THE MYTHOLOGY OF SALOMON'S CASE AND THE LAW DEALING WITH THE TORT LIABILITIES OF CORPORATE GROUPS: AN HISTORICAL PERSPECTIVE

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Salomon's Case has for a long time been widely seen as a landmark case that is the keystone of modern company law. A mythology has developed around the case that has resulted in the Salomon principle exercising an iron grip on company law. The rigid application of the principle in Salomon's Case to corporate groups has enabled corporate groups to structure themselves in ways that limit the tort liabilities of the group as a whole and so raises important social, economic and ethical questions regarding the allocation of risk that are not addressed by the application of the Salomon principle. This article suggests that given the importance of the social, economic and ethical issues raised in cases of mass torts that invariably involve corporate groups, it is preferable that these issues are resolved by tort law, which is concerned with the allocation of risk, thereby circumventing the dead hand of Salomon.

I INTRODUCTION

The Supreme Court of the United Kingdom has recently handed down two decisions — VTB Capital PLC v Nutritek International Corporation¹ and Prest v Petrodel Resources Ltd² — that dealt with the separate legal personality of a registered company and the circumstances in which it might be possible to disregard the separate personality of a company by 'piercing the corporate veil' or looking beyond an individual company's ownership of assets or bearing of liabilities.³ The Prest decision in particular contains detailed judicial observations on the narrow operation of the 'piercing the corporate veil' doctrine, in the sense of the courts disregarding the separate personality of the company.⁴ In all

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- 1 [2013] 2 AC 337 ('VTB Capital v Nutritek').
- 2 [2013] 2 AC 415 ('Prest').
- See especially the observations of Lord Neuberger in *VTB Capital v Nutritek* [2013] 2 AC 337, 382–7 [118]–[142] and Lord Sumption in *Prest* [2013] 2 AC 415, 478–88 [16]–[36].
- In *Prest* [2013] 2 AC 415, Lord Walker expressed some doubts as to whether there was in fact a 'piercing the corporate veil doctrine': at 508–9 [106]. He thought it was simply a label rather than a coherent principle or rule of law. Lord Sumption and Lord Neuberger concluded there was a principle that the corporate veil could be pierced, but it was a 'limited' rule: at 488 [35], 503 [82].

likelihood these cases will prompt considerable academic and judicial discussion on these legal issues. It is, therefore, perhaps timely to revisit the case of *Salomon* v A Salomon & Co Ltd⁵ from which much of the legal personality doctrine stems.

The importance of the decision in *Salomon* has two aspects. The first of these concerns the legal concept for which it is famously known; that is, that the decision established, clarified, or confirmed, the fundamental principle that a registered company is a separate legal entity, distinct from its shareholders, and is to be treated as any other independent person with its own rights and liabilities. According to this perception, it is at least implicit that before the decision in *Salomon* the separate legal entity concept had not yet been fully recognised or developed, and that therefore until *Salomon* was decided in 1897, it remained unclear to what extent, and in what circumstances, a company was thought to be legally separate from its shareholders. Moreover, the decision in *Salomon* was seen at the time, in narrower terms, as legitimising the concept of the one person or private company, whereby a business controlled by an individual could be incorporated as a limited liability company that was separate from its shareholders with the result that the individual, as a shareholder, was protected from the claims of creditors of the company.

The second important aspect of *Salomon* is seen in its significance in the evolution of company law. The decision is widely viewed as *a*, if not *the*, landmark decision in the development of company law. It has been described as having an 'iron grip' on English company law,¹¹ as 'perhaps the most famous company law decision ... In many respects it marks the beginning of modern company law'.¹² On the other

- 5 [1897] AC 22 ('Salomon').
- Davies and Worthington consider that 'corporate personality became an attribute of the normal joint stock company only at a comparatively late stage' and that its implications were not 'fully grasped' until *Salomon*: Paul L Davies and Sarah Worthington, *Gower and Davies' Principles of Modern Company Law* (Sweet & Maxwell, 9th ed, 2012) 35. John Farrar and Brenda Hannigan state that *Salomon* 'firmly established' the separate legal personality of a limited liability company: John H Farrar and Brenda Hannigan, *Farrar's Company Law* (Butterworths, 4th ed, 1998) 66.
- Paul Redmond suggests that Salomon was '[t]he starting point, although ... not the first decision to reveal the implications of the [separate personality] doctrine': Paul Redmond, Corporations and Financial Markets Law (Thomson Reuters, 6th ed 2013) 174.
- 8 Salomon [1897] AC 22, 30–3 (Lord Halsbury), 50–1 (Lord Macnaghten).
- In the judgments at first instance, the Court of Appeal and the House of Lords there were differences of opinion expressed as to whether *Salomon*'s *Case* was concerned with a one person company where Salomon was the only 'real' shareholder and the other family members were contrived nominees, or instead a partnership type of company where provision was made for share ownership by the children of the company's founder. See the discussion in Ron Harris 'The Private Origins of the Private Company: Britain 1862–1907' (2013) 33 Oxford Journal of Legal Studies 339, 368–9.
- See case notes written by Edward Manson on Salomon: Edward Manson, 'One Man Companies' (1895) 11 Law Quarterly Review 185 (after the Court of Appeal decision); Edward Manson, 'The Evolution of the Private Company (1910) 26 Law Quarterly Review 11 (after the House of Lords decision). See also an untitled and unattributed case note (probably Frederick Pollock): Note (1897) 13 Law Quarterly Review 6. These commentaries are discussed in Part D below.
- 11 Daniel D Prentice, 'Some Aspects of the Law Relating to Corporate Groups in the United Kingdom' (1999) 13 Connecticut Journal of International Law 305, 316.
- 12 Redmond, above n 7, 174.

hand, it has also been described as 'calamitous', 13 as 'a sad finale for the high liberalism of Victorian England', 14 and as having been more recently 'dethroned from the position of the most important case in company law'. 15

Taking these two perspectives together one can observe the overall significance of the case. The importance of the separate legal entity concept in its own right is clear enough, but the fact that the case subsequently assumed its lofty status as a landmark company law case has made it difficult, and at times, virtually impossible, to challenge in principle. One of the core purposes of this paper is to revisit the decision in *Salomon* and to re-assess the mythology surrounding the case in light of its historical context, particularly the prior common law development of the separate legal personality concept, and the evolving commercial practices of 19th century Britain.

One of the most important modern consequences of the decision in *Salomon*, and its enduring landmark status, concerns the extension of its principle to corporate groups in situations where actions in tort have been brought against one or more companies within those groups. Although the operation of the separate legal entity and limited liability concepts has general application to corporate groups in a wide range of circumstances, of particular concern has been their application in circumstances where tort victims are unable to claim compensation because a tortfeasor subsidiary company is insufficiently capitalised to meet the full extent of its tort liabilities. In such circumstances the application of the separate legal entity concept, together with limited liability, enables a holding company, as a shareholder of its subsidiary, to avoid liability for the subsidiary's debts by strategically drawing corporate boundaries within a group to quarantine actual or potential tort liabilities within an under-capitalised subsidiary.

The ability to control companies within such groups to confine liability to underfunded subsidiaries has been highly controversial to say the least. It remains an open question whether the decision in *Salomon* was an inevitable outcome of a logical progression in the development of the law, and if the importance attributed to it has tended to eclipse otherwise preferable alternative approaches based on the law of negligence or principles of agency or trust law. The continued legal

¹³ O Kahn-Freund, 'Some Reflections on Company Law Reform' (1944) 7 Modern Law Review 54, 54.

¹⁴ Rob McQueen, 'Life Without *Salomon*' (1999) 27 *Federal Law Review* 181, 201. McQueen considers *Salomon* in its historical context and argues that the landmark importance of *Salomon* is a 'fact' which evolved after the decision itself: at 182.

¹⁵ Clive M Schmitthoff, 'Salomon in the Shadow' [1976] Journal of Business Law 305, 312.

¹⁶ For a critique of the law in this situation, see New South Wales, Special Commission of Inquiry into the Medical Research and Compensation Foundation, Report of the Special Commission of Inquiry into the Medical Research and Compensation Foundation (2004) vol 2, annexure T.

Hugh Collins, 'Ascription of Legal Responsibility to Groups in Complex Patterns of Economic Integration' (1990) 53 Modern Law Review 731, 736–8, where the author describes the 'capital boundary' problem.

controversy across several countries, and the ongoing economic and social issues with which the legal position is associated, remains a highly relevant concern.¹⁸

In order to address these issues, the following questions arise. What was *Salomon* thought to have decided at the time of the decision? Was the decision an inevitable and necessary step in the evolution of company law? Was the decision of such significance as to justify the landmark status subsequently conferred on it? Was the later application of the *Salomon* principle to corporate groups an inevitable, necessary or desirable development in the law?

As noted above, this article seeks to re-assess the decision in *Salomon*, and does so by means of a consideration of these questions and a re-appraisal of the historical evidence. It finds that the separate legal personality concept was already largely developed, and that a very large number of 'one person' or closed companies had already been formed at the time of the decision. Consequently, *Salomon* did not have the major legal and commercial effect supposed in much of the subsequent judicial and academic discussion of the case. Moreover, the legal outcome of the case was by no means inevitable, and, as we will see, it was entirely possible that the case may have been very differently decided. It is argued further that *Salomon* was a decision principally about one person companies. Its subsequent application to corporate groups, with severe adverse effects, especially upon tort litigants and other involuntary creditors, was not contemplated by the courts or companies legislation at the time of the case.

II THE DEVELOPMENT OF THE SEPARATE LEGAL ENTITY CONCEPT BEFORE SALOMON'S CASE

Before considering the early development of the separate legal entity concept it is necessary to explain the terminology used in the first half of the 19th century to describe the main forms of business organisations. Prior to 1844, when the system of company registration was first introduced, the term 'company' was understood

There is a vast amount of United States literature critical of the law dealing with the tort liability of corporate groups. See, eg, Jonathan M Landers, 'A Unified Approach to Parent, Subsidiary, and Affiliate Questions in Bankruptcy' (1975) 42 University of Chicago Law Review 589; Richard A Posner, 'The Rights of Creditors of Affiliated Corporations' (1976) 43 University of Chicago Law Review 499; Phillip I Blumberg, 'Limited Liability and Corporate Groups' (1986) 11 Journal of Corporation Law 573; Henry Hansmann and Reinier Kraakman, 'Toward Unlimited Shareholder Liability for Corporate Torts' (1991) 100 Yale Law Journal 1879; Phillip I Blumberg, 'The Increasing Recognition of Enterprise Principles in Determining Parent and Subsidiary Corporation Liabilities' (1996) 28 Connecticut Law Review 295. There has also been considerable discussion in Australia: see, eg, Ian M Ramsay, 'Allocating Liability in Corporate Groups: An Australian Perspective' (1999) 13 Connecticut Journal of International Law 329; Robyn Carroll, 'Corporate Parents and Tort Liability' in Michael Gillooly (ed), The Law Relating to Corporate Groups (Federation Press, 1993) 91; Peta Spender, 'Weapons of Mass Dispassion — James Hardie and Corporate Law' (2005) 14 Griffith Law Review 280; Peta Spender, 'Blue Asbestos and Golden Eggs: Evaluating Bankruptcy and Class Actions as Just Responses to Mass Tort Liability' (2003) 25 Sydney Law Review 223; Edwina Dunn, 'James Hardie: No Soul to be Damned and No Body to be Kicked' (2005) 27 Sydney Law Review 339; Helen Anderson, 'Piercing the Veil on Corporate Groups in Australia: The Case for Reform' (2009) 33 Melbourne University Law Review 333; Jason Harris and Anil Hargovan, 'Cutting the Gordian Knot of Corporate Law: Revisiting Veil Piercing in Corporate Groups' (2011) 26 Australian Journal of Corporate Law 39; Corporations and Markets Advisory Committee, Long Tail Liabilities — The Treatment of Unascertained Future Personal Injury Claims (Report, May 2008).

in a commercial sense as denoting a 'joint stock company'. A joint stock company was a pooled investment business enterprise formed to develop and carry on a relatively large undertaking, and comprised of a relatively large number of shareholders who had a right to freely transfer their shares and generally expected to have no role in management.¹⁹ From a commercial perspective, such companies were differentiated from traditional partnerships which usually conducted smaller businesses, generally were funded by relatively few partners who were mostly known to each other, and who often each participated in management of the partnership business. Transfers of partnership interests generally required the consent of all partners, in accordance with their agreement, as compared with the usual free transferability of shares in joint stock companies.

