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AN EXTENSIVE ANALYSIS ON THE DOCTRINE OF SEPARATE LEGAL ENTITY, PRE-INCORPORATION CONTRACT & PROMOTER DUTIES

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ABSTRACT

The company is at law a different person altogether from the subscribers to the memorandum; and though it may be that after incorporation the business is precisely the same as it was before, and the same persons are managers, and the same hands receive the profits, the company is not in law the agent of the subscribers or trustee for them. Nor are the subscribers members liable, in any shape or form, except in the manner provided by the Act. That is the declared intention of the enactment per Lord Macnaughten; *Solomon v Solomon* [1897] AC 22. It is at this point where the relevance of the doctrine of Separate Legal Entity is dictated with justifications provided through quoting relevant authorities (case laws and/or provisions). The research also analyzes a complex case study on Pre-Incorporation of Contract and Its Status, and subsequently also addresses, evaluates and explains Promoter's Duties and Claiming of Secret Profits, in the context of the complex case study.

Keywords: Legal, Separate, Contract, Promoter, Profits.

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Question 1

The company is at law a different person altogether from the subscribers to the memorandum; and though it may be that after incorporation the business is precisely the same as it was before, and the same persons are managers, and the same hands receive the profits, the company is not in law the agent of the subscribers or trustee for them. Nor are the subscribers members liable, in any shape or form, except in the manner provided by the Act. That I think is the declared intention of the enactment per Lord Macnaughten; *Solomon v Solomon* [1897] AC 22

With reference to the statement above discuss on the relevance of the doctrine of "Separate Legal Entity". Support your answer with relevant authorities (case laws and/or provisions).

Question 2

Bungkus and Tapau incorporated a shoe retail company called Good Shoe Sdn. Bhd. Prior to its incorporation, Bungkus as the promoter of the company has entered into a contract on behalf of the company with the manufacturer of shoes, Jual Sdn. Bhd. for the price of RM 2 million. Subsequent to Good Shoe Sdn. Bhd.'s incorporation, Good Shoe Sdn. Bhd. refused to ratify the contract made with Jual Sdn Bhd.

Besides that, Tapau entered into a contract for the sale of machineries worth of RM 5 million with ABC Sdn. Bhd. However, the machineries were sold to Good Shoe Sdn. Bhd. for the sum of RM10 million. The difference sum of RM 5 million was never disclosed to Good Shoe Sdn. Bhd.

- i) With reference to section 65 of the Companies Act 2016, advise Jual Sdn. Bhd. on the status of the contract entered into between Bungkus and Jual Sdn. Bhd. (7 Marks)
- ii) Advise Good Shoe Sdn. Bhd. on whether it could claim the secret profit of RM 5 million received by Tapau.



