealand's Court of Appeal had adopted the same reasoning in *Trevor Ivory Ltd v Anderson*[30] on similar grounds.

Halpern, Trebilcock and Turnbull have suggested a *pro rata* liability rule where shareholders in default are each liable for the amount of money invested in purchasing the equity plus a proportion of unsatisfied claims arising from the default.[31] These unsatisfied claims are calculated in such a manner that it would be equal to the proportion of the shares which are outstanding in the name of each investor. The optimal benefit derivable from this proposal, according to these commentators, is that it will be in the shareholder's interests to ensure that the company does not undertake projects which increase the risk to earnings. As the risk increases, the insurance provided by the equity holder becomes more important, and the value of the equity falls.[32] The implication is that this has the potential to reduce equity participation by shareholders who may demand adequate compensation to be induced in order to hold the shares of the company. Sollars supports a version of proportional liability wherein each shareholder is to be liable for the excess of liabilities over the corporation's assets to the extent of the proportion of her shares in

[29] [1998] 1 BCLC 689, HL
[30] [1992] 2 NZLR 517
[31] P.Halpern et al., 'An Economic Analysis of Limited Liability in Corporation Law' (1980), *The University of Toronto Law Journal*, vol. 30, No. 2, 117-150.
[32] Ibid.

relation to the total number of shares outstanding.[33] However, such liability of the shareholders would only be to the victims of tort or other so-called involuntary creditors because, according to him, creditors who interact contractually with the company have the opportunity to adjust their terms so as to compensate them for expected losses.[34] Thus, the liability to which voluntary creditors are exposed can be altered by contract from the legal default.

In terms of ending the externalisation of risk onto tort creditors by extending vicarious liability to all shareholders, Hansmann and Kraakman offer the best known proposals.[35] According to them, an unlimited liability regime would be efficient provided that shareholder's liability is pro rata. They contend that a pro rata liability which limits a shareholder's exposure for tort losses to the shareholder's proportionate share of ownership, retains the benefits of limited liability, including information costs savings, diversification, and share fungibility.[36] In the same vein, they argue that such unlimited shareholder liability forces the firm to internalize the risks created by its activities, thereby inducing socially efficient levels of monitoring to avoid risk as well as capitalization and insurance to cover unavoided risks.[37] Hansmann and Kraakmann further contend that the new transaction and administrative costs that this regime would create would not be serious and, in all likelihood, would be offset easily by the social costs it would prevent.[38]

So thorough and provocative is their critique of limited liability that Hansmann and Kraakmann have all but defined the debate in the last few decades.[39] While conceding that it is at least preferable to joint and several liability, which could require individual members to be held liable for all the debts of the company regardless of their shareholding, critics of this proposal argue that it might prove more costly and less effective than Hansmann and Kraakmann acknowledge.[40] Mendelson, for example, argues that pro rata liability is insufficient to deter

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[33] G.G. Sollars, 'An Appraisal of Shareholder Proportional Liability' (2001) *Journal of Business Ethics*, 32: 329-345.
[34] Ibid.
[35] H. Hansmann and R.Kraakman, 'Towards Unlimited Liability for Corporate Torts' (1991) 100 *Yale L.J.* 1879
[36] Ibid. at 1903-06.
[37] Ibid., at 1904.
[38] Ibid., at 1896-1901.
[39] Bainbridge, n.7 at 539-40
[40] See Nina A. Mendelson, 'A Control-Based Approach to Shareholder Liability for Corporate Torts', 91 *COLM. L. REV.* 1283-1284.

shareholders from engaging in excessively risky activities since they could use their control to extract greater than a pro rata share of benefits from the firm.[41] Leebron argues that the solution lies in the amendment of legislation that can provide tort creditors with special priority in insolvency proceedings.[42] He argues that this would ultimately facilitate the shifting of additional tort risk to creditors.

For Leebron, there are four reasons to be given for increasing the liability of those he called 'financial creditors' i.e. contractual creditors such as banks, lenders or financial houses.[43] The first is that creditors, unlike tort victims, can easily diversify this loss, since their exposure will only be the amount of the loan. Second, if the creditor's liability is increased, it will have the potential to decrease the externality created by limited liability for companies with debt. By this arrangement, if tort claimants had priority over financial creditors, only the risk of harm in excess of a firm's entire capital, not just its equity capital, could be externalised. A third reason for granting priority to tort claimants would be to restore capital structure neutrality, at least in so far as tort risks are concerned. Finally, it would incentivise creditors to monitor corporate tort risks, since change of priority would mean that the cost of corporate torts would fall first on debt holders and not tort victims.

However, monitoring risk may be too cumbersome and expensive to achieve in practical terms. Again, shifting additional tort risk to financial creditors will further increase their burden, particularly in situations of company insolvency where there is a possibility that creditors could lose everything that they have invested.

6.2.2 Beyond Loss Allocation Orthodoxy: Responsible Corporate Personality

Despite the efforts made by previous scholars to suggest improvements to the system, they are still premised on loss allocation analysis. They fall short of providing an effective, comprehensive system capable of weighing the pertinent factors and assessing fraud, abuse of limited liability and the denial of the gains of the fraud from the corporate controller which may be suitable for a developing country such as Nigeria. The focus of constructive trust lies on whether the ultimate

[41] Ibid.

[42] D.W. Leebron, 'Limited Liability, Tort victims and Creditors',(1991) 91 *Columb. L. Rev*. 1565 at 1643. See also B.R. Cheffins, *Company Law, Theory, Structure and Operation*, Clarendon Press, Oxford, 1997, 508.

[43] Leebron, n.42 above.

holder should retain the proceeds flowing from title to a misappropriated asset. Constructive trust is established upon proof that the retained proceeds constitutes unjustified enrichment.[44] This is different from trying to determine the attributes that attract liability for a shareholder or corporate controller.

Therefore, until the conceptual path linking veil- piercing and limited liability in terms of loss allocation without disgorging the gains made by corporate controllers is discarded, it will remain impossible to find a cogent remedy to the problem. This is because pure veil-piercing should enable a claimant to reach the personal assets of the corporate controller, instead of merely imposing liability with no delineation of recovery.[45] The ultimate effect of veil-piercing therefore, would not only be the displacement of limited liability for the corporate controller, but to recover the gains of the unjust enrichment through the disgorgement of his asset. The potential of this measure is that it lays emphasis on recovery of the gains of the fraud instead of loss. Due to the problems identified above, courts found it difficult to deal with this under the existing system.

The present approach which is tied to limited liability does not allow a creditor to reach the personal assets of the corporate controller in order to recover his debt. This is because all the proposals share a conceptual deficiency. To date, it is difficult to see any of the proposals that have classified veil-piercing options from the direction of a substantive claim on enforcement of judgment against a shareholder/corporate controller, emanating either from property or unjust enrichment.[46] The lack of commentary in this area of law appears curious, particularly when it is considered that shareholder liability has historically been conceived as a property –based *mesne process*.[47]This situation may not be justified, particularly in a country like Nigeria,

[44] Oh, n.13 at 129

[45] See for instance Helen Anderson, 'Piercing the Veil on Corporate Groups in Australia: The Case of Reform', (2009) 33 *MELB. U.L. REV*. 333, 342, where she asserted that pure veil piercing occurs where liability is imposed because a person occupies the position of a shareholder.

[46] See Oh, n.13 at 108; Peter B. Oh, 'Veil- piercing', (2010) 89 *TEX. L.REV*.81, 90; Christina L. Boyd & David A. Hoffman, 'Disputing Limited Liability', (2009) *North Western University Law Review*, vol. 104, 853; Charles Mitchell, 'Lifting the Corporate Veil: An Empirical Study', (1999) 3 *COMPANY FIN. & INSOLVENCY L. REV*. 15, 16, where 188 British cases from 1888 up to and including 2006 were examined.

[47] O. Handlin & M. F. Handlin, 'Origins of the American Business Corporation', (1945) 5 *J. ECON. HIST*.1, 12-13; W.N Hohfeld, 'Nature of Stockholders' Individual Liability for Corporation Debts',(1909) 9 *COLUM. L. REV*, 285, 304.

where the benefit derived from fraud manifests in the acquisition of numerous assets and setting up entities different from the company where the fraud was perpetrated.

Against this background, corporate law must find other ways or means of dealing with the disgorgement of the benefit of fraud. To do this, the responsible corporate personality model re-conceives veil-piercing as constructive trust, which has over time appeared to have been detached from its equitable nature and remedial structure. Restitution law has for centuries provided the courts the means to enforce judgments by making unjustifiably enriched parties to disgorge misappropriated assets. Thus, unjust enrichment is a fundamental element of constructive trust.[48] The attraction of this equitable procedure lies in its remedies which are more flexible, elastic, progressive, and by far more extensive than those in contract or tort. Thus, the constructive trust in its very nature can be employed when an initial remedy in either equity or law, is unavailable. Within this context, the constructive trust's principles and rationales operate independently of the nature of the creditors claim against the company or shareholder in the original claim.

A major component of constructive trust is the location of benefit of misappropriated assets. This unlike loss allocation procedure and veil piercing investigates whether the retention of assets is justified in the circumstance of the case. This inquiry, which is not restricted to a shareholder, follows and traces a disputed asset to its ultimate holder.[49] Therefore, once a constructive trustee is designated, the claimant is endowed with proprietary rights to the assets. Such proprietary rights take priority over general unsecured creditors, regardless of whether the constructive trustee is insolvent or not. The details of constructive trust and other components of responsible corporate personality will be dealt with below.

6.3 Constructive Trusts

The proper role of equity in commercial transactions is a topical question. Increasingly, claimants have had to seek recourse to equity for an effective remedy when the person in default, typically a company, is insolvent. Claimants also seek to obtain relief from others who were involved in a transaction, such as directors of the company or its bankers or its legal or other advisers. They seek to fasten fiduciary

[48] Oh, n.13 at 95
[49] Ibid at 96

obligations directly onto the corporate controllers, officers or agents or advisers, or to have them held personally liable for assisting the company in breaches of trust, fiduciary obligations, or fraudulent acts of the officers/ agents.[50] Such action can also arise against corporate controllers when they are implicated in fraud. Equity has always given relief against fraud by making any person implicated in the fraud accountable in equity. In such circumstances, the courts would give relief to the injured party by declaring the defendant chargeable as a constructive trustee.[51] In the case of a defaulting director, the imputation of a constructive trust will ensure that he does not benefit from his wrongdoing.[52] Unfortunately, constructive trusts have been under-utilised in company law largely due to lack of attention to readily identifiable principles entitling relief in this form.[53]

Constructive trusts are the creation of equity.[54] The doctrine of constructive trust emerged as a flexible remedy for maintaining effective justice between parties.[55] Simply put, a constructive trust is an equitable remedy imposed to prevent unjust enrichment.[56] Considered to be the most important contribution of equity to the remedies for prevention of unjust enrichment, the constructive trust as a remedial institution empowers the courts to make an order declaring a defendant to be holding a disputed asset on trust for the claimant.[57]

Constructive trust is also a property concept by which the claimant can obtain an equitable proprietary interest in a property held by a defendant. It is a species of equitable remedy akin to injunction or decree of specific performance.[58] Unlike an express trust, which arises out of intentional creation of the relationship, a constructive trust is imposed by the court whenever it is considered just to do so as a remedy to prevent unjust enrichment. Such imposition by the court arises as a result

[50] *Royal Brunei Airlines Sdn Bhd v. Tan*, [1995] 3 All ER 97,per Lord Nicholls of Birkenhead.
[51] P.J. Millett, 'Restitution and Constructive Trusts' (1998) 114 *LQR* 399 at 400-401.
[52] B.M. McLachin, 'The Place of Equity and Equitable Doctrines in the Contemporary Common law World: A Canadian Perpective' in Waters, *Equity, Fiduciaries and Trust*, Carswell, Scarborough Ontario (1993), 37 at 48
[53] See *Russel v Wakefoeld Waterworks Company* (1875) 20 LR Eq 474 at 479 per Jessel MR.
[54] Nicholls (1998), 233
[55] McLachlin, n.52 above.
[56] *Simonds v Simonds*, [1978] 45 NY2d 233, 242
[57] J.P. Dawson, *Unjust Enrichment: A Comparative Analysis*, Little Brown & Co, Boston, 1951. 26; Roscoe Pound, 'The Progress of the Law',(1918-1919), 33 *HARV. L. REV*. 420,421; A. Duggan, 'Constructive Trusts from a Law and Economics Perspective' (2005) 55 *TORONTO L.J*. 217, 217.
[58] J. Langbein, 'The Contractarian Basis of the Law of Trusts' (1995) 105 *YALE L.J.* 625, 631

of the conduct of the trustee independently of the intention of the parties.[59] No element of consent is therefore necessary; the court in this circumstance simply declares that a defendant holds a disputed asset for the benefit of a claimant.[60] It is also distinct from an express trust because it is not a fiduciary relationship[61] which as Millett LJ pointed out in *Bristol and West Building Society v Mothew*[62] is built on a position of trust and confidence and gives rise to an obligation of loyalty to the fiduciary. The fiduciary relationship is thus created in circumstances whereby one party has undertaken to act for, or on behalf of, another in relation to some particular matter or matters e.g. property, although fiduciary relationships are not confined to undertakings with respect to property.

