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The Misuse and Abuse of the Corporate Form

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ABSTRACT:

This paper suggests that there has been little abuse of the corporate form as a proprietary institution. What abuse as there is usually relates to the corporation being used as a unlawful wealth protection device (which should be the preserve of trusts and its perpetuity/accumulation rules) as opposed to one carrying on a business producing goods and services, or perhaps a specific stage in a company's existence where the separate fund is violated and/or the corporate nomenclature misused in a way which benefits one corporate constituent over another. The former is met by the narrow doctrine of veil piercing and the latter by various rules that may reflect the duty to act for proper purposes, as this counteracts an appeal to the company's best interests when this is inappropriate.

Key words: Company law, Separate personality, Lifting the veil, Asset partitioning, Capital maintenance, Insolvency, Takeovers, Proper purposes

Although the corporation is sometimes seen as an unruly horse, it has created enormous wealth and, for various reasons, other types of business vehicles have not been used as much. Perhaps one reason is political rent-seeking,[1] but there must be some intrinsic advantages to the corporate structure that other vehicles find difficult to mimic. We see, for example, that UK real estate investment trusts (REITs) have been required to adopt the corporate form and how REIT deeds in Singapore typically attempt to replicate the dual property structure of a company in order to provide artificial entity status to the REIT, in the process creating a form of non-charitable purpose trust, with the following clause:

> The Trust Deed sets out the rights of the Unitholder. Each Unit represents an undivided interest in the (REIT). A Unitholder has no equitable or proprietary interest in the underlying assets of the (REIT) and is not entitled to the transfer to it of any asset or of any estate or interest in any asset of the (REIT). A Unitholder's right is limited to the right to require due administration of the (REIT) in accordance with the provisions of the Trust Deed, including by suit against the Trustee or the Manager.[2]

Consequently, it is the separate legal status of corporation, and the ring-fenced fund that it owns, that is crucial and which Commonwealth trusts do not generally have. Any study of abuse must necessarily relate to this aspect of separate personality, which protects the entity in that its assets are insulated from the insolvency of its contributories. Affirmative asset partitioning (as opposed to defensive asset partitioning, *ie*, limited liability) is thus really to facilitate entity lending, as creditors can look to the segregated fund for priority repayment. The concern is much less with limited liability for its shareholders even if that was traditionally seen as a benefit of incorporation, but which was said by Hansmann and Kraakman[3] at the start of the

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[1] Larry Ribstein, "Why Corporations?" [2004] 1 Berkeley Business Law Journal 183.

[2] This is a typical clause found in the trust deeds of Singapore REITs. See further, Hans Tjio & Lee Suet Fern, "Developments in Securities Law and Practice" in *SAL Conference 2006: Developments in Singapore Law between 2001 and 2005* (Teo Keang Sood gen ed) (Academy Publishing, 2006). (indeed the beneficiary principle conflicts with any entity status of the trust)

[3] H Hansmann and R Kraakman, "The Essential Role of Organizational Law" (2000) 110 Yale LJ 387.

millennium to be something which can be contracted for and came about independently of incorporation. The latter which, as of right and without a Royal Charter or Private Act, was facilitated by the Joint Stock Companies Act 1844, with the Limited Liability Act 1855 enacted later. Today we also see a proliferation of business vehicles offering limited liability as well, but perhaps not a fully ring-fenced fund.[4]

The view taken here is that there has been little abuse of the corporate form as a proprietary institution given that the corporate form is largely reified in a similar way worldwide. What abuse as there is usually relates to the corporation being used as a unlawful wealth protection device (which should be the preserve of trusts and its perpetuity/accumulation rules) as opposed to one carrying on a business producing goods and services,[5] or perhaps a specific stage in a company's existence where the separate fund is violated and/or the corporate nomenclature misused. The former is met by the doctrine of veil piercing and the latter by various rules that reflect the duty to act for proper purposes, which counteracts an appeal to the company's best interests when this is inappropriate.