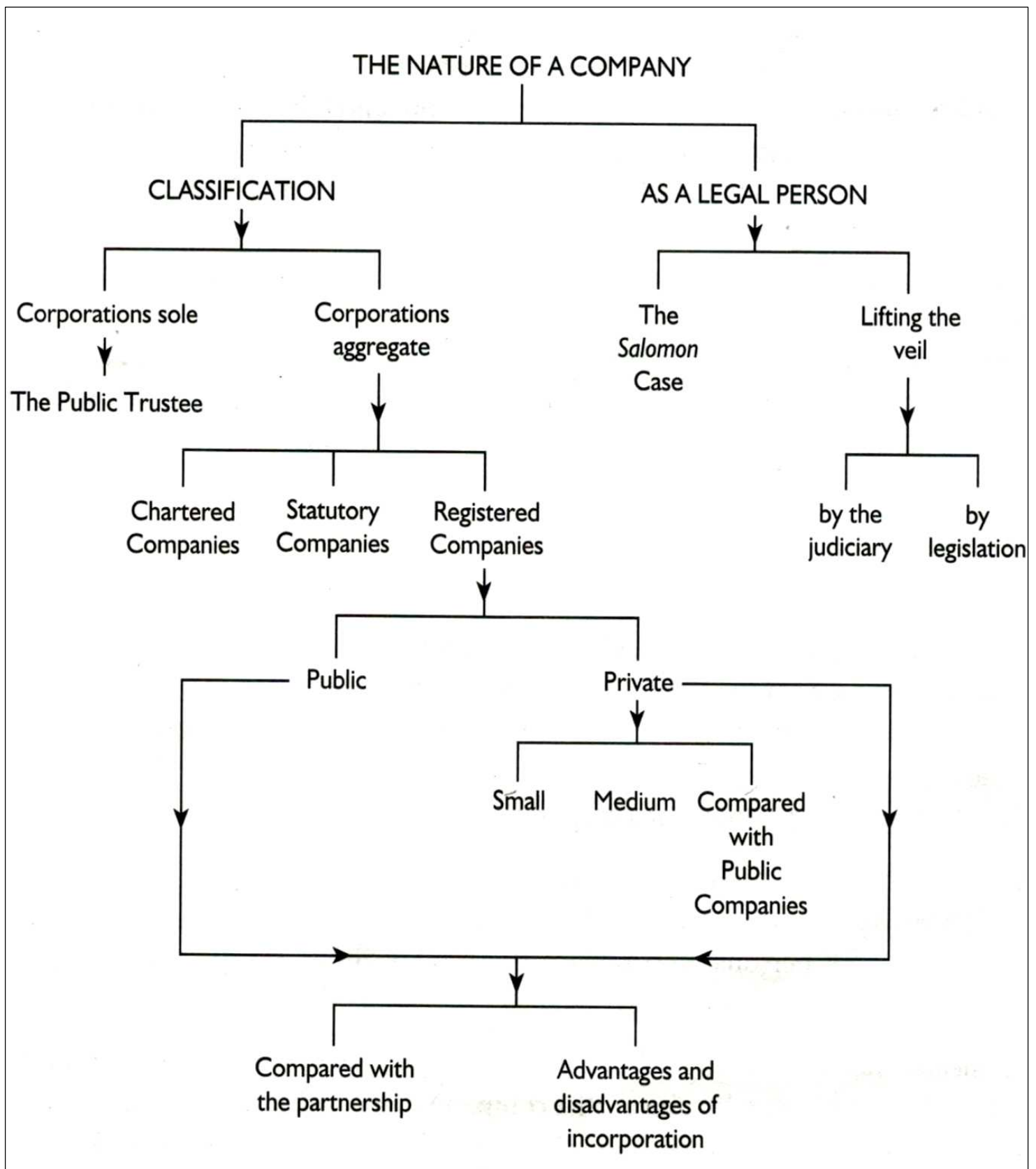
LITERATURE REVIEW APPROACH

QUESTION 1

- Discuss on the relevance of the doctrine of “Separate Legal Entity”.
- Support your answer with relevant authorities (case laws and/or provisions).

ABBREVIATIONS and MEANING

- **s-** Section
- **(number)-** subsection
- **HOL-** House of Lords
- **CA-** Companies Act
- **OUTCOME-** Principles established from case
- **COA-** Court of Appeal



Source: Keenan and Smith, 1996

1.0 Relevance of doctrine of Separate Legal Entity

1.1 Separate Legal Entity- Its Concept

S20 CA 2016 dictates- company is body corporate having legal personality separate from that of its members and continues to exist till removed from register.

The doctrine of '**Separate Legal Entity**', according to Nyombi (2014) and Becker (2014), from landmark case; *Salomon v Salomon & Co Ltd* (1897), accentuates legal personality (existence) of corporation; dictating that a company comes into '*being*' after incorporation and is at law a juridical legal *persona*, artificial and independent in nature, bearing own rights, duties and obligations appropriate to itself but irrelevant to members and shareholders. Based on Chan (2012) and Chan, Koh and Ling (2006), this is because corporation is a legal person and that no person can own another person; drawing '*line of divergence*' between company and its members.

According to Nyombi (2014), this emphasizes '*identity distinction*' using metaphorical concept of clothing corporation with 'separate legal entity' by analogy with natural person. The choice of metaphor is partially arbitrary as corporation must possess organizational realities and execute intelligible role of legal actor that satisfies the term 'personality'-corporation's traditional and modern attributes. (Rachagan, Pascoe and Joshi, 2010)

Thus, according to Riaan Becker (2014), Tan and Woon (2009) and Keenan and Smith (1996), company is association of person existing as separate legal entity but with legal personality after incorporation- where essence of legal entity is not natural phenomenon but juristic creation of capacity in sustaining rights and duties.

Cases: Please refer appendix

1.2 Emergence of Corporate Veil

According to Tan and Woon (2009), Chan, Koh and Liang (2006) and Rachagan, Pascoe and Joshi (2010), this ideology of separation gives rise to principle of '**Corporate Veil**'- illustrating '*line of divergence*' as veil (mask or curtain) that distinguishes corporation with members- reemphasizing concept of separateness.

1.3 Lifting of Corporate Veil- Statutory Exception Concept

Tan and Woon (2009), Rachagan, Pascoe and Joshi (2010) and Chan (2012) depict judges and jurists propose statutory exceptions that permit '**Lifting of Corporate Veil**'- a judicially imposed exception to doctrine of separate legal entity where courts disregard the separateness of the corporation between:

- *members and outsiders*- where law goes behind corporate personality to individual members as protection of public interests is of paramount. (Chan, 2012)
- *company and members* - = For example: fraudsters and officers get protected by veil from incorporating company for fraudulent actions and carrying out wrongful deeds in the name of corporation. (Tan and Woon, 2009 and Becker, 2014)

Thus, Tan and Woon, (2009), dictate enactment of statutory exceptions function to pierce veil at specific situations to hold members liable for their wrong- as doctrine of privity and separate legal entity object to protect wrongdoers.

Note: *The word "person" in statute shall mean either juridical person (corporation) or natural person- until interpretation matches general design and intent of act.*

1.4 Significance of doctrine

The doctrine of Separate Legal Entity is significant and important in the present day:

First, body corporate. In *Salomon v Salomon & Co Ltd* (1897), COA declared Salomon bound to pay unsecured creditors of company- which HOL reversed decision as company was seen as *body corporate* by virtue of **s20 CA 2016**, with powers of incorporate company and is not agent or trustee of subscribers, regardless after incorporation:

- Business is operated same as before
- Third party dealing with same personnel
- Same people are managers (Rachagan, Pascoe and Joshi, 2010)
- Same hands receive profits (previously as partners, now as members)
- Company has minimum of one to two, or, large number of members
- If all shares are held for benefit of one person (Tan and Woon, 2009)

These interpretations build dimension of *corporate personality* which is the reason for companies being incorporated today. Without doctrine, company and member shall be viewed as one and there would be no incorporation.