However, while there was a clear differentiation of companies and partnerships from a commercial point of view, the legal meaning of these forms of business enterprise did not correspond to the commercial understandings. A joint stock company could be either incorporated or unincorporated. A company incorporated — whether by Royal Charter or by Act of Parliament — was described as a 'corporation' whose constitution and governance rules, set out in its charter, reflected its joint stock character.²⁰ It was usual for the shareholders of such a corporation to have limited liability, and for the corporation to be seen to some extent as possessing a separate personality from its shareholders. An unincorporated joint stock company, on the other hand, often described as a 'deed of settlement' company, was formed by contractual agreement and so was considered legally a partnership, but one that was adapted to approximate the characteristics of a corporation.²¹ From a commercial point of view, the fact that an enterprise was incorporated or not made little or no difference. What was important was the public nature of the organisation and the fact that it allowed for freely transferable shares. Stock exchanges traded shares in both incorporated and unincorporated companies. In some industry sectors such as railways, canals and docks, corporations predominated. In other sectors such as insurance, unincorporated companies were more common.²²

The first legislation that provided for the freely available registration of companies was introduced in 1844.²³ One of its main features was that it attempted to

- 19 A B Du Bois, The English Business Company after the Bubble Act 1720–1800 (New York, 1938) 87. See also P W Ireland 'The Rise of the Limited Liability Company' (1984) 12 International Journal of the Sociology of Law 239, 239–41.
- 20 Ibid
- Sir Nathaniel Lindley, A Treatise on the Law of Partnership: Including Its Application to Joint-Stock and Other Companies (William Maxwell, 1860) vol 1, 4 defined unincorporated joint stock companies as 'associations of persons intermediate between corporations known to the common law and ordinary partnerships, and partaking of the nature of both'. The title of Lindley's text clearly indicates that the law applicable to joint stock companies was part of the law of partnerships. In 1889 the title of the book was changed to A Treatise on the Law of Companies: Considered as a Branch of the Law of Partnership recognising that while company law was a separate area of law, it was still a branch of partnership law.
- 22 Ron Harris provides an explanation of why different industries mostly used either incorporated or unincorporated companies: Ron Harris, *Industrializing English Law: Entrepreneurship and Business Organization* 1720–1844 (Cambridge University Press, 2000) ch 4. He suggests this was largely due to whether or not there were powerful vested interest groups that could block incorporation applications made by potential competitors.
- 23 Joint Stock Companies Act 1844, 7 & 8 Vict, c 110.

distinguish clearly between 'companies' and 'partnerships'. The Act introduced a requirement that business organisations, including partnerships with more than 25 members or with shares that were transferable without the consent of all the members, must be registered as unlimited liability companies.

In 1793 Kyd had defined a corporation as 'a collection of individuals, united into one body'. This implied that the corporation was nothing more than the individuals comprising it, which conceptually also described a partnership. Commenting many years later on this definition, Brice noted that 'sufficient stress is not laid upon that which is its real characteristic in the eye of the law, viz., its existence separate and distinct from the individual or individuals composing it'. This perceived difference in the fundamental relationship of a joint stock company and its shareholders indicates the extent to which the separate legal entity concept had developed by 1875. The preparedness of the courts to confer a personality on a corporation that was separate from its shareholders could already be seen in the 1846 case *R v Arnaud*. In that case, a corporation, of which a number of members were not British subjects, was held to be capable of being registered as a British shipowner even though foreigners were prohibited from owning in whole or in part, directly or indirectly, a British ship. Denman CJ held that it was the corporation that was the owner and not its members.

The development of the separate legal entity concept is the main feature of the gradual separation of company law from its origins as a branch of partnership law during the course of much of the 19th century. The development of the separate legal entity concept involved a number of common law developments, especially the changing legal conception of a share. The Companies Act 1862²⁸ reflected these changes by introducing new wording in s 6 that implicitly described a registered company as being separate from its members by providing that members may 'form an incorporated company'. However, in addition to case law developments it is also important to take into account the effect of changing commercial practices that reinforced the perception that a joint stock company was separate from its shareholders, such as the trend towards lower par value shares and unpaid capital, and the increasingly common use of alternative forms of capital investment such as preference shares and debentures. These commercial developments changed the legal and functional nature of the company form, and also served to further differentiate a company from a partnership from a commercial and investment point of view. By the time of Salomon, the company form had largely evolved away from its partnership origins, and the separate legal entity concept, in relation to joint stock companies, had become almost fully developed.

We turn now to a closer examination of the important interacting legal and commercial developments that shaped the evolution of the separate legal entity concept.

- 24 Stewart Kyd, A Treatise on the Law of Corporations, (London, 1793) vol 1, 13.
- 25 Seward Brice, A Treatise on the Doctrine of Ultra Vires: Being an Investigation of the Principles Which Limit the Capacities, Powers, and Liabilities of Corporations, and More Especially of Joint Stock Companies (Stevens & Haynes, 1874) 2.
- 26 (1846) 9 QB 806.
- 27 Ibid 818
- 28 Companies Act 1862, 25 & 26 Vict, c 89.

A The Changing Conception of a Share

The 18th century conception of a share reflected the nature of the interest a partner had in partnership property or a beneficiary held in trust property. A share was seen as having a legal link to the company's assets and the possession of a share in a joint stock company implied ownership of a defined share of the totality of the company's assets. Shareholders of incorporated companies were seen as holding an equitable interest in the company's assets in a similar way as beneficiaries under trust law, while the company held a legal interest as a trustee. A similar position arose in the case of unincorporated joint stock or deed of settlement companies, which vested legal ownership in their assets in the trustees under their deed of settlement, while equitable ownership was held by the shareholders.²⁹ This view equated the position of shareholders with that of beneficiaries under a trust or with partners. A consequence of this conception of a share was that its legal nature related to the nature of the company's assets so that if the company held land, its shares were treated as real estate or included some realty in a similar way as beneficial interests under a trust.³⁰ While the nature of a share was seen in this way, shareholders were not completely separate from the company because their shares were linked — commercially and legally — to the company's assets. This conceptualisation of a company and its shares remained tenable at least for as long as joint stock companies were not widely used. This changed dramatically with the advent of railway and infrastructure companies which greatly increased both the number of shareholders and the liquidity of shares and consequently the commercial character of companies.

During the 19th century the common law refined the separate legal entity concept by gradually differentiating the legal nature of shareholdings from the ownership of the company's assets and thereby disconnected a company's shares from its assets. In *Bligh v Brent*,³¹ it was decided that shareholders of an incorporated joint stock company which conducted a water works held an interest in the profits of the company and a right to assign their shares for value, but held no interest in the company's assets. The shares were personal property in their own right, independent of the nature of the company's assets and could be passed by the will of a shareholder. This case marked a significant turning point in the evolution of the separate legal entity concept as it clearly drew a distinction between a company's assets and the nature of shareholdings. A share was no longer seen as constituting an equitable interest in the company's assets but was a right to participate in the

²⁹ Child v Hudson's Bay Co (1723) 2 P Wms 207; 24 ER 702 (Lord Macclesfield).

³⁰ This was a matter of significance in determining the application of the *Statute of Frauds* which applied to the sale of interests in real estate. Sales of interests in land were required to be in writing. *Statute of Frauds 1677*, 29 Car 2, c 3, s 4; *Buckeridge v Ingram* (1795) 2 Ves Jun 652; 30 ER 824; *Howse v Chapman* (1799) 4 Ves Jun 542; 31 ER 278.

^{31 (1837) 2} Y & C Ex 268; 160 ER 397.

distribution of profits.³² A share had become a separate right of property in the hands of the shareholder while the assets of the company were solely the property of the company.³³ This conception of a share as personal property, irrespective of the nature of the company's assets, came to have application to both incorporated and unincorporated companies.³⁴ This is the basis of the modern concept of a share as intangible personal property³⁵ or a chose in action, which represents a fractional part of the company's total capital.

A further differentiation of companies and partnerships was established in *Re Agriculturist Cattle Insurance Co.*³⁶ In that case James LJ considered the question of whether the liability of a shareholder of an unincorporated deed of settlement company continued after his death so that the executrix of his estate should be included in the list of contributories. Under partnership law, a person ceased to be a partner upon death, and therefore could not be liable as a partner thereafter.³⁷ James LJ held that this principle of partnership law did not apply to joint stock companies and that the liability of a shareholder continued after death.³⁸ His Lordship commented that unincorporated joint stock companies were invented for the purpose of escaping the law and the consequences of partnerships.³⁹ A joint stock company was not constituted by an agreement between a large number of partners but rather, was an agreement between shareholders.⁴⁰

B Statutory Developments

We have seen so far that the separate legal entity concept evolved during much of the 19th century as a result of common law developments that both refined the conceptual nature of a company, and increasingly differentiated the company from its shareholders. In this process the law increasingly distinguished the company form from that of a partnership. Apart from the common law, legislative developments also began to contribute to this process of legal evolution. The *Joint Stock Companies Act 1844* ('1844 Act')⁴¹ introduced a requirement that business organisations, including partnerships with more than 25 members or with shares that were transferable without the consent of all the members, must be registered as unlimited liability companies pursuant to the legislation.⁴² This more or less

- 32 See Samuel Williston, 'History of the Law of Business Corporations Before 1800' (1888) 2 Harvard Law Review 105 (Part I); Samuel Williston, 'History of the Law of Business Corporations before 1800' (1888) 2 Harvard Law Review 149 (Part II) 149; Paddy Ireland, Ian Grigg-Spall and Dave Kelly, 'The Conceptual Foundations of Modern Company Law' (1987) 14 Journal of Law and Society 149, 159. Talbot suggests that Bligh v Brent was decided under long standing principles that were specific to the case and did not mark a major shift in how the law conceptualised a company's shares: Lorraine Talbot, Critical Company Law (Routledge-Cavendish, 2008) 49–50.
- 33 See Macaura v Northern Assurance Co Ltd [1925] AC 619, 626–7, 630.
- 34 Watson v Spratley (1854) 10 Ex 222; 156 ER 424.
- 35 Corporations Act 2001 (Cth) s 1070A(1)(a).
- 36 (1870) LR 5 Ch App 725 ('Baird's Case').
- 37 Ibid 732.
- 38 Ibid 734–5.
- 39 Ibid 734.
- 40 Ibid
- 41 Joint Stock Companies Act 1844, 7 & 8 Vict, c 110.
- 42 Ibid s 2.

formalised the kind of distinction between a company and a partnership that reflected commercial practice and which was evolving in the common law.

In addition to requiring registration as a company in the circumstances specified, the *1844 Act* also imposed a number of restrictions and obligations on registered companies, especially concerning disclosure and minimum share capital requirements.⁴³ The *1844 Act*, however, did not significantly change the broad conception of the company which retained the main features of unincorporated joint stock companies. These companies were also known as deed of settlement companies because their governance provisions and internal rules were contained in a trust deed.

The clear distinction between companies and partnerships drawn by the 1844 Act, based upon a relatively large number of members and unrestricted share transferability, again became blurred with the passing of the Joint Stock Companies Act 1856 ('1856 Act'), which enabled companies to be registered with limited liability. This Act required no minimum amounts of share capital and it also reduced the minimum number of shareholders to seven. As a consequence of this liberalisation, it became open to existing one person businesses, family businesses and small partnerships to adopt the company form by registering under the Act, and thereby reducing personal financial risk by taking advantage of limited liability. This partitioning of the debts of a registered company from the debts of its shareholders further reinforced the idea of a separation between the company and its shareholders.

However, notwithstanding the importance of these developments, neither the 1844 Act nor the 1856 Act had stated clearly that incorporation created an entity completely separate from its shareholders. The 1856 Act had arguably implied that a connection remained between a registered company and its members by virtue of an expression in s 3 which stated that 'seven or more persons ... may ... form themselves into an incorporated company'. Consequently, incorporated joint stock companies were identified with their members as entities composed of those members merged into one legally distinguishable body. The shift from this conceptualisation to the modern view of the company as a completely separate legal entity from its members, and as an entity with which its members could stand in an external relationship, was not clearly spelled out until the consolidating legislation of the Companies Act 1862 ('1862 Act'). That Act removed the words 'themselves into', thereby making it clear that the members, or incorporators, were forming a completely separate body, rather than something composed of themselves.

As Ireland, Grigg-Spall and Kelly note, this variation in wording, and other linguistic changes, reflected the law's slow evolution in separating the shareholder

⁴³ See, eg, ibid s 42, which required disclosure to shareholders of the company's balance sheet and auditors' report.

⁴⁴ Joint Stock Companies Act 1856, 19 & 20 Vict, c 47, ss 3, 61.

⁴⁵ Limited liability was first introduced by the short-lived *Limited Liability Act 1855*, 18 & 19 Vict, c 133, which imposed a requirement that a registered company had at least 25 members holding £10 shares paid up to the extent of 20 per cent.

⁴⁶ Joint Stock Companies Act 1856, 19 & 20 Vict, c 47, s 3 (emphasis added).

⁴⁷ Companies Act 1862, 25 & 26 Vict c 89.

⁴⁸ Ibid s 6.

from a company.⁴⁹ Up until the mid-19th century, a joint stock company had been referred to in the plural as 'they'.⁵⁰ For example, in *Bligh v Brent*, Alderson B stated that 'the corporation may do what they like with [the money], and may obtain their profit in any way they please from the employment of their capital stock',⁵¹ implying that conceptually a company was composed of a plurality of persons. As we have noted, the wording adopted by the *1862 Act* struck a very different note and indicated that, as of this point in time, a company's legal personality was to be seen as being quite separate from its shareholders.