Piercing the veil

There is no public policy that calls for the veil of incorporation to be pierced. This was recently confirmed by Beatson LJ (with whom the other judges agreed) in *Antonio Gramsci and Alliance Bank JSC v Lembergs*[6]. Indeed, Lord Sumption in the leading judgment in *Prest v Petrodel* stressed that "if it is not necessary to pierce the corporate

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[4] FD Rose, "Raising the corporate sail" [2013] LMCLQ 566, 568 sees the limited liability partnership as an "intermediate" or "hybrid" form of association that may not fully be a separate legal entity. But H Hansmann, R Kraakman and R Squire, "Law and the Rise of the Firm" (2006) 119 Harvard LR 1333 at 1381 describe English general partnerships as already having had "weak entity shielding" ever since *Craven v Knight* (1683) 21 ER 664 (Ch), and this partly explains the continued relevance of the general partnership form.

[5] While the Singapore Companies Act s 17(3) requires any association of 20 persons or more carrying on a business for gain to be incorporated as a company, it does not say that all incorporated companies must be set up to carry on a business. There is no longer such an equivalent UK provision.

[6] [2013] EWCA Civ 730; [2013] 2 Lloyd's Rep 295, [65] (Beatson LJ).

veil, it is not appropriate to do so, because on that footing there is no public policy imperative which justifies that course"[7].

Even if the Justices in *Prest* did not speak with one voice in relation to veil piercing, Lord Sumption (and Lord Neuberger) may have stabilised an area of law that the latter described as not having had a "single instance in this jurisdiction where the doctrine has been invoked properly and successfully"[8]. The case itself actually involved a matrimonial dispute. The wife argued that the husband sought to hide some of his assets by vesting them in companies that he controlled, and asked that those underlying properties be transferred to her by way of an order under the Matrimonial Causes Act 1973[9] s. 24(1)(a) as the husband was "entitled … in possession" to them. The Supreme Court allowed the wife's claim as the properties were held by the companies for the husband on "ordinary resulting trust" principles.[10] However, they dismissed the wife's appeal in relation to both piercing the veil and the statutory claim. The properties had been transferred to the companies long before the matrimonial dispute and so the husband was not evading any liability when he sought to protect his assets. In *dicta*, Lord Sumption thought that the real purpose for piercing the corporate veil was "depriving the company or its controller of the advantage that they would otherwise have obtained by the company's separate legal personality"[11]. There was nothing to pierce if the entity was used simply to conceal the controller's identity as this could be revealed in other ways.[12] In this regard, it is perhaps relevant that the UK government

[7] *Prest*, *supra* n 1, [35] (Lord Sumption); *cf* S Ottolenghi, "From Peeping behind the Corporate Veil to Ignoring it Completely" (1990) 53 MLR 338.

[8] *Prest*, *supra* n 1, [64] (Lord Neuberger).

[9] 1973 c. 18.

[10] *Prest*, *supra* n 1, [49] (Lord Sumption).

[11] *Prest*, *supra* n 1, [35] (Lord Sumption).

[12] *Prest*, *supra* n 1, [28], where Lord Sumption drew the distinction between concealment and evasion, and thought that it was only in the latter instance that a corporate veil needed to be pierced.

as proposed a public register reflecting the beneficial ownership (25% and above) of the shares in its unlisted companies and limited liability partnerships.[13]

Lord Sumption in *Prest* pointed out that "(i)t is not an abuse to cause a legal liability to be incurred by the company in the first place. It is not an abuse to rely upon the fact (if it is a fact) that a liability is not the controller's because it is the company's"[14]. He was also quite clear that the "objection would have been just as strong if the liability in question had not been consensual"[15], even if the ability to bargain for limited liability, or otherwise, is arguably more constrained in this context.[16] Accordingly, true veil piercing is only applicable "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"[17].
While the doctrine as suggested by Lords Sumption and Neuberger is narrow (and the other Justices did not commit themselves without further argument), it does suggest that the company as an asset protection device is more vulnerable than one used to shield a controller from liabilities arising from a business that is owned by the company. The reason for this is that capital contributed by the shareholders has already been locked-into the company for the purposes of meeting those liabilities (which is the essence of asset partitioning).[18] It is quite different in the former situation, which involves persons trying to protect assets from their own creditors or to escape some immediate liability pressing on them by using the separate entity of a company to shield

[13] Department of Business, Innovation & Skills, *Transparency & Trust: Enhancing the Transparency of UK Company Ownership and Increasing Trust in UK Business – Government Response* (April 2014).