The doctrine of constructive trust emerged as a remedy of great flexibility for doing effective justice between parties.[63] Yet, like veil-piercing, it has its own problems, having been denigrated as a troubled child of equity because it is been seen as somewhat confusing in contemporary times.[64] As Millett pointed out, this confusion arises not only from the ambiguous meaning of the expression ‘constructive trust’, but also because it only describes the trust itself yet also sometimes describes a particular proprietary remedy.[65] Moreover, it is difficult to ascertain clearly whether it is substantial or remedial.[66]

A constructive trust essentially arises whenever the circumstances are such that it would be unconscionable for a legal title owner to assert any beneficial interest which denies the interest of the rightful holder of the beneficial interest. Thus, constructive trust arises when circumstances which are *ex hypothesi* known to the legal owner that affects his conscience.[67]

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[59] A.J. Oakley, *Constructive Trusts*, Sweet & Maxwell, London, 1996, 1-10.
[60] L. Kaplan, Palmer’s Law of Restitution: Volume 1-IV, 1998 Cumulative Supplement No 2 &1.14, at 26, 1998.
[61] Restatement of the Law of Restitution: Quasi-Contracts and Constructive Trust, 1936, 160, at 640-41
[62] [1996] 4 All ER 698; See also *Arklaw Investments v Maclean* [2000] 1 WLR 594
[63] McLachlin, n.52 above.
[64] Oakley, n.59 above. The precise origins of constructive trust are unknown. Constructive trust is not even a proper trust since it is a remedy imposed by the court as a result of the conduct of the trustee.
[65] Millett, n.51 above.
[66] Ibid.
[67] See generally P.D. Finn, Fiduciary Obligations, Law Book Company Limited, 1977. 33; J.C.Shepherds, The Law of Fiduciaries, Caswell Company 1981. 43

More importantly, a constructive trust arises when a defendant is implicated in a fraud. Equity has always given relief against fraud by making any person sufficiently implicated in the fraud accountable in equity. In such a case, he is liable to account personally to his beneficiary for his actions as trustee.[68] In the case of a defaulting director who had acted in breach of his fiduciary duty, this will involve the recovery of company assets or their equivalent value in keeping with the traditional obligation of a defaulting director to effect restitution to his company which in a commercial case is the first remedy for consideration.[69]

Fiduciaries are those who have a single-minded loyalty to their principals, such as directors of companies and agents. A de jure or de facto company director is plainly a fiduciary for the company and treated as a trustee of the company's property under his control. Whether a shadow director is one depends on whether he has undertaken to act for the company in a particular matter. A fiduciary relationship is ultimately founded upon a legitimate expectation that the fiduciary will not use his or her position in such a way which is adverse to the interests of the principal.

The fiduciary must act in good faith, and must not make an unauthorised profit out of his position in which his duty and his own interest may conflict. If the fiduciary makes an unauthorised profit by use of his position or engages in a fraudulent act, he is liable to account for the profit to his principal, and this is said to be a 'liability to account as a constructive trustee'.[70]

6.3.1 Constructive Trust and Corporate Veil-Piercing Scenarios

Courts often impose constructive trust where traditional remedies prove inadequate or unavailable. Thus, constructive trust as a remedy may be applied in a variety of situations where equity demands. More importantly, it serves as a potential claim to correct a wrong that may not fit squarely within any other cause of action.

The constructive trust is not restricted to unjust enrichment. For, as Birks who had earlier espoused it later confirmed, obligations can warrant restitution.[71] This brings to the fore the scope of civil law which is divided between the dual goals of

[68] See *Paragon Finance Plc v DB Thakerur & Co,* [1999]1 All ER 400 CA.
[69] *Re Dawson* [1966] 2 NSWR 211
[70] Ibid.
[71] P. Birks, *An Introduction to the Law of Restitution*, Clarendon Oxford University Press, Oxford, 1985, 30

compensation and restitution.[72] Within this context, as pointed to by Birks, civil law is divided entirely between the twin objective of achieving compensation and restitution- both of which translate into obligations as found in contract or tort and unjust enrichment.[73]

This analysis is fundamental to the question of the link between veil-piercing and constructive trust. Thus, restitution functions to complement, and not supplant compensation which is ordinarily found as a remedy for breaches of contract or tort. Restitution therefore becomes necessary only when the initial remedy in equity or law seems unavailable. Indeed, this is the precise function performed by the constructive trust.

The constructive is thus detached from and applies independently of the underlying claim. As the nature of the underlying claim is irrelevant, the application of a constructive trust does not depend on whether a substantive claim is grounded in contract, property, tort, or unjust enrichment, or concerns a voluntary or involuntary creditor.[74] A claimant seeking to benefit from constructive trust must show that he has been deprived of an asset through some wrongful means. This position was illustrated in *State of Michigan v. Little River Brand of Ottawa Indians*[75] for instance, where the court reiterated that a party seeking to have a constructive trust imposed bears the burden of establishing fraud, misrepresentation, concealment, undue influence, duress, or some other circumstance that would make it inequitable for the holder of a legal title to retain the property. In this connection, all that matters for purposes of invoking constructive trust is whether the process by which the asset was misappropriated warrants equitable relief.

The process of invoking constructive trust applies to the defendant's enrichment. As a subset of restitution, constructive trust concerns the propriety of benefits, and not losses.[76] The central focus of constructive trust is therefore to strip the defendant of benefit unjustly gained at the claimant's expense. The nature and extent of the harm caused is not really relevant since the retention and enjoyment of the misappropriated asset is sufficiently wrongful on its own.

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[72] Ibid., at 11
[73] Ibid., at 21
[74] Oh, n.13 at 117
[75] (2006)No. 5:05-CV-95.
[76] See R. Goff & G. Jones, The Law of Restitution, Sweet & Maxwell, 1978, 14

A unique feature of constructive trust is that it is not a party –specific inquiry. Because the primary focus is on the status of the misappropriated asset, such asset can be traced from the wrongdoer to its ultimate custodian.[77] Except where the transfer was made bona fide, any other person or party holding the asset qualifies as a constructive trustee and even if altered or substituted, the asset will still be subject to a proprietary claim that can result in disgorgement.[78]

Thus, the structure of constructive trust seems to suit the classic veil-piercing scenarios. The constructive trust, unlike a loss allocation analysis which sifts through different types of creditor/claims, corporation and shareholders to find an exception to a general rule focusses on whether a corporation's inability to satisfy a judgment results in an unjustifiable allocation of benefits. The principles of constructive trust avoid the pitfall of trying to justify a remedy by resorting to the attributes of the original claim.[79] To this end, greater emphasis is placed on the consequences the victim of the wrong stands to suffer and the potential available remedy to him, for example, either in restitution or damages to satisfy the wrong done to him. What is more, the inquiry is sufficiently flexible to accommodate any transfer of benefit from a corporation to its shareholder. To this extent, the constructive trust is not intended to reach the personal assets of most of the shareholders or bona fide recipients without notice of adverse claims, but only those who had elected to profit from the company in an unjustified manner.

6.3.2 Liability of Corporate Controllers as Constructive Trustees

A limited liability company is of course not a trustee of its own funds: it is their beneficial owner; but because of the fiduciary character of their duties directors of limited liability companies are treated as trustees of those funds of the company which are in their hands or under their control, and if they misapply them they commit a breach of trust.[80] Thus, where a director commits a breach of duty, a constructive trust would be imposed. This would result in the loss of the corporate shield by the director as well as the potential effect of disgorgement of his assets for fair distribution to creditors. Therefore, the director upon whom constructive trust is

[77] Oakley, n.59 above.
[78] See L.O. Smith, *The Law of Tracing*, Clarendon, Oxford University Press, 1997, 10
[79] See Oh, n.13 at 118
[80] See *Re Lands Allotment Co*. [1894] 1 Ch 616 at 631 per Lindley LJ and Kay LJ at 638.

imposed cannot rely on the corporate form to escape liability since he is deemed to hold the benefit of the breach in trust for the company. In fraud cases, imposition of constructive trusts commonly arises in the following situations:[81]

a.) Where a person in a fiduciary position makes an unauthorised profit;
b.) Where a person is in "knowing receipt" of trust property";
c.) Where there has been rescission of a contract entered into as a consequence of fraud.

In the UK, a claimant relying on constructive trust to make a claim must demonstrate a pre-existing fiduciary relationship or some fraudulent conduct on the part of the defendant. As explained by Millett LJ in *Paragon Finance plc v D B Thakerar & Co*,[82] obligation on the trustee which may give rise to a claim can come in two situations: first, where a defendant assumes fiduciary duties prior to the specific item or property by a lawful transaction preceding the breach of trust; and second, where the trust obligation arises only from unlawful transactions, such as breach of trust. The implication of the two '*Paragon*' categories is that, while in respect of the first, trusteeship arises by operation of the law and confers on the beneficiary a proprietary claim, the second category is no more than a way of expressing a liability to account in equity particularly where the person is implicated in fraud.[83] Consequently, where directors of a company in breach of their fiduciary duties misapply the funds of their company, they are regarded as constructive trustees for the misapplied funds and liable to the company under the first set of Millett LJ's two classifications.

The company has a choice to claim that the director as trustee should restore the trust asset, whilst it may still pursue a proprietary claim to trace the asset or its identifiable substitute which will operate against the whole world except a bona fide purchaser for value.[84] On the other hand, only a personal claim for account of profit can arise for the second paragon's case. This has obvious implications for the claimant who, unlike class 1 of the paragon's case, has to compete with other unsecured creditors of the company. The views of Millett LJ above seems to be the way constructive trust is perceived in the UK and this has influenced later decisions. Unauthorised profits for purposes of holding a director liable to account for the gains made may be articulated

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[81] T. Mascarenhas, 'Constructive Trusts in Fraud Cases', (2011) *I.C.C.L.R*, Issue 10, 27
[82] [1999] 1 All ER 400
[83] Ibid., at 409.
[84] B.Hannigan, *Company Law*, Third ed., Oxford University Press, Oxford, 2012, 279

under the current law in the UK as secret profits and bribes and misuse of corporate opportunities.

6.3.2.1 Secret Profits and Bribes

Secret profit and bribe is a misuse of a person's position in the company. Although not directly company assets or property, a corporate controller who while acting for the company in any transaction makes such an unauthorised profit, has abused the corporate form and cannot therefore escape liability for his actions.

The basis for this is that a corporate controller as a fiduciary must act in the best interest of the company and should not do anything which is capable of having adverse consequences on the company and the interest of its stakeholders such as the creditors. As secret profits and bribes constitute a breach of fiduciary duty, equity will not allow such corporate controller to take the benefit of such ill-gotten gains which influence the company to act in a particular way thereby causing its potential insolvency.[85] To this extent, a constructive trust would be imposed to protect the company and by implication its creditors to avoid the directors using the company for illegitimate ends. The inherent vice of depriving the principal, without his knowledge or informed consent, of the disinterested advice which he is entitled to expect from his agent, free from the potentially corrupting influence of his own is one which should be abhorred.[86]

Further, the corporate controller would be required as a personal duty to account to the company for the value of the bribe received as a fiduciary less the profit or benefits made from it. The recent decision of the Court of Appeal in *Sinclair v Versailles*[87] confirms this point. *Sinclair* had departed from *Attorney General for Hong Kong v Reid*[88] which ruled that such bribes should be accounted for including the profits made thereon (proprietary claim) but upheld the opinion expressed in the old case of *Lister v Stubbs*[89] decided at the Court of Appeal well over a century ago that such a claim was personal. However in Nigeria the law does not seem to tackle

[85] See *Attorney General for Hong Kong v Reid*, [1994] 2 All ER 1, 11; See also the recent Court of Appeal decision in *FHR European Ventures v Mankarious* [2013] EWCA Civ 17
[86] Mascarenhas, n.81 above.
[87] [2011] 1BCLC 202 at 80; [2011] WTLR 1083
[88] [1994] 2 All ER 1
[89] (1890) 45 Ch. D 1

this problem effectively. This may be because bribe and secret profits are not seen as money or assets belonging to the company.

Although *Sinclair* remains the current position of the law in the UK as far as secret profit and bribes by the fiduciary are concerned, it is submitted that the decision in *Reid* is preferred as it is more encompassing in meeting the demands of equity. This view is predicated on the ground that asking the fiduciary simply to account for the bribe money less the profit made with it will amount to denying him the benefit in part. If the property representing the bribe increased in value, the fiduciary should not be entitled to retain any surplus in excess of the initial value of the bribe as he was not allowed by any means to make a profit out of a breach of duty.

It is therefore submitted for the purposes of reform of the law, that where a corporate controller is found to receive bribe or made secret profits through misuse of his position, constructive trust should be imposed on him not only to make him lose his corporate shield but to also disgorge the assets or money subject matter of the bribe money plus the profit made through the investment of the bribe. In addition, he should be subjected to disqualification proceedings from holding that office. This will act as a deterrent to corporate controllers who might want to misuse their positions in future to receive bribes and secret profits and thereby undermining the existence of the company.