C The Changing Capital Structures of Joint Stock Companies

In the second half of the 19th century, directors and promoters developed a number of commercial practices which both reflected and reinforced the idea of the separate legal entity concept and the differentiation of companies from partnerships which, as noted above, had been slowly evolving prior to the 1862 Act. The 1856 Act had removed the requirement of a minimum par value for shares.⁵² However it took a number of years for the trend to lower par value shares and smaller unpaid capital to take hold. During the 1850s and 1860s, company promoters, creditors and investors in practice still perceived companies as modified forms of partnerships, and the concept of limited liability was not fully accepted in a commercial sense in most sectors of industry. In the immediate aftermath of the statutory introduction of limited liability in 1855, the issue of shares of high par value with a large unpaid component remained the common practice. This was especially the case in the established industries of iron, coal, engineering, shipping, land development and cotton, where family run businesses and insider shareholders predominated.⁵³ This practice enabled companies to raise capital when required by making calls on partly paid shares, and it also strengthened the position of creditors thereby encouraging lending and extension of credit to the company by creating a large pool of reserve capital in the event of a winding up. From the point of view of shareholders, the issue of high par value partly paid shares largely detracted from the advantage of limited liability. If a

- 49 Ireland, Grigg-Spall and Kelly, above n 32, 150-1.
- 50 Ibid 151.
- 51 (1837) 2 Y & C Ex 268, 296; 160 ER 397, 409.
- 52 The first Limited Liability Act of 1855 sought to prevent closely held businesses conducted as sole traders and partnerships from incorporating so as to gain the advantage of limited liability. The Act prohibited the issue of shares of less than £10 each and required a deed of settlement executed by not less than 25 shareholders holding shares comprising at least three quarters of the nominal capital of the company: Limited Liability Act 1855, 18 & 19 Vict, c 133, s 1(4).
- J B Jefferys, 'The Denomination and Character of Shares 1855–1885' (1946) 16 Economic History Review 45, 45, states that 52 per cent of companies registered between 1856 and 1865, which were still in existence in 1865, had shares of a par value between £10 and £100. More than 30 companies in the Limited Liability Joint Stock Companies List (1864–6) issued shares with a par value in excess of £1000, including the Liverpool and Philadelphia Steam Ship Company that in 1850 had shares of £9000 each: at 45, 47. Bishop Carleton Hunt estimated that less than 10 per cent of issued capital of new companies formed between 1863 and 1866 was paid up in cash: Bishop Carleton Hunt, The Development of the Business Corporation in England: 1800–1867 (Harvard University Press, 1936) 155 n 49. By contrast, in 1885, over three quarters of the issued share capital of the 661 companies listed in Burdett's Official Intelligence was paid up: Jefferys, 'The Denomination and Character of Shares 1855–1885', above n 53, 46

company failed, as often occurred in the depressed economic environment of the second half of the nineteenth century, the shareholders were liable, in a similar way to partners, for large unpaid amounts on their shares, even though they were shareholders of a limited liability company.

It was not until the 1870s that companies began widely to adopt the practice of issuing lower par value and fully paid shares to make themselves more attractive to investors. Low par value shares were generally easier to trade, they attracted investment from a wider group of investors who were unconnected to the original proprietors of the company's business, and the issue of shares as fully paid (or with a relatively small amount unpaid), enabled shareholders to gain the advantage of limited liability in the event of company insolvency. High par value shares were typically held by 'insider' shareholders who were similar to partners in that they controlled the company, and were usually disinclined to sell their shares. ⁵⁴ Companies also raised capital by various other means, issuing ordinary shares, preference shares and debentures in proportions which varied according to the activities of the company, the types of investors likely to be attracted, and whether the investors were based in Britain or overseas. ⁵⁵

The Panic of 1866 associated with the collapse of the bank Overend, Gurney & Co Ltd caused promoters and investors to reassess their attitude towards shares of high denomination and large uncalled liabilities.⁵⁶ It became apparent to investors that these shares were a cause of considerable instability and illiquidity, and could potentially bring about substantial further liability. The practice of issuing high denomination partly paid shares which was prevalent in the early 1860s became less common after 1867, except in banking.⁵⁷ After the Panic of 1866, the change in the nature of shares was part of a broader shift in the attitude of the commercial community and the courts, as companies came to be increasingly regarded as distinct from their shareholders. A contract to take up shares was no longer seen as akin to agreeing to enter a partnership.

The trend towards a reduction of the par value of shares was aided by amendments introduced by the *Companies Act 1867* ('1867 Act'), ⁵⁸ which allowed for reductions of capital by reducing the unpaid amount on each share and subdividing shares. ⁵⁹ However these amendments did not allow a company to reduce its nominal

- 54 Jefferys, 'The Denomination and Character of Shares 1855–1885', above n 53, 47; J B Jefferys, Trends in Business Organization in Great Britain since 1856, with Special Reference to the Financial Structure of Companies, the Mechanism of Investment and the Relations between the Shareholder and the Company (PhD Thesis, University of London, 1938) 197–8 ('Trends in Business Organization in Great Britain since 1856').
- 55 See A R Hall, The London Capital Market and Australia 1870–1914 (Australian National University, 1963) 28–37 for a discussion of the types of securities issued on the London capital market.
- 56 Jefferys, 'The Denomination and Character of Shares 1855–1885', above n 53, 51; Hunt, above n 53, 155.
- 57 When the City of Glasgow Bank collapsed in 1878, shareholders had to pay £2750 on each £100 share held.
- 58 Companies Act 1867, 30 & 31 Vict, c 131.
- 59 Jefferys, 'The Denomination and Character of Shares 1855–1885', above n 53, 46 n 3 noted that 71 companies reduced their capital in the period 1867–77.

capital.⁶⁰ This was not permitted until amendments introduced by the *Companies Act 1877* enabled any part of the share capital to be reduced.⁶¹ During the period between 1885 and 1914 the differences between industries in share par value and amount paid up diminished as low par value fully paid up shares came to predominate. Industries which traditionally had high par value shares such as the iron, steel and coal industries took advantage of their ability to subdivide shares which was permitted by the *1867 Act*.

The differentiation of companies from partnerships in commercial practice was apparent from the increased use by widely held 'public' companies⁶² of preference shares and debentures, which are both forms of investment particularly associated with companies. Preference shares appealed to a different type of investor who primarily wanted a steady return without unpaid liabilities. Hence preference shares were generally fully paid and had lower par value than ordinary shares at a time when ordinary shares often had high par values. Preference shares became important as a means of raising capital from the 1880s.⁶³ The demand for ordinary shares was limited to particular types of investors and so a company could raise more capital and access a broader base of investors by issuing a type of share that was appealing to investors who regarded ordinary shares as too risky. An advantage from issuing preference shares was that it enabled the holders of the majority of ordinary shares, often the original owners of the company's business, to retain control of the company and its board of directors while at the same time they were also able to raise funds from the public to meet the financing needs of their enterprises.

As with preference shares, debentures were also a form of capital that could be utilised by companies in meeting the needs of investors seeking more conservative investments as alternatives to riskier ordinary shares. Debentures were used by railway companies in particular from the 1830s to finance working capital. However, it was not until the 1870s that it became common for companies (other than railway companies) to issue debentures, and these were usually issued as a form of payment to vendors of firms that converted into limited liability companies. There were also some instances in the 1870s where debenture stock was issued to the public to raise additional capital, and this became more common in the 1880s when the use of debentures spread to most industries, especially where there was strong demand for capital.⁶⁴ It became common for new companies to issue a mix of ordinary and preference shares and debentures at the formation of the company. Typically debentures were secured by floating charge.

- 60 In *Re Ebbw Vale Steel, Iron, and Coal Co* (1877) 4 Ch D 827, 832 Jessel MR held that the 1867 Act contained no provision enabling a company to write off losses to its paid up capital by reducing the nominal value of its shares, it could only reduce the unpaid amount on each share.
- 61 Companies Act 1877, 40 & 41 Vict, c 26, s 3.
- 62 The United Kingdom legislation did not recognise the distinction between public and private companies until 1907 with the introduction of the *Companies Act* 1907, 7 Edw 7, c 50. The term is here used loosely to refer to those companies that sought to raise share capital from the public as opposed to private companies which did not seek to do so.
- 63 Jefferys, *Trends in Business Organization in Great Britain since 1856*, above n 54, 222–3. Preference shares as a percentage of the total share and loan capital of commercial and industrial companies increased from 8.8 per cent to 29.7 per cent between 1885 and 1915: at 223.
- 64 Ibid 252–3. Jefferys noted that in 1885, 30 to 40 per cent of companies listed in *Burdett's Official Intelligence* had issued debentures, comprising 16.8 per cent of total capital: at 253.

The increased use of debentures continued through to 1914.⁶⁵ This development took place entirely outside the law and without any restrictions or regulation, as the successive Companies Acts made no reference to debentures.

This discussion of the changing capital structures and means of raising capital adopted by joint stock companies in the second half of the 19th century shows that commercial practice increasingly differentiated the limited liability company from partnerships, and in so doing, emphasised that in both a commercial and legal sense the company was increasingly regarded as separate from its shareholders.

III THE GROWTH OF THE PRIVATE COMPANY

It follows from the preceding discussion that the separate legal entity concept was already largely developed in both a legal and commercial sense well before *Salomon* was decided. Consequently the status of *Salomon* as a landmark decision instrumental in the development of modern company law is difficult to justify. Nevertheless it *can* be said that *Salomon* confirmed the legitimacy of the 'one person' or 'private' company. In order to assess the significance of the decision in *Salomon* in this respect, it is important to gain an appreciation of the business context surrounding the case, especially the rise of the private and the 'one person' company which became increasingly popular from the mid-1870s.

The 1856 Act dispensed with the minimum capital and disclosure requirements of previous legislation and enabled associations of at least seven members to incorporate. This made it much easier for small businesses to incorporate as limited liability companies. Even though the introduction of a general incorporation regime and limited liability resulted in England having the most permissive company law regulatory regime in Europe,⁶⁷ the initial impact of the introduction of limited liability was relatively modest, and partnerships remained the dominant form of business organisation.⁶⁸ The relatively slow development of the private company after 1856 has been attributed to the discrediting of the

- 65 Ibid 269. Jefferys commented that '[i]n the period 1885–1914 there was a general acceptance of debentures as a method of raising about one-third of the capital of most public companies'.
- 66 The term 'private' is used here as descriptive of a closed company restricted to a small number of shareholders whose relationship with each other is similar to that of partners or as nominees for a sole trader appointed to make up the minimum statutory number. The term 'private company' was not recognised by the legislation until it was introduced by the *Companies Act 1907*, 7 Edw 7, c 50 to differentiate the disclosure requirements of closely held companies from public companies thereby enabling closely held companies to maintain the confidentiality of their financial positions.
- 67 This was after having the most restrictive regulation as a result of the Bubble Act: see Harris, Industrializing English Law, above n 22, 2; Michael Lobban 'Corporate Identity and Limited Liability in France and England 1825–67' (1996) 25 Anglo-American Law Review 397, 426.
- Jefferys estimated that in 1885 there were over 100 000 'important' partnerships and under 10 000 limited liability companies so that companies accounted for between 5 and 10 per cent of 'important business organisations (excluding one-man concerns and public utilities)': Jefferys, *Trends in Business Organization in Great Britain since 1856*, above n 54, 105. While the number of incorporations increased from around 400 in 1860 to 1250 in 1880, a large proportion of these were short lived. In 1885, only 58 per cent of companies formed in 1880 were still in existence: Geoffrey Todd, 'Some Aspects of Joint Stock Companies 1844–1900' (1932) 4 *Economic History Review* 46, 59, 63. See also Ireland, above n 19, who notes that 'the Registrar of Joint Stock Companies told the [1886] Royal Commission on the Depression in Industry and Trade that of 26 000 limited companies registered since 1856, only 9300 were still making returns' and therefore appeared to be 'still carrying on business' by 1884: at 244.

limited company form in the aftermath of the share crash of 1866. This meant that a large proportion of registered companies in the late 1860s were joint stock companies rather than 'private' companies.⁶⁹ While there was eventually a great increase in company registrations, especially of closely held companies, this largely occurred from the mid-1870s and was readily apparent by the 1890s.⁷⁰

The rapid growth in company registrations *after* 1870 highlighted two trends. Firstly, there was increased use of public companies to raise the necessary capital to implement technological and scientific advances and economies of scale. Secondly, there was also a large increase in registrations of private companies, as the realisation sank in that limited liability could be utilised by closely held business enterprises in the increasingly volatile economic environment of the Great Depression of the last quarter of the 19th century.⁷¹ This latter development occurred despite the widely held expectation that the legislation of the period 1844 to 1862 should apply only to larger joint stock companies with many shareholders, and not to sole traders, small partnerships or family enterprises.⁷²

A further reason that has been put forward to explain the popularity of the private company form was that the social and economic background to British business generally favoured family controlled enterprise. Forbes thought that the introduction of limited liability may have been delayed in England compared with a number of states in the United States because in England wealth was more unevenly distributed. As a consequence, for the wealthy in England it was feasible and preferable to seek investment from family members or from a relatively small number of individuals known to the entrepreneur personally or through networks,