[14] *Prest*, *supra* n 1, [34] (Lord Sumption).

[15] *Prest*, *supra* n 1, [34] (Lord Sumption).

[16] See F Rose, *supra* n 2, 590, pointing out that while contractual liability is determined by "contractual construction", "the circumstances in which tortious liability may arise are less restricted".

[17] *Prest*, *supra* n 1, [35] (Lord Sumption).

[18] M Blair, "Locking In Capital: What Corporate Law Achieved for Business Organizers in the Nineteenth Century" (2003) 51 UCLA L Rev 387; L Stout," On the Nature of Corporations" (2005) Illinois L Rev 253. See also F Rose, *supra* n 2, 573, pointing out that the "separation of corporate personality is therefore real and may operate to the disadvantage of the members."

assets that would otherwise have been available to those creditors or obligors. Separately, Hansmann, Kraakman and Squire believe that the next stage in the evolution of organisational law is to deal with this problem,[19] both within and outside of bankruptcy. Factors to look out for are the time when the relevant transfer occurred (as in *Prest*), whether the entity is generating any operating income for which it pays corporate taxes, and if and how the corporate fund has been violated. The starting point, though, is that the corporate form should be recognised, particularly when it has a real business, and was not set up simply to hold assets passively.

Misusing the property characteristic of the company

The next part deals with two slightly different things: misuse of the company fund and the corporate label. But they are largely constrained by various doctrines which it is suggested emanates from the same source. This is the proper purpose rule, which "is the least discussed and least well understood of the fiduciary obligations affecting a director."[20] The proper purpose rule usually comes up in share issues, where it is difficult to articulate the duty of directors in terms of the company's interest. This is because the company is less relevant here as a separate entity, and the balance of power between shareholders may be affected by the decision to issue new shares. According to Latham C.J. in *Mills* v. *Mills*[21]:

> "The question which arises is sometimes not a question of the interests of the company at all, but a question of what is fair between different classes of shareholder. Where such a case arises some test other than 'the interests of the company' must be applied ...."

Company law has traditionally assumed that shareholders have similar interests, compared to the adverse interests of trust beneficiaries, which is why trustees have a

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[19] Hansmann, Kraakman and Squire, *ibid*, 1401.

[20] R C Nolan, "The Proper Purpose Doctrine and Company Directors", in *The Realm of Company Law*, (Kluwer Law International, 1998) at 1.

[21] (1938) 60 C.L.R. 150 at p. 164.

duty of impartiality.[22] But there are conflicts within a company. The conflict inheres in the constituencies interested in the outcome of a decision, usually the shareholders, but this could include creditors and employees of the company as well, as what ostensibly is for the benefit of the company affects some of them adversely.

Disguised returns of capital

There are situations when capital can properly be returned to shareholders in a way not seen as prejudicing creditors. An example of this would be dividend payments, which is out of corporate profits. In Singapore, however, Companies Act section 403 only deals with “dividends” and so disguised forms of capital return may not be captured under this provision, unlike in those jurisdictions where other forms of distributions are controlled by statute. In England, for example, a sale of an asset at an undervalue to a related company was seen as an unlawful distribution in *Aveling Barford Ltd v Period Ltd*[23], but that was for the purposes of the then section 263 of the UK Companies Act 1985, which concerned the broader notion of “distributions”. But *Aveling* is also seen to reflect older common law cases like *Re Halt Garages*[24] that frowned upon such acts, particularly when it was carried out at an undervalue. [25] These may be seen either as an unlawful capital return or an abuse of corporate power,[26] unless it is a bona fide commercial exchange that benefits the company. It has recently been suggested that they are examples of the duties on directors to exercise their powers for proper purposes.[27]

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22 Robert H Sitkoff, “An Agency Costs Theory of Trust Law” (2004) 89 Cornell Law Review 621 at 650–652. There is some recognition in Singapore that fiduciary duties in general include a duty of impartiality: *Ng Eng Ghee v Mamata Kapildev Dave* [2009] 3 SLR(R) 109 (sales committee in a en-bloc collective sale).

