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Caveat Empty Stockings – Does *Palmer Birch* make Limited Liability less Limited?
By: Robert Blackett

The present article principally concerns *Palmer Birch (a partnership) v Lloyd & Anor* [2018] EWHC 2316 a decision of the TCC (Russen HHJ) from July 2018 about corporate personality and limited liability. The judgment opens with the following passage:

> *"This claim reveals the perils of contracting with an undercapitalised limited liability company, with no guarantees from the individuals associated with it, as HHL was plainly one such company. The claim also reveals less directly the potential pitfalls for those individuals who choose to operate through the medium of such a limited company which proves not to be good for its contractual obligations …"*

The case raises interesting issues and the decision is not easily reconciled with the leading authorities (*Aron Saloman (Pauper) v A. Saloman & Co. Ltd.* [1897] AC 22, *Petrodel v Prest* [2013] UKSC 34) or with the statutory scheme laid down by parliament in the Insolvency Act 1986.

For all that the nearly-400 paragraph judgment in the *Palmer Birch* case may be an interesting one, it is not the most promising subject for an article to be featured in the December edition of this publication, wherein articles must traditionally make some attempt at a Christmas theme.

New Life from the Wreckage

The closest that the story of corporate personality comes to Christmas seems to be Northern Lapland, which has been claiming to be the home of Santa Claus since around 1926. In that year a Finnish radio station claimed that Santa lived at Korvatunturi, a remote mountainous spot in the far North. In the 1960s Santa would bow to commercial pressures and he officially moved to Rovaniemi, 225 miles to the South, a spot which was more accessible for tourists.

In early 1553 North of Korvatunturi, long before Santa began looking into the local real estate, fishermen working the coast made a grim discovery. They stumbled upon two sailing ships, the Bona Esperanza and the Bona Confidentia which had set off from Deptford docks in London the preceding summer to look for a Northeast passage to China. Each was an icy tomb, filled with the frozen bodies of its crew. Trapped by the encroaching ice and forced to overwinter in the darkness above the Arctic circle, they had died, not of starvation or hypothermia (for they were well-provisioned) but of carbon monoxide poisoning, having gathered and burned coal in an attempt to warm their poorly-ventilated ships.

Those deaths came at the dawn of a mercantile age characterised by extraordinarily risky ventures. Those willing to undertake long sea voyages might acquire great riches, sometimes for little more than glass beads and baubles (the most famous example being Minuit's acquisition of Manhattan), or else lose their vessels and, with them, their fortunes and their lives.

The ill-fated voyages of Bona Esperanza and Bona Confidentia are a footnote in the history of company law because they comprised the first expedition funded by a group of men operating under the snappy sobriquet of "the mystery and company of marchants adventurers of England, for the discovery of lands, territories, iles, dominions, and seigniories unknowen, and not before that late adventure or enterprise by sea or navigation, commonly frequented."

In London in 1555 the same men (minus those who had perished in Northern Lapland) would succeed in creating for the first time a new, fully formed, artificial person. Unlike Prometheus or Frankenstein they did, however, still require some female assistance to give life to their new creation, specifically from Mary I of England, who granted their venture the first royal charter of incorporation.

The effect was to cause English law to recognise for the first time the existence of a new, distinct person, which was to become known as the "Muscovy Company". This new person could sue and be sued in its own name, could act separately to its members and would exist in perpetuity. It continued trading until 1917, and survives today as a registered charity. Mary's successors would grant many more such charters and create many more such charter companies. Today (according to Palmer's Company Law) there are still 859 extant companies which were created by Royal prerogative.

The Early Corporate Form

Why did 'marchant adventurers' (i.e. investors) want to create these new legal entities in the first place? The answer is that they probably didn't, at least to begin with. A royal charter was, in essence, a mechanism whereby the crown would grant a group of favoured subjects a legal monopoly (or, strictly, an oligopoly). The neonate Muscovy Company *and also each of its individual members* were granted an exclusive right to trade with the Tsardom of Russia. Initially, at least, such charter companies do not therefore seem to have been vehicles for commerce in their own right. Each member would exploit the monopoly which the charter conferred by trading privately on their own account. The creation of a corporation was entirely incidental.

In his Devil's Dictionary (1911) Ambrose Bierce later defined a corporation as *"an ingenious device for obtaining individual profit without individual responsibility"* – a pretty fair description of its modern role. But 17th century 'marchant adventurers' were slow to seize upon the corporate form as mechanism for avoiding personal liability. Indeed: (Per Gower *Principles of Modern Company Law*): "*many charters expressly conferred a power on the company a right to make levitations (or calls) on the members and it was by no means clear that a company did not have this power in the absence of an express provision … so limited liability was illusory … moreover the creditors by a process resembling subrogation could proceed directly against the members if the company refrained from taking the necessary action*".