6.3.2.2 Misuse of Corporate Opportunity: UK Current Law

A director is required not to put himself in a position where his duty and his interest may conflict. He, as a trustee, must not therefore profit from his trust.[90]Thus under the 'secret profits' rule, proof that the trustee had acted with any fraudulent intent or lack of probity is not required.[91] Consequently, where for example, a trustee speculates in a commercial venture from which he stands to benefit, he will be liable for any losses and must disgorge all profits, even if he has acted in good faith. The similarity of a trustee duty to that of a company director who owes a fiduciary duty to the company cannot be mistaken. A director, when performing his duties to the company, must act as a prudent man would in relation to their business whilst being

[90] S. Evans, 'Constructive Trust and Tracing', (2007) *The Journal of Asset Protection and Financial Crime*, Vol. 2 No. 3, 222 at 223
[91] Ibid.

loyal to the company by acting throughout in good faith for the benefit of their company.[92] A director who makes profit by virtue of his position without the company's consent will be required to account for such profits to the company.

Further, unauthorised profit by a fiduciary may also result for instance, where a director of a company diverts a corporate opportunity of the company for his own benefit. Courts in the UK are not prepared to countenance a fiduciary exploiting an opportunity for his own benefit and are more concerned with penalising him for having taken up the opportunity of entering into profitable transactions on his own behalf than to ascertain whether or not there has been a conflict between his duty of loyalty to his principal and his own self-interest.[93] Thus the corporate opportunity doctrine prevents a director from diverting to his own advantage a commercial opportunity that could have been exploited by the company. In *Bhullar v Bhullar*,[94] the Court of Appeal was invited to answer the question of whether directors' who acquired premises on their own account in breach of their fiduciary duties, held the property on trust for the company, irrespective of whether the company might or might not have had an interest in acquiring the property. The court held that the directors of the family business were under a fiduciary duty to communicate the existence of the opportunity to acquire the nearby property to the company since they were in fiduciary relationship with the company by virtue of their capacity and the acquisition of the property would have been commercially attractive to the company.

In light of *Bhullar's* case, a director could not carry on competing business with his company or turn the company's assets , opportunities or information to his own profit unless there was consent.[95] It further epitomises the age-long fundamental principle of company law that directors of a company are under a strict duty not to place themselves in a position where there is potential conflict between their duties to the company and their interests or duties to others. This obligation on the part of directors has been codified in section 175 of the Companies Act 2006 and expounded most memorably by the House of Lords several decades ago in the case of *Regal (Hastings) Ltd v Gulliver* to include a duty by the director to account for

[92] CA 2006, s. 175
[93] Oakley, n.59 at 74
[94] [2003] 2 BCLC 241
[95] D. Prentice & J. Payne, 'The Corporate opportunity Doctrine' (2004) *LQR* 120, 202

profits from such breach of duty made from improper use of corporate opportunity.[96] Again, this may increase company assets and so help the creditors indirectly. It also enhances the deterrent effect of that prohibition of conflict of interest.

The corporate opportunity doctrine therefore makes a director liable to hold any profits on constructive trust for the company if those profits were made from an opportunity which the company could or would have exploited but for the actions of the director in diverting the opportunity for his own personal benefit. In the circumstance, the company may have the right to damages (to be paid off) for such improper appropriation of the opportunity with respect to the director's breach of his contract of employment or claim for an account of profits for breach of duty. However, the two actions cannot be maintained for the same transaction as the company must elect which remedy to pursue.[97] It may also proceed to obtain an injunction to prevent the use of the knowledge or opportunity. Angry shareholders may bring their own legal action for their benefit in derivative claims, though such claims must be maintained in the name of the company subject to the leave of the court.[98] The range of possibility of actions by the company may also include criminal prosecution in case of fraud or bribe under the Fraud Act 2006 and Bribery Act 2010 respectively. In addition, where the company becomes insolvent, the director as pointed out in Chapters 3 and 5 may be declared unfit to hold such position in relation to the management of a company pursuant to the Company Directors' Disqualification Act 1986.[99]

The strict duty to account in the UK for improper profit is not closed as it was restated in *Gencor ACP Ltd v Dalby.* [100] The only escape from potential accountability is the obtaining of the prior approval of the company's shareholders after full disclosure of all the facts and circumstances.[101]

In any event, whilst a director does owe a fiduciary duty to the company,[102] that does not *ipso facto* make him a trustee as he is not constricted by a trustee's obligations to

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[96] [1967] 2 AC 134; [1942] 1 All E.R. 378
[97] See *Coleman Taymar Ltd v Oakes*,[2001] 2 BCLC 749. See Hannigan, n. 79 at 275
[98] See CA 2006, s.260 (1); See also *Waddington Ltd v Chan Chun Hoo Thomas*, [2009] 2 BCLC 82
[99] See CDDA 1986, s.6
[100] [2000] 2 BCLC 734
[101] Ibid at 741.
[102] See CA 2006,s 170(1)

safeguard and protect trust assets.[103] A director is not precluded from dealing with the company's assets for *bona fide* commercial purposes. He can freely deal with such assets provided it is within the company's powers. To require otherwise would mean to severely compromise corporate expansion or indeed undermine it. However, where a director misapplies company assets such as money which comes under his control, he will become liable upon the same footing as if he were a trustee.[104] The imposition of liability on a director within this context raises some fundamental questions as to the obvious perception of constructive trust: for example, is constructive trust institutional or remedial? This is particularly important as various jurisdictions and jurists have taken diametrically opposing views as to how remedies can be founded on constructive trust. [105]Whilst these arguments relate to the proper delineation and role of constructive trust in identifying who is a trustee and how a constructive trustee can be used as a remedy to impose liability against someone for unlawful transactions, it is nonetheless important to stress that a company director who misappropriates company's assets under his control is still liable and should be accountable in equity.[106] The institutional constructive trust or remedial constructive trust paradigm reflecting whether if constructive trust is imposed due to a pre-existing fiduciary duties or as a remedy consequent upon some unlawful transaction in relation to directors will be discussed below.

As with the company's assets, a director is not a trustee for the company's shareholders,[107] to the extent that share dealings can take place between them without the necessity of disgorging profits. A director is also not in a fiduciary relationship with any third parties who deal with the company.[108]This obviously raises some problems as to how the law will deal with a situation where the fiduciary acts fraudulently at the expense of someone who is not necessarily in a fiduciary relationship with them, like a creditor. Put differently, how can a claimant victim of commercial fraud or transaction lacking in probity seek redress from a defendant

[103] Evans, n.90 at 223
[104] See the dictum of Lindley LJ in *Re Lands Allotment Co*, [1894] 1 Ch 616 at 631
[105] See S. Tappenden, The Emergence of the Concept of Unjust Enrichment in New Zealand, Its Relationship to the Remedial Constructive Trust and the Development of the Status of Joint Ventures in Equity, (2008) 3 *Journal of Politics and Law*, vol.3 , 32-42. Here the application of constructive trust principles in the UK, US, Canada and New Zealand was fully discussed.
[106] *Paragon Finance plc v D B Thakerar & Co*, [1999] 1 All ER 400 at 409; Hannigan, n.79 at 277.
[107] *Percival v Wright* (1902) 2 Ch. 421
[108] *Bath v Standard Land Co. Ltd* (1911) 1 Ch. 407, 426

who is not his trustee and who is not in a fiduciary position with them? What can the courts do to help a claimant when there is no contractual or tortious link to help the claimant, especially in modern company practices where shareholders, directors, nominees and agents feel that the doctrine of separate legal personality of the company protects them for their actions? The answer to these questions are some of the issues constructive trust seeks to answer by trying to impose liability on corporate controllers through the extension of right of action to persons who otherwise may be regarded as outsiders to company affairs, such as creditors who nevertheless may be having one form of transaction or the other with the company. This duty may also include an implied responsibility or obligation by the directors to the creditor, which, as pointed out in chapter 4, arises when the company is in insolvency or near insolvency. To this extent, the imposition of constructive trust to disgorge the assets of the corporate controller in a period of company's insolvency is one step along in helping to solve the problem of creditors. The basis for this assertion is that although money recovered from the directors are funds going to the company, they are meant for distribution to creditors. This is particularly important as the burden of risk borne by the creditors during insolvency are quite enormous owing to the doctrine of separate legal personality which insulates corporate controllers from any liability in relation to the debt of the company. [109]

6.3.2.3 Liability of Knowing Receipt

In terms of knowing receipt in relation to corporate entities, a constructive trust may be constituted in situations where persons receive trust property that has been taken in breach of trust. To be liable, those who receive the property must do so for their own benefit. The essential requirements of knowing receipt were clearly stated by Hoffmann LJ in *El Ajou v Dollar Land Holding Plc.*[110] The claimant must show: firstly, a disposal of his assets in breach of fiduciary duty; secondly, the beneficial receipt by the defendant of assets which are traceable as representing the assets of the claimants; and thirdly, knowledge on the part of the defendant that the assets received are traceable to a breach of fiduciary duty.

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[109] See R.B. Thompson, Piercing the Corporate Veil: An Empirical Study, (1990) 76 *Cornell L. Rev*. 1036 at 1039.

[110] [1994] 1 All E.R. 685 CA (Civ. Div.) at 700; See also *Williams v Central Bank of Nigeria* [2013] EWCA Civ 785

In considering the requirement of knowledge, the Court of Appeal in *Bank of Credit and Commerce International (Overseas) Ltd v Akindele*,[111] sought to determine firstly, and within the context, the meaning of knowledge, and secondly, whether it is necessary for the recipient to act dishonestly for him to be caught by the test. Whilst the courts answer to the second question was in the negative in that dishonesty was not a requirement for knowing receipt, for the first question Nourse LJ concluded that the single test of knowledge for knowing receipt is that the recipient's state of knowledge must be such as to make it unconscionable for him to retain the benefit of the receipt. Consequently, the court dismissed the claim of the liquidators under both the knowing assistance and knowing receipts heads of constructive trust brought against the defendant.

The above views of Nourse L.J. remains ultimately the test under the English law, though there have been calls for a strict liability test subject only to a change of position defence.[112]

The change in the defendant's position following his receipt of the enrichment was accepted by the House of Lords in *Lipkin Gorman (a firm) v Karpnale Ltd*[113] as a defence at common law to the claimant's claim for restoration. According to Lord Goff, where an innocent defendant's position is so changed that he will suffer an injustice if called upon to repay or repay in full, the injustice of requiring him to repay outweighs the injustice of denying the (claimant) restitution.[114] The position taken in *Lipkin Gorman* was followed by the majority of the High Court of Australia in *David Securities Pty. Ltd v. Commonwealth Bank of Australia.*[115]

A change of position post – receipt defence would arise where, in certain circumstances, the wealth received innocently has been lost. A typical example is where the claimant mistakenly pays D a certain amount. D in good faith purchased a lottery ticket which he could not have purchased had he not received the mistaken payment. It turned out however that the ticket is a losing ticket. A claim by C for restoration can be deflected by D on the ground that he (D) has changed his

[111] [2001] Ch. 437 CA (Civ. Div.)
[112] Mascarenhas, n.81 above.
[113] [1991] 2 AC 548
[114] See R.B Grantham & C.E.F Rickett, n.3 at 175-176
[115] (1992) 175 C.L.R353

position.[116] Thus the ultimate aim of change of position defence is one of balance of justice between the claimant and the defendant which recognises the fact that although the defendant has been enriched, the claimant's claim is nevertheless denied because of the injustice its success would inflict upon the defendant.

The effect of liability of knowing receipt for the purposes of this study is that constructive trust stands as a bar for the utilisation of the separate legal personality of the company by the corporate controllers to escape liability for breach of fiduciary duties or to defeat claims for recovery of company assets which has been fraudulently transferred to third parties. With the imposition of a constructive trust, such assets would be traced and recovered from the third party unless there is supervening events which makes recovery impossible such as defendant's good faith loss of the advantage received (i.e. disenrichment)[117] to the extent of the initial receipt which enables him to argue that he should be excused from making restitution to that extent.[118]

Nonetheless, it is submitted that the existing law on liability of third parties following the knowing receipt claim is defective. Under the existing law such a claim can only be maintained by the company against the corporate controller based on the fiduciary relationship the latter owes the former. It excludes creditors from maintaining action under that head because of absence of fiduciary relationship. Further, where the company is solely managed by the controlling shareholder or director, it becomes difficult for such claim to be taken in the absence of any other existing fiduciary.

It is further submitted that this defect in the current law call for urgent attention. It is here proposed that this existing state of affairs should be changed such that constructive trust should be imposed to recover assets of the company fraudulently transferred to third parties wherever it is found without the requirement of establishing fiduciary relationship or making it a condition precedent for the existence of such claim. With this in mind, such claim would be made flexible enough to accommodate all those who may have transaction with the company

[116] For views and analysis on change of position defence see R.B Grantham & C.E.F Rickett, n.3 at 175-176.
[117] See A. Burrows, 'The English Law of Restitution: A Ten –Year Review' in J.W. Neyers, et al, *Understanding Unjust Enrichment*, Hart Publishing Oxford, 2004 at 19
[118] J. Beatson, E. Schrage (eds.) *Unjustified Enrichment*, Hart Publishing, Oxford, 2003, 33

including the creditor. The only requirement for such outsiders who are not fiduciaries is for the claim to be maintained in the name of the company under the conditions enunciated in right of action below. This will not only make recovery easier and faster but will obviate the difficulty claimant's face in court to deal with the recovery of company assets from third parties under the knowing receipt head.

Finally, where it is proved that a controlling shareholder or director indeed transferred company assets to a third party and such assets have been dissipated, the shareholder or director's personal assets should be disgorged to satisfy the claim. This will not only deter such fraudulent corporate controllers from embarking on such behaviour but will go a long way towards boosting the asset base of the company for distribution to creditors, particularly during insolvency.