23 (1989) 5 BCC 677.

24 [1982] 3 All ER 1016.

25 E Micheler, “Disguised Returns of Capital – An Arm’s Length Approach” (2010) 69 CLJ 151. See now UK Companies Act 2006 s 830.

26 J Armour, “Avoidance of Transactions as a ‘Fraud on Creditors’ at Common Law” in J Armour and H Bennett ed. *Vulnerable Transactions in Corporate Insolvency* (Oxford, 2003).

27 J Lee SL, “Making a case for the duty to act for proper purposes” [2014] Sing JLS (forthcoming).

Ford's Principles of Corporations Law[28] has also observed that the financial assistance prohibition is a manifestation of the general rule that a company's resources should be used for proper corporate purposes, and for the company's benefit, and not to assist in the purchase of its shares. These rules, such as those found in the Companies Act 2006 section 678[29], much maligned in modern corporate practice for hindering corporate reorganisation, could have prevented one problem that arose in the Enron problem, which probably could not have happened outside the US. This involved the sale of Enron shares to closely-related SPVs in return for debt in the SPVs (Enron assisted by providing credit), thus boosting the balance sheets of both parties.[30] In this regard, Singapore has seen a revival of the financial assistance rule in *Wu Yang Construction Group Ltd v. Mao Yong Hui*[31] which was similar in effect to that of Arden L.J.'s judgment in the English Court of Appeal in *Chaston v. SWP Group Plc,*[32] in that it reversed what appeared a trend towards reducing the relevant test to whether the transaction was in the commercial interest of the company. Both decisions signalled the need for legislative change, if that was what the regulators desired, in order to further relax the financial assistance rules, but the Ministry of Finance in Singapore recently decided to preserve the rule for public companies (as in the U.K.), when it had initially considered removing it altogether.[33]

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[28] R.P. Austin and I.M. Ramsay, Ford's Principles of Corporations Law, 14th ed. (Australia: LexisNexis Butterworths, 2010) at 24.670.

[29] Singapore Companies Act (Cap. 50, 2006 Rev. Ed. Sing) s 76(1)(a).

[30] William W. Bratton, "Enron and the Dark Side of Shareholder Value" (2002) 76 Tul. L. Rev. 1275 at 1314-1315.

[31] [2008] 2 S.L.R.(R.) 350 (C.A.), disapproving its earlier decision in *Intraco Ltd v. Multi-Pak Singapore Pte Ltd* [1994] 3 S.L.R.(R.) 1064 (C.A.).

[32] [2003] 1 B.C.L.C. 675 where, according to Arden L.J. at para. 38, "it is clear…that the test is one of commercial substance and reality". The Australian position was more objective: *Darvall v. North Sydney Brick & Tile Co Ltd* (1987) 12 A.C.L.R. 537 (N.S.W.S.C.), aff'd *Darvall v. North Sydney Brick & Tile Co Ltd* (No. 2) (1989) 15 A.C.L.R. 230 (N.S.W.C.A.).

[33] The Ministry of Finance in October 2012 accepted the *Steering Committee Committee for Review of the Companies Act* (June 2011) Recommendation 3.27. The *Companies Act 2006* (U.K.), 2006, c. 46, s. 678 still covers the situation in *Chaston*, *ibid.*, where a private subsidiary financed the acquisition of shares in its public parent. Where public companies are concerned, the recommendation in Singapore is to adopt the position in Australia under *Corporations Act 2001* (Cth.), s. 260A (which applies to all companies incorporated there) to allow a public company or its subsidiary to provide financial

