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Piercing the Corporate Veil

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## Piercing the Corporate Veil

Lam Chun Leung Johnson

## *Issues*

In the question, R Ltd is a subsidiary wholly owned by Q Ltd. R Ltd incurs a business accident which the projected damages and fines payable will be out of its capability to withstand. In determining whether the parent company Q Ltd and/ or its members could be liable for the actions of R Ltd, 1) the doctrine of separate legal entity, and; 2) issues in lifting the corporate veil in a group structure, should be considered.

## *Separate Legal Entity*

It is a fundamental principle that a company incorporated under the Companies Ordinance is a separate legal entity. In this case, both the parent company Q Ltd and its subsidiaries -- including R Ltd -- are incorporations which have been legally formed. A company, once incorporated, is a separate and distinct legal entity from the people in setting it up (**Salomon v Salomon & Co Ltd [1897] AC 22**). This legal entity has the capacity and the rights, powers and privileges of a natural person (**Section 115(1) of the Companies Ordinance**).

In a company limited by shares, a shareholder (member) will not be personally liable for its debts. The members and the directors are treated as independent and separated from the company and are said to be managing the company behind a corporate veil which the courts would not pierce that veil in normal cases.

In general, Q Ltd and/ or its members will not be liable for the actions of R Ltd. However, the power to pierce the corporate veil can be exercised by the court in some exceptional situations, and the separate legal personality of R Ltd would be ignored. We need to take a deeper look into the issues relating to the lift of corporate veil in order to make a more concise conclusion for the case.

## *Piercing the Corporate Veil*

First, the court may lift the corporate veil if the corporate group structure would be considered as a “mere façade” concealing the true facts. As mentioned above, the court will pierce the corporate veil only under certain circumstances.

The existence of this doctrine under the common law has been justified on the basis of the need to prevent abuse of corporate legal personality, and providing a means to undo such wrongdoing where no other legal principle is available; this is applicable on the

sense to prevent persons from obtaining an advantage which he has obtained by fraud (**Prest v Petrodel Resources Ltd [2013] UKSC 34**). The scope of operating this doctrine has been a narrow one.

If we need to prove that Q Ltd and/ or its members will be liable for the actions of R Ltd, besides showing the “ownership and control” relationship between Q Ltd and R Ltd, the “impropriety” -- that is the misuse of R Ltd by it as a device or façade to conceal their wrongdoing -- must also be evidenced (**Hashem v Shayif [2008] EWHC 2380**). Following the UK practice, the similar idea has been founded in **Windland Enterprises Group Inc v Wex Pharmaceutical Inc [2012] 2 HKLRD 757**, that: “The court will lift the corporate veil of a company if it is a façade or a puppet of the controller used to perpetrate fraud or evade legal obligation and liability.” The court has emphasized that under this principle, it is necessary for there to be an illegitimate purpose in the use of the company as a “mere façade” before there can be a piecing of the corporate veil. In other words, both “control” and “impropriety” will be the essential elements for the court to lift the corporate veil under the “mere façade” principle.

It must be noted that the court should not pierce the veil to just in achieving justice itself. The idea of lifting the corporate veil in pursuit of justice was originally championed by Lord Denning in **Wallersteiner v Moir [1974] 3 ALL ER 217**, and it is held in **Adams v Cape Industries plc [1990] BCLC 479** that the veil cannot be lifted merely in pursuit of justice. The earlier decision in **Creasy v Breachwood Ltd [1993] BCLC 480** showed that the power of the court to pierce corporate veil should be exercised to achieve justice was also held to be wrong in **Ord v Belhaven Pubs Ltd [1998] 2 BCLC 447**.

Recent cases have indicated that the case **Creasy** should not be relied on to justify the proposition that justice is in itself a separate ground of lifting the corporate veil. The court in **China Ocean Shipping Co v Mitsui Bussan Kaisha Ltd [1995] 3 HKC 123** held that achievement of the justice is just a result of the exercise of the power to lift the veil but it is not a separate ground. In deciding whether the power should be exercised, the court should see whether the case should be fitted into the established exceptions to the rule as mentioned in earlier paragraphs of this paper.

From what have been mentioned above, when looking back into the case it should be clear that although there is “ownership and control” relationship between Q Ltd and R

Ltd, we cannot find a direct evidence pointing out the “impropriety” between the company group.

Mentioned in the case, the subsidiaries including R Ltd was set up specifically to minimize Q Ltd’s liability for tax and tortious actions. “Whether or not this is desirable, the right to use a corporate structure in this manner is inherent in our corporate law (**Adams v Cape**).” Bokhary J in **China Ocean** himself added: “Using a corporate structure to evade legal obligations is objectionable. The courts’ power to lift the corporate veil may be exercised to overcome such evasion so as to preserve legal obligations.” More importantly he mentioned, “But using a corporate structure to avoid the incurring of any legal obligation in the first place is not objectionable. And the courts’ power to lift the corporate veil does not exist for the purpose of reversing such avoidance so as to create legal obligations.” The above was also affirmed in **Windland** case.

To sum up the above findings and facts, it can be argued that the group structure of Q Ltd and its subsidiaries including R Ltd is legitimate. It is unlikely that the court will hold Q Ltd and/ or its members liable on the ground of fraud, sham or mere façade.

Another point arguing that Q Ltd and/ or its members should be liable could be viewing them as “one economic unit”. This theory was first mentioned by Lord Denning in **DHN Food Distributors Ltd v Tower Hamlets London Borough Council [1976] 3 ALL ER 462**.

Lord Denning noted that a group of companies was in reality a “single economic entity” and should be treated as one; the court was entitled to look at realities of the situation to pierce the corporate veil. However, Slade J in case **Adams** has rejected to treat the group as a single entity, arguing by stating that there was no general principle that all companies in a group of companies were to be regarded as one. The fundamental principle as laid down in **Salomon** has always been that each company in a group of companies is a separate legal entity with separate legal rights and liabilities. This disapproval of the single economic unit theory was affirmed in **Ord**, and also HK has also been following **Adams** in this aspect.

Therefore, if our case of Q Ltd is to be judged under HK’s jurisdiction, it will be very unlikely that the court will hold Q Ltd and/ or its members liable for the claim that they should be treated as one economic unit.

## ***Conclusion***

Based on the above findings and facts, I find it more likely than not that Q Ltd and/ or its members will not be liable for the actions of R Ltd.

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