6.3.2.4 Fraudulent Contracts

With respect to contracts induced by fraud, it is important to note that constructive trust would arise in favour of the victim where funds are stolen or are transferred pursuant to a void transaction. On the other hand, if the contract is voidable, for example, by reason of the fact that it has been induced by fraudulent misrepresentation under which assets are transferred by the victim, both legal and equitable ownership in the assets are transferred. If the victim had full knowledge of the fraud and elects to affirm the transaction, no constructive trust will arise. The victim would then have to seek rescission of the contract.[119] In *Cundy v Lindsay*,[120] a rogue persuaded a vendor to deliver goods on credit by fraudulently misrepresenting his identity. The vendors brought an action in conversion against the appellants, innocent purchasers of the goods from the rogue. The Queen's Bench Division held that the contract was merely voidable and that title had therefore passed to the rogue. Though that title was liable to be divested by the vendor's act of rescission, the right to rescind the contract of sale had been lost on the appellant's good faith purchase. Both the Court of Appeal and the House of Lords found the contract to be void and the appellant liable in conversion.

[119] Grantham, n.3 above; See also *Shogun Finance Ltd v Hudson* [2003] UKHL 62; [2004] 1 A.C. 919 (HL)
[120] (1878) 3 App. Cas. 459

For the victim to obtain rescission in this circumstance, he needs to be able to give *restitution in integrum*, i.e. to be able to return the parties to the position they were in prior to the performance of the contract. However, rescission may be barred by delay, for example, where there has been substantial performance in implementing the contract, and an intervention of third-party rights.[121]

Once there is notification of avoidance of the contract for fraud, the fraudster becomes a constructive trustee of the property. Since rescission is an equitable remedy and is discretionary, it can be applied against fraudulent misrepresentation by corporate controllers who rely on the shield of the corporate form to induce creditors to enter into fraudulent contracts.

6.4 Constructive Trust: The US and Canada Model

Under the US and Canadian model, the constructive trust is seen as an instrument for remedying unjust enrichment.[122] This is different from the institutional proprietary approach adopted in the UK. Thus a constructive trust may be imposed whenever the constructive trustee has been unjustly enriched at the expense of the constructive beneficiary. All that the claimant has to show is that the constructive trustee has received some benefit which, as against the constructive beneficiary, he cannot justly retain.[123] This view reflected in paragraph 60 of the American Restatement of Restitution states as follows:

> Where a person holding title to property is subject to an equitable duty to convey it to another on the ground that he would be unjustly enriched if he were permitted to retain it, a constructive trust arises.

This provision underlies the attitude of American judges in respect of constructive trust of whose leading exponent is Justice Cardozo.[124]

A remedial constructive trust is imposed at the discretion of the court. Whilst the institutional constructive trust recognises the existence of a fiduciary relationship or the necessity of some previously existing fiduciary duty, that has been breached, or some proprietary rights that had been established prior to the action that led to the

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[121] Mascarenhas, n.81 above.
[122] Oakley, n.59 at 10
[123] Ibid.
[124] See *Berkley v. Third Ave. Ry. Co*, (1926) N.Y., N.E. 58, 61; See also *Beatty v. Guggenheim Exploration Co*., (1919) 225 N.Y. 380, 386; *Meinhard v. Salmon*, (1928) N.Y. 164 N.E. 545, 548.

unjust enrichment, a remedial constructive trust requires neither a subsisting proprietary interest nor any established fiduciary duty. Remedial constructive trust is therefore based on broad equitable principles that are being developed under the banner of restitution, that of unjust enrichment.[125] Once an element of unjust enrichment is found, remedial constructive fraud can be imposed to give a claimant proprietary remedy even where no proprietary interest hitherto existed.

Thus, under the US and Canadian model, in a case of unjust enrichment, and irrespective of any fiduciary relationship with the claimant, the court has discretion to grant relief by way of constructive trust if it concludes that other proprietary and personal remedies are inadequate. In the event of the court proceeding to decide as such, the constructive trust ultimately will be deemed to have arisen at the time when the duty to make restitution first arose rather than when the duty is enforced.[126] This has the effect of giving the court the flexibility to deal with the claimant's action against the trustee in a more expansive manner rather than what is obtained in the more limited institutional approach. A claimant seeking rights over a corporate controller needs not be a fiduciary to seek any remedy. This ultimately saves him the difficulty of proving proprietary restitution which Etherton describes as a notoriously difficult area because according to him, the law of unjust enrichment has been developed explicitly as a subject of English law only recently and is far from settled.[127]

The concept of remedial constructive trust has not been followed by many judges in the UK.[128]The remedial constructive trust's features of subjectivity, retrospective effect and the courts discretion are seen as undermining an overriding need for certainty in commercial transaction, and interfering with the rights of third parties, particularly creditors. Indeed, the very essence of the English institutional approach to constructive trust is based on a pre-existing proprietary interest as explained by Millett LJ in *Paragon Finance plc v D B Thakerar & Co*.[129] Constructive trust is not

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[125] S. Tappenden, n.105 at 39.
[126] See T. Etherton, 'Constructive Trusts: A New Model for Equity and Unjust Enrichment' (2008), The Cambridge Law Journal, 67, 265 at 267; See also P. O'Connor. 'Happy Partners or Strange Bedfellows: The Blending of Remedial and Intuitional Features in the Evolving Constructive Trust' (1995) 20 Melbourne University Law Review 735.
[127] Etherton, n. 126 above.
[128] The possibility of a remedial constructive trust was robustly rejected by Nourse LJ in *RE Polly Peck International plc.* (No. 2) [1998] 3 All E.R. 812, 830-832
[129] [1999] 1 All ER 400

seen as a remedy arising from the discretion of the court but as a trust in its true sense which comes into being between the parties by the operation of the law even before a claim is made.[130]

Nonetheless, Oakley has pointed out that while English law does not regard constructive trust as a remedy in the way it regards injunction, it would be difficult to say that a claimant seeking the imposition of constructive trust is not seeking a remedy. [131] Lord Browne -Wilkinson in the *Westdeutsche* case *(Westdeutsche Landesbank Girozontrale v Islington Borough Council*)[132] recognised this fact when he stated thus:

> Court by way of remedy might impose a constructive trust on a defendant who knowingly retains property of which the plaintiff has been unjustly deprived. Since the remedy can be tailored to circumstances of the particular case, innocent third parties would not be prejudiced and restitution defences, uch as change of position, are capable of being effect.

The implication of the Lord Browne-Wilkinson's view above is that while the English courts still insist on the institutional character of constructive trust because of its certainty, it undoubtedly uses it as a remedial instrument. In *Metall und Rohstoff AG v Donaldson Lufkin & Jenrette Inc*[133] the Court of Appeal was satisfied that there is a good arguable case that circumstances may arise in which the court would be prepared to impose a remedial constructive trust. [134] Lord Browne-Wilkinson has even, in *Westdeutsche*, considered the fact that the remedial constructive trust might be a suitable basis for developing proprietary restitutionary remedies whilst upholding the fact that an unconscionable conduct applied in other countries as the very basis of remedial constructive trust is the underlying test for the recognition of an institutional constructive trust. [135] An unconscionability test for "knowing receipt" was favoured by Nourse L.J. in *Bank of Credit and Commerce International (Overseas) Ltd v Akindel.*[136] However, Virgo regards unconscionability

[130] Ibid.
[131] Oakley, n.59 at 11
[132] (1996) 2 WLR 802 at 839
[133] [1990] 1 Q.B. 391
[134] Ibid at 479 per Slade, Stocker and Bingham L.JJ
[135] [1996] 1 A.C. 74, at 104
[136] [2001] Ch. 437

which is dependent on the views of judges too vague a concept to be used as a principle in its own right.[137]

Despite these efforts to find a mix between institutional and remedial constructive trust, recent decisions in the UK tend to follow the institutional approach as demonstrated in Millett LJ in *Paragon's* case.[138]

The lack of flexibility in the institutional constructive trust approach as applied in the UK company law underscores the rigidity of the principles of corporate personality and the difficulty faced by the courts to widen the scope of recovery available to claimants who are victims of wrongs but do not have pre-existing fiduciary relationship with the company. It is therefore submitted that the courts in the UK should consider imposing a constructive trust against corporate controllers once there has been a finding of unconscionable conduct on their part notwithstanding whether or not (as in US) the claimant has a pre-existing fiduciary relationship with the company.

6.5 The Nigerian Position

Unlike in the UK and other common law jurisdictions such as the US and Canada, the idea of constructive trust is not in much use in company law in Nigeria. There has also been a significant dearth of case law on this subject. A search of the law reports generally revealed that few cases on constructive trust existed and those cases that did exist related to issues pertaining to land and conveyancing. None could be found in company law. An example of this can be found in *Anthony Ibekwe v Oliver Nwosu*,[139] which was decided by the Supreme Court on appeal from the Court of Appeal. In that case, constructive trusteeship principles were applied in favour of the respondent against the appellant in respect of a land transaction between the parties.

Although the case borders on issues related to land, its relevance to this study is the recognition by the court of the essential elements of constructive trust as applicable in Nigeria. According to the Supreme Court, a constructive trust is an equitable remedy that a court imposes against one who has obtained property by wrong doing. The court further asserted that it is imposed to prevent unjust enrichment and creates

[137] See G. Virgo, *The principles of the Law of Restitution*, 2nd ed., Oxford University Press, 2006, 55
[138] See *Sinclair Investments (UK) Ltd v Versailles Trade Finance Ltd*, [2011] 1 BCLC 202 at 80.
[139] (2011) 9 NWLR 1; SC. 108/2006

no fiduciary relationship. It is also termed implied trust, involuntary trust, trust ex delicto, trust ex maleficio, remedial trust, trust in invitum, or trust de son tort.[140] The implication of these statements is that Nigeria appears to be leaning towards the remedial or non-fiduciary relationship approach applied in the US and Canada, as distinct from the institutional approach which results from operation of the law, favoured in the UK.

However, as in the UK, there are still provisions in the Companies and Allied Matters Act (CAMA) 2004 dealing with directors' fiduciary relationship to the company, [141] directors' trusteeship of the company's moneys, properties and accounting for all the moneys over which they exercise control as well as the no-conflict rule, secret profit,[142] corporate opportunity and misappropriation of company assets and money, which are all recognised in the Act.[143] Yet the imposition of constructive trust against corporate controllers has remained unutilised both by the courts and litigants. The reason, as pointed out earlier, may be ignorance on the part of litigants with regard to the efficacy of constructive trust remedies and perhaps the rigid adherence by the courts to the orthodox loss allocation prevalent in the separate legal personality of the company. The small number of claims against corporate fraud and abuses can also be accounted for by the nature of business ownership in Nigeria, which as pointed out in previous chapters, is largely in the hands of individuals and families. The effect is that victims of wrongs, particularly the creditors, continue to suffer at the hands of fraudulent corporate controllers who are themselves the wrongdoers.

A case in point is *Co-operative Bank Ltd v Samuel Obokhare & ors*.[144] In that case, the appellant obtained judgment against the respondent's company (named as 3rd respondent) in a previous case to the tune of N25, 778.11k (twenty five thousand Naira). When it began the process of executing the judgment, the 1st respondent and the Managing Director of the company (3rd respondent) transferred the assets, including stock-in-trade and vehicles to another premises under the name of a new company (2nd respondent) of which he was also the Managing director. With the

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[140] Ibid.
[141] See CAMA 2004, s 279(1). See also *Okeowo v Migliore* (1979) 11 S.C. 133 per Eso JSC
[142] CAMA, s.280(6)
[143] See s.280 (1)
[144] (1996) 8 NWLR (Pt. 468) 579

move by the 3rd respondent, the appellant became helpless hence the second action leading to this appeal.

Both the High Court and the Court of Appeal dismissed the suit and upheld the contention of the respondents disclaiming liability. The grounds for dismissal were that the 1st and 2nd respondents were not parties to the previous suit and that the 1st respondent, being the director or agent of the 3rd respondent company was not liable for the liability of the company debts.

While the court could be said to have held rightly that the 1st respondent is not liable for the debt of the company in view of the separate legal personality doctrine, it is difficult to agree with the judgment that the fraudulent action of the 1st respondent in transferring the assets of the 3rd respondent to the 2nd respondent to deny the appellant the fruit of his litigation does not deserve a remedy. This is an instance in which constructive trust could have been used in order to help the appellant. If anything, the court should have imposed the constructive trust against the appellant in respect of the transferring of the 3rd respondents' assets and the same extended to the 2nd respondent for purposes of tracing the property for disgorgement in order to satisfy the judgment creditor.