Insolvency situations

In cases of minority oppression, the previous Singapore Chief Justice Chan SK consistently held that winding-up was a 'last resort'[34] as opposed to a buy-out remedy, despite noting that that Lord Wilberforce in *Re Kong Thai Sawmill (Miri) Sdn Bhd*[35] had held that the winding up as an option "ranks equally with the others". But even with the slightly separate jurisdiction to wind-up a company on the just and equitable ground (such as a loss of substratum), Chan C.J. always displayed a reluctance to wind-up a company that had an underlying business as opposed to one "initially incorporated as a dormant or shelf company"[36] that was, in his words, "merely an investment holding company".[37] This is consistent with the theme here, that the corporate form is seldom misused (and should be preserved) except when used purely as an asset holding device.

But what about possible abuses in companies carrying on a business when insolvent, given that any further losses are borne by creditors only? Possibly because of her experience with the earlier Asian Financial Crisis, directors have been less worried when trying to trade a company out of insolvency in Singapore. There is no duty is imposed on directors to prevent insolvent trading and wrongful trading such as exists under Australia's *Corporations Act 2001* (Cth.), s. 588G and the *Insolvency Act 1986* (U.K.), 1986, c. 45, ("*Insolvency Act 1986*") s. 214 respectively.[38] What is found instead is

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assistance for the acquisition of shares in the company or holding company, respectively, if the assistance does not materially prejudice the interest of the company or its shareholders or the company's ability to pay its creditors. This confirms that the financial assistance rule, and perhaps even capital maintenance generally, though largely for creditor protection, also takes into account the interests of shareholders.

[34] *Tang Choon Keng Realty (Pte) Ltd v. Tang Wee Cheng* [1992] 2 S.L.R. 1114 at para. 61.

[35] [1978] 2 M.L.J. 227 (P.C.), referred to by Chan J (as he then was) in See *Re Chong Lee Leong Seng Co (Pte) Ltd* [1989] S.L.R. 685 (H.C.).

[36] *Sim Yong Kim v. Evenstar Investments Pte Ltd* [2006] 3 S.L.R.(R.) 827 (C.A.) [*Evenstar*] at para. 14, referring to his earlier judgment in *Chua Kien How v. Goodwealth Trading Pte Ltd* [1992] 2 S.L.R. 296 (C.A.). In *Evenstar* Chan C.J. thought that the winding-up order there could be tailored so that it looked like a buy-out order, and also applied the practice of staying a winding-up order for the parties to work out an alternative arrangement.

[37] *Evenstar*, *ibid*. at para. 44.

[38] Both the *Company Legislation and* Regulatory *Framework Committee* (October 2002) and *Steering Committee for Review of the Companies Act* (June 2011) made no recommendations to amend the *Companies Act* (Singapore) ss. 339/340. See also Andrew Keay, "The Duty of Directors to Take Account of Creditors' Interests: Has it Any Role to Play?" [2002] J.B.L. 379.

a relatively weaker provision which permits a civil claim to be made against the directors under s. 340(2) only if there has been a criminal prosecution under s. 339(3), and the test is whether there was a "reasonable or probable ground of expectation… at the time of the company being able to pay the debt"

But the general concept of insolvency may have to be revisited in any case given developments in England seeing insolvency more as a liquidity or cash flow problem. Partly due to the difficulties of taking contingent and prospective liabilities into account, it was held, in a case where a trustee of longer dated notes was asked to declare a contractual event of default mirrored on the tests of insolvency in the *Insolvency Act 1986* s. 123, by the English Court of Appeal in *BNY Corporate Trustee Services Ltd v. Eurosail-UK 2007-3BL plc*,[39] that a company could not be said to be insolvent simply because its liabilities appeared to exceed its assets. The insolvency provisions were meant to identify companies that could not pay its debts, and this would be so only if there was an incurable deficiency in its assets, where a "point of no return" had been reached.[40] The Supreme Court rejected the need for the last point, but thought that the cash flow test worked for the reasonably near future only. A balance sheet test was more sensible when looking forward but the Court thought that this was imprecise and depended on the party asserting it to prove. On the facts, given that the final redemption of the notes was only in 2045, the Court felt it had to proceed with caution. Eurosail could pay its debts presently and the Court could not be sure that it would eventually be unable to do so until a time closer to 2045.