- 69 Ireland, above n 19, 246.
- 70 The large increase in company registrations after the 1870s is indicated by the approximate number of companies believed to be in existence in the following years: 1856 700, mid-1860s 3000, 1883 7800, 1907 39 600, and 1914 58 900: Todd, above n 68, 62. Harris, 'The Private Origins of the Private Company', above n 9, 347 shows the proliferation of small companies by the decline in the average registered nominal capital per company from £170 188 in the 1860s to £33 519 in the early twentieth century. McQueen dates the rise of the private company to the mid-1870s: Rob McQueen, A Social History of Company Law: Great Britain and the Australian Colonies 1854–1920 (Ashgate, 2009) 219. See his discussion of the growth of the private company: at 233–8. In 1890 between one third and one fifth of company registrations were private companies; in 1914 the proportion had increased to four fifths: Jefferys, Trends in Business Organization in Great Britain since 1856, above n 54, 130. Jefferys claims that in 1914 there were 48 492 private companies and 14 270 public companies.
- 71 Francis Palmer, the noted company law text writer, was influential in the increased popularity of private companies towards the end of the 19th century. He said the use of limited liability by private companies 'freed the community at large from the tyranny of unlimited liability': Sir Francis B Palmer, Private Companies and Syndicates: Their Formation and Advantages Being a Concise Popular Statement of the Mode of Converting a Business Into a Private Company, and of Establishing and Working Private Companies and Syndicates for Miscellaneous Purposes (Stevens and Sons, 10th ed, 1892) 5. The existence and extent of the so-called Great Depression has been the subject of controversy among economic historians. However the period after 1875 was seen by contemporaries as a difficult period for business, characterised by declining profits and increased insolvencies. Eric J Hobsbawm dated Britain's economic decline from this period: E J Hobsbawm, Industry and Empire: An Economic History of Britain since 1750 (Weidenfeld and Nicolson, 1968) ch 9.
- 72 Ireland, above n 19, 241–4, 256 argues that the framers of the legislation thought it would not apply to private companies. He commented that there was 'general agreement that [private companies] were a perversion of the 1856–1862 Acts': at 256. See also McQueen, 'Life Without Salomon', above n 14, 185–8. The question of whether small enterprises should be able to 'convert' to limited liability companies was the subject of considerable discussion before the 1886 Royal Commission on the Depression in Trade and Industry; see McQueen, A Social History of Company Law, above n 70, 244–8.

rather than from external investors through joint stock companies.⁷³ A similar argument could also explain why the predominant form of business enterprise in Britain until well into the 20th century was the partnership or private company, rather than the public corporation as in the United States. Jefferys attributed the predominance of the partnership form of business organisation over joint stock companies to the geographical reason that the leading centres of the Industrial Revolution were in the north, far away from London which remained the financial centre.⁷⁴

Since much of British industry in the late 19th century was conducted as family controlled businesses, interests associated with private companies were politically powerful in guarding and promoting the economic interests of controllers of private companies as opposed to the interests of creditors. This was consistent with the laissez-faire approach of freedom of contract and the view that creditors should take steps to safeguard their own interests. Proposals were unsuccessfully put forward from the 1880s onwards to protect the interests of creditors of private limited liability companies by providing for public disclosure of financial information by all companies.⁷⁵ Similar disclosure requirements were removed from the 1844 Act by the 1856 Act, which also introduced limited liability.

By the late 1880s there were a rapidly growing number of private companies such as A. Salomon & Co Ltd which took advantage of limited liability for their shareholders, but were not required to disclose their financial accounts. This was a period of economic depression and falling profits, so a common response to the high level of business uncertainty was for business proprietors to seek the protection of limited liability by incorporating a company and then entering into a sale of the business to the company, often at an overvalue, where the consideration for the sale was a mix of fully paid shares, cash and debentures, secured by a floating charge over the company's business assets. In the event of the subsequent insolvency of the business, the founder or controller of the company was not only protected by limited liability as a shareholder, but also gained priority over unsecured trade creditors by claiming as a secured creditor by virtue of a debenture issued by the company. This method of companies borrowing from the vendor of the business by means of a debenture secured by floating charge only needed to be registered at the company's registered office and other creditors could be kept unaware of the loan. By way of comparison,

⁷³ Kevin F Forbes 'Limited Liability and the Development of the Business Corporation' (1986) 2 Journal of Law, Economics, and Organization 163, 173.

⁷⁴ Jefferys, Trends in Business Organization in Great Britain since 1856, above n 54, 6.

⁷⁵ A Royal Commission on the Depression of Trade and Industry (1886) was presented with a number of law reform proposals including a proposal to require greater financial disclosure by all companies. The government introduced a Bill in 1888 that would have required the filing of audited annual accounts by public and private companies but this was strongly opposed in the House of Lords. The main opponent of reform was Lord Bramwell, whose main concern was that disclosure would give away confidential secrets of family businesses to competitors. The Davey Committee (1895) also considered this question. See P L Cottrell, *Industrial Finance 1830–1914: The Finance and Organization of English Manufacturing Industry* (Methuen, 1980), 65–6; McQueen, *A Social History of Company Law*, above n 70, 246–53. For a discussion of social attitudes towards the use of private companies in commercial fraud see: at 223–33.

partnerships that borrowed had to publicly register details under the *Bills of Sale Act 1878*. In many cases, the company failed relatively soon after incorporation and the creditors received little or no return because the vendor stood as a secured creditor by virtue of a debenture. It was the effectiveness of this stratagem that was considered by the House of Lords in *Salomon*.

IV SALOMON: A LANDMARK CASE?

If the separate legal entity concept had already been largely developed in both a legal and commercial sense before the time of *Salomon*, and the case itself was concerned with the relatively limited issue of the legitimacy of the private or one person company,⁷⁷ the question arises why the decision was accorded the landmark status it subsequently attained. As we will see, it was only with the passing of time that the case came to be seen as the foundation of modern company law, and the principle derived from it came to have a broader application which extended to corporate groups.

The facts of the case are well known and need only be briefly stated.⁷⁸ Salomon conducted a boot manufacturing business as a sole trader. He formed a company which was incorporated under the 1862 Act. The shareholders were Salomon, his wife and five children, each of whom initially held one share, thereby meeting the legislative requirement that a company have a minimum of seven shareholders. Salomon and his two eldest sons were the directors. The company purchased Salomon's business — the purchase price comprising shares, a debenture, cash and the discharge of the debts of the business. After the purchase price was paid by the company to Salomon and the shares were issued, Salomon held 20 001 shares and the other shareholders each held one share. The company became insolvent soon after and went into liquidation. The main issue that had to be addressed by the liquidator was whether Salomon could claim as a secured creditor, ahead of unsecured creditors, by virtue of the debenture secured by a floating charge that he held as part of the purchase price of the sale of his business to the company. The liquidator argued that Salomon's claim under the debenture was invalid and sued Salomon personally in order to recover funds to pay the unsecured creditors.

- 76 Bill of Sales Act 1878, Vict 41 & 42, c 31. The term 'bill of sale' is broadly defined in s 4.
- 77 Sir Francis Gore-Browne, Handbook on the Formation, Management and Winding Up of Joint Stock Companies (Jordan & Sons, 36th ed, 1925) 4, referred to the decision in Salomon in narrow terms, describing it as holding that 'however large the proportion of the shares and debentures owned by one man, even if the other shares were held in trust for him, the company's acts were not his acts nor were its liabilities his liabilities'.
- For a discussion of the facts of Salomon and the House of Lords decision see L S Sealy, 'Modern Insolvency Laws and Mr Salomon' (1998) 16 Company and Securities Law Journal 176; Harris, 'The Private Origins of the Private Company', above n 9, 365–6. Virtually all company law texts also discuss this case. See, eg, Davies and Worthington, above n 6, 35–9; R P Austin and I M Ramsay, Ford's Principles of Corporations Law (LexisNexis Butterworths, 14th ed, 2010) 120–1 [4.150]; Farrar and Hannigan, above n 6, 66–8. For a discussion of the personalities involved in the litigation and the social context of the case see G R Rubin, 'Aron Salomon and his Circle' in John Adams (ed), Essays for Clive Schmitthoff (Professional Books, 1983) 99.

At first instance in the Chancery Division, Vaughan Williams J had held that the shareholders other than Salomon were mere nominees of Salomon and that no real interest in the company was ever given to them or intended to be given to them in the future.⁷⁹ Consequently he viewed the company as a mere fraud.⁸⁰ The business was Salomon's business and he chose to employ the company as his agent. Thus the creditors of the company could have sued Salomon on the basis that he was liable as a principal, or alternatively, he was bound to indemnify the company as his agent.81 In the Court of Appeal, Lindley LJ stated that 'the legislature never contemplated an extension of limited liability to sole traders or to [enterprises of] of a fewer number than seven'. 82 He suggested that even though there were seven members in accordance with the legislative requirements, six of them were relatives who were members solely for the purpose of enabling the seventh, Salomon himself, to carry on business with limited liability. 83 Lindley LJ thought the seven members were not associated for a lawful purpose, but to attain a result not permitted or intended by the Act, and construed the company as acting as a trustee for Salomon and as a device to defraud creditors.⁸⁴ Agreeing, Lopes LJ thought that:

It would be lamentable if a scheme like this could not be defeated. If we were to permit it to succeed, we should be authorizing a perversion of the Joint Stock Companies Acts. We should be giving vitality to that which is a myth and a fiction. ... It never was intended that the company to be constituted should consist of one substantial person and six mere dummies, the nominees of that person, without any real interest in the company. ... To legalize such a transaction would be a scandal.⁸⁵

It was implicit in this approach that the benefits of incorporating a limited liability company did not extend to small business entrepreneurs who acted unfairly towards their creditors.⁸⁶

The decision of the House of Lords, 87 on appeal, to overturn the decisions of both the Chancery Division of the High Court, and of the Court of Appeal, consequently represented a substantial shift in attitude from the two lower court decisions.

- 79 Broderip v Salomon [1895] 2 Ch 323, 329.
- 80 Ibid 331-2.
- 81 Ibid.
- 82 Ibid 337.
- 83 Ibid
- 84 Ibid 337–40. Lindley LJ stated that the arrangements implemented by Salomon 'do infinite mischief; they bring into disrepute one of the most useful statutes of modern times, by perverting its legitimate use, and by making it an instrument for cheating honest creditors': at 339.
- 85 Ibid 340-1
- 86 Allan C Hutchinson and Ian Langlois, 'Salomon Redux: The Moralities of Business' (2012) 35 Seattle University Law Review 1109, 1117.
- 87 Salomon [1897] AC 22.

The House of Lords judges⁸⁸ did not directly consider the business morality of the parties or the supposed intention of the legislature but confined themselves to interpreting the words in the Act, taking a literal approach in its statutory interpretation to determine whether the requirements of the Act were met. The House of Lords held that the formalities of incorporation had been observed, and even though there were only seven subscribers, that they were a body corporate 'capable forthwith' of exercising the powers of an incorporated company.⁸⁹ It was not contrary to the intention of the legislation that a trader gained the advantage of limited liability by incorporating a company and transferring the business to it.⁹⁰

The narrative that has subsequently developed around Salomon suggests that its outcome was an inevitable step in the development of modern company law.91 However, the marked difference in the approaches taken by, on the one hand the lower courts, and on the other the House of Lords, strongly supports the view that the outcome of the House of Lords decision was not inevitable. The Court of Appeal decision would have stood had Salomon not been granted leave to appeal the case to the House of Lords in the unusual circumstances of a pauper litigant.⁹² The literal approach adopted by the House of Lords could, on the one hand, be seen as overly legalistic and ignoring commercial practice — in the sense of enabling a proprietor to use a legal fiction to defraud, or at least defeat, the legitimate claims of unsecured creditors. 93 However the outcome of the decision could also, on the other hand, be seen in economic and commercial terms as essentially pragmatic. It would have been extremely difficult, if not impossible, to ascertain whether Parliament had in fact intended to allow single person or private companies to obtain the benefit of limited liability given the diverse and sometimes contradictory range of views expressed during the debates on the various matters relating to the mid-century reforms. 94 The question of whether one person and private companies should be permitted to be registered under the Companies Act was not specifically debated at the time the 1856 legislation was passed. The Court of Appeal decision, while appearing to take a commercially realistic view of the nature of private companies and the position of their creditors,