In the light of the above, it is proposed that the application of constructive trust in Nigerian corporate law will help stem the tide of corporate fraud and abuses through the provision of alternative remedies that seem to be lacking or have remained unavailable within existing veil piercing principles which have failed to provide useful results, as in the case above. The benefits of the responsible corporate personality model using the constructive trust for Nigerian corporate law can be seen in a number of ways. First, it would enable corporate controllers to exercise prudent investment decisions as well as the scrupulous maintenance of accounts, which are pivotal for the growth of business.[145] Secondly, by means of constructive trust, the entitlement of the true owner, i.e. the company, the assets misappropriated is

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[145] See for example the anomalies which occurred in *Federal Republic of Nigeria v Mohammed Sheriff & 2 others* (1998) 2 F.B.T.L.R 109; *Federal Republic of Nigeria v Alhaji Murnai* (1998) 2 F.B.T.L.R 196; Federal *Republic of Nigeria v Ajayi* (1998) 2 F.B.T.L.R 32 where directors of their respective banks granted loans to companies in which they had interest without taking securities or collaterals. Details of these cases can be found in chapter 4.

preserved in equity.[146] Thirdly, where corporate property is unjustifiably transferred to a shareholder, director or other party, i.e. a third party in breach of fiduciary duty or fraudulent act, the company may be able to recover the property or the value of that property from its recipient in circumstances where the recipient acted as a constructive trustee.[147] This will in turn help the creditors as the assets recovered will increase the pool for distribution. Above all, the model will give certainty to Nigerian corporate law by stripping corporate controllers of gains made through unjust enrichment, instead of trying to allocate loss which is prevalent in the present veil-piercing policy and has failed to yield any dividend, has adversely affected creditors and is characterised by confusion and uncertainty. Adopting a constructive trust model will act as a deterrence measure by stripping the gains made by the corporate controller and will go a long way towards dissuading those who may like to use the corporate form to perpetuate fraud.

Rather than applying the UK fiduciary based institutional constructive trust which is narrow and limited in scope for the purposes of making claims, it is submitted that Nigeria should better adopt the US - Canadian remedial model which de-emphasises a pre-existing fiduciary relationship as a *sine qua non* to the imposition of a constructive trust. The American approach built on the principle of unjust enrichment, is in any event, a more appropriate starting point for the enquiry into whether a constructive trust should be imposed than is the English search for a fiduciary relationship, since it focuses attention on the relevant issues, namely, the facts and circumstances surrounding the obtaining or retention by the defendant of the gain or property in question. The relaxation of the requirement of fiduciary relationship as a basic requirement for maintaining action will also facilitate claims against third parties which are the predominant means of defrauding companies in Nigeria.

6.6 Tracing

Tracing has always remained an effective instrument towards the realisation of the constructive trust remedy because it enables a claimant to demonstrate what has

[146] See the following cases: *Access Bank PLC v Erastus Akingbola and others*, [2012] EHWC 2148*; Federal Republic of Nigeria v. Dr (Mrs) Cecilia Ibru*, FHC/L/CS/297C/2009 (unreported) cited in chapters 4 and 5 respectively.
[147] Ibid.

happened to his property, identify its proceeds and the persons who have handled or received them, and justifies his claim that the proceeds can properly be regarded as representing his property.[148] Indeed, tracing will often interact with a constructive trust claim.[149] A corporate controller who misapplies or transfers corporate assets to himself or third parties or to other ventures or companies can have such assets traced for the purposes of disgorging it from him. A property could be traced both at common law and in equity. However, tracing at common law has a limited threshold as it is impossible to trace property into mixed funds. Equitable tracing therefore becomes more advantageous because it allows tracing into mixed funds.

The essence of tracing is that it enables the claimant to show that the asset to which he has proprietary interest is in the hands of the defendant, even though the defendant may not have the property in its original character. Where therefore the defendant has received the original property transferred to him by the plaintiff, there would be no difficulty in tracing or following it.

The main advantage of tracing to the claimant is that his proprietary claim will not be defeated by the insolvency of the defendant. Thus, if a defendant mixed the property or assets of the claimant to which the claimant has a proprietary interest with his own, and afterwards became insolvent, the defendants trustee in bankruptcy would be in no better position than him vis-a-vis the claimant in a claim for recovery. Secondly, as shown in *AG for Hong Kong v Reid*,[150] where the wrongdoer has made profit out of the trust money, the claimant is allowed to make recovery beyond his original loss. The same reasoning was also applied by the House of Lords in *Foskett v Mckeown*[151] where the claimants sought to enforce their rights against a third party.

Nonetheless, when tracing property, a bona fide purchaser for value without notice will receive the court's protection.[152]

Therefore under the new model being proposed, the court is not only empowered to make appropriate orders for personal liability against the fraudulent controlling

[148] *Foskett v Mckeown*, [2001] AC 102
[149] Evans, n.90 above.
[150] [1994] 1 AC 324
[151] [2001] AC 102
[152] Ibid.

shareholder or director but for the recovery of the misappropriated company assets or money wherever they are found. In that case, such shareholder or director would be disentitled from relying on the corporate shield to escape liability or to hold the said asset or property as his own. Again, although fiduciary relationship may often arise in tracing, it has to be pointed out that under the new scheme being proposed, fiduciary relationship is not required. This is intended to eliminate obstacles in tracing claims where, under the existing UK laws, the existence of a pre-existing fiduciary relationship has become a condition precedent.

6.7 Right of Action

A claim for company money or assets which have been misapplied by a director might be pursued in equity as well as in law. Consequently, the company as the beneficial owner of the trust could seek constructive trust, on the basis that the director is a fiduciary to the company.

A liquidator can also take action to impose constructive trust against the trustee where the company is approaching insolvency or already insolvent. Whether such action is taken by the company as a going concern or at insolvency by the liquidator, it has the potential effect of disgorging the gains made by the corporate controller and by so doing maximising the return to the company for the benefit of the creditors.

However, where the company is unable to take action against wrongdoers who commit fraud because they are in control of the company, a minority shareholder can bring a derivative claim against the wrongdoer on behalf of the company. This, as noted earlier, is one of the exceptions to the rule in *Foss v Harbottle*.[153]

The question that arises is whether a creditor who stands to lose if a company is run down or its officers or directors have committed fraud or abuse affecting his interest can maintain an action on behalf of himself or the company. The simple answer at present would be 'no' with regard to the fact that outsiders or so-called third parties such as the creditor have no fiduciary relationship with the company. In any event, the right of the creditor to enforce the rights of the company may be said to rest upon

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[153] (1843) 2 Hare 461; See also CA 2006, s.260 (1). See also D. Milman, 'Shareholder Litigation in the UK: The Implication of Recent Authorities and Other Developments', (2013) *Sweet and Maxwell's Company Law Newsletter*, 342; *Banford v Harvey* [2013] BUS. LR 589

the fiduciary relation which the officers owe to the corporation, and indirectly to the creditors. However, creditors might maintain action in equity when the corporation is unable to do so particularly where there is no other person to do so, for example in a one-person enterprise where the sole shareholder/director is the wrongdoer.

On this point there is currently no authority in the UK or Nigeria entitling a creditor to take action against a shareholder or director directly or indirectly for any wrongdoing directly or on behalf of the company. However, there seems to be judicial approval in the US for a creditor to take a derivative action against a director for breach of duty when a company is insolvent. In *North American Catholic Educational Programming Foundation, Inc v Gheewalla*,[154] the main issue for determination was whether a creditor of a company operating in 'the zone of insolvency' could bring a direct claim against its directors for alleged breach of fiduciary duty and allied fraudulent matters.

The Delaware Supreme Court expressly stated that, whilst creditors of a company that is either in the zone of insolvency or actually insolvent cannot, as a matter of law, directly sue directors of the company for breaches of the directors' fiduciary duties, creditors of an insolvent company can make derivative claims against directors on behalf of the company for breaches of fiduciary duties or fraudulent acts, just as shareholders can when a corporation is solvent. The court predicated its decision on the grounds that when a company is insolvent, its creditors take the place of shareholders as the residual beneficiaries of the company. This is likely to be the case in UK as well, since English law recognises that if a company is insolvent directors owe duties to creditors. However, the point of departure between the two jurisdictions appears to be the extension of right of action given the creditors to maintain derivative claims against directors during insolvency which is lacking in the UK. Nigerian laws do not recognise that directors owe duties to creditors during insolvency at all either in case law or statute let alone the right to sue.

It is submitted that UK's recognition of right to creditors during insolvency without standing to sue is no right at all. A possible counter argument for this denial may be that allowing creditors to sue directors during insolvency may open up a floodgate of actions which might undermine corporate rescue. The simple response to that

[154] [2007] Del. LEXIS 227

counter argument is that giving creditors right to maintain claims against directors is on limited grounds, and, instead of affecting corporate rescue, it will rather enhance recovery as recoveries under these actions are for the benefit of the insolvent company for distribution to all the creditors and not the particular creditor or group of creditors suing. This is a welcome development in company law. Both UK and Nigeria should borrow from the Delaware position.

In the light of the above, it is proposed that the UK and Nigeria should consider applying the principles enunciated in *North American Catholic Educational Programming Foundation, Inc v Gheewalla* by giving standing to creditors to make claims against directors for breach of fiduciary duties in a derivative manner when the company is insolvent analogous to the derivative claim made by the shareholders when the company is solvent. Such derivative claims can be brought against any director (including former and shadow directors) and other persons implicated in the breach such as a third party.[155] However, a third party for the purposes of this claim applies only to persons who have assisted the director in breach of their duties as in the knowing receipt claim discussed above. As with all derivative claims, the claimant would be required to seek the permission of the court in order to commence the action.[156] The permission requirement is purely for the purposes of determining the standing of the claimant to issue proceedings and not meant to engage him in what may look like a 'trial within a trial'.[157]

The permission stage or procedural aspects involves two hurdles. First, the court must dismiss the claim unless a prima facie case can be made out showing that there is a serious question to be tried.[158] Such a prima facie case would particularly be relevant if it appears in the best interest of the company that the action be brought, prosecuted, defended or discontinued. Secondly, the court must be satisfied that the claim was brought in good faith among other factors.[159] Under the new scheme being proposed, and because of the diversity of situations in which the constructive trust had been employed, it is submitted that there would be no need for the court to consider questions of whether the act would likely be authorised or ratified by the

[155] See CA 2006, s. 260 (3)
[156] See CA 2006, s.261(1); CAMA 2004,s.303 (1).
[157] Ibid.
[158] See CA 2006, s.261(2); CAMA 2004, s.303(2)
[159] See CA 2006, s. 263 (2); CAMA 2004, s.303 (2)

company before or after it occurs, since the timing of the institution of the claim by the creditor is when the company is at the 'zone of insolvency' or already insolvent.[160] This ultimately marks a little shift from the normal shareholders derivative claims which is usually taken when the company is solvent. A creditor, just like the shareholder, cannot bring the action or intervene on behalf of himself and all other creditors as being proposed if his conduct is such as to disqualify him, as it would be, for example, he was party to the wrong about which he complains.[161]

Further, since the remedy sought lies in unjust enrichment, the claimant must plead some underlying cause of action, such as fraud, breach of fiduciary duty or another act entitling the claimant to some relief i.e. the recovery of specific property (either in money or assets), otherwise the action may be defeated by the separate legal personality of the company, which shields the corporate controller from personal liability.

When this is done, the court, upon making a finding of wrongful acquisition or detention by the defendant of property to which the claimant is entitled would, impose constructive trust to disgorge the property forming the basis of the claim from the defendant.

This is a fertile area of possible reform in both the UK and Nigeria in respect of the separate legal personality of the company.

Nonetheless, there could still be concern as to how the intervention of the creditors through right of action against controlling shareholders or directors will impact on their relationship with the liquidator in view of the fact that the latter has been assigned the role to bring or defend action during insolvency on behalf of the company as well as distribute company assets in the UK and Nigeria respectively under the Insolvency Act 1996 and Companies and Allied Matters Act 2004.[162] It is submitted that this concern is not likely to exist as the right of action sought to be given the creditor does not seek to supplant the role of liquidators during insolvency but merely to complement it. Where for instance the liquidator has taken action against a fraudulent shareholder or director, no right of action exist for the creditor in

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[160] See *North American Catholic Educational Programming Foundation, Inc v Gwella*, [2007] Del. LEXIS 227

[161] See *Prudential Assurance Co. ltd v Newman Ind. Ltd.*(1979) 3 All E.R. 507.

[162] See Insolvency Act 1996, ss.143(1) & 144(1) and CAMA 2004, s.424

the circumstances envisaged. It will also amount to *res judicata* if he proceeds to do so.[163] Consequently, it is only when the liquidator has failed to take action that the right of the creditor to do so arises.

With respect to recovered assets consequent upon the action, it is submitted that on a practical level, any recoveries under these actions are for the benefit of the insolvent company for distribution to all creditors, not to those who initiated the misfeasance proceedings to the exclusion of others. Thus the creditors' right of action ends with the determination of the suit. Once the suit is determined, the task of distribution of company assets shifts to the liquidator in line with prevailing insolvency rules such as the *pari pasu* principle discussed in chapter 5, which requires creditors to be treated equally. The creditors would earn no more than what is available for distribution. These claims may therefore be of limited value to creditors seeking recourse against directors of insolvent or near-insolvent companies except that it would widen the scope of recovery, maximise the assets of the company available for distribution whilst imposing further liabilities on corporate controllers. This takes us to the next issue of cost of litigation.