According to Chan (2012) and Rachagan, Pascoe and Joshi (2010), the decision in Salomon's case affirmed that, as debts were incurred by company, creditors can look to company and not members for repayment- deducing only parties to contract can sue or be sued. Also, member can lend money to company and if loan is secured, member-creditor has priority over proceeds from secured assets. Member ranks prior to other unsecured creditors in respect to secured creditors.

However, Million (2007), Chan, Koh and Ling (2006) and Becker (2014) argue the actions above are only possible if company is formed according to required procedures in line with Registrar and not misused to execute fraud- in virtue of **s14, 15 and 17 CA 2016**. This was visible in Salomon's case which is why HOL refused to regard Salomon and company as one legal person- stressing on importance of legal incorporation to benefit from doctrine. (Tan and Woon, 2009)

Cases: Please refer appendix

Second, limited liability. The decision in Salomon case expanded perception of doctrine to company lawyers and world of e-commerce whereby incorporation was not only available to large public companies but readily available to small private partnerships and sole traders- in virtue of **s11 CA 2016**.

This depicts how sole proprietors and partners shall no longer be vulnerable towards being forced by creditors to sell their possessions for recovering debts- when business cannot pay its debts.

Upon incorporation, their liability shall be limited to the investment made in the business, as business would become separate from members- responsible for own rights and obligations. Also, traders shall be able to avoid risks by subscribing for debentures rather than shares. This clearly explains significance and usefulness of doctrine when companies benefit from limited liability. (Chan, Koh and Ling, 2006)

Cases: Please refer appendix

Third, perpetual succession. Upon emergence of doctrine, in light of *Re Noel Tedman Holdings Pty Ltd* (1967), all existing and potential incorporated companies shall benefit from continuity- where company shall exist despite changes in shareholding or death of all controllers and members.

This broadens the relevance of doctrine where businesses especially sole trader and partnerships shall be able to have someone take control of business when they are ill and could pass on business to their sons if they die.

Their business would not cease to exist- which is exactly what happened in *Re Noel's* case when court allowed personal representatives of deceased to appoint directors for transferring shares to beneficiary- all because company was still existing. (Chan, 2012 and Chan, Koh and Ling, 2006)

However, Rachagan, Pascoe and Joshi (2010) argues, perpetual succession is limited if company articles address ceasing of company upon winding up, removal from Register or passing of resolution. Then upon latter, company shall discontinue.

Cases: Please refer appendix

Relevance of Separate Legal Entity, Pre-Incorporation and Promoter's Duties

In virtue of **s21 of CA 2016**, next *three* paragraphs address **company's unlimited capacity**.

Fourth, contract. Salomon's case was applied in *Lee v Lee's Farming Ltd* (1961), on how compensation was payable due to company seen separate from Lee. However, Tan and Woon (2009) and Chan (2012) support that it also showed how company could contract with anyone, including its members- where Lee was accepted as worker despite being controller.

In sense- as managing director Lee is company's agent negotiating contract with Lee, the pilot. This was because controller and company, under doctrine, were not same people. So, the doctrine signifies how controller can have employment with company. (Tan and Woon, 2009)

Fifth, property. The classic case of *Macaura v Northers Assurance Co Ltd* (1925) depicted how company, just like a person, has right to own land transferred to it by members- and that once transferred, the property becomes company's despite member is beneficial owner of shares and effectively controlling company.

The judgment brought greater significance to doctrine, where current and future companies shall only transfer properties when they completely have no interest in it and prepared to lose suing rights when wrong committed against company- as upon transfer, only company can sue. (Chan, Koh and Ling, 2006)

Cases: Please refer appendix

Sixth, can sue or be sued. This attribute inherited by company could be an extension of the paragraph above. It was seen in *Foss v Harbottle* (1843) where property belonged to company and inappropriate usage of it only permitted company to sue on its behalf based on rights and duties owed to it. (Chan, 2012)

Keenan and Smith (1996), Rachagan, Pascoe and Joshi (2010) and Becker (2014) accentuate the judgment brought greater significance to doctrine, where “Proper Plaintiff *Rule*” was established, dictating how members cannot sue or arrogate to himself on company's behalf to the extent even if director breached duty, it is for company to enforce rights against party under contract.

Thus, companies today shall practice this *rule*, but, if company breached obligations, members can go against *rule* and sue company. (Rachagan, Pascoe and Joshi, 2010)

Cases: Please refer appendix

Relevance of Separate Legal Entity, Pre-Incorporation and Promoter's Duties

According to Chan, Koh and Ling (2006) and Tan and Woon (2009), despite relevance of the doctrine, there are times when doctrine is used as façade to perpetrate wrongdoing. Thus, court developed exception to the rule- allowing 'lifting of corporate veil' which caused debate amongst legal scholars, whether it renders century-old principle insignificant in modern company law. Out of many, two factors distort significance:

First, fraud. In light of *Re Darby* (1911), partners who were undischarged bankrupts and convicted for fraud used company as a promoter and when sued for making secret profit, Darby defended that company should be held liable, as, at law, company and him were different person. In today's business environment, this may reduce trust and usefulness of doctrine.

