



**UNIT 1 : BUSINESS  
STRUCTURES AND  
CORPORATE  
PERSONALITY**

# THE MAIN BUSINESS STRUCTURES



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# SOLE TRADERSHIP/PROPRIETORSHIP

## Definition:

A sole proprietorship is a business structure where a single individual owns and operates the business. The owner has complete control over the business and is personally liable for its debts and obligations. This structure is relatively easy to set up and offers simplicity and flexibility for small businesses.

## Characteristics:

- Owned and operated by a single individual.
- Simplest and most common form of business structure.
- The owner has complete control and decision-making authority.
- The owner is personally liable for the business debts and obligations.
- Easy to set up and maintain.
- Taxes are typically filed under the owner's personal income tax.

# PARTNERSHIP

## Definition:

A partnership is a business structure where two or more individuals or entities agree to share the profits, losses, and responsibilities of the business. Each partner contributes resources, skills, or capital to the business. Partnerships can be general partnerships, where all partners have equal liability, or limited partnerships, where some partners have limited liability. Partnerships are governed by a partnership agreement that outlines the terms and conditions of the partnership.

## Characteristics:

- Owned and operated by two or more individuals or entities.
- Partners contribute resources, skills, or capital to the business.
- Partners share profits, losses, and decision-making responsibilities based on the terms outlined in a partnership agreement.
- Partners are personally liable for the debts and obligations of the partnership.
- Partnerships require a partnership agreement that outlines the rights and responsibilities of each partner.

# THE COMPANY/CORPORATION

## Definition:

A corporation is a legal entity that exists separately from its owners, known as shareholders. It is formed by filing the necessary documents with the appropriate government authorities. A corporation has its own legal rights and liabilities, and shareholders' liability is generally limited to their investment in the company. Corporations are managed by a board of directors and are subject to specific legal and regulatory requirements.

## Characteristics:

- A separate legal entity from its owners (shareholders).
- Formed by filing necessary documents with the appropriate government authorities.
- Shareholders own the corporation through the ownership of shares of stock.
- Limited liability for shareholders, meaning their personal assets are generally protected from business liabilities.
- Managed by a board of directors elected by shareholders.
- Subject to specific legal and regulatory requirements, such as annual meetings, financial reporting, and adherence to corporate governance standards.
- Can issue shares of stock to raise capital.
- Taxes are filed separately for the corporation, and shareholders may also be subject to taxes on dividends received.

# CORPORATE PERSONALITY



# CORPORATE PERSONALITY

Under the concept of corporate personality:

- A corporation is treated as a separate legal entity, capable of entering into contracts, owning assets, and engaging in legal transactions in its own name.
- The liabilities and debts of the corporation are generally limited to the assets owned by the corporation, and the shareholders' personal assets are protected from the company's liabilities (subject to certain exceptions).
- The corporation can sue and be sued in its own name, separate from the shareholders or directors.
- The corporation can own property, hold bank accounts, and engage in business activities.
- The corporate entity continues to exist even if there are changes in its shareholders or management.
- The rights and obligations of the corporation are distinct from those of its individual shareholders, directors, or employees.

## THE LANDMARK DECISION OF SALOMON V A SALOMON & CO LTD HAS BEEN CITED TO APPRECIATE THE TRUE SIGNIFICANCE OF CORPORATE PERSONALITY

### FACTS:

- Aron Salomon was a successful leather merchant who specialized in manufacturing leather boots. For many years he ran his business as a sole proprietor.
- By 1892, his sons had become interested in taking part in the business. Salomon decided to incorporate his business as a Limited company, Salomon & Co. Ltd.
- At the time the legal requirement for incorporation was that at least seven persons subscribe as members of a company i.e. as shareholders. The shareholders were Mr. Salomon, his wife, daughter and four sons. Two of his sons became directors; Mr. Salomon himself was managing director.
- Mr. Salomon owned 20,001 of the company's 20,007 shares - the remaining six were shared individually between the other six shareholders.
- Unfortunately, the business failed, leading the company into liquidation. Mr. Salomon sold his business to the new corporation for almost £39,000, of which £10,000 was a debt to him. He was thus simultaneously the company's principal shareholder and its principal creditor.

## DECISION OF THE COURT AT FIRST INSTANCE: SALOMON V A SALOMON & CO LTD

HELD:

- When the company went into liquidation, the liquidator argued that the debentures used by Mr. Salomon as security for the debt were invalid, on the grounds of fraud. The judge, Vaughan Williams J. accepted this argument, ruling that since Mr. Salomon had created the company solely to transfer his business to it, the company was in reality his agent and he as principal was liable for debts to unsecured creditors.
- The liquidator argued that Salomon should be personally liable for the company's debts, asserting that the company acted as his agent or trustee.