The concept of *"joint stock"* emerged later, whereby each member would contribute working capital to the venture, which would later be redistributed in the same proportions. Only from the late seventeenth century do such companies become exclusively joint stock companies, and so come to resemble the corporate form with which we are familiar. It is around that same time that references start to appear in the case law (e.g. *Edmunds v Brown & Tillard* (1668) 1 Lev 237) to such companies as having limited liability, in the sense that they were distinct from the members who owned them, and the individual members were not automatically liable for their companies' debts.

There were many further twists on the path from protean charter companies, to the modern corporate form. Most notably, there was a period of around 135 years (from the Bubble Act in 1720 to the Limited Liability Act 1855) during which English law showed considerable resistance to the concept of limited liability, and the outrageous idea – today so unremarkable and, indeed, so fundamental to the modern world - that members should be permitted to shelter behind the corporate form from the debts their companies incurred. And it was not until (of course) *Aron Saloman (Pauper) v A. Saloman & Co. Ltd.* [1897] AC 22 that this corporate veil was definitively confirmed.

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Saloman

In 1859 Aron Salomon, then in his twenties, moved to London from Velbert (near modern Dusseldorf) in Prussia. He settled in Whitechapel in East London and married a local girl, with whom he would go on to have six children. Over the next twenty years he established a successful business making boots and shoes somewhere on Whitechapel High Street.

Whitechapel High Street / Whitechapel Road, is an artery which follows the route of the old Roman road from London to Colchester, and is the cheapest square on a British *Monopoly* game board. At the time Whitechapel was a commercial hub featuring a bustling haymarket where farmers would bring cartloads of the hay on which London depended, serving as a sort of congested filling station for the horses which powered London's economy. The narrow capillaries surrounding Whitechapel High Street were replete with pungent tanneries, abattoirs, breweries and the accompanying drinking establishments, gambling dens and prostitution. Saloman's business attained its zenith at around the same time that Joseph Merrick was first exhibited to the paying public as the 'Elephant Man' at a shop on Whitechapel High Street, and with the 'Jack the Ripper' murders being committed in the alleys nearby.

The London Borough of Tower Hamlets does not consider Salomon worthy of a blue plaque and my attempts to work out precisely where his shop was, have been in vain – hence no picture of the modern building to accompany this article, but the picture below, which shows the street in 1901, gives a sense of the place.

Whitechapel High Street in 1901 Source: Wikimedia Commons, author AΩ

In 1892 Saloman resolved to incorporate his business, there being, by this time, a statutory procedure for doing so and no need to petition to monarch. Saloman, his wife and five of his children each subscribed for one £1 share in that company, the reason for their involvement being that, at the time, the law required every company to have at least seven shareholders.

Saloman then sold his business to the company in exchange for 20,000 shares and 100 debentures (i.e. documents evidencing a debt – like an IOU), each for £100. These debentures were secured by a floating charge over the company's assets. Hence Saloman held 20,001 shares and debentures for £10,000 and his wife and children held the other 6 shares issued by the company. These transactions appear to have completed in January 1893.

Subsequently Broderip loaned Saloman £5,000 "*upon the security of*" the debentures (the terms of that loan are not stated). Subsequently "*the original debentures were returned to the company and cancelled; and in lieu thereof … fresh debentures to the same amount were issued to Mr. Broderip, in order to secure the repayment of his loan, with interest at 8 per cent*". It is unclear whether the debt which Saloman owed to Broderip was cancelled. But the end result seems to have been that Saloman held debentures for £5,000 and Broderip held debentures for £5,000, and that Broderip's debentures took precedence over Saloman's. Also, while it is clear that the new debentures which the company issued to Broderip provided for the payment of interest, it is unclear whether that had been true of the debentures which were originally issued to Saloman – i.e. it is unclear whether the company agreed to exchange a £5,000 interest free debt which it owed Saloman for a £5,000 debt with interest at 8% owed to Broderip – effectively agreeing to pay the interest on Broderip's loan to Saloman.

The company, as their Lordships would later put it, soon "fell upon evil days", defaulted on payments due to Broderip and its other creditors. A liquidator was appointed in October 1893, and so the company had only a very short life. Once Broderip had enforced his security and recovered the principal and interest owed to him, the company was left with £1,055, which Saloman claimed under his £5,000 debentures. If those debentures were enforced the company's unsecured creditors, whom the company owed £7,733, would get nothing.