However, courts usually refuse to hold true malfeasors liable and lift corporate veil- which proved misuse of doctrine to conduct fraud. Indirectly, going against the principle was important to detect fraud and showcase its original significance. (Tan and Woon, 2009)

Second, evasion of legal obligation. In light of *Jones v Lipman* (1962), owner formed company to keep property and refused for company to be obliged under specific performance- claiming company was separate from owner and was not party to contract. It shows how company was creature of owner and used as mask to avoid eye of equity. (Rachagan, Pascoe and Joshi, 2010)

Similar act was performed in *Gilford Motor Company v Horne* (1933), where company was used to solicit competitor's customers despite prohibited by covenant. Therefore, law went against doctrine to detect evasion of legal obligation and prove corporate body misused to disguise and aid fraudulent scheme. (Rachagan, Pascoe and Joshi, 2010)

Cases: Please refer appendix

CONCLUSION

The principle of separate legal entity established from Salomon's case was relevant and over centuries become more significant when principle was applied to different types of cases. This made the doctrine to become wider in its interpretation as it has solved more issues and deduced new attributes towards entity as a body corporate.

However, misuse of doctrine has questioned its relevance- but courts have pierced corporate veil to uplift significance. In short, courts did not give chance for the doctrine to be proved irrelevant. That is why, principle of separate legal entity is not outdated and still relevant in modern company law.

QUESTION 2

iii) Pre-Incorporation Contract and its Status

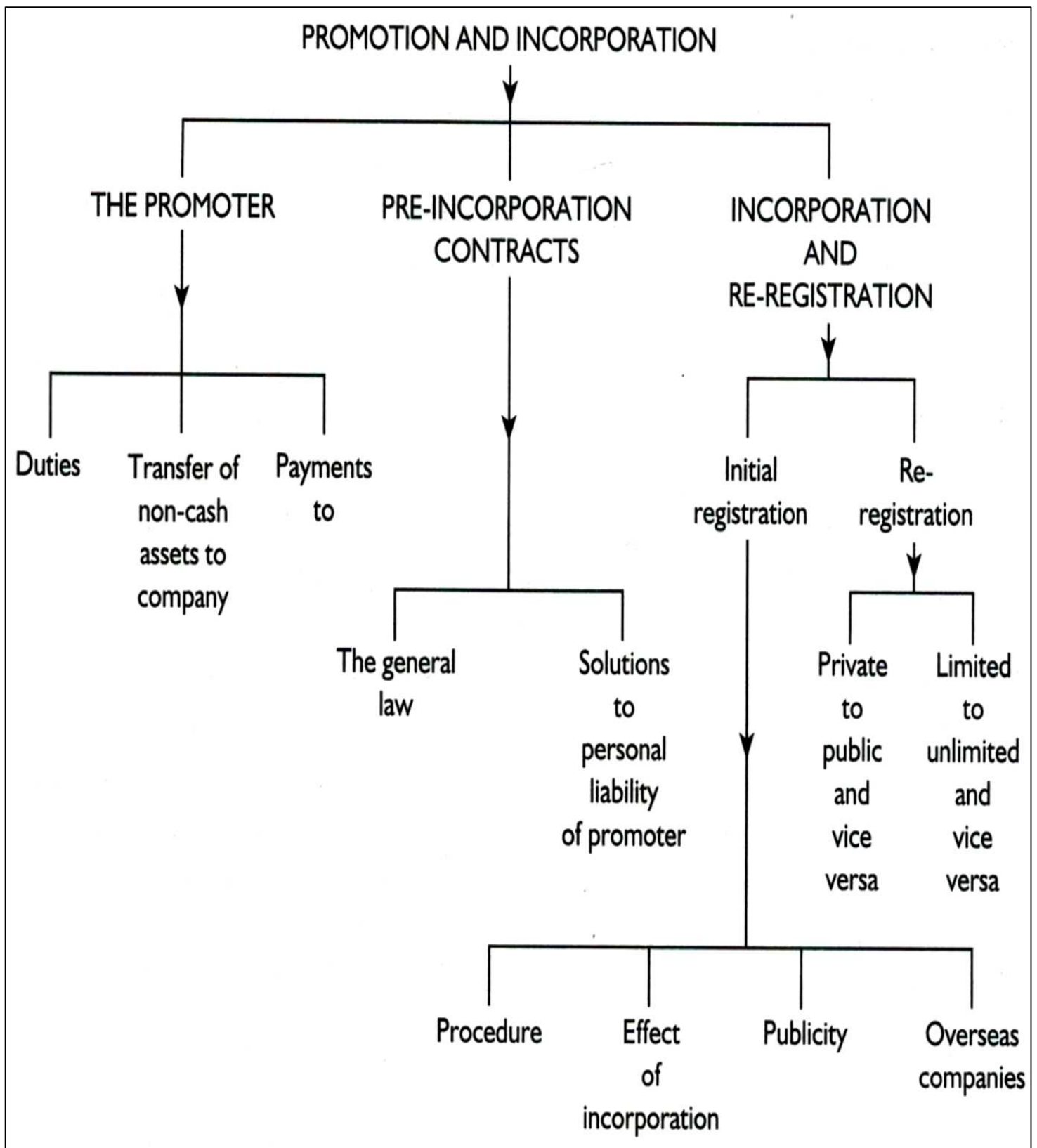
- *According to S65 of CA 2016, advise Jual Sdn. Bhd. on the status of the contract entered into between Bungkus and Jual Sdn. Bhd.*

iv) Promoter's Duties and Claiming of Secret Profit

- *Advise Good Shoe Sdn. Bhd. on whether it could claim the secret profit of RM 5 million received by Tapau.*