- 88 Lord Cooke of Thorndon said that the Lord Halsbury LC, was 'not a learned lawyer' but someone who 'excelled in "plain advocacy before plain men about plain matters", however he did assemble some of the 'intellectual judicial leaders of the day' to sit with him on the Salomon case: Lord Cooke of Thorndon, Turning Points of the Common Law (Sweet & Maxwell, 1997) 8, quoting R F V Heuston, Lives of the Lord Chancellors 1885–1940 (Clarendon Press, 1964) 18, 74.
- 89 Salomon [1897] AC 22, 51 (Lord Macnaghten).
- 90 Ibid 31–2 (Lord Halsbury LC), 51 (Lord Macnaghten).
- 91 See McQueen, 'Life Without Salomon', above n 14, 181–2, 202. He claimed that the 'narrative history' approach to Salomon placed the House of Lords decision at the centre of the development of company law: at 182. The idea that law inevitably progresses towards its most functional design has been described as 'teleological'. Teleological statements imply that a process has particular goals and that change occurs in order to achieve these goals. For a critique of such narratives see Robert W Gordon, 'Critical Legal Histories' (1984) 36 Stanford Law Review 57, 61–3.
- 92 For a discussion of the circumstances surrounding the appeal to the House of Lords see Rubin, above n 78, 101–2.
- 93 See, eg, the critical comments presented by Kahn-Freund, above n 13; Justice Paul Finn, 'Opening Remarks' (1999) 27 Federal Law Review 173, 173.
- 94 See McQueen, 'Life Without Salomon', above n 14, 185–95; Ireland, above n 19, 241–4.

would also have created considerable legal uncertainty had it been allowed to stand. It would have required judges to decide on a case by case basis whether incorporations were to be treated as valid, or disregarded because they were 'fictions' or designed to cheat creditors. Courts would also have been presented with the challenge of determining in particular cases whether or not shareholders were independent or mere 'dummies'.95

The House of Lords may well have taken into account, advertently or inadvertently, the broader commercial reality that the private company had already become a prominent part of the late Victorian business landscape, and that to try and roll back this development would have been extremely disruptive to many important sectors of British business. Fe The businessmen who were the beneficiaries of the use of private limited liability companies exerted a powerful political and economic influence. It appears likely that if the case had not proceeded to the House of Lords, or if the House of Lords decision had withheld legal recognition from private companies as a vehicle for conducting individual or family controlled enterprise, Parliament would have been compelled to step in to ensure that such companies already in existence were legitimised and that limited liability private companies could continue to incorporate. Had Parliament been forced to intervene in this way, the evolution of the separate legal entity concept, as it came to be applied to corporate groups, may have occurred in a significantly different way to how it came about under the grip of *Salomon*.

The commentary which appeared after each of the decisions of *Salomon*'s *Case* indicates that contemporaries thought the case was one of considerable importance because it dealt with the legitimacy of the one person or private company. Perhaps it is a reflection of the practical nature of Victorian lawyers that little or no attention was given by the commentators to the conceptual issues derived from the separate legal personality concept. Manson wrote about one person companies after the first instance hearing before Vaughan Williams J. While he saw no harm in what amounted to, in reality, sole traders and partnerships operating with limited liability, he commented that the real mischief arose because outsiders dealing with the company did not know the extent to which the capital of the company was previously charged. If the company became insolvent, a debenture holder,

- 95 Michael J Whincop, An Economic and Jurisprudential Genealogy of Corporate Law (Ashgate, 2001) 51-2
- 96 Simon Ville contrasts the predominance of small private companies in Britain to the greater role played by large companies in the United States and Germany: Simon P Ville, 'Judging Salomon: Corporate Personality and the Growth of British Capitalism in a Comparative Perspective' (1999) 27 Federal Law Review 203, 212–15. See also Harris, 'The Private Origins of the Private Company', above n 9, 368–9; McQueen, 'Life Without Salomon', above n 14, 201.
- 97 Margaret Rix, An Economic Analysis of Existing English Legislation Concerning the Limited Liability Company (MSc (Econ) Thesis, University of London, 1936) 43.
- 98 Ron Harris suggests that '[c]orporate personality discourse did not play a major role in Britain in the context of business organization': Ron Harris, 'The Transplantation of the Legal Discourse on Corporate Personality Theories: From German Codification to British Political Pluralism and American Big Business' (2006) 63 Washington and Lee Law Review 1421, 1462, citing Harris, Industrializing English Law, above n 22, 112.
- 99 Manson, 'One Man Companies', above n 10.
- 100 Ibid 186.

usually either the promoter or vendor of the business or someone to whom the debenture was passed, had priority over outside unsecured creditors. To prevent this type of practice from occurring, Manson suggested that the borrowing powers of companies should be restricted to a proportion of the company's assets, and those dealing with a company should be better able to ascertain the extent to which the company's assets were charged.¹⁰¹ A similar point was made by an anonymous writer in an American case note of the Court of Appeal decision.¹⁰²

Shortly after it was handed down, the House of Lords decision in *Salomon* also came in for some criticism. In an unattributed case note in the *Law Quarterly Review*, the writer described the *Companies Act* as 'oracular' in style and 'leaving to the Courts the interpretation of its mystic utterances'.¹⁰³ Of *Salomon* the author said that no one who knew anything of the earlier history of the *Companies Acts* could doubt that the decision handed down by the House of Lords 'would have been impossible thirty or even twenty years [previously]'.¹⁰⁴ This observation appears to have recognised that the separate legal entity principle had largely been developed before *Salomon*, and that the case itself did not mark a major turning point or dramatic change in the law. Rather it reflected an already apparent legal and commercial reality.

An important effect of Salomon was that it placed an unsecured creditor of a limited company in a more vulnerable position than that of a creditor of a partnership. The writer of the case note thought that the central question was whether the reference in the Act to seven or more 'associated' persons meant that all seven persons must have the intention to trade in partnership or that they might comprise one trader and six 'dummies'. 105 He considered that the founders of the company law legislation, in using the word 'associated' meant an 'ordinary' common law partnership with unlimited personal liability.¹⁰⁶ The House of Lords in effect allowed for 'dummy' shareholders as this complied with the literal statutory requirements. The writer of the case note thought the significance of the case was not its literal construction of the legislation but the fact that the decision sanctioned the one man company trading with limited liability. The author commented that this was not 'startling' because creditors of a limited liability company could look only to the capital of the company as the fund from which their claims could be met. 'Whether there is one person behind the company or seven or 70 000 makes no difference whatever to the creditors. It is not the constituency of the company, but its capital which concerns them'. 107

Another anonymous contemporary case note discussing the House of Lords decision observed that the decision would be 'a satisfaction to most lawyers, and

¹⁰¹ Ibid 188.

¹⁰² Note, 'One-Man Corporation' (1895) 9 Harvard Law Review 280.

¹⁰³ Note, above n 10, 6. Lord Cooke of Thorndon, above n 88, 8, believed this review to have been written by Sir Frederick Pollock.

¹⁰⁴ Note, above n 10, 7.

¹⁰⁵ Ibid 6.

¹⁰⁶ Ibid 7.

¹⁰⁷ Ibid 6.

certainly a great relief to many business men'. ¹⁰⁸ This comment recognised the economic reality that the use of private companies was already entrenched in business practice and was very common. The note also observed that the main issue resolved by the case was that six of the seven required shareholders could be 'straw men' and in the opinion of the writer, that this was not objectionable. The case note added that '[i]f this ... seem[ed] undesirable, it [was] for the legislature, not the courts, to make the change'. ¹⁰⁹

Some decades later, Otto Kahn-Freund described the decision in *Salomon* as 'calamitous'.¹¹⁰ He was mainly considering the legal position of creditors and noted that English law developed detailed fiduciary duties aimed at protecting shareholders from the actions of promoters and directors.¹¹¹ However creditors were not given the protection they ought to have as a 'corollary of the privilege of limited liability'.¹¹² He argued that the encouragement to incorporate small businesses resulted in a large number of problems stemming from 'the rigidities of the "folklore" of corporate entity'.¹¹³ It became uncertain in any given case whether the corporate veil would be lifted or drawn, and creditors in particular were often the victims of the application of the separate legal entity principle. This criticism of *Salomon* from the point of view of unsecured creditors appeared to have trade creditors in mind. The more recent advent of mass torts and tort creditors of corporate groups make these criticisms of *Salomon* even more compelling.

The widely accepted view of *Salomon* is that it is the landmark or 'great' case that marked a turning point in the development of modern company law. ¹¹⁴ Why did *Salomon* come to assume this exalted status? ¹¹⁵ Perhaps one reason why it was seen as a critical turning point in the development of company law was because the House of Lords resoundingly rejected the approach of the Court of Appeal, and thus the law appeared to strike out in an entirely new direction which legitimised the increasingly popular commercial practice of registering one person and private limited liability companies. Viewed from this perspective, the decision gave the highest judicial imprimatur to the underlying *laissez-faire* economic policy of the *1856 Act* — incorporating freedom of contract and an approach of 'creditor beware'.

- 108 Note, 'One-Man Corporations Broderip v Salomon Reversed' (1896) 10 Harvard Law Review 304, 304.
- 109 Ibid.
- 110 Kahn-Freund, above n 13, 54.
- 111 Ibid 55, citing Erlanger v New Sombrero Phosphate Co (1878) 3 App Case 1218; Gluckstein v Barnes [1900] AC 240; Alexander v Automatic Telephone Co [1900] 2 Ch 56.
- 112 Kahn-Freund, above n 13, 55.
- 113 Ibid.
- 114 See Prentice, above n 11, 315–23; Redmond, above n 7, 174.
- 115 Prentice suggests a number of reasons that explain why Salomon has been so durable. These include: the recognition by the legal community of the importance of the case at the time it was decided; the presence of compulsory insurance to deal with workplace and vehicle liability; the very few company law cases reaching the House of Lords that could possibly re-examine Salomon; the general refusal of the courts to see corporate groups in terms of enterprises; acceptance of the notion that groups may limit liability to particular entities within groups; and a reluctance to depart from the Salomon principle without legislative direction: Prentice, above n 11, 321–3.

It has been argued that some judicial decisions 'attain greatness' not because of their inherent legal reasoning, but because they are in accord with prevailing economic, social and political ideas and so gain community support. The For the reasons discussed above, the House of Lords decision in *Salomon* certainly reflected the values of the family business community in placing a priority on entrepreneurship and commercial risk-taking over the interests of creditors. This was consistent with the prevailing economic philosophy of *laissez-faire* capitalism and freedom of contract which underpinned the *1856 Act.* In other words, this argument suggests that the significance of key cases arises more as a matter of politics and social attitudes rather than legal coherence. As society moves and attitudes change, the usefulness of the case may diminish and more suitable laws may take its place.

Salomon thus appears to have served a particular purpose in the economy of late 19th century Britain. By this time, the small private company had become so widespread it was no longer practically possible to reconsider the foundations of English company law without major disruption.¹¹⁹ It can certainly be said that the case represented the imprimatur of the apex of the court hierarchy in the legitimisation of one person and private companies whose standing had been left in some doubt by the legislature. The effect of the House of Lords decision was to bring private companies within the legislation, taking away the immediate need for Parliament to reconsider a more effective means of regulating small companies separately from public companies.¹²⁰ The development of modern corporate group structures raises important social and economic questions about the allocation of risk between corporate groups and those harmed by their activities that were not contemplated at the time of Salomon. These contemporary questions require legal answers determined by the politics, economy and society of the present times rather than by the iron grip of Salomon.

- 116 Allan C Hutchinson, Evolution and the Common Law (Cambridge University Press, 2005) 128-30.
- 117 See generally P S Atiyah, The Rise and Fall of Freedom of Contract (Clarendon Press, 1979). Atiyah argued that the rise of formalism and the emergence of freedom of contract in the 19th century were associated with free market ideology as judges were strongly influenced by laissez-faire political and economic ideas and values. See especially: at 388–90, 398–405. Morton J Horwitz similarly argued that the rise of judicial formalism in the United States was associated with preserving the gains of the emerging business interests: Morton J Horwitz, The Transformation of American Law 1780–1860 (Harvard University Press, 1977) 253–4.
- 118 Hutchinson, above n 116, 131-2.
- 119 Rix argued that changes to the legislation became increasingly difficult from the 1880s as entrenched interests became too difficult to disturb: Rix, above n 97, 43. Opposition from private company interests on the grounds of retaining secrecy prevented the introduction of financial disclosure requirements for private companies for a number of years: at 65–70.
- 120 The Davey Committee of 1895 recommended a dual classification of companies as 'private' or 'public' for the purpose of applying different disclosure and investor protection provisions to each. These recommendations were adopted by Victoria very soon after: see Phillip Lipton, 'A History of Company Law in Colonial Australia: Economic Development and Legal Evolution' (2007) 31 Melbourne University Law Review 805, 827. United Kingdom legislation did not adopt the recommendations of the Davey Committee until 1907.

V SALOMON'S PRINCIPLE IN ITS APPLICATION TO CORPORATE GROUPS

As we have noted in the above discussion, contemporary and subsequent commentary on the decision in *Salomon* was centred around the issue of the legitimacy of a one man or private company. The implications that the decision might have for corporate groups, that is, situations where a holding or parent company controlled a number of subsidiaries or related entities, did not appear to have been addressed.