A major drawback of creditors' derivative claim is cost. Cost may be a hindrance to taking creditors derivative claim. First, the cost of taking the derivative claim may be too much for the creditor to bear. This may be frustrating and is likely to lead to unwillingness by creditors to claim against corporate controllers or lead to the outright abandonment of claims already initiated. Second, a creditor who is taking such a derivative claim on behalf of the company would want to be reimbursed. However, the company may not have enough resources to reimburse him or would not want to further deplete its assets for distribution. This may lead to a lack of interest on the part of creditors to take a derivative claim, there being uncertainty on the refund of the cost of the litigation. The effect would be that the company will not have an opportunity of recovering such lost assets fraudulently taken by corporate controllers. It is therefore submitted that in order to make effective the proposed

[163] The general rule is that where a claimant has prosecuted an action against a defendant and obtained a valid final judgment, neither the parties nor their privies can re-litigate that issue again by bringing a fresh action. The matter is said to be *res judicata*. The estoppel created, is one by record inter parties. Thus, a successful plea of *res judicata* ousts the jurisdiction of the court in the proceedings in which it is raised. See *Alhaji Ladimeji & Anor. v. Salami & 2 ors.(*1998) 5 NWLR (Pt. 548) 1; *Osurinde & 7 ors. V Ajomogun & 5 ors*. (1992) 6 NWLR (Pt. 246) 156 (a); See also *Arnold v. National Westminister Bank* [1991] 2 A.C. 93 (H.L.) 104-05.

right of action to creditors, the cost of litigation in respect of creditors derivative claim should be made part of the debt of the company to be paid when all creditors are paid. This will act as a major motivating factor for creditors to embark on such derivative claims and enhance recovery.

Finally, to avoid abuse of court process, the company should not reimburse latter claims or allow a multiplicity of claims against the same controlling shareholder or director where a claim is already before the court against him. This will ensure discipline and effective utilization of the proposed creditors' right of action.

6.8 Remedies

The benefit inherent in transforming a defendant into a constructive trustee leaves the claimant /beneficiary with a two-fold remedy options. First, the constructive trustee may be held personally liable for actions that amount to a breach of trust. Secondly, the claimant/beneficiary may exercise proprietary rights to the misappropriated assets.[164] With these two remedies available, it is now left to the claimant to make an informed decision on how to maximise recovery through appropriate election of the available choices.

The asset's value is determinative when a constructive trustee is solvent since the aim is to recover benefits from the constructive trustee. Holding the constructive trustee personally liable if the misappropriated property has depreciated allows the original value to be recovered.[165] If the misappropriated property has appreciated, the original value and its identifiable fruits can be recovered by allowing the claimant/beneficiary to exercise proprietary rights over them.[166]

Where for instance the trustee is insolvent, a clear choice is presented to the claimant/beneficiary. The claimant/beneficiary may likely choose to rely on the remedy of personal liability of the constructive trustee if the percentage reduction in the value of the property is smaller than the percentage that is likely to be paid out by the trustee in bankruptcy to the general creditors.[167] However, it may be in the beneficiary's interest to both recover the property and claim damages for the fallen

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[164] *Meinhard v. Salmon*, (1928) N.Y. 164 N.E. 545, 549
[165] Oakley, n.59 at 5-6. See also Oh, n.13 at 122
[166] Oh, n.13 at 122
[167] Ibid.

value. If the claimant/beneficiary does not or cannot claim for both the property and fallen value, the claimant/beneficiary's proprietary rights will take priority over general unsecured creditors.[168] The priority is justified on three grounds. First, constructive trust represents a pre-bankruptcy claim on misappropriated asset that must be forfeited by a current holder who only possesses bare legal title.[169] Second, priority, from a relative entitlement standpoint, serves to protect the superior constructive trust claim that the claimant/beneficiary possess outside of the defendant's bankruptcy. Third, priority, from the corrective justice perspective, denies general unsecured creditors the ability to benefit unjustifiably from an asset that would otherwise not be available for distribution.[170]

6.9 Conclusion

In light of the weaknesses identified in the existing veil piercing regime, this chapter proposes a responsible corporate personality model in the UK and Nigeria based on the imposition of constructive trust against corporate controllers for unjust enrichment. The proposed model focuses on recovery of ill-gotten gains or otherwise misappropriated assets of the company from those who own, run or manage its affairs for distribution to creditors instead of loss allocation prevalent in the existing veil piercing regime. Consequently, profits or benefits improperly made by corporate controllers whether in tort or contract would become the subjects of constructive trust with liability to account to the company or a proprietary claim by the company, or shareholders or creditors on its behalf.

The model can be applied in a variety of situations where equity demands, and should be kept in mind as a potential claim to correct a wrong that may not fit squarely within any cause of action. By focussing on gain instead of the laundry list of factors which has characterised the existing veil-piercing regime, the proposed model provides the courts with definitive guidance and eliminates uncertainty in the steps to be taken in imposing liability on corporate controllers.

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[168] A. Wakeman Scott et al., 5 *Scott on Trusts*, Aspen Publishers, 2006, 398

[169] .A. Kull, 'Restitution in Bankruptcy: Reclamation and Constructive Trust', (1998) 72 *AM. Banker. L.J.* 265, 287.

[170] See E.L. Sherwin, 'Constructive Trusts in Bankruptcy', (1998) *U. ILL. L. Rev.* 297,332.

By providing a wide range of choice during insolvency, constructive trust provides claimants with the opportunity to optimise equitable reliefs as opposed to the orthodox veil piercing claims that are pooled with general unsecured creditors.

The proposed model attempts to further extend the scope of exceptions available in *Foss v Harbottle* by giving creditors of insolvent companies the right to maintain actions against fraudulent corporate controllers when the company is unable to do so. Again, rather than focusing on fiduciary relationships, the courts should focus more on gains as they have in the US. This are additions to the corporate law jurisprudence in the UK and Nigeria not only intended to give impetus to the recovery of gain made by corporate controllers particularly in a one-person company where the wrongdoer may be in control but to widen the scope of recovery generally.

Constructive trust as applied to the veil-piercing scenarios is well suited for a developing country such as Nigeria where the tendency is for corporate controllers to misapply corporate assets and funds and use the same to invest in other ventures beyond the reach of creditors. It will also mark a new milestone in the quest to find the solutions to the problems associated with the rigid adherence to the separate legal personality of the company.

The next chapter concludes the thesis and sets out various measures to preserve equity and combat abusive behaviour by fraudulent corporate controllers hiding behind the shield of limited liability.

CHAPTER 7 CONCLUSION

7.1 Introduction

The general rule that a company is a separate legal entity limits creditor's rights to the company assets only and lies at the core of corporate jurisprudence in the UK and Nigeria. This thesis assessed the far reaching consequences that the application of this principle has had on creditors with regard to abusive and fraudulent behaviour of controlling shareholders and directors, while also highlighting the need for ways of dealing with the problem through equitable and flexible means.

The thesis contends that the conceptual framework of the corporate form and the rigid application of the principle of separate legal personality as espoused in *Salomon's* case have both undermined the interest of creditors and wider society. It argues that existing laws have not only been inadequate for dealing with the problem but have failed to restore investors and creditors' confidence in companies, thereby eroding economic growth and expansion in Nigeria and the UK.

An essential element of the separate legal personality of the company is the transfer of uncompensated risks from shareholders and directors to creditors in the event of business failure. In most cases, this has been found to have arisen from the opportunistic behaviour on the company's part due to actions by its controlling directors or shareholders. With regards to the directors, the most common form of opportunism is a waste of corporate assets or misuse of the same through fraud or abuses by those who, when exercising their functions, do not comply with the standard of a diligent and conscientious director, namely those who violate their duty of care or the duty of loyalty owed to the company. In addition, if the company continues to do business even though it is already insolvent or, according to reasonable expectations, will become insolvent in future, directors may still benefit from opportunism since they continue to receive salary payments and enjoy other privileges linked with their position. With respect to shareholders, the lack of personal liability for the company's debt (limited liability) will serve as a powerful incentive to cause the company to act opportunistically, either in the form of a subsequent distribution of assets or by taking on riskier business projects. This is undesirable as shareholders who reap the benefits of the corporate form ought to equally take corresponding losses. It is therefore argued in this thesis that controlling shareholders and directors who act in an opportunistic manner, or who misappropriate company assets through fraud and abuses, should be held personally accountable for their actions and assets recovered from them should enhance the pool of resources available to creditors.

To achieve this end, the thesis proposes a change of the existing common law approach to a more equitable approach, which instead of rationalising the abuse of the corporate form, focuses more on disgorging the assets of controlling shareholders and directors who have misused the corporate form for illegitimate ends or for improper purposes. This approach arguably, offers a more realistic and practical solution to the abuse of the corporate form and obviates the difficulties faced by the courts in dealing with existing veil piercing mechanisms. By adopting a comparative analysis of the problem within the framework of the UK and Nigeria, the thesis provides impetus for Nigeria to learn lessons and examine the problems of the separate legal personality of the company and limited liability for its members in the UK and other common law countries with relatively long periods of legal advancement in the commercial and corporate fields.

7.2 Restating Key Arguments

This thesis has undertaken an analysis which is consistent with appropriate methodology and the core aims of the thesis regarding the protection of creditors and the need for an appropriate balance between legitimate and illegitimate uses of the company. The doctrinal content of company law with regards to the separate legal personality of the company has been assessed by reference to the same themes as had been adopted for analysis of the structure of the law, namely: the effect of incorporation and registration; the position of shareholders and directors as well as those who deal with the company; contractual basis; regulation; administration and disclosure; liability and failure including take-over and winding up processes. These issues are juxtaposed with existing law and legal commentaries in chapters 3-6 regarding the appropriate legal measures to tackle corporate fraud and abuses, the role of sanctions, appropriate institutional and regulatory reforms and the need for, and role of, international co-ordination in jurisdictional and enforcement issues.

These considerations formed the basis for the propositions on appropriate reforms made in the thesis with regards to the identified problems of the corporate form.

In chapter 2, this thesis has formulated a theoretical framework and provided the frame of reference for the analyses and arguments in the subsequent chapters. What is theorised in this thesis is the artificial entity theory. This theory, unlike other theories of the corporation, postulates the notion that the company is an artificial person whose existence comes into being by the constitutive act of the state through laws and regulations. The notion of the company is what the law wants it to be. The company was equal in law to a natural person, at least as long as it acted intra vires. The artificial entity theory was chosen because it sufficiently explains the underlying organisation characteristics of a legal person and explains the relationship between the organisation and its members. It is this principle which separates the company from human beings who control its affairs, which in turn removes the latter from the liabilities of the company. The theory also provides justifications for the company to own its properties, be liable to its debts and have the capacity to enter into contracts and maintain actions in court of law in its own name.

Thus, a key argument is that artificial entity theory as well as its variant of concession theory, addresses to a considerable degree the inadequacies of other theories, particularly in the way it recognises the separate existence of the company from its members and the role of the state in providing regulations for the existence of the company and responses to the problems of the corporate form. The problems as indicated in chapter 1 include the negative impact of the strict application of Salomon's case, the misuse of the corporate form by controlling shareholders and directors, and the inadequacies of existing laws aimed at dealing with fraud and abuse of the corporate form.

The artificial entity theory further provides legitimacy for dealing with the problems and answering the question raised in the thesis, namely: whether there are exceptions to the separate legal personality of the company and if they are adequate to provide solutions to the problems of the corporate form; whether further measures should be taken to make corporate controllers personally liable in the event of abuse of the corporate form and thirdly; or whether there is need in certain circumstances to introduce further measures to make controlling shareholders liable beyond agreed contributions.

The artificial entity theory therefore formed the basis for the evolution and subsequent operations of English company law which were extended to other common law countries, including Nigeria. The potential in the theory lies in its far reaching implications for understanding the nature of a corporation and the regulatory powers of the state in corporate matters. The separate personality and property of the company is sometimes described as a fiction. However, as discussed in chapter 3 the fiction is the whole foundation of English company and insolvency laws which are based on common law.

The nature of the company as an artificial entity set out in chapter 2 was espoused in the celebrated case of *Salomon v Salomon*. Despite the reverence with which the case has been held by legal doctrine and its subsequent importance in defining the doctrine of separate legal personality, the case, when examined closely, actually allows for and highlights the mutability of separate legal personality. This relates to only those cases which are true exceptions to the rule in *Salomon v Salomon*, i.e. 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. Thus where the company has been abused for a purpose that was in some respect improper, the veil of the company could be lifted to hold those who are responsible for the fraud or abuses to account for their actions.[1]

With the theoretical and analytic framework formulated, the first task of this thesis as shown in chapter 3 therefore is to determine how the UK has responded to the application of the separate corporate legal personality and limited liability since the *Salomon's* case. Chapter 3 confirms the findings in chapter 2 that in spite of the shield of protection given to shareholders and directors by virtue of the principles enunciated in the *Salomon's* case, the corporate veil can be lifted to find personal liability in limited circumstances such as in cases of fraud or impropriety. Nonetheless, the thesis finds that what constitutes fraud still remains elastic; the UK approach to corporate veil has been remarkably rigid; and fraud or impropriety therefore remains within the province of the court to determine.

[1] See the recent case of *Prest v Petrodel Resources Limited and others*, [2013] UKSC 34

It has thus been argued in chapter 3 that the UK's response to the effect of *Salomon's* case has been anything but satisfactory. In spite of an acceptance that rigid application of *Salomon's* case could lead to unjust results, the courts in the UK have been reluctant to lift the corporate veil to hold the persons managing the company responsible for their actions. Instead, the courts have without well-defined criteria formulated metaphors such as 'sham', 'facade', 'device', 'fraud', or evasion of contractual obligation as grounds for lifting the veil of the corporation. The matter has not been helped by commentators who have adopted this categorisation approach in determining grounds upon which the veil of the company could be lifted. This thesis argues that the categorisation approach, whether of 'sham', 'fraud', 'device', 'façade', single economic unit, agency or otherwise, has not resolved the problem of separate corporate legal personality, and has actually led to more difficulties and confusion with the courts making conflicting decisions. The fact that the UK veil piercing doctrine does not consider the notion of justice as exemplified in *Adams* case has further led to considerable difficulties.