ABBREVIATIONS

- **ROC:** Registrar of Companies
- **Sdn. Bhd:** Sendirian Berhad (Private Limited Company)
- **CA:** Companies Act
- **s:** section
- **(number):** subsection number



Source: Keenan and Smith, 1996

2.0 PRE-INCORPORATION CONTRACT and PROMOTER'S DUTIES

2.1 Pre-Incorporation Contract and its Status

ISSUE:

Good Shoe Sdn. Bhd., after receiving Certificate of Incorporation from ROC, bluntly declines to adopt and ratify contract of RM 2 million formed between promoter Bungkus and shoe manufacturer Jual Sdn. Bhd. This leaves Jual Sdn. Bhd. in a dilemma regarding contract status- as questions arise whether Jual Sdn. Bhd, as other contracting party, can sue anyone under the contract and is contract even valid and enforceable.

LAW:

At **common law**, pre-incorporation contract is not binding on company as corporation is liable for own acts only after legal existence- till then, none can sustain agent relationship with corporation and contract is void for want of competent parties. Also, incorporated company is incapable of ratifying pre-incorporation contract, due to precondition of ratification regarding principle's existence during contract formation.

In light of English common law cases like: -

***Kelner v Baxter* [1866] LR 2 CP 174**

***Newborne v. Sensolid (Great Britain) Ltd* [1953] 1 All ER 708; [1954] 1 QB 45, (Court of Appeal, England)**

Note: Please refer appendix

Relevance of Separate Legal Entity, Pre-Incorporation and Promoter's Duties

However, in Malaysia, effect of such contract is different:

S65(1) and (2) 'Pre-incorporation contract' of CA 2016 explicitly dictates its effects in two stages: -

(1) Before Ratification: Any contract or transaction, purporting to be entered by *company*, or *any person* on behalf or as agent of company, prior to its formation and legal registration- shall directly influence the purporting person (and not the company); where he shall be personally bound by the contract or other transaction and entitled to benefit therefore, *even though he expressly excludes* his liability.

(2) After Ratification: It operates retrospectively in nature whereby company shall be bound by contract or transaction as if it had been in existence during original date of contract or transaction and had been a party therein, *if* it utilizes opportunity to ratify pre-incorporation contract formed in (1), after incorporation. However, company can be sued upon failure to perform contract after ratification.

Note: CA 2016, unlike CA 1965, does not contain provision dealing with agreement to exclude promoter from being liable for pre-incorporation contract if it is not ratified by company.

A Singaporean case quoted in Malaysian Law, in point is: -

***Cosmic Insurance Corpn Ltd v. Khoo Chiang Poh* [1981] 1 MLJ 61,
(Privy Council on appeal from Singapore)**

Note: Please refer appendix

APPLICATION:

By applying above authorities:

Applying Common Law, Kelner v Baxter and Newborne v Sensolid :

Good Shoe Sdn. Bhd is not bound by pre-incorporation contract between Bungkus and Jual Sdn.Bhd because:

- 1) It was not existing during contract formation
- 2) After incorporation, it does not want to ratify and nor at common law may company ratify and adopt such contract
- 3) Following both reasons above, contract is invalid

Since, Bungkus signed contract on behalf of Good Shoe Sdn.Bhd (not for Good Shoe), a valid contract exists between Bungkus and Jual Sdn.Bhd. So, Bungkus as promoter is bound by contract and personally liable as he was originally party to the contract. Although Bungkus might have assured payment of two million, it cannot be presumed that Jual has treated payment to be contingent on formation of company. It is a cardinal rule that oral evidence cannot project intention different from that which appears on writing face. So, based on this status, Jual Sdn.Bhd cannot sue company but can sue Bungkus.

Applying Cosmic Insurance Corpn Ltd v. Khoo Chiang Poh and S65

Although S35 and S65 allow ratification of pre-incorporation contract, Jual Sdn.Bhd cannot sue Good Shoe Sdn.Bhd as no ratification nor new resolutions with specified conditions was made. This makes Bungkus bound by contract and personally liable- allowing Jual to sue Bungkus.

CONCLUSION:

The decision at common law is little of assistance as it is outdated. Following S65 of CA 2016, since Good Shoe Sdn.Bhd did not ratify contract after incorporation, company is not bound, but Bungkus is liable to settle two million and is vulnerable to be sued by Jual Sdn.Bhd as contract status is valid between them.

2.2 Promoter's Duties and Secret Profit

ISSUE:

Whether Good Shoe Sdn.Bhd can sue Tapau and claim remedies for breach of promoter's duty.

LAW:

1. Promoter defined

S2 of CA 2016 depicts promoter of corporation as party to preparation of prospects or of any relevant portion thereof and not including any person by reason only of his acting in professional capacity

S14(1) of CA 2016 dictates promoter as person desiring incorporation.