The development of the law concerning company shareholders was related to the broader shift of company law away from partnership law. There was no common law principle that prevented a company from being a shareholder in another company. Neither the 1856 Act nor the 1862 Act expressly prevented a company holding shares in another company, so a company was able to confer upon itself the power to hold shares in another company.¹²¹ However, it was prima facie ultra vires for one company to hold shares in another without the power to do so expressly or impliedly stated in the memorandum of association.¹²² The 1862 Act implicitly recognised that a company could be a shareholder by providing for voting by proxy, 123 and the Table A articles contained proxy forms which allowed proxy appointors to be corporations.¹²⁴ The ability of a company to own shares in another company is an aspect which differentiates companies from partnerships. Under partnership law, a partner in one partnership cannot be forced to become a partner in another partnership without consent. If two partnerships merge, all partners become partners of the merged partnership. This is a change to the underlying terms of the partnership and so the consent of all partners is required. This is not the same as the situation where a company acquires shares in another company. The shareholders of the acquirer company do not become shareholders in the company whose shares were acquired, because the acquirer company is separate from its shareholders. The shareholders therefore do not acquire an interest in the assets of the company whose shares were acquired.

It was only from around the time of *Salomon* that corporate groups began to appear in the commercial landscape. The emergence of corporate groups in Britain was

¹²¹ Great Eastern Railway Co v Turner (1871) LR 8 Ch App 149; Re Barned's Banking Co; Ex parte The Contract Corporation (1867) LR 3 Ch App 105. Cf Re European Society Arbitration Acts; Ex parte Liquidators of the British Nation Life Assurance Association (1878) 8 Ch D 679 where it was held that a contract which sought to transfer partly paid shares to a deed of settlement company was ultra vires and invalid. As a result, the company could not be placed on the list of contributories of the issuing company. This approach regards a company as an aggregation of shareholders in the same way as partnerships rather than a separate legal entity distinct from its shareholders and this case can be seen, even in its time, as an anachronism.

¹²² Great Eastern Railway Co v Turner (1871) LR 8 Ch App 149, 152 (Lord Selborne LC). See Sir Nathaniel Lindley, A Treatise on the Law of Companies: Considered as a Branch of the Law of Partnership (Sweet and Maxwell, 5th ed, 1889) 43.

¹²³ Companies Act 1862, 25 & 26 Vict, c 89, ss 50-1.

¹²⁴ Ibid sch 1 cl 49.

largely related to merger activity during the 1890s. 125 The main purpose of these mergers was to reduce competition and raise prices. Consequently, they were more in the nature of loose federations than integrated corporations. Family control of individual companies within a merged group remained largely the same as before the merger. In a commercial sense, these merged companies operated in a similar way to partnerships, rather than as integrated separate legal entities distinct from their shareholders. 126 Other corporate groups were established to enable subsidiaries to conduct business in foreign jurisdictions. As discussed above, *Salomon* was concerned with the legitimacy of the one person company. Integrated corporate groups were relatively rare in the 1890s and so it was by no means certain at the time that what became known as the principle in *Salomon* would be applied to company groups as they are understood today.

Whether a partly held subsidiary was a separate legal entity distinct from its parent company was considered independently of *Salomon* in a number of early revenue cases.¹²⁷ However, it was unclear when a subsidiary could be held to be acting as an agent for a parent company that exercised complete control over that subsidiary's business.¹²⁸ As discussed below, the question of whether a subsidiary acts as an agent of its holding company or another company in its group has presented difficulties ever since. At times the courts appear more prepared to construe an agency or trust relationship and look behind the corporate veil, but at other times the *Salomon* principle is an 'unyielding rock' on which 'complicated arguments' become 'shipwrecked'.¹²⁹

One of the earliest references to *Salomon* in the context of a holding company and subsidiary relationship was in *The Gramophone and Typewriter Ltd v Stanley*. In that case an English company which carried on business in the United Kingdom was the holder of all the shares in a German company. The German company made a profit and the question arose whether the profits of the German company were the profits of the English company such that the English company would be taxed on them

Walton J applied the principle in *Salomon* in a corporate group context:

- 125 P L Payne, 'The Emergence of the Large-Scale Company in Great Britain, 1870–1914' (1967) 20 Economic History Review 519, 519.
- 126 Leslie Hannah, 'Mergers in British Manufacturing Industry, 1880–1918' (1974) 26 Oxford Economic Papers 1; Payne, above n 125.
- 127 See, eg, Bartholomay Brewing Co (Of Rochester) Ltd v Wyatt [1893] 2 QB 499; Kodak Ltd v Clark [1903] 1 KB 505. In both cases English companies owned all but a small number of shares in United States companies. It was held in both cases that the American company was separate from its English parent and so was not carrying on business for the English company, which was not liable to pay tax on the profits of the United States company.
- 128 See *Apthorpe v Peter Schoenhofen Brewing Co Ltd* (1899) 4 TC 41, where a parent company was liable to pay tax on the whole of the profits derived by the subsidiary. There were three other Apthorpe cases which all held that brewing businesses carried on by United States companies were in fact carried on by their English parent companies or by the United States companies as agents of the English parent companies: *The Frank Jones Brewing Co Ltd v Apthorpe* (1898) 4 TC 6; *United States Brewing Co Ltd v Apthorpe* (1898) 4 TC 111.
- 129 Lord Templeman, 'Company Law Lecture Forty Years On' (1990) 11 Company Lawyer 10, 10.
- 130 [1908] 2 KB 89, affd The Gramophone and Typewriter Ltd v Stanley [1906] 2 KB 856 (Walton J).

To my mind there is no evidence that the business of the German company was the business of the English company except the fact that the English company has become the owner of all the shares in the German company. That does not extinguish the German company. The German company is an existing person and a different entity from the English company, and I think that the effect of the judgement of the House of Lords in the case *Salomon v Salomon* is that the fact that the shares of the German company all belong to the English company does not make the German company a mere alias, or a trustee, or an agent for the English company, or for the shareholders in the English company.¹³¹

The Court of Appeal affirmed the decision of Walton J, but, interestingly, none of the judgments referred directly to *Salomon*. This appears to indicate that holding companies and their subsidiaries were clearly regarded as separate legal entities without the need to rely on *Salomon* as authority.

Even though *Salomon* did not deal with a corporate group, it later came to be applied in diverse circumstances involving groups of companies where a subsidiary was held to be a separate legal entity from its parent company and other companies in the group.¹³² Perhaps the most problematic area where the *Salomon* principle has been applied to corporate groups is where tort claimants seek to recover damages from a holding company or companies in a group other than the tortfeasor company.

In Salomon itself, Lord Halsbury LC left open the possibility that a company could act as an agent for a shareholder.¹³³ The effect of determining that a company acts as an agent of its holding company or other shareholders is to attribute the acts, property or liabilities of a company to those who control it. It does not require the courts to pierce the corporate veil in the sense of disregarding the separate legal personality of the company.¹³⁴ An agency relationship between a holding company and its subsidiary was construed in Smith, Stone and Knight Ltd v Birmingham Corporation¹³⁵ where a local government authority sought to compulsorily acquire land occupied by a wholly-owned subsidiary. The authority argued that it was only required to pay an amount of compensation in accordance with the subsidiary's occupation of the land and could disregard the earlier occupation of the land by the holding company. The holding company successfully claimed that its subsidiary carried on the holding company's business as its agent, and that

^{131 [1906] 2} KB 856, 872 (citations omitted).

¹³² See, eg, Ebbw Vale Urban District Council v South Wales Traffic Area Licensing Authority [1951] 2 KB 366, where a government body (the British Transport Commission) acquired all the share capital of a previously privately held bus company. The company applied to a licensing authority to increase its fares. The applicable legislation prevented the licensing authority from hearing applications brought by the Commission. The question arose whether the Commission was the provider of a passenger road transport service and the company was merely acting as its agent. The Court of Appeal applied Salomon and held that the Commission and the company were separate entities and there was no evidence to show that the company was acting as an agent of the Commission: at 371.

^{133 [1897]} AC 22, 31. See also *The Gramophone and Typewriter Ltd v Stanley* [1908] 2 KB 89, 95–6 (Cozens-Hardy MR).

¹³⁴ Prest [2013] 2 AC 415, 478–9 [16], 484 [28] (Lord Sumption), 503 [83] (Lord Neuberger).

^{135 [1939] 4} All ER 116.

this should be taken into account in determining the period of occupation by the holding company and the amount of compensation. ¹³⁶ In Spreag v Paeson Pty Ltd, ¹³⁷ a subsidiary which held virtually no assets made a number of misleading and deceptive statements regarding a product it advertised and sold that were in contravention of the Trade Practices Act 1974 (Cth)138 and other consumer protection provisions. The subsidiary did not have a bank account, assets or premises in its own name, nor did it maintain accounting records. The holding company made payments on the subsidiary's behalf but these payments were not recorded as debts owing by the subsidiary. Money received by the subsidiary was paid over to the holding company. The business card of the salesperson with whom the purchaser dealt indicated that he was a representative of the holding company and not the subsidiary. In the light of this high degree of control exercised by the holding company over its subsidiary, Sheppard J applied the reasoning in Smith, Stone and Knight v Birmingham Corporation to hold that the holding company was liable to the purchasers for the statements that were made, on the basis that the subsidiary acted, 'at least by analogy', as an agent for its holding company.¹³⁹

Several other cases have also construed the existence of an agency relationship. These cases have indicated willingness on the part of the courts to depart from a rigid and inflexible application of the principle in *Salomon* in the corporate group context. Writing in 1976, Schmitthoff noted that:

The great change which has taken place in company law theory generally is the advance from the concept of the company as a formal legal person to that of the enterprise constituting an economic unit. This reflects the transition of the concept of the company as an instrument of unrestricted capitalism to a form of business organisation in the social order of the community. ... The result is that *Salomon* is still law but it has been dethroned from the position of the most important case in company law and now occupies the position of one of the ordinary cases on which the structure of company law rests.¹⁴¹

This preparedness to circumvent the strict application of the principle in *Salomon* proved to be short-lived. The strong hold exercised by the *Salomon* principle in the context of liability within corporate groups was reasserted in the United Kingdom case *Adams v Cape Industries PLC*. ¹⁴² Interestingly, this case involved an attempt by Cape Industries PLC ('Cape'), a United Kingdom company, to avoid liability to United States resident asbestos tort claimants who were awarded damages by a United States court against Cape and its wholly owned United

- 136 Ibid 121 (Atkinson J).
- 137 (1990) 94 ALR 679.
- 138 Now Competition and Consumer Act 2010 (Cth) sch 2 s 18.
- 139 Spreag v Paeson Pty Ltd (1990) 94 ALR 679, 711-12.
- 140 See, eg, Re FG (Films) Ltd [1953] 1 All ER 615; Wallersteiner v Moir [1974] 3 All ER 217, 237-8.
- 141 Schmitthoff, above n 15, 311-12.
- 142 [1990] 1 Ch 433 ('Adams'). The refusal of courts to lift the corporate veil can also be seen in Yukong Line Ltd of Korea v Rendsburg Investments Corp of Liberia (No 2) [1998] 4 All ER 82; Re Polly Peck International PLC (in admin) [1996] 2 All ER 433.

States subsidiary NAAC. Proceedings were commenced in the United Kingdom to enforce the United States judgment. The main issue revolved around whether Cape was a United States resident at the time of commencement of the action. To be a United States resident required Cape to possess a place of business in the United States or to carry on business through an agent who had power to conduct business on its behalf. Asbestos was marketed by NAAC until 1978 when it was put in liquidation. This set of circumstances gave rise to an argument that Cape was a resident of the United States through the activities of its subsidiary NAAC. Cape placed NAAC in liquidation in an attempt to prevent United States jurisdiction reaching it through its subsidiary's United States business. This enabled Cape to avoid exposure to potential asbestos-related liabilities. It soon established another subsidiary to conduct the marketing of its asbestos in which Cape held no shares.

The Court of Appeal refused to consider the companies within the Cape group as a single economic unit, or to lift the corporate veil, despite the high degree of control exercised by the parent company over the United States subsidiary.¹⁴⁴ The court drew a distinction between situations 'where a [parent] company itself trades in a foreign country and the case where it trades in a foreign country through a subsidiary, whose activities it has full power to control'.¹⁴⁵ In the latter case, the parent company was not a resident of the foreign country so as to be subject to the jurisdiction of the courts where the subsidiary carried on business. It was held that the economic inter-relationship of the companies did not justify piercing the corporate veil and departing from the *Salomon* principle. While the corporate veil might be lifted where the subsidiary was a 'façade' that was being used for a deliberately dishonest purpose, ¹⁴⁶ the principle in *Salomon* could not be disregarded 'merely because [the court] considers that justice so requires'. ¹⁴⁷

Slade LJ expressed reservations about applying the *Salomon* principle to cases of tort liability within corporate groups but felt compelled to apply the law:

we do not accept as a matter of law that the court is entitled to lift the corporate veil as against a defendant company 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 activities of the group (and correspondingly the risk of enforcement of that liability) will fall on another member of the group rather than the

¹⁴³ Adams [1990] 1 Ch 433, 450 (Scott J), 539-41 (Slade LJ).

¹⁴⁴ United States courts are more likely to hold a holding company liable for the acts of a subsidiary where it totally dominates the subsidiary and the legal action is brought by an involuntary creditor such as a tort creditor. See Meredith Dearborn, 'Enterprise Liability: Reviewing and Revitalizing Liability for Corporate Groups' (2009) 97 California Law Review 195, 231–51.