## THE APPEAL : SALOMON V A SALOMON & CO LTD

- The Court of Appeal also ruled against Mr. Salomon, though on the grounds that Mr. Salomon had abused the privileges of incorporation and limited liability, which the Legislature had intended only to confer on "independent bona fide shareholders, who had a mind and will of their own and were not mere puppets".
- The Lords Justices of Appeal variously described the company as a myth and a fiction and said that the incorporation of the business by Mr. Salomon had been a mere scheme to enable him to carry on as before but with limited liability.

## DECISION OF THE HOUSE OF LORDS: SALOMON V A SALOMON & CO LTD

- The House of Lords unanimously overturned this decision, rejecting the arguments from agency and fraud. They held that there was nothing in the Act about whether the subscribers (i.e. the shareholders) should be independent of the majority shareholder.
- The company was duly constituted in law and it was not the function of judges to read into the statute limitations they themselves considered expedient. The 1862 Act created limited liability companies as legal persons separate and distinct from the shareholders.
- Lord Halsbury stated that the statute "enacts nothing as to the extent or degree of interest which may be held by each of the seven [shareholders] or as to the proportion of interest or influence possessed by one or the majority over the others."

## SALOMON V A SALOMON & CO LTD

- Salomon was not personally liable for the company's debts. The company was not an agent or trustee for Salomon—it was a separate entity, with which the creditors had contracted.
- Accordingly, its debts were not Salomon's debts and, as his debt outranked the debts of the other creditors, he was entitled to the money owed to him.

## KEY CASES ON SEPARATE LEGAL PERSONALITY :

### 1. ADAMS V CAPE INDUSTRIES PLC [1990] CH 433 (CH)

#### FACTS:

- The defendant parent company (Cape) was based in England. A subsidiary of Cape was based in South Africa where it mined asbestos.
- The asbestos was sold by other subsidiaries, one of which was based in Illinois, USA. The asbestos was sold to a factory in Texas and a number of the factory's employees developed asbestos-related medical conditions.
- A US court ordered that \$15 million be paid in damages, but this could only be enforced in the UK against Cape if the claimants could show that Cape was present in the USA.
- Accordingly, the claimants argued that Cape was present in the USA through its Illinois subsidiary. For this argument to succeed, the separate personalities of the various companies would need to be ignored.

#### HELD:

- Each company in a group has its own separate corporate personality. The US subsidiary was separate and distinct from its English parent and the claimants could not therefore enforce the US judgment in an English court.
- The Court refused to lift the veil and held that the US subsidiary was separate and distinct from its UK parent.
- Accordingly, Cape was not present in the USA and the judgment of the US court could not be enforced against it.
- Salomon allowed a parent to use its subsidiaries to avoid liability in this way, and the Court was of the opinion that, on the facts, there were no grounds to avoid following Salomon.

## KEY CASES ON SEPARATE LEGAL PERSONALITY :

### 2. LEE V LEE'S AIR FARMING LTD [1961] AC 12 (PC)

#### FACTS:

- Lee was employed as a pilot by a company in which he held 2,999 shares (out of 3,000 in total) and of which Lee was the only director. Whilst engaged on company business, his plane crashed and he was killed.
- His widow sought compensation for his death from the company, which, under the relevant legislation, was payable only to the widows of deceased employees.
- The company's insurers argued that Lee was not an employee of the company, on the basis that he was synonymous with the company and had therefore made a contract with himself (which is not permitted by the law, as agreement required two parties).

#### HELD:

- Lee's widow was entitled to compensation. Lee had not made a contract with himself; rather he had made a contract with the company, which was a separate entity.
- The fact that he owned virtually all the shares and was its only director did not change that fact that the company was the employer and he was its employee.
- As the company is a legal person, it can enter into binding contracts, with persons inside the company, as well as those outside the company.

**KEY CASES ON SEPARATE LEGAL PERSONALITY :**  
**3. GILFORD MOTOR CO LTD V HORNE [1933] CH 935 (CA)**

**FACTS:**

- The defendant was the managing director of the claimant company. His employment contract provided that, should he leave the company, he would not attempt to solicit any of its customers.
- His employment was terminated, and his wife set up a rival company, which competed directly with the claimant. It was clear that this new company was set up at the defendant's behest and was under the defendant's control.

**HELD:**

- The Court granted an injunction preventing the defendant (and the new company) from soliciting the claimant's customers.
- Lord Hanworth stated that the new company was 'formed (p. 35) as a device, a stratagem, in order to mask the effective carrying on of a business of [the defendant]' and to avoid the restrictive covenant.
- Corporate personality will be cast aside where a company is a sham or is used to evade a contractual obligation.