A case in point:

***Twycross v. Grant* [1877] 2 CPD 469 at 541.**

Note: Please refer appendix

2. Promoter's Duties: Specifically, Secret Profit

Promoter's Fiduciary Duties

- 1) Not to gain secret profit
- 2) To account or report to company
- 3) Not to cheat/ defraud company
- 4) Not disclosure or reveal company's information

(Tan and Woon, 2009)

A case in point:

***Erlanger v. New Sombrero Phosphate Co* [1878] 3 App Cas 1218, 1236;
[1874-80] All ER Rep 271, HL**

Note: Please refer appendix

3. Remedies Available to Company for Breach of Duty by Promoter

- **Recession of Contract: -**

- 1) Section 17 Contracts Act 1950 - Non-Disclosure of Promoter's interest amounts to Fraud
- 2) Section 19 Contracts Act 1950 - A valid contract that can either be rejected due to fraud
- 3) Section 34(1) Specific Relief Act 1950- Company can rescind contract on application to court

- **Damages- Recovery of Secret Profit**

Plaintiff can claim losses suffered by it in monetary form- by recovering secret profit

APPLICATION:

By applying above authorities:

Applying Erlanger v. New Sombrero Phosphate Co

Tapau, as a promoter has duty to disclose RM5 million profit made by him to independent board of directors of Good Shoe Sdn.Bhd. However, Tapau failed to do so- showing he has made secret profit and consequently breached duty as promoter.

Applying S17 and S19

Good Shoe Sdn.Bhd can rescind contract due to act of fraud committed by Tapau.

Applying S34(1)

Good Shoe Sdn.Bhd can rescind contract on application to or order from court.

Applying damages

Good Shoe Sdn.Bhd can also claim damages to recover losses suffered by it due to Tapau's fraudulent action that breached fiduciary duty.

CONCLUSION:

Tapau as promoter breached fiduciary duty when making secret profit of RM5 million. Thus, Good Shoe Sdn. Bhd can elect to put an end to contract made by Tapau by applying to court and/or claim for damages as compensation for losses suffered in transaction by recovering secret profit of RM5 million made by Tapau.

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Cosmic Insurance Corpn Ltd v. Khoo Chiang Poh [1981] 1 MLJ 61

Erlanger v. New Sombrero Phosphate Co [1878] 3 App Case 1218, 1236; [1874-80] All ER Rep 271, HL

Foss v Harbottle [1843] 2 Hare 461

Gilford Motor Company v Horne [1933] Ch 935

Jones v Lipman [1962] 1 WLR 832

Kelner v Baxter [1866] LR 2 CP 174

Lee v Lee Air Farming Ltd [1961] 1 AC 12

Macaura v Northern Assurance Co. ltd [1925] AC 619

Newborne v. Sensolid (Great Britain) Ltd [1953] 1 All ER 708; [1954] 1 QB 45

Re Darby [1911] 1 KB 95

Re Noel Tedman Holdings Pty Ltd [1967] Qd R 561

Salomon v. Salomon & Co. Ltd. [1897] A.C. 22, HL

Twycross v. Grant [1877] 2 CPD 469 at 541

APPENDIX

QUESTION 1: Cases

First, the company as separate legal entity is firmly established in the landmark case of: *Salomon v. Salomon & Co. Ltd.* [1897] A.C. 22, HL

FACTS:

Salomon, a sole proprietor, sold his boots manufacturing business to a company he incorporated, Salomon & Co. Ltd- in consideration for all but six shares and received debentures worth ten thousand pounds. The other six shares were held by his wife and five children.

The business collapsed, and Salomon claimed as secured creditor based on debentures held. However, the liquidator argued that company operated business on Salomon's behalf and that company and Salomon are one- forbidding Salomon rank ahead of other creditors.

JUDGMENT:

HOL held- once artificial juridical legal *persona* has been created, it must be treated like any other independent person with its rights and liabilities appropriate to itself. Thus, Salomon & Co. Ltd. was not a mock and liabilities of the corporation were not liabilities of Salomon because they were two separate legal entities. HOL overturned decision of COA.

Lord Macnaghten observed:

“The company is at law a different person altogether from the subscribers to the memorandum, and, though it may be that after incorporation the business is precisely the same as it was before, and the same persons are managers, and the same hands receive the profits, the company is not in law the agent of the subscribers or trustee for them.”

OUTCOME:

The separateness is an incident of incorporation despite one controller

Company may be sued in its own name and liability of members is limited

Company is responsible for own debts and contractual obligations

Effects of Incorporation

Second, *Lee v Lee Air Farming Ltd* [1961] 1 AC 12

FACTS:

Lee Air Farming Ltd was incorporated by Lee who owned 2999 out of 3000 shares with one share held by his nominee. Lee was sole governing director and employed by company as chief and only pilot. While flying for company, Lee was killed and his widow claimed for workmen's compensation under New Zealand legislation. Issue was if Lee could be regarded as person entered into service contract with employer.

JUDGMENT:

New Zealand COA refused to regard Lee as worker as man could not employ himself.

However, Privy Council allowed claim on grounds that at law, controller and company are two distinct person and he could be a worker of that company despite being controller. In sense- as managing director Lee is company's agent negotiating contract with Lee, the pilot.

OUTCOME: Company is able to contract with anyone, including its members

- 1) Controller and owner of company is not the company itself
- 2) They are different people
- 3) Controller can have employment with company

Third, *Macaura v Northern Assurance Co. Ltd* [1925] AC 619

FACTS:

Macaura owned timber estate in County Tyrone, Ireland. He sold all timber insured under his name to a company, Irish Canadian Sawmills Ltd.- in which his nominees and him owned all the shares. In fortnight, all timber destroyed in fire. Macaura put in a claim. The insurance company rejected to pay.