¹⁴⁵ Adams [1990] 1 Ch 433, 536. Cf Bulova Watch Co Inc v K Hattori & Co Ltd, 508 F Supp 1322 (ED NY, 1981)

¹⁴⁶ Adams [1990] 1 Ch 433, 542-3.

¹⁴⁷ Ibid 536.

defendant company. Whether or not this is desirable, the right to use a corporate structure in this manner is inherent in our corporate law.¹⁴⁸

The decision in *Adams* applied the *Salomon* principle in a formal way and did not consider the social implications flowing from limiting the ability of asbestos victims to gain compensation from a parent company for the tortious acts of one of its wholly-owned subsidiaries.¹⁴⁹

The effect of the application of *Salomon* in a corporate group context has been observed by judges and commentators alike as problematic in many instances, as it inappropriately favours the shareholders of the parent company at the expense of the creditors of companies in a corporate group.¹⁵⁰ The resultant social and economic issues are not directly addressed by formal legal analyses determining whether the separate legal entity principle should be applied or the acts of one member of a group should be attributed to other group members. For example, Templeman LJ in *Re Southard & Co Ltd* expressed the difficulties faced by a creditor in this context:

English company law possesses some curious features, which may generate curious results. A parent company may spawn a number of subsidiary companies, all controlled directly or indirectly by the shareholders of the parent company. If one of the subsidiary companies, to change the metaphor, turns out to be the runt of the litter and declines into insolvency to the dismay of its creditors, the parent company and the other subsidiary

- 148 Ibid 544. See also comments by Rogers AJA in Briggs v James Hardie & Co Pty Ltd (1989) 16 NSWLR 549, 577. His Honour commented that there is no general principle that all companies in a group are to be regarded as one, and for better or worse, the law recognises the creation of subsidiaries. It was the very nature of the holding company-subsidiary relationship that the holding company exercised complete control over the general policy of the subsidiary. Meagher JA stated that the fact that a subsidiary company was formed for the purpose of evading tortious liability did not provide a ground for lifting the corporate veil: at 556–7. The Court in James Hardie & Co Pty Ltd v Hall (1998) 43 NSWLR 554 arrived at a similar conclusion to Adams. The position is different where there is an existing tortious liability and a holding company seeks to protect itself by incorporating a separate group entity to assume liability after the claim has arisen. This could amount to using a company as a sham or façade for the purpose of defeating a claim or frustrating its enforcement: Jones v Lipman [1962] 1 All ER 442. However the circumstances where the corporate veil may be pierced are very limited: Prest [2013] 2 AC 415, 488 [35] (Lord Sumption).
- 149 The background considerations the Court may have implicitly taken into account in coming to its decision could have been related to its reluctance to accord jurisdiction to a United States court which sought to gain control of assets held by a United Kingdom company in order to meet the claims of United States asbestosis victims. Viewed in this light, the case may also be seen as a jurisdictional wrestle between courts, rather than a balance of economic and social interests which reflected broader community values.
- 150 In a number of instances, judges have felt resigned to applying the Salomon principle while questioning whether it reflected commercial reality or led to a desirable outcome. See, eg, The Albazero [1977] AC 774, 807 (Roskill LJ); Adams [1990] 1 Ch 433, 544 (Slade LJ); Re Southard & Co Ltd [1979] 3 All ER 556, 565 (Templeman LJ); Atlas Maritime Co SA v Avalon Maritime Ltd; The Coral Rose [No 1] [1991] 4 All ER 769, 779 (Staughton LJ); Briggs v James Hardie & Co Pty Ltd (1989) 16 NSWLR 549, 577 (Rogers AJA).

companies may prosper to the joy of the shareholders without any liability for the debts of the insolvent subsidiary.¹⁵¹

Since the 1970s, the approach of the English courts has been to see the *Salomon* principle as sacrosanct and so central to the structure and fabric of company law that to depart from it would blur the fundamental distinction between a company and its shareholders, and thereby create considerable legal and commercial uncertainty. While there may be some scope for piercing the corporate veil, it is restricted to very narrow circumstances. Lord Sumption in *Prest* concluded that the corporate veil may only be pierced 'when a person is under an existing legal obligation or liability or subject to an existing legal restriction which he deliberately evades or whose enforcement he deliberately frustrates by interposing a company under his control'. The limited circumstances where the courts will pierce the corporate veil do not appear to extend to cases where a holding company quarantines the possible or potential future tort liabilities of a group within a subsidiary because it would be difficult to show there was an *existing* legal obligation or liability that was deliberately evaded by interposing a controlled company.

VI CORPORATE GROUP TORT LIABILITIES

The problem raised by the application of the *Salomon* principle to corporate groups is particularly acute where the creditors concerned are tort creditors, as important public policy issues then arise concerning who should bear the losses resulting from negligent or risky behaviour.¹⁵³ This becomes a critical factor where the subsidiary that turns out to be the 'runt of the litter', due to a deliberate strategy of the holding company, has been utilised so as to carry

- 151 [1979] 3 All ER 556, 565. Roskill LJ in *The Albazero* [1977] AC 774, 807 described the principle that each company in a group is a separate legal entity possessed of separate legal rights and liabilities from other companies in the group as a 'fundamental [principle] of English law long established and now unchallengeable by judicial decision'. His Lordship said further that '[i]t is perhaps permissible under modern commercial conditions to regret the existence of these principles. But it is impossible to deny, ignore or disobey them'. See also *Briggs v James Hardie & Co Pty Ltd* (1989) 16 NSWLR 549, 577 (Rogers AJA); *Qintex Australia Finance Ltd v Schroders Australia Ltd* (1990) 3 ACSR 267 ('Qintex'). In *Qintex*, Rogers CJ expressed the view that there was a tension between 'the realities of commercial life and the applicable law' which rigidly upheld the demarcation between corporate group members. He commented that '[i]t may be desirable for parliament to consider whether this distinction between the law and commercial practice should be maintained': at 268–9.
- 152 [2013] 2 AC 415, 488 [35]. Commenting on veil-piercing in the United States, Easterbrook and Fischel said that ""[p]iercing" seems to happen freakishly. Like lightening, it is rare, severe, and unprincipled': Frank H Easterbrook and Daniel R Fischel, 'Limited Liability and the Corporation' (1985) 52 University of Chicago Law Review 89, 89. Thompson claimed that in the United States, piercing the corporate veil was the most litigated issue in corporate law: Robert B Thompson, 'Agency Law and Asset Partitioning' (2003) 71 University of Cincinnati Law Review 1321, 1325. See the comments of Lord Neuberger in Prest [2013] 2 AC 415, where his Lordship explained that the piercing the corporate veil doctrine was widely criticised as 'controversial and uncertain': 501–2 [75]–[79].
- 153 Briggs v James Hardie & Co Pty Ltd (1989) 16 NSWLR 549, 578–9 (Rogers AJA). His Honour noted the difficult position of involuntary tort creditors and thought this was relevant in determining whether to pierce the corporate veil. See also Justice Andrew Rogers, 'Reforming the Law Relating to Limited Liability' (1993) 3 Australian Journal of Corporate Law 136, 139.

on a particularly hazardous activity, or to assume liabilities arising from such activities. In carrying out this strategy, the holding company anticipates that, should substantial liabilities accrue in the future from the carrying on of such risky activities, the other companies in the group will be insulated from liability on the basis that they are separate legal entities.

Tort creditors are described as 'involuntary creditors' because they have 'no choice in the selection of the tortfeasor' and cannot realistically be expected to make themselves aware of a corporate group structure and assess which companies in the group will have funds to meet their claims in the event of insolvency within the group.¹⁵⁴ By the nature of their position, tort victims are generally unable to predict in advance the likelihood or nature of the loss or injury they suffer, and so are unable to protect themselves by means of insurance or alleviate the harm they have suffered in any other way. It is usually the tortfeasor who is in a position to assess and manage risk. Contract creditors, on the other hand, are usually better positioned to protect themselves by securing guarantees, making inquiries about the creditworthiness of the contract counterparties, deciding the parties with whom they wish to enter into a contract, and specifying the compensation for bearing the risk stemming from the limited liability of the other parties to the contract.

By using an underfunded or insolvent subsidiary to meet the claims of tort creditors, a holding company is thus able to effectively shift at least some of the losses of tort claimants onto the claimants themselves or government funded health services, thereby receiving a form of subsidy from uncompensated tort victims. ¹⁵⁵ Given this greater vulnerability of tort creditors, it is surprising that empirical studies indicate that the corporate veil is more likely to be pierced in contract cases than in tort cases. ¹⁵⁶ It has been argued that this legal situation is inefficient and encourages unethical corporate behaviour because the ability to avoid or reduce liability to tort claimants enables tortfeasors to externalise some of their costs and creates a moral hazard that may encourage excessive risk taking or harmful activities. As a result, the overall social cost of the harmful activity giving rise to tort claims exceeds the benefits to shareholders and to society as a whole. ¹⁵⁷

- 154 Briggs v James Hardie & Co Pty Ltd (1989) 16 NSWLR 549, 578-9. See also Carroll, above n 18, 93-5.
- 155 David Millon, 'Piercing the Corporate Veil, Financial Responsibility and the Limits of Limited Liability' (2007) 56 Emory Law Journal 1305, 1324.
- 156 Ian M Ramsay and David B Noakes, 'Piercing the Corporate Veil in Australia' (2001) 19 Company and Securities Law Journal 250, 265. It has been suggested that this is also the case in the US: Robert B Thompson, 'Piercing the Corporate Veil: An Empirical Study' (1991) 76 Cornell Law Review 1036, 1068. Thompson's findings have been disputed by Oh, who conducted a detailed empirical study that found that veil-piercing claims have prevailed more often in tort than contract cases: Peter B Oh, 'Veil-Piercing' (2010) 89 Texas Law Review 81, 124–5. See also Corporations Act 2001 (Cth) ss 588V–588X, which lifts the corporate veil of subsidiary companies in certain situations to make a holding company liable for the debts of its subsidiaries. This liability arises where a subsidiary incurs a debt at a time when there were reasonable grounds to suspect that it was insolvent. The term 'incurs a debt' implies that the debt arose from a contract and not from a tort liability.
- 157 Hansmann and Kraakman, above n 18, 1880 put forward this argument to suggest that limited liability should be withdrawn from shareholders of tortfeasor companies because the economic benefits of deterring injuries and compensating tort victims outweighs the costs of removing limited liability within corporate groups. See also Millon, above n 155, 1324–5; Frank H Easterbrook and Daniel R Fischel, *The Economic Structure of Corporate Law* (Harvard University Press, 1991) 41–50; Easterbrook and Fischel, 'Limited Liability and the Corporation' above n 152, 103–4.

The application of the *Salomon* principle to corporate groups is especially problematic because holding companies have the freedom to establish subsidiaries and decide upon the size and financing of the various legal entities in the group, and to draw the boundaries between them.¹⁵⁸ Where a company in a group becomes insolvent, its creditors are unable to recover from other companies in the group as a direct result of the manipulation of capital boundaries. The parent may go even further by funding the subsidiary in the form of secured debt rather than equity, thereby achieving priority over unsecured creditors in the event that the subsidiary becomes insolvent.

Recent developments in tort law have seen a number of cases where the duty of care has been extended to impose liability on holding companies for injuries caused to employees of their subsidiaries. These cases indicate that the law of negligence and corporate law have contradictory responses in cases of corporate group tortfeasors. Tort law has been more responsive than company law to the social and economic issues raised in mass tort cases, by enabling tort victims to bypass *Salomon* to hold a parent company liable in circumstances where the parent company itself owed a duty of care to employees of an under-funded, insolvent or deregistered subsidiary. The application of tort law in these circumstances recognises that holding companies are generally able to control the business activities of their subsidiaries, implement appropriate risk management strategies and reduce the risk of harm to employees and users of their subsidiaries' products.

In CSR Ltd v Wren,¹⁶⁰ Wren was an employee of Asbestos Products Pty Ltd (AP), a manufacturer of asbestos building products, which was a wholly owned subsidiary of CSR. AP was subsequently wound up. Some 45 years after ceasing to work for AP, Wren contracted mesothelioma. It was not disputed that this was caused by inhaling asbestos dust while working for AP at its factory. The New South Wales Court of Appeal held that CSR owed a duty of care to an employee of AP to protect him from the risk of foreseeable injury. Beazley and Stein JJA in a joint majority judgment noted that 'no case was made at trial that the circumstances were such that the corporate veil [should] be lifted or that ... [the subsidiary had acted as] CSR's agent'.¹⁶¹ Beazley and Stein JJA then proceeded to

¹⁵⁸ Collins, above n 17, 732, described this as the 'capital boundary problem'. LoPucki puts forward the argument that legal structures are increasingly used to place liabilities in asset-poor subsidiaries so as to make defendants 'judgment-proof' to at least some extent as a means of thwarting creditors: Lynn M LoPucki, 'The Death of Liability' (1996) 106 Yale Law Journal 1. Schwarcz argues that in the United States (even in the case of non-arms-length transactions within corporate groups) there are considerable constraints on the ability of a parent company to create judgment-proof structures imposed by existing law in bankruptcy, corporate law, tort law and criminal law: Steven L Schwarcz, 'The Inherent Irrationality of Judgment Proofing' (1999) 52 Stanford Law Review 1. Such constraints appear to be less powerful in Australia and the United Kingdom. See New South Wales, Special Commission of Inquiry into the Medical Research and Compensation Foundation, Report of the Special Commission of Inquiry into the Medical Research and Compensation Foundation (2004) vol 2, annexure T.