**KEY CASES ON SEPARATE LEGAL PERSONALITY :**  
**4. MACAURA V NORTHERN ASSURANCE CO LTD [1925] AC 619 (HL)**

**FACTS:**

- Macaura owned a timber yard. He created a company and transferred all of the timber to this new company, in return for which he obtained a number of shares in the company.
- He then insured the timber, in his own name, against loss caused by fire. Subsequently, the timber was destroyed in a fire, but the insurance company refused to pay out.

**HELD:**

- The insurance company was entitled to refuse payment as, whilst the timber was insured in Macaura's name, it did not belong to him—it belonged to the company he created.
- Accordingly, Macaura had no insurable interest in the timber and so could not claim on the insurance policy.
- The assets of the company are separate from the assets of its members, and the members have no proprietary interest in the company's assets.

## KEY CASES ON SEPARATE LEGAL PERSONALITY :

### 5. CHANDLER V CAPE PLC [2012] EWCA CIV 525

#### FACTS:

- Mr Chandler (the claimant) was, for periods between 1959 and 1962, an employee of Cape Building Products Ltd (CBP), a subsidiary of Cape plc. In 2007, Chandler discovered that he had contracted asbestosis as a result of being exposed to asbestos whilst working for CBP.
- He sought to obtain compensation, but CBP had been dissolved many years before and, during Chandler's period of employment, CBP had no insurance policy in place that would indemnify Chandler for his loss.
- Accordingly, Chandler commenced proceedings against the parent, Cape plc.

#### HELD:

- The Court held that Cape plc assumed responsibility towards Chandler and so owed him a duty of care, which it had breached. Accordingly, Cape plc was ordered to pay damages to Chandler.
- A parent company can owe a duty of care directly to an employee of its subsidiary, providing that the three-stage test for establishing duty has been satisfied.
- This does not involve piercing the corporate veil.

# THE CONCEPT OF LIFTING/PIERCING THE VEIL OF INCORPORATION



# THE LIFTING/PIERCING OF THE VEIL OF INCORPORATION

- The concept of lifting or piercing the veil of incorporation refers to a legal doctrine that allows a court to disregard the separate legal personality of a corporation and hold its shareholders, directors, or officers personally liable for the company's actions or debts. In essence, it involves looking beyond the corporate structure to hold individuals accountable for the company's obligations.
- The veil of incorporation is the legal barrier that separates a company's assets and liabilities from those of its shareholders or owners. It is a fundamental principle of company law that protects shareholders from being personally liable for the company's debts beyond their investment. However, there are situations where the courts may decide to disregard this separate legal personality and "pierce the veil" to achieve justice or prevent an abuse of the corporate form.

# THE LIFTING/PIERCING OF THE VEIL OF INCORPORATION

The veil can be lifted or pierced in various circumstances, including:

- **Fraud or wrongdoing:** If a company is used as a device to perpetrate fraud, evade legal obligations, or engage in illegal activities, the court may disregard the separate entity status and hold the individuals behind the company personally liable.
- **Improper or illegal conduct:** When the company's operations are conducted in a manner that goes against the principles of fairness, public interest, or legal requirements, the court may disregard the corporate form and hold individuals accountable.
- **Thinly capitalized companies:** If a company is significantly undercapitalized, with little assets or resources to meet its obligations, the court may disregard the separate legal personality and hold shareholders personally liable for the company's debts.
- **Group of companies:** In certain cases, where a group of companies is involved, and there is an abuse of the corporate structure to evade legal obligations or defraud creditors, the courts may disregard the separate legal personality of one company within the group.

# THE LIFTING/PIERCING OF THE VEIL OF INCORPORATION

- It is important to note that the lifting or piercing of the veil is an exceptional remedy and is generally applied in exceptional circumstances where there is clear evidence of wrongdoing or unfairness. The decision to lift the veil is at the discretion of the court, which carefully considers the facts and circumstances of each case.
- The concept of lifting or piercing the veil serves as a safeguard to prevent the misuse or abuse of the corporate structure and ensures that individuals cannot hide behind the legal entity to escape personal liability for their actions or to perpetrate fraudulent or unfair activities.

# STATUTORY EXAMPLES OF CORPORATE VEIL-LIFTING

➤ By exception, the law/statute sometimes expressly allows the lifting of the veil of incorporation to hold the directors personally liable for the debts of the company.

## Examples:

- 1. Section 335 Companies Act 2001 - carrying on business fraudulently
- 2. Breach of Section 162 Companies Act 2001 - Duty of directors on insolvency
- 3. Section 214 (6) of the Companies Act 2001 - Group accounts

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