JUDGMENT:

HOL held Macaura's act of selling timber to company depicts having no insurable interest in timber. Thus, insurance policy was void and Macaura cannot claim indemnity from insurance company.

OUTCOME: Company's ability to own property

- 1) Once person sells or gives property to company, he has parted interest in that property.
- 2) The property becomes company's and not his anymore despite member is beneficial owner of all shares and effectively controlling company.
- 3) Only company can take action if wrong committed against it.

Fourth, *Foss v Harbottle* [1843] 2 Hare 461 (Vice Chancellor's Court, England)

FACTS:

Victoria Park company's two shareholders sued company directors and other people for misapplying and inappropriately using property of company.

JUDGMENT:

It was held, company is different person and so members cannot maintain such a suit. It was for company to sue.

OUTCOME: Company can sue

Company *can sue*-

- 1) It must sue on its behalf based on its rights and duties owed to it
- 2) Company having rights against party under contract, it is for company to sue
- 3) Proper Plaintiff Rule: Members cannot sue or arrogate to himself on company's behalf
- 4) If director breached duty, it is for company to enforce rights

Or *be sued*-

- 5) If company breached obligations, company must be sued
- 6) Members cannot be sued as there are not responsible for company's acts

Fifth, *Re Noel Tedman Holdings Pty Ltd* [1967] QdR 561 (Supreme Court Queensland)

FACTS:

Two shareholders, husband and wife, as only directors of company died in traffic accident. Their infant survived. Court was in dilemma as company still existed and transferring shares needed director's approval according to articles- but there were no directors and appointment couldn't be executed as there were no members for vote.

JUDGMENT:

Court allowed personal representatives of deceased to appoint directors for transferring shares to beneficiary.

OUTCOME: Perpetual Succession

- 1) Company is immortal
- 2) Lasts till wound up or struck off from register
- 3) Identity remains despite changes in shareholding
- 4) Company survives even if all members and controllers die

Lifting of Corporate Veil by COURTS

Sixth, *Re Darby* [1911] 1 KB 95 (High Court, England)

FACTS:

City of London Investment Corporation Ltd (“City”) was incorporated by undischarged bankrupts Darby and Gyde who used City to promote Welsh Slate Quarries Ltd (“Quarries”) and sold £3500 quarrying license and plant to Quarries at £18,000. Quarries fell into liquidation and liquidator charged Darby liable to account profit as promoter. Darby rejected that City and not him, was promoter.

JUDGMENT:

Phillimore J rejected Darby's defense, in sense that Darby took advantage of company's separateness to cloak his disregard of obligations.

OUTCOME: Fraud

- 1) Company used as curtain to hide fraud
- 2) Unlikely court refuses to hold true malfeasors liable

Seventh, *Jones v Lipman* [1962] 1 WLR 832 (High Court, England)

FACTS:

Lipman who agreed to sell house to Jones later refused to transfer the house. So, Lipman incorporated Alamed Ltd and transferred house to it. His solicitors wrote to Jones' solicitors offering to pay damages but Jones sought order of specific performance. Lipman defended that Alamed Ltd was not a party against who specific performance could be ordered.

JUDGMENT:

Russell J refused defense dictating Alamed Ltd is creature of Lipman, a device used as mask to avoid eye of equity. Thus, both Lipman and company were ordered to sell the house.

Eighth, *Gilford Motor Company v Horne* [1933] Ch 935 (Court of Appeal, England)

FACTS:

Horne was managing director of Gilford Motor. He covenanted not to solicit customers of company after termination of employment. However, after leaving, he solicited company's customers through JM Horne & Co Ltd.

JUDGMENT:

Horne, despite operating through JM Horne & Co Ltd breached his covenant. An injunction was granted against Horne and company. Lord Hanworth MR said company was a 'channel' for breaching covenant because business was really being carried on by Mr Horne.

OUTCOME from Jones v Lipman and Gilford Motor Company v Horne case: Evade Legal Obligations

- 1) Court is not obliged to be blind to reality and lend aid to fraudulent scheme
- 2) Company is not seen as separate to showcase how it is used to disguise fraud and enable person avoid legal obligation.
- 3) Courts discovers illegal and improper act

QUESTION 2 (Part I) - Cases

Kelner v Baxter [1866] LR 2 CP 174

FACTS:

Prior incorporation- promoters on behalf of Gravesend Royal Alexandra Hotel company entered into contract for wine procurement. After incorporation, company ratified contract. The wine was consumed and company fell into liquidation before debt was paid. This caused wine sellers to sue promoters. However, it was argued on the grounds that liability was transferred to company by ratification and thus promoters cannot be liable.

JUDGMENT:

Principle's existence during contract formation is precondition of ratification; which was disobeyed in this case- making contract to be inoperative unless binding upon the person who signed it and a stranger cannot by a subsequent ratification relieve him from that responsibility.

Since, promoters signed contract on behalf of Gravesend, a valid contract exist between promoters and wine sellers. Although promoters assured payment according to agreed price, it cannot be presumed that plaintiff has treated payment to be contingent on formation of company. It is a cardinal rule that oral evidence cannot project intention different from that which appears on writing face.