Although *Adams* case is the first systematic consideration of disparate body of English case law on this subject since *Salomon*, it has narrowed the scope of veil piercing approaches in the UK to circumstances where the court is entitled to pierce the corporate veil and recognise the receipt of the company as that of the individual(s) in control of it, as long as the company was used as a device or facade to conceal the true facts, thereby avoiding or concealing any liability of those individual(s). For years after it was decided, *Adams* was regarded as having settled the general law on the subject. Nonetheless, what constitutes façade was not defined in the case. It would have to be inferred that the corporate veil could only be disregarded where it was being used for deliberately dishonest purposes or where an abuse of the separate corporate legal personality has been used to evade the law or to frustrate its enforcement.[2] This implies that a court, before lifting the corporate veil, should find evidence of an unlawful purpose or some other impropriety such as fraud or deliberate concealment of the identity and activities of corporate controllers.[3] The company may be a 'façade' even though it was not originally incorporated with any deceptive intent, provided that it is being used for the purpose of deception at the

[2] See *Gilford Motor Co v Horne* [1933] Ch 935 and *Jones v Lipman* [1962] 1WLR 832
[3] B.R. Cheffins, *Company Law, Theory, Structure and Operation*, Clarendon Press, Oxford, 316.

time of the relevant transactions.[4] *Adams* case thus provides a particularly stark example of the application of the *Salomon* principle.[5] It brings to the fore the denial of corporate protection to tort claimants or involuntary creditors and thus limits veil piercing jurisprudence in the UK to contracts. This thesis argues that this may be unfair to tort claimants, some of whom may have genuine claims against the company even though they had no pre-existing contractual relationship with it. It therefore welcomes the recent Court of Appeal decision in *Chandler v Cape plc*[6] which imposed for the first time liability on a company for breach of duty of care to an employee of its subsidiary. This landmark case tends to open up recourse for tort victims in certain circumstances and therefore tends to support the thesis proposal not only for the denial of separate legal personality for companies in a group but an arrangement where companies operating in a group would be treated as an enterprise or collective whole. This ultimately will act as a means of promoting justice in respect of the group's action and commitment to victims of its activities, particularly tort creditors.

It is further argued that the UK's cautious approach in imposing liability on controlling shareholders and directors, and not reaching their assets, demonstrates the inadequacy of the existing common law approach. Further, the existing approach of veil piercing having failed there is need to adopt a more equitable and flexible approach to the problem instead of holding tenaciously to present standards. The standards with their references to metaphors such as 'façade' and 'sham' are simply not clear.

Having seen in chapter 3 that the courts' intervention have failed, there have been legislative interventions aimed at holding the directors liable during insolvency and, in some cases disqualifying them through the wrongful trading provision in the Insolvency Act and disqualification of directors' laws. This thesis recognises that the wrongful trading provision as set out in section 214 of the Insolvency Act 1986, is a bold attempt by UK Parliament to deal with the problem of abuse of the corporate form through the imposition of liability on delinquent directors who continue to

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[4] See the dictum of Munby J in *Ben Hashem Al Shayif* [2009] 1 FLR 115 and also the analysis provided by Sir Andrew Morritt VC in *Trustor AB v Smallbone* (No 2) [2011] 1 WLR 1177

[5] J. Dine & M. Koutsias, Company Law, Palgrave Macmillan, 2009, 29.

[6] [2012] EWCA Civ 525; See also M. Petrin, 'Assumption of Responsibility in Corporate Groups: *Chandler v Cape plc*, [2013] 76 (3) MLR 589-619

trade while the company is insolvent. Section 214 requires that the court can, on application by a company's liquidator, declare that a director has engaged in wrongful trading and therefore must contribute to the assets available to creditors. Unlike the fraudulent trading provision before it, it does not require proof of intent to defraud or dishonesty. However, under the new regime of wrongful trading, Parliament simply extended the familiar concept of fraud to cover situations where directors are merely negligent or reckless.

The wrongful trading provision in spite of its good intentions has inherent problems which need to be redressed. As pointed out in chapter 3, the wrongful trading provision lacks clarity in so many respects, making it difficult to implement. It, for instance, has no clear provision on funding and also limits the right of action to the liquidators only, extending no right of action to creditors. This has limited the number of claims that go to court as the liquidator may show apathy or unwillingness to pursue claims against erring directors because of the huge cost involved. Similarly, the wrongful trading provision lacks clarity in relation to specification of the time when insolvency is triggered or the steps to be taken by the director in such an event. This has created confusion and uncertainties in the minds of directors, some of whom may only speculate on the proper course of action to take. Similarly, determining the time when a company is insolvent becomes a tricky exercise which the courts face unless it is clarified by the law.

The thesis whilst drawing examples from other jurisdictions such as Australia where similar provisions exist, argues that in order to make the wrongful trading provision meaningful and effective, there should be clarity on the issue of funding of claims, timing of insolvency and steps to be taken by directors when insolvency sets in. In order to obviate the problem of cost which the liquidator may face in bringing claims under the wrongful trading provisions, the scope of recovery should be widened to give the UK Secretary of State for Trade and Industry the power to initiate claims or allow creditors to bring action either as individuals or a class. Clarity in the wrongful trading provision is required to make directors personally accountable for corporate debts in order to make them responsive to creditors.

In chapter 3 it is also shown that a director may be disqualified from holding the office of a director or senior management position in a limited liability company for periods ranging from two to fifteen years if he has been declared unfit by the court or engaged in fraudulent or wrongful trading or violated a varying number of statutory prohibitions or requirements designed to protect creditors pursuant to the Directors Disqualification Act 1986. The essence of disqualification as provided in the law is to protect the public interest from the unfit conduct of delinquent directors hence disqualification of directors cuts in two ways: as an ex post sanction for past violations and as a pre-emptive mechanism for creditor protection. The problem with this legislation, as demonstrated in the chapter, is that the law provides no clarity of what is 'unfit' for the purposes of determining when to disqualify a director. Unfitness can therefore be the subject of wide and varied interpretations which are not dependent on law but facts. It is arguable whether this legislation has achieved its purpose as most disqualification orders come too late after debts have been incurred whilst some disqualified directors continue to serve in companies because of lack of effective monitoring process. It is therefore proposed that disqualification proceedings may be meaningful if they are instituted early before serious harm is done to the company. On the other hand, what is 'unfit' for the purposes of disqualifying a director should be clearly stated. Again, it is important that an effective mechanism should be put in place to monitor and put a check to the re-emergence of disqualified directors from reappearing in the management of companies before the due date of their disqualification order.

Having established in chapter 3 that the doctrine of separate corporate legal personality is not absolute and examined the UK responses as reflected in the state of its veil piercing approaches, chapter 4 then turns to explain how the doctrine has been recognised, interpreted and applied in Nigeria. Although Nigeria has had a very long relationship with the UK dating from the initial contact in the second half of the nineteenth century and has accepted UK laws including company law, the doctrine of corporate separate legal personality as exemplified in the case of *Salomon v Salomon* applies in current Nigerian law by virtue of section 37 of the Companies and Allied Matters Act 2004.

It is shown that Nigerian courts have been influenced by English decisions on this matter. This is evident from the courts' reluctance, as in the UK, to lift the corporate veil except in limited circumstances. The rigid adherence to the doctrine expressed in the *Salomon's* principle coupled with the unpredictability in determining circumstances when corporate controllers have abused the corporate form or committed fraud or any act of misconduct against the company and creditors demonstrates the problems faced by the courts. However, Nigerian courts have shown a willingness to lift the corporate veil where fraud is involved.

Nonetheless, there has been a paucity of cases on this subject. This could be attributed not only to the low commercial environment in Nigeria, but also institutional problems and an ineffective regulatory system. This could be seen in the lapses in the activities of the Corporate Affairs Commission, the weak judicial system and a lack of adequate legislation that would tackle relevant problems and enable the court to act when faced with the issues of corporate fraud and abuses. A clear example is the fact that Nigeria does not have an insolvency legislation similar to the UK's. Thus, the courts lack the necessary legal framework or guidelines on how to deal with the problems. In addition, the courts have been faced with long delays in hearing cases to the extent that some cases last such a long time before they are determined. There is also the problem of corruption in the judicial system which may make it possible for cases of abuse of corporate form to be compromised or unduly delayed thereby thwarting justice. The result is that controlling shareholders and directors rely on the absence of relevant laws and weak regulatory and judicial systems to escape liability.

This thesis proposes that Nigeria should, like the UK, consider enacting separate insolvency legislation different from the existing Companies and Allied Matters Act 2004 (CAMA). This has become pertinent because CAMA fails in many respects to provide new areas of corporate law such as insolvency. The thesis advocates the general overhaul of the Nigerian regulatory landscape as it relates to corporate matters, including the judicial system, administrative and disclosure mechanisms in order to make them more effective in dealing with the problem of corporate fraud and abuses. It is recommended that as a precondition for incorporation or registration of any company, its promoters should be required to produce a certificate from the Ministry of Trade to the Corporate Affairs Commission (CAC) confirming that in view of the risks involved in the enterprise, or for other reasons, the formation of the company is justified. The proposed framework can be used as a basis to hold the civil and political officials of the ministry personally liable if they abuse the issuance of such certificate. This would prevent uncontrolled registration of companies, most of who could be said to be non-existent in terms of real corporate activities. There is also the need to amend the extant company law; for example, the CAMA may contain provisions stipulating periodic mandatory investigations into the affairs of the companies, at least on a quarterly basis. This could be done by establishing a corporate monitoring unit in CAC to serve as an actual supervision department of the Commission. It is further recommended that the mechanism of investigation into the activities of companies sought to be adopted by the CAC should also evolve a system whereby delinquent or fraudulent directors are punished or sanctioned in a manner akin to what obtains in the UK under the Director's Disqualification Act. This may not only enable early detection by the Commission of fraudulent activities of controlling shareholders and directors before the company collapses but also protects the interest of creditors and will go a long way in imposing appropriate sanctions against such corporate controllers.

Further, there ought be a provision in CAMA that where the court is satisfied that a person who controls a company by means of majority shareholding or being able to determine the composition or policy of the board of directors has abused the corporate form with the result that the rights of creditors have been delayed or defeated, the court may declare the controlling person to be personally liable for all or some of the debts of the company. The judges will probably use this power only in extreme cases but the knowledge that it might be applied may operate as a deterrent. In particular cases of fraud, a provision in CAMA is recommended to the effect that where a company has been used to commit fraud exceeding N1, 000, 000 (£4,000)[7] the company shall be compulsorily wound up. This new provision is required in the Act notwithstanding section 408(e) of CAMA that provides for the winding up of a company if in the court's opinion it is just and equitable. The proposed provision arguably provides sufficient deterrent against corporate controllers for the abuse of the corporate form.

In addition, the courts should adopt a liberal and flexible approach in dealing with issues concerning the abuse of the corporate form instead of the existing rigid standards under the common law. The effect is that specific facts of cases would be

[7] On the basis that the full weight of the law should be triggered by the seriousness of an act, this amount is a substantial amount in Nigeria because the National mininmum wage, for example, is N18, 000 under the National Minimum wage Act.

determined on grounds of equity instead of lumping cases together based on categories and thereby sending out conflicting decisions on similar facts.

In chapter 5, the thesis undertakes a comparative analysis of veil piercing approaches in the UK and Nigeria. Following from the examination in chapters 3 and 4 of respective veil piercing approaches adopted in the UK and Nigeria, chapter 5 sets up the original contribution of the thesis in chapter 6. The chapter shows areas Nigeria needs to learn lessons from UK particularly in the areas of insolvency laws, disclosure mechanisms and creditor protection whilst also demonstrating areas Nigeria's expansive and wider interpretation of fraud is different from what obtains in the UK.

While the concepts of corporate personality and limited liability in the UK and Nigeria examined in this thesis have some common themes such as the rigid application of the *Salomon's* principle, differences exist in the commercial sectors and regulatory backgrounds of the two jurisdictions.

As a foundation for analysis in chapter 5, the thesis has highlighted the existing incorporation requirements in the UK and Nigeria, including the formation of companies with little or no capital which is prevalent among closed or private companies. Even though it is difficult to determine the level of sufficient capital needed to establish a business, where a company is established without initial capital or with low capital ratio, undercapitalisation potentially affects subsequent activities and operations. Notwithstanding that low or minimum capital requirement arguably can encourage entreprenuers with good ideas a relatively easy route to set up businesses and transform those ideas for their benefit and that of the society, it raises concerns of fraud among single member companies. In such companies a controlling shareholder may, for fraudulent purposes, incorporate with initial capital aware to be inadequate to meet the expected liabilities of the business. Despite the problems this poses, undercapitalisation is not made a ground for lifting the corporate veil or veil-piercing in the UK and Nigeria. The prevalent position in the US is different. The thesis argues that the omission of this important factor in the consideration of grounds for lifting the corporate veil has serious implications given the risk and adverse consequences undercapitalisation poses to small trade creditors. The thesis argues that this major omission needs to be redressed and proposes the need to ensure adequate capitalisation of companies on incorporation. In the alternative, a minimum standard may be set such that the interest of creditors is covered before a company is allowed to enter the market. This will ultimately deter unscrupulous shareholders from using the company as a means of fraud and protect creditors from companies who may wish to enter the market without capital.