¹⁵⁹ See, eg, CSR Ltd v Wren (1997) 44 NSWLR 463; CSR Ltd v Young [1998] Aust Torts Reports ¶81-468; Chandler v Cape PLC [2012] 3 All ER 640. For a discussion of the issues raised and an analysis and critique of this case, see Martin Petrin, 'Assumption of Responsibility in Corporate Groups: Chandler v Cape PLC' (2013) 76 Modern Law Review 603.

^{160 (1997) 44} NSWLR 463.

¹⁶¹ Ibid 466.

base their judgement on tort law without further discussion of the corporate veil. They found that CSR 'adopted a patriarchal attitude towards its subsidiaries' and exercised a particularly high degree of control over AP. 162 CSR exercised control over the operational aspects of the AP factory; the management staff of AP who had control over its factory operations were employees of CSR; and CSR's board was closely involved in the purchase of equipment for AP.¹⁶³ They also found that it was known at the time of Wren's employment by AP that asbestos was a hazardous product.¹⁶⁴ Beazley and Stein JJA held that it was reasonably foreseeable that there was a risk of injury to employees as a result of the work practices adopted by AP. These circumstances indicated a proximity between the holding company and the employees of its subsidiary that was sufficient to give rise to a duty of care owed by CSR to Wren to protect him from the risk of foreseeable injury that was 'co-extensive with that owed by an employer to an employee'.165 Their Honours touched upon the interaction of corporate law and tort law pointing out that the imposition of a duty of care on CSR did 'not do any violence' to the principle in Salomon. 166 CSR's liability arose because of the proximity of its relationship with AP.167 This statement is correct in the sense that the corporate veil was not directly pierced, however the principle in Salomon was effectively evaded by the imposition of a duty of care so as to bring about a similar result as would have occurred had the corporate veil been pierced. 168

A similar decision was reached in *CSR Ltd v Young*.¹⁶⁹ It was held by a majority of the New South Wales Court of Appeal that both CSR Ltd as holding company and Australian Blue Asbestos Ltd (ABA), its mining company subsidiary, owed a duty of care to the young child of an employee of ABA who lived in Wittenoom, an asbestos mining town. While living in the mining town from birth until the age of 27 months, the child was exposed to blue asbestos dust in the town and around the family home and, as an adult, contracted mesothelioma and died of the disease. Giles AJA stated that the question in the case was whether the dominant parent, CSR, was in a relationship of proximity to the injured party and whether the subsidiary, ABA, was in truth 'merely a conduit for the parent'.¹⁷⁰

It was held by the majority that the state of knowledge, at the time of exposure, about the dangers of asbestos to residents of Wittenoom who were not engaged in working in the mines or mills, was such that it was reasonably foreseeable that residents of Wittenoom could suffer harm as a result of exposure to asbestos dust.¹⁷¹ CSR and ABA were both under a duty of care to warn employees of the

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162 Ibid 470.
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¹⁶³ Ibid 469-71.

¹⁶⁴ Ibid 471–6.

¹⁶⁵ Ibid 485.

¹⁶⁶ Ibid.

¹⁶⁷ Ibid.

¹⁶⁸ Peter Edmundson and Pam Stewart, 'Liability of a Holding Company for Negligent Injuries to an Employee of a Subsidiary: CSR v Wren (1998) 6 Torts Law Journal 1, 7–8.

^{169 [1998]} Aust Torts Reports ¶81-468.

¹⁷⁰ Ibid 64 953, quoting Craig v Lake Asbestos of Quebec Ltd, 843 F 2d 145, 148 (3rd Cir, 1988).

¹⁷¹ Ibid 64 955 (Giles AJA).

risks presented by asbestos dust and they failed to issue such warnings. Little mention was made of piercing the corporate veil. Giles AJA thought that if there was proximity between the holding company and the injured party, there was no question of piercing the corporate veil. He also suggested that construing a subsidiary as acting as agent for its holding company was inappropriate in negligence cases.¹⁷²

The Court of Appeal of England and Wales in *Chandler v Cape PLC*¹⁷³ also considered the circumstances where a parent company owed a duty of care towards an employee of a subsidiary. It found in this case that the parent company exercised a high degree of control over its subsidiary. Relevant factors in determining control included the parent company's 'practice of issuing instructions about the [subsidiary's] products'; the requirement that the subsidiary would seek parent company approval for significant capital expenditures; a centralised product development process; and common company policies which were subject to parent company direction.¹⁷⁴ In deciding whether there has been an assumption of responsibility by a parent company for the health and safety of its subsidiary's employees, the Court of Appeal set out a four part test:

- (1) the businesses of the parent and subsidiary are in a relevant respect the same;
- (2) the parent has, or ought to have, superior knowledge on some relevant aspect of health and safety in the particular industry;
- (3) the subsidiary's system of work is unsafe as the parent company knew, or ought to have known; and
- (4) the parent company knew or ought to have foreseen that the subsidiary or its employees would rely on its using that superior knowledge for the employees' protection.¹⁷⁵

The requirement of proximity to found a duty of care arises from the control exercised by a holding company over its subsidiary's trading operations.¹⁷⁶ The relevant degree of control does not necessarily have to be *absolute* control, nor does it require the parent company to have a comprehensive policy of protecting employees.¹⁷⁷ This liberal construction of what constitutes control sufficient to establish proximity for the purposes of a duty of care will usually be met in a parent-subsidiary relationship, especially where the subsidiary is wholly owned.¹⁷⁸

¹⁷² Ibid 64 953.

^{173 [2012] 3} All ER 640.

¹⁷⁴ Ibid 658 [73], [75].

¹⁷⁵ Ibid 659 [80].

¹⁷⁶ Ibid.

¹⁷⁷ Ibid 655 [66].

¹⁷⁸ See Petrin, above n 159, for a critique of this case where he argued that the court adopted a test that is 'dangerously broad and has the potential to open the floodgates': at 619.

James Hardie & Co Pty Ltd v Hall¹⁷⁹ was another asbestos related case where the New South Wales Court of Appeal adopted a different approach and declined to impose a duty of care on a holding company towards an employee of a subsidiary. The plaintiff was an employee of a New Zealand subsidiary of James Hardie. He was barred from bringing a negligence action against his employer in New Zealand by legislation that introduced an insurance based no-fault scheme for compensation for personal injuries. He therefore brought an action in New South Wales against related New South Wales companies that supplied asbestos to his employer in New Zealand. One of these companies was the holding company of the James Hardie Group that held 95 per cent of the shares of the New Zealand subsidiary. The plaintiff claimed that a duty of care was owed by the New South Wales companies and this duty was breached by his exposure to asbestos.

The New South Wales Court of Appeal distinguished this case from *CSR Ltd v Wren*. In the present case the holding company did not exercise direct control over the operations of its subsidiary's factory in the way that occurred in *CSR Ltd v Wren*, where the holding company's employees 'controlled the day to day operations of the subsidiary'. The court directly addressed the corporate law problem faced by the plaintiff and applied the principle in *Salomon* to this corporate group so that the New Zealand subsidiary was a separate legal entity from the New South Wales companies. The corporate veil could only be lifted where there were special circumstances in that a company was used as a façade to conceal the true fact that the plaintiff was employed by the New South Wales companies, or that the New Zealand subsidiary acted as an agent for the New South Wales companies. This was not the case in the present circumstances so the holding company did not owe the plaintiff a duty of care. [81]

It was central to the decisions in CSR Ltd v Wren and CSR Ltd v Young that in both cases CSR exercised close control over the activities of its wholly owned subsidiaries. It was that control which gave rise to a duty of care owed by the holding company in relation to employees of its subsidiaries. It is generally the case that holding companies exercise a high degree of control over their wholly owned subsidiaries, as the purpose of establishing a subsidiary is to carry out the corporate purposes determined by the holding company as a 'conduit for the parent'. 182 Typically the board of a subsidiary will comprise directors or executive employees of the holding company. For the purposes of tort law this degree of control can establish the requisite proximity that imposes a duty of care on a holding company that is co-extensive with the duty of an employer to an employee. On the other hand, in James Hardie & Co Ltd v Hall, the corporate veil represented a major stumbling block in the plaintiff's path which ultimately prevented the court from determining the case according to tort law principles. Had the court proceeded to do so, it appears that the holding company may not have exercised a sufficient degree of control over its subsidiaries to enable the

^{179 (1998) 43} NSWLR 554.

¹⁸⁰ Ibid 583.

¹⁸¹ Ibid 584.

 $^{182 \}quad \textit{CSR Ltd v Young} \ [1998] \ \textit{Aust Torts Reports} \ \P 81\text{-}468, 64953.$

court to conclude that there was the requisite degree of proximity between the holding company and the employee of a subsidiary to enable a duty of care to be imposed on the holding company.

These cases indicate some confusion in the law determining whether tort victims, who primarily are able to bring an action against a subsidiary, are also able to bring an action against the subsidiary's holding company. As shown in *CSR Ltd v Wren* and *CSR Ltd v Young*, the application of tort principles provides a plaintiff with a means of recovery against a holding company. The principle in *Salomon* usually presents an insuperable obstacle. The main aims of tort law are compensation of deserving victims and to provide disincentives for risky behaviour and attempts to externalise costs. The social and economic issues raised in the cases discussed here are better resolved by tort law principles which directly address these issues, rather than according to corporate law principles which developed in a very different context and for entirely different purposes.

VII CONCLUSION

Salomon has for a long time been seen as a landmark case that is the keystone of modern company law. This article argues that the case has been given an exaggerated and unjustified importance. It is further argued that the decision in Salomon brought about no significant change in the direction of the law or commercial practice, because the concept of a company having a legal personality separate from its shareholders had already been largely developed in both a legal and commercial sense by the time the case was decided. Seen in this light, the great importance that has been attached to Salomon was by no means inevitable. Rather, the law could quite feasibly have taken a different course, and its path probably owes more to the values and expectations of the family business commercial community than it does to the inherent logic of legal evolution.

Corporate groups were little known at the end of the 19th century and so were not within the contemplation of the Law Lords who handed down the decision in *Salomon*. However the principle in the case later came to be applied to corporate groups. This was also not an inevitable development in the law as there was a period between the 1930s and 1970s when the courts were in some cases prepared to hold that an agency relationship existed between a holding company and one of its subsidiaries, and that the group might thus be seen as both an economic and legal enterprise. This approach proved to be short-lived and in more recent times the iron grip of *Salomon* has reasserted itself.

The application of the *Salomon* principle to corporate groups has enabled the controllers of corporate groups to limit tort liabilities to certain companies in the group and thereby insulate the rest of the group from actual and potential liabilities. The ability of corporate groups to structure themselves in ways that limit the liability of the group to involuntary tort creditors raises important social and economic questions regarding the discouragement of excessive risk-taking, the allocation of risk between corporate groups and those who are harmed by the

group's activities, and the externalisation of risk by corporate groups that stand to profit from a risky activity while avoiding liabilities when the activity causes harm.

These important and complex questions could be better addressed if the courts were more prepared to look behind or disregard corporate group arrangements which were designed to shield group assets from the claims of tort creditors. The decision in *Prest*¹⁸³ provides an illustration of how the *Salomon* principle may be avoided. In the context of distributing marriage property upon a divorce, the court looked behind the ownership of assets by several companies to find that they beneficially belonged to a husband. The particular circumstances in which the property came to be vested in the companies created a trust in favour of the husband. Nevertheless the judges in that case stated that the corporate veil could be pierced only in very limited circumstances, meaning that the prospects of success for tort creditors seeking to pierce the corporate veil in a direct way are unlikely, or at the very least, uncertain.

Recent developments in tort law have seen a number of cases where holding companies were held liable to employees of their subsidiaries by the imposition of a duty of care owed by the holding company. In this respect tort law and corporate law are uneasy bedfellows where each addresses the issue of tort liability in corporate groups from an entirely different viewpoint. The law of torts has been more responsive to modern social expectations than company law in addressing the social and economic issues raised in mass tort cases where a holding company exercises close control and dominance over a subsidiary. In a number of cases in Australia and the UK, tort victims have been able to bypass the principle in Salomon so as to hold a parent company liable in circumstances where the parent company itself owed a duty of care to employees of an under-funded, insolvent or deregistered subsidiary. This approach based on tort law seems to mark a preferable way forward by directly addressing complex economic and social questions as negligence issues. Given the importance of the social and economic issues raised in cases of mass torts involving corporate groups, it is preferable that these issues are resolved by torts law rather than the dead hand of Salomon.