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[39] [2011] 1 W.L.R. 2524 [*BNY Corporate Trustee*]. In contrast, Grimberg J.C. in *Re Great Eastern Hotel (Pte) Ltd* [1988] S.L.R.(R.) 276 (H.C.) held that the Singapore test for insolvency is, first, whether there is a proper and unsatisfied demand for a debt already due which the company is unable to pay out of its present liquid resources and, second, whether there is a deficit in terms of the company's assets and liabilities. The inter-relationships between the various tests were recently discussed by the Court of Appeal in *BNP Paribas v. Jurong Shipyard Pte Ltd* [2009] 2 S.L.R.(R.) 949 [*BNP Paribas*]. *Cf*. Peter Walton, "'Inability to pay debts'—beyond the point of no return?" [2013] J.B.L. 212, pointing out that the meaning in s. 123 went beyond winding up and affected other ancillary areas.

[40] *BNY Corporate Trustee*, *ibid*. at [52], Neuberger M.R., and para. 114, Toulson L.J., referring to Roy Goode, *Principles of Corporate Insolvency Law*, 4th ed. (London: Sweet & Maxwell, 2011) at [4-06].

However, what was said by Neuberger LJ (as he then was) in *BNY Corporate Trustee*[41] is quite consistent with the position in Singapore with respect to trading in the vicinity of insolvency. In particular, he cited with approval the part of the Cork Committee Report which had in turn reflected the views of Professor Goode:[42]

> "A balance has to be drawn between the right of an honest and prudent businessman, who is prepared to work hard, to continue to trade out of his difficulties if he can genuinely see a light at the end of the tunnel, and the corresponding obligation to 'put up the shutters', when, by continuing to trade, he would be doing so at the expense of his creditors and in disregard of those business considerations which a reasonable businessman is expected to observe."

It is a weighing exercise that recognises that there is a shareholder/bondholder conflict in that residual claimants have an incentive to shift value to themselves from those ranking about them.[43] Shareholders are willing to take the riskiest course of action given that their claims to the few remaining assets rank last.[44] However, courts around the world have acknowledged that directors owe no duty to creditors (as opposed to the company) even in insolvency. But to focus on the company as entity here is also perhaps a proxy for saying that directors have to be even-handed in their treatment of shareholders and creditors in that particular setting. In other words, they have to exercise their powers properly.

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[41] *Ibid* at [54].

[42] *Report of the Review Committee—Insolvency Law and Practice* (1982) (Cmnd 8558) at 216.

[43] See Jensen & Meckling, Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure, (1976) 3 Journal of Financial Economics 305; Myers, Determinants of Corporate Borrowing (1977) 5 Journal of Financial Economics 147.

[44] This is one of the three agency problems identified by Kraakman, Davies, Hansmann, Hertig, Hopt, Kanda and Rock, *The Anatomy of Corporate Law* (OUP, 2004).

Takeovers

This balancing exercise is also required of directors of target companies in a takeover. Shareholder interests appear to become paramount in these situations.[45] Under UK-type Takeover Codes, the philosophy is to leave the decision whether to accept or reject the offer to the shareholders themselves through the provision of adequate information and advice, and directors cannot do anything to frustrate the offer.[46] In the US, however, the position seemed to be the other way round with the entity's interest coming to the forefront only when there is a possible change of control. Director primacy has been seen to be a good thing in this situation,[47] although it has been questioned whether this is good for constituencies within the company other than the directors themselves, particularly in the context of poison pills.[48] But the UK is now considering whether to strengthen the entity focus even more in the takeover context after the takeover of Cadbury plc by Kraft Foods Inc.[49] It is also anticipated that there would be changes to the English takeover rules following the acceptance of the 2012 Final Report of the *Kay Review of UK Equity Markets and Long-Term Decision Making* which overall philosophy appears directed at disenfranchising short term shareholders. Developments in Europe at the same time appear to be focused on giving long-term shareholders more rights. But it is unlikely that this will allow corporate interests to be used as an excuse by a target board to prevent a takeover altogether. Indeed, the UK Government's response to the *Kay Review* was that it would not be practical to disenfranchise some shareholders

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[45] See Wan Wai Yee, "The Validity of Deal Protection Devices in Negotiated Acquisition or Merger Transactions under Anglo-American Law" (2010) 10 JCLS 179 at 189 and 207.