In continuing the analysis of the responses of the UK and Nigeria to the problems of the corporate form, chapter 5 has examined directors' duties in relation to creditors' interest, highlighting differences between the two jurisdictions. The UK has made greater advancement than Nigeria in terms of creditors protection both in case law and legislation, particularly when a company is approaching insolvency or already insolvent. In the UK, the corporate veil could be lifted to hold a director liable if he fails to consider creditors interest during insolvency. While the case law in the UK holds tenaciously to this indirect duty placed on directors which are framed widely enough to include conduct which shall not be detrimental to creditors during insolvency, the wrongful trading provision in the Insolvency Act appears to be a legislative re-enactment of this position. Chapter 3 shows that the courts and legislature in the UK have begun to widen the scope of directors' duties to include a duty owed to creditors by directors' during insolvency. Nigeria lacks similar case law and legislation to support director's duties to creditors. Chapter 5 argues that Nigeria has a lot to learn from the progress made in the UK in relation to creditors' protection, particularly through the wrongful trading provision, director's disqualification mechanisms and case law analyses. Nigeria should consider having similar legislative measures for protecting the interest of creditors.

Chapter 5 demonstrates that fraud is a common feature of and the only predictive ground for veil piercing approaches in both the UK and Nigeria. However, the judicial approach and interpretations of fraud differs due to the peculiar commercial enviroments that exist between the two countries. While fraud is limited in the UK to instances of evasion of contractual obligations as demonstrated in the leading case of *Adams v Cape Industries*, fraud as interpreted and applied in Nigerian courts, goes beyond issues of contract and extends to matters of deceit, misrepresentation, diversion of company assets and misappropriation. A unique feature of fraud in Nigeria's approach is the use of the corporate form as a protection for controlling shareholders and directors who deliberately set up companies for scam or fraudulent intention in what is otherwise referred to as '419' scheme. It has therefore been argued that the notion of fraud should be expanded to include other unconscionable conduct including activities which may be regarded as sharp practices. In addition, once a finding of fraud is made, the corporate veil may be lifted to find the corporate controller liable if the company has been used as a conduit to perpetrate the fraud.

Veil piercing processes in relation to contract and tort claims in the UK and Nigeria have also been examined. The corporate veil is commonly lifted in contract more than in tort. Following the decision in *Adams v Cape Industries Plc* which seems to foreclose consideration for claims in tort, it is difficult to lift the corporate veil on grounds of tort. Adams case demonstrates that English law does not provide for the liability of the parent for the debts of the wholly owned subsidiary even when there is manifest wrong on victims of tort. The implication is that subsidiary companies may, therefore, be set up as a bulwark against risk of loss even though as *Chandler v Cape plc*[8] has shown, liability may be imposed on a parent company for breach of duty of care to an employee of its subsidiary in relation to health and safety matters in which it was seen to have assumed responsibility. There is no authoritative case law like *Adams* or *Chandler* on this subject in Nigeria. However victims of tort are known to prefer out-of-court settlement. The thesis supports the maintenance of adequate insurance for victims of tort to cover foreseeable damages even though no contract is maintained by tort victims with the company. For contract claims, a charge over company property or personal guarantees by creditors is favoured as efficient mechanisms for the protection of creditors because of the certainty of contractual terms.

Chapter 5 shows that disclosure mechanisms, regulatory and administrative processes aimed at combating fraud and abuses in companies are relatively weak in Nigeria when compared to the UK. Disclosure for the purposes of effective creditor protection would only be achieved if the following perquisites are fulfilled: the information is easily available, e.g. via the internet from the company's homepage or commercial register; the information is reviewed periodically, every three months; the information is standardised and all companies employ the same framework, standardised methodologies and calculations, and reporting formats; and if the

[8] Ibid.

information is easily understood and can easily be acted upon accordingly. The thesis therefore argues that the CAC in Nigeria should rely on these principles and, as found in the UK, set up a companies' website where existing companies existing are listed. The website should be set up in such a manner that it would be able to give, and possibly even assess information about companies operating in Nigeria without the unnecessary bureaucratic hurdles associated with the present system.

Whilst effective disclosure and other measures outlined above are fundamental to corporate existence and maintenance of the corporate form, the thesis argues that the measures would only be meaningful if those who fraudulently mismanage a company to the detriment of creditors are not allowed to benefit from their action. This is particularly important as the authorities reveal that most judgments in the common law systems are declaratory in nature without consequential orders to effect recovery of the company assets or mitigate the harsh realities of the effect of the corporate form on creditors. This raises issue of applying equitable measures to disgorge the assets of controlling shareholders and directors whenever they are found culpable in order to meet the contractual and other obligations the company owe to creditors.

The thesis as contained in chapter 6 has therefore been that responses to corporate fraud and abuses conceptualised in the existing veil piercing remedies are neither adequate nor capable of confronting the complex nature of problems associated with the corporate form. The existing veil piercing approaches have remained fundamentally flawed whilst most of the legislations on the subject, in spite of their good intentions, require urgent reforms in order to achieve any meaningful result.

7.3 Restating the Proposed Corporate Personality Model

It is clear from the cases and commentaries that the law relating to the lifting the veil doctrine is unsatisfactory and confused. Those cases and commentaries appear to suggest: firstly, that it is difficult to invoke the doctrine of lifting the corporate veil successfully; secondly, there is doubt as to whether the doctrine should exist; and thirdly, it is impossible to discern any coherent approach, applicable principles, or defined limitations to the doctrine. The lack of coherent principles in the application of the doctrine is evident in judicial pronouncements in major common law jurisdictions.[9] The result is that there is no consistent principle on when to lift the corporate veil nor has the principle itself provided any guidance on when it can be used. It can therefore be said that the principle is fraught with ambiguity with few predictable results. Nevertheless, scholarly arguments and proposals on how to mitigate the negative effects of the corporate form on creditors and the misuse of limited liability have followed the same trend. Proposals have been framed along the path of loss allocation analyses and fail in several respects to articulate an effective mechanism to deny the proceeds of fraud or gains made from it from controlling shareholders and directors. Owing to this conceptual deficiency, the problems of corporate fraud and abuses have remained unabated as it is difficult to reach the assets of corporate controllers either by the company or creditors. This is a major task for this thesis, demonstrating the distinctiveness of its approach to the issues.

Unlike previous proposals, the approach adopted in the thesis is predicated on two major principles: that a person, for instance, a controlling shareholder or director as a constructive trustee, shall not benefit by his own fraud and shall not benefit as a result of his own crime.

In order to achieve this, the thesis proposes the adoption of the 'responsible corporate personality model' built on the concept of unjust enrichment to deal with the problem of corporate fraud and abuses. The model conceives gain made by a controlling shareholder or director through fraud or abuses as constituting an unjustified enrichment which must be disgorged. Unlike previous proposals, the constructive trust-based model puts in place a mechanism to trace the proceeds of fraud and abuses wherever they are located, even to third parties, and gives wider rights of action to creditors in order to bring claims against controlling shareholders and directors to recover a company's misappropriated assets when that company is approaching insolvency or insolvent.

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[9] See the following cases: Clarke J in *The Tjaskemolen*[1997] 2 Lloyd's Rep 465, 471 (UK); *Chief Nye John D. Georgewill v Madam Grace Ekene*, (1998) 8 NWLR (Pt. 562) 454, 459 ratio 8 (Nigeria); *Briggs v James Hardie & Co Pty Ltd* (1989) 16 NSWLR 549, 567 (Australia); *Constitution Insurance Co of Canada v Kosmopoulos* [1987] 1 SCR 2, 10 (Canada); *Attorney- General v Equiticorp Industries Group Ltd (In Statutory Management)* [1996] 1 NZLR 528 (New Zealand); *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd*, [1995] (4) SA 790 (A), 802-803 (South Africa); *Secon Serv Sys Inc v St Joseph Bank & Trust Co*, (1988) 7th Cir, 855 F2d (US); *Allied Capital Corp v GC-Sun Holdings LP*, (2006) 910 A2d, 1020, 1042-1043 (Delaware US).

Thus, under this model proposed a creditor could maintain a claim against a controlling shareholder or director in a derivative manner on behalf of the company so as to recover misappropriated assets of the company wherever they are found. The creditors right of action against a controlling shareholder or director is akin to a derivative claim which a minority shareholder or director may utilise to assert his own right against those in control when a company is solvent. Consequently, a creditor instituting such a claim must obtain the permission of the court to proceed.

A creditor bringing a claim against a controlling shareholder or director under the proposed model need not be a fiduciary to the company to do so. The question of being in a fiduciary relationship with the company which the creditor lacks has been an obstacle to the creditors' claims in the UK and indeed in the whole of the Commonwealth world including Nigeria. The departure from the requirement of fiduciary relationship as a basis of enforcing claims against a controlling shareholder or director by a creditor is a novel approach which is not presently in existence in the UK and Nigeria. The model attempts to remove this obstacle as a means of enhancing recovery and maximising benefits for distribution to creditors.

It is clear that the legal personality principle restrains creditors from suing shareholders and directors in order to avoid a multiplicity of suits and double recovery while simultaneously guaranteeing that the principle of *pari pasu* applies to claimants. Nevertheless, the proposed model argues that the right of action given to creditors is for the benefit of the company. Thus any recovery made is for distribution to the whole body of creditors and not for the particular creditor or creditors who brought the claim although the claimants will be entitled to the reimbursement of their expenses which will be charged as part of the general debt of the company. The model supports the principle that the distribution of company's assets belong to the liquidator acting on behalf of the company and not to the creditor, no matter the role played in the recovery of the assets. Its major concern remains largely the need to widen the scope of recovery of misappropriated assets by stripping the controlling shareholders and directors of the gains they made through fraud and abuses. However, as it argues that in recognition of the enormous cost such creditors' claims can take, the model proposes a scheme where the creditors cost of litigation should be included as part of the debt of the company to be paid or reimbursed when all creditors are paid. In addition, where a creditor or liquidator has taken action against a particular controlling shareholder or director, it abates all subsequent action by any other creditor or the liquidator on the same subject as continuance of such claim may be defeated by the principles of issue estoppel or estoppel per *rem judicata*.

From the above analysis, it is clear that the responsible corporate personality model has as its main features the recovery of misappropriated assets from controlling shareholders and directors, maximisation of benefits for distribution to creditors and extending the right of action to creditors. It therefore proposes the extension of the rule in *Foss v Harbottle* so as to incorporate certain rights of action by creditors against controlling shareholders and directors, particularly when the company is unable to do so. The model also attempts to strip from controlling shareholders or directors gains made by them through their fraudulent actions or unjust enrichment, and the model removes the burden of proving fiduciary relationship before a claimant can bring a claim. Thus, once the court is convinced that there is an unconscionable conduct on the part of the director or shareholder, the court will impose constructive trust against him in order to recover the proceeds of gain made and make him liable for his actions.

With the courts focus on stripping the gains made by those in control of companies instead of the laundry list of factors in the existing veil piercing approach, the difficulties the courts face in imposing liability against controlling shareholders and directors following the strict application of the *Salomon's* principles is greatly reduced if the proposed model is applied. The novelty of the responsible corporate personality model lies in its integrated approach to removing all obstacles affecting effective recovery of company's assets for the benefit of creditors such as fiduciary relationship, limitation of right of action to the company and the rigid approach to the doctrine of separate legal personality and limited liability. By applying constructive trust to veil-piercing scenarios, the model marks a departure from the tepid responses to problems of fraud and abuses of the corporate form under the existing approaches.

The application of the responsible corporate personality would signify a major milestone in finding a solution to the problem of corporate fraud and abuses in a developing country like Nigeria through its capacity to trace misappropriated company assets wherever they are located. Its extension of right of action to creditors means, in effect, that creditors can effectively enforce claims against controlling shareholders and directors notwithstanding the lack of a fiduciary relationship with the company. The implication is that, in Nigeria where single-member companies are dominant, the controlling shareholder or director cannot use his position to frustrate claims by the creditor based on the principle of corporate personality. Again, the fact that the controlling shareholder or director knows that the misappropriated assets could be stripped off from him has the effect of deterring him from fraud and abuses.The proposed model can assist Nigeria's economic development by restoring investor and creditor confidence in the corporate form.

Clear from this analysis, at least from a practical angle, is that the responsible corporate personality model is a pragmatic approach to dealing with the problem inherent with the rigid application of the *Salomon's* principles and the negative effect of fraud and abuses associated with it. The model is also likely to be highly predictive of judicial outcomes. Unlike the current intuitive and *ad hoc* understanding of the cases and commentaries under which it is difficult to determine when the court could accept or refuse to hold shareholders and directors liable through the veil-piercing approaches or the extent of damage to be imposed, the responsible corporate personality model gives clear guidance to the courts. Through effective balancing of interests of the company and all the actors involved (namely the shareholders, directors and creditors), the courts will be in a position to apply equitable measures and hence produce efficient results in this important area of corporate law which is often abused at the moment. The new approach therefore provides enough security to honest shareholders and directors whilst ensuring that the interest of creditors are protected and not in any way undermined under the guise of the separate legal personality of the company.

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