Saloman brought a claim against the company seeking to enforce his debentures. The liquidator counterclaimed, seeking to set aside the debenture agreements.

The judge at first instance was Roland Vaughan Williams (uncle, incidentally, of the composer Ralph Vaughan Williams, known, amongst other things, for his Christmas carol arrangements). At the close of argument Vaughan-Williams J took what seems, to the modern eye, an unusual step, suggesting that, rather than seek to set aside the debentures, the company amend its counterclaim and instead seek an indemnity from Saloman for the whole of the £7,733 owed to the unsecured creditors. The liquidator duly made the amendments and the judge ordered Saloman to pay the company that sum.

The Court of Appeal also found Saloman liable for the company's debts. Although, on its literal wording, the relevant legislation allowed incorporation and conferred the protection of limited liability provided that the company had seven shareholders, it was thought that it could not have been parliament's intention that a sole trader should be able to take advantage of this corporate form by having six members of his family take only nominal shares.

The Court of Appeal thus found that the formation of the company and the company's agreement to buy Saloman's business in exchange for the debentures were "*a mere scheme to enable him to carry on business in the name of the company with limited liability contrary to the true intent and meaning of the Companies Act 1862 and further to enable him to obtain a preference over other creditors of the company by procuring a first charge on the assets of the company by means of such debentures*".

In the House of Lords, Lord MacNaghten said of that conclusion:

> *"I must say that I … have great difficulty in understanding this declaration. If it only means that Mr. Salomon availed himself to the full of the advantages offered by the Act of 1862, what is there wrong in*

that? Leave out the words "contrary to the true intent and meaning of the Companies Act, 1862," and bear in mind that "the creditors of the company" are not the creditors of Mr. Salomon, and the declaration is perfectly innocent: it has no sting in it."

The first instance and appeal judgments are founded it seems, less upon a lingering distrust of limited liability, but rather upon an indignation that someone like Salomon, a sole trader, might presume to avail himself of its benefits. Lord MacNaghten said:

"… I cannot help thinking that the appellant, Aron Salomon, has been dealt with somewhat hardly in this case."

"Mr. Salomon did what hundreds of others have done under similar circumstances. He turned his business into a limited company."

Lord Herschell said:

"Many industrial and banking concerns of the highest standing and credit have, in recent years, been, to use a common expression, converted into joint stock companies, and often into what are called "private" companies, where the whole of the shares are held by the former partners. It appears to me that all these might be pronounced "schemes to enable" them "to carry on business in the name of the company, with limited liability," in the very sense in which those words are used in the judgment of the Court of Appeal."

"I know of no means of ascertaining what is the intent and meaning of the Companies Act except by examining its provisions and finding what regulations it has imposed as a condition of trading with limited liability. The memorandum must state the amount of the capital of the company and the number of shares into which it is divided, and no subscriber is to take less than one share. The shares may, however, be of as small a nominal value as those who form the company please: the statute prescribes no minimum; and though there must be seven shareholders, it is enough if each of them holds one share, however small its denomination. The Legislature, therefore, clearly sanctions a scheme by which all the shares except six are owned by a single individual, and these six are of a value little more than nominal."

"… we have to interpret the law, not to make it; and it must be remembered that no one need trust a limited liability company unless he so please, and that before he does so he can ascertain, if he so please, what is the capital of the company and how it is held."

Their Lordships thus allowed Salomon's appeal and, with that decision, the "*corporate veil*" was lowered. The term "*veil*" (which is never actually used by their Lordships in *Saloman*) belies of course the nature of the doctrine, suggesting as it does something flimsy, fleeting transparent and easily pushed aside.

Piercing the Corporate Veil

Notwithstanding their Lordship's decision in *Saloman*, there evidently prevailed a sense among judges that – whatever the company law statutes of the day might say – there must be *some* circumstances in which the legal personality of a company could be disregarded, and those who controlled a company fixed with personal liability.

The first and most famous such case is *Gilford Motor Co Ltd v Horne* [1933] Ch 935. Horne had been managing director of the Gilford Motor Co. His contract precluded him being engaged in any competing business in a specified geographical area for five years after the end of his employment "*either solely or jointly with or as agent for any other person, firm or company.*" He left Gilford and formed a company, in which his wife and a business associate were shareholders, which carried on a competing business in the specified area. The Court of Appeal granted an injunction against both Horne and the company to restrain them from carrying on the business, saying that the company was a "mere cloak or sham" because the business was really being carried on by Mr Horne. The interposition of the company was to maintain the pretense that it was being carried on by others.