Erle CJ held, at common law, that, despite incorporation and contract ratification, Gravesend is still not liable- because ratification was invalid as principle did not exist *during contract formation and was not in capacity to contract*. When company comes into existence, it is not bound by rights or obligation made before its name. This is because, rights and obligations created when two parties' contract cannot be transferred by one of them to a third party who is not in condition to be bound by it at the time it is made. This makes promoters bound by contract and personally liable as they were originally party to the contract and oral evidence cannot contradict written contract.

OUTCOMES:

Promoters can be liable but can **escape being personally liable** under two circumstances: -

- 1) **Act of Novation-** where company enters new contract to put into effect terms of pre-incorporation contract
- 2) **Signing of contract-** promoter places initials of company on agreement, making himself neither promoter nor principal

Kelner v. Baxter developed confusion whether: -

- 1) **Rule of Law approach-** promoters instantly liable
- 2) **Rule of Construction approach-** promoter's intentions to be party to contract or not decided promoter's liability

***Newborne v. Sensolid (Great Britain) Ltd* [1953] 1 All ER 708; [1954] 1 QB 45, (Court of Appeal, England)**

FACTS:

Newborne contracted to sell 200 cases of tinned ham to Sensolid (Great Britain) Ltd. The market for tinned ham fell and Sensolid refused to take deliveries from Newborne. The contract had been signed by Leopold Newborne underneath the words Leopold Newborne (London) Ltd- a company that had yet to be incorporated. It was not formally signed “on behalf of Leopold Newborne (London) Ltd.” as had been the case in *Kelner v. Baxter*.

Later, Leopold Newborne (London) Ltd. was incorporated and it sued Sensolid Ltd. However, Leopold Newborne (London) Ltd. Could not enforce contract as it had not been in existence when contract was made.

Then, Leopold Newborne sued Sensolid Ltd. in his own name seeking to enforce contract. So, there was an argument that if contract was not with company, then it is with person who signed on behalf of company- namely, Leopold Newborne.

JUDGMENT:

The *English Court of Appeal* used rule of constructive approach and held that, the way Leopold Newborne signed contract clearly shows it was intended to be contract with company and that Leopold Newborne himself did not intend to be party to contract. Thus, Leopold Newborne cannot enforce contract, neither can company.

OUTCOMES:

This case made it clear that promoter liability was to be based on a *rule of construction* approach – i.e. promoters were only liable if it was intended in the circumstances that they were themselves to be parties to the contract.

Cosmic Insurance Corpn Ltd v. Khoo Chiang Poh [1981] 1 MLJ 61,
(Privy Council on appeal from Singapore)

FACTS:

Twelve promoters set up Cosmic Insurance and offered job of managing director -through a letter to Khoo Chiang Poh (one of the twelve promoters; prior company's incorporation.

Relevant part of letter stated: "*Mr. Khoo Chiang Poh shall be managing director for life unless he resigns, dies, or commits offence under CA or is prohibited to become director under CA for certain offences*".

Later, company was incorporated and contract was alleged to have been ratified by resolution stating: "*Resolved that Mr. Khoo Chiang Poh be appointed Managing Director holding office for life in accordance to Articles and Memorandum of Association and is responsible to Board of Directors*".

A dispute arose when company sought to remove Mr. Khoo. Mr. Khoo brought an action to the court. In Privy Council, Board's attention was drawn to differences between terms in letter and resolution. Two main issues were argued, namely:

- 1) whether letter constituted pre-incorporation contract
- 2) whether contract was ratified through resolution

JUDGMENT:

Lord Roskill held that letter was a pre-incorporation contract and difference in conditions between initial letter and resolution does not affect or invalidate appointment of defendant as director- because additional conditions were subject to and in line with provisions of memorandum and articles of association. The passing of resolution was not express but in different terms- thus amounting to ratification of pre-incorporation contract. This is possible as there is no special procedure for ratification of pre-incorporation contract. This makes the ratification valid while termination of director invalid.

OUTCOMES:

S65 of CA 2016 is newer version of S35 of CA 1965. During 1981, three things were invoked for S35(1):

- 1) Contract must be entered on behalf of company prior incorporation
- 2) Fulfilling condition above allows company ratify contract after incorporation
- 3) Fulfilling both conditions above makes ratified pre-incorporation contract ante-dated to original date

QUESTION 2 (Part II) - Cases

Twycross v. Grant [1877] 2 CPD 469 at 541.

FACTS and JUDGMENT:

The owner of concession who wished to form company, the person he engaged to assist him in doing this, and contractors as finance providers were, in that case, held to be promoters.

Thus, Cockburn C.J. declared most accepted definition of 'promoter' as one who undertakes project to form company, and to set it going while taking necessary steps to accomplish this purpose.

Erlanger v. New Sombrero Phosphate Co [1878] 3 App Cas 1218, 1236;
[1874-80] All ER Rep 271, HL

FACTS:

As promoters, Erlanger and associates formed syndicate to acquire lease of an Island in West Indies for £55,000. Then, they incorporate a company and sold land for £110,000 through nominee. The promoters who were company's directors ratified the purchase.

JUDGMENT:

Court held that promoters breached fiduciary duty as they failed to make full and frank disclosure of interest in contract to independent board of directors. Therefore, contract is voidable at company's option and must be rescinded.





NOTES