[46] Singapore Code on Takeovers and Mergers, General Principles 9 and 10.

[47] Lynn A Stout, "Takeovers in the Ivory Tower: How Academics are Learning Martin Lipton May be Right" (2005) 60 Business Lawyer 1435.

[48] "The case of the poison pill: Will Leo Strine re-engineer takeover law in America?" *The Economist* (11 December 2004). Wan Wai Yee, "The Validity of Deal Protection Devices in Negotiated Acquisition or Merger Transactions under Anglo-American Law" (2010) 10 JCLS 179 at 207 believes that there will continue to be US target board autonomy, although independent directors will increasingly serve as the will of the company in such situations.

[49] The UK regulators are looking to make it harder for bidders to succeed there, and allowing directors to take into account interests other than those of shareholders (or at least short-term shareholders). They are also considering prohibiting deal-protection measures like inducement fees, and raising the minimum acceptance condition to 60%.

even if it agreed that the influence of short-term investors in a takeover bid should be reduced.[50]

In these situations what is required is a balancing of interests of existing shareholders, those with short term interests who are keen to sell, and those with longer term interests in the company's viability, which cannot therefore be seen as a monolithic whole. At an extreme, we may even require shareholders themselves to act properly in some situations, even if there are usually no duties imposed on them. This was seen most controversially in the Australian High Court decision in *Gambotto v. WCP Ltd*,[51] which attempted to lay out a proper purpose rule even on the part of shareholders when it came to voting on an expropriation or even variation of their rights, which was seen as a high point of court activism. While that decision made no inroads in England, or indeed even in Australia after that,[52] it reflects the difficulty with decisions that are ostensibly taken for the benefit of the company but which hides the wealth transfers that may be going on between its contributories.

Conclusion

There is little risk of the corporate structure generally being misused. Any possible abuse as a going concern is met by the doctrine of veil piercing, but that is increasingly limited to asset transfers to evade existing liabilities of the controller. *Prest* is perhaps an indirect attempt in law to distinguish industrial/service companies from asset holding ones, whether those are of a long or short term nature. The strength of the corporation is capital lock-in leading to corporate growth.[53] Underpinning all that is a

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[50] Business, Innovation and Skills Committee - Second Special Report, *The Kay Review of UK Equity Markets and Long-term Decision Making*, 22 October 2013 (Annex B, Summary of analysis of the policy proposal to disenfranchise short-term shareholders during a takeover bid).

[51] (1995) 182 C.L.R. 432. Where directors' duties are concerned, the proper purpose rule was found not to have been breached in *Townsing Henry George v. Jenton Overseas Investment Pte Ltd (in liquidation)* [2007] 2 S.L.R.(R.) 597 at para. 58: discussed in Hans Tjio, "Understanding the Company in Context" in Chao Hick Tin et al., eds., *The Law in His Hands – A Tribute to Chief Justice Chan Sek Keong* (Singapore: Academy Publishing, 2012) at 153.

[52] Ian Ramsay & Benjamin Saunders, "What Do You Do With a High Court Decision You Don't Like? Legislative, Judicial and Academic Responses to *Gambotto v. WCP Ltd*" (2011) 25 Austl. J. Corp. L. 112.

[53] See Blair and Stout, supra n 18.

business that employs people, even if some companies later incur liabilities which cannot be met from its assets (where insolvency rules intervene). That there is no need to pierce the veil even in this latter situation is also due to old capital maintenance rules preventing the violation of the corporate fund which is founded on the duty on directors to exercise their powers for proper purposes. This doctrine also helps mediate situations in which it is necessary to see through the corporate entity to the various constituents behind it where there may be conflict between them, and where recourse to the company's best interest can be a refuge for those seeking to take unfair advantage of its entity status. We were recently reminded in *Elairs Group Ltd v JKX Plc Oil and Gas Ltd* [54] that the proper purpose rule (applicable to directors by Companies Act 2006 s 171) imposes different requirements on directors when contrasted with their duty to act *bona fide* in the interest of the company (Companies Act s 1712),[55] although it may be that some form of but-for test which provides a defence for directors that they would have acted in the same way even had they acted properly. In addressing counsel's argument that imposing voting restrictions at an AGM on certain shareholders who did not respond to a notice (served under a power conferred by the UK Companies Act s 793 and company articles) to disclose their interests in shares should only be tested by whether it was in the company's best interest even if the purpose of the power was to compel disclosure (and not, as was the case with the majority of the board, to stop the shareholders from preventing some resolutions from being passed), Mann J said (at [208]-[210]):

> "In doing so he misconstrues the purpose of section 172 and ignores the provisions of section 171. Section 172 is in the nature of an overarching obligation which arises when the directors are considering the exercise of their powers. It can easily and properly coexist with other limitations on powers, and does not, by itself, necessarily fill a gap if the purposes of certain powers are not actually articulated in the articles…Section 172 does not somehow trump the

[54] [2013] EWHC 2631can provide.

[55] See further C.L. Mok, "Re-thinking Director's Duties: An Analysis of the Proper Purpose Doctrine" (2002) 14 SAcLJ 387; R. Grantham, "The Powers of Company Directors And The Proper Purpose Doctrine" (1994-1995) 5 Kings College LJ 16; *Cf.* S. Fridman, "An Analysis of the Proper Purpose Rule" (1998) 10 Bond L.R. 164 who does not think that the proper purpose rule adds much to the duty that directors have to act in the best interest of the company.

> provisions of section 171. In relation to any given power, it is necessary to identify the purposes for which the power is to be exercised (so far as possible), and having identified that purpose one then has to see whether the directors have exercised it for that purpose, and also whether it was exercised so as to "promote the success of the company". The first step is a necessary step, and is not rendered unnecessary by the existence of the second obligation."

While the Court of Appeal[56], by majority, reversed this decision, they did not question the fact that both duties were different. Instead, Sir Robin Jacob and Lord Justice Longmore applied a variant of the causation argument by seeing that the "victim" of the decision could have avoided it simply by disclosing their interests and so was "not a victim of any improper use of a power of the board of directors" (at [136]). But they also thought that the particular power considered here to compel disclosure and/or to disenfranchise the shareholder was not susceptible to a proper purpose review. This though shows how difficult the doctrine is as there may be situations where the power is exercised in a discriminatory way. Indeed, Briggs LJ, who dissented, expressly rejected the argument that the proper purpose duty is only applicable where this is commercially necessary (an implied terms argument), and thought that all fiduciary powers have to be exercised properly. He said (at [122]):

> "I consider it important that the court should uphold the proper purpose principle in relation to the exercise of fiduciary powers by directors, all the more so where the power is capable of affecting, or interfering with, the constitutional balance between shareholders and directors, and between particular groups of shareholders. The temptation upon directors, anxious to protect their company from what they regard as the adverse consequences of a course of action proposed by shareholders, to interfere in that way, whether by the issue of shares to their supporters, or by disenfranchisement of their opponents' shares, may be very hard to resist, unless the consequences of improprieties of that kind are clearly laid down and adhered to by the court."

[56] *JKX Plc Oil and Gas Ltd* v *Elairs Group Ltd* [2014] EWCA Civ 640.

The internal constitutional structure of a company could, as has been suggested here, also include creditors and employees in the mix. While the proper purpose rule is sometimes difficult to pin down, as seen in *Eclairs*, its existence helps prevent egregious abuses where a decision taken ostensibly in a company's best interest has in fact unjustifiable and disproportionate discriminatory outcomes amongst its constituents.