In the ensuing 80 years a number of other judgments followed in which those behind companies were either fixed with liability for a company's actions, or else in which the courts declined to fix those people with liability. But the rule or principle to be derived from those decisions remained elusive.

Petrodel v Prest [2013] UKSC 34 is a decision of the Supreme Court in which these various authorities were examined. Mr Prest was a wealthy businessman who owned interests in a variety of companies. The case concerned the financial relief to be granted to his wife upon the couple's divorce. At first instance, Mrs Prest was held to be entitled to assets held by Mr Prest's companies. The order was set aside on appeal. Mrs Prest appealed to the Supreme Court. Among the issues considered in the case was whether there existed a power at common law to 'pierce the corporate veil' and, if so, its scope.

Their Lordships confirmed that there is a power at common law to pierce the corporate veil. Lord Sumption stated that it is "*well established in the authorities*" and that "*the consensus that there are circumstances in which the court may pierce the corporate veil is impressive*". Lord Neuberger (who had been more equivocal in *VTB Capital v Nutritek* [2013] 2 WLR 398) said that *"it would be wrong to discard a doctrine which, while it has been criticised by judges and academics, has been generally assumed to exist in all common law jurisdictions, and represents a potentially valuable judicial tool to undo wrongdoing in some cases, where no other principle is available."*

As to the precise scope of the principle, that is more difficult to discern. One point which does seem clear is that piercing the corporate veil is a remedy which is to be available only when the law does not provide for any other remedy against the wrongdoer (Lords Sumption, Neuberger and Clarke were all agreed on this point, Lady Hale, Lord Mance and Lord Wilson agreed with Lord Sumption, only Lord Walker did not).

This is potentially significant. One can see a parallel here with another common law doctrine the precise boundaries of which remain unsettled – namely the *Albazero* principle and Lord Griffiths' principle or (as Lord Sumption termed it in *Lowick Rose LLP (in liquidation) v Swynson Ltd and another* [2017] UKSC 32) the question of "*transferred loss*" i.e. the circumstances under which a party which is owed a duty may recover for a loss suffered by a third party consequent upon a breach of that duty. It is evident that, whatever principle governs recovery in such circumstances, they do not permit recovery for a loss suffered by a third party which has its own cause of action against the wrongdoer, even if that cause of action is in some sense narrower or subject to limitations (e.g. a contractual cap on liability, a time bar). See *Alfred McAlpine Construction Limited v Panatown Limited* [2001] 1 AC 518.

Aside from a (near) consensus that the corporate veil will similarly not be pierced where the law provides some other remedy against the wrongdoer, quite when the corporate veil will be pierced remains open to debate.

Lords Sumption and Neuberger distinguished two concepts: the "*concealment principle*" and the "*evasion principle*". Per Lord Sumption "*the concealment principle is legally banal and does not involve piercing the* *corporate veil at all. It is that the interposition of a company or perhaps several companies so as to conceal the identity of the real actors will not deter the courts from identifying them, assuming that their identity is legally relevant. In these cases the court is not disregarding the "facade", but only looking behind it to discover the facts which the corporate structure is concealing."*

Lord Sumption gave as an example *Gencor ACP Ltd v Dalby* [2000] 2 BCLC 734. ACP claimed against Dalby, a former director, who, in breach of his duties, had procured that a third party pay a secret profit to a BVI company called '*Burnstead*' which was under Dalby's control. The court held that Dalby was liable to account for the money paid to Burnstead, characterising this as piercing the corporate veil. But Lord Sumption took a different view: "*Burnstead was Mr Dalby's nominee for the purpose of receiving and holding the secret profit, it followed that Burnstead had no right to the money as against Mr Dalby, who had in law received it through Burnstead and could properly be required to account for it to ACP. Burnstead itself was liable to account to ACP because, as the judge went on to point out, Mr Dalby's knowledge of the prior equitable interest of ACP was to be imputed to it … This is in reality the concealment principle. The correct analysis of the situation was that the court refused to be deterred by the legal personality of the company from finding the true facts about its legal relationship with Mr Dalby. It held that the nature of their dealings gave rise to ordinary equitable claims against both. The result would have been exactly the same if Burnstead, instead of being a company, had been a natural person, say Mr Dalby's uncle, about whose separate existence there could be no doubt.*"

The evasion principle, by contrast is that "*is that the court may disregard the corporate veil if there is a legal right against the person in control of it which exists independently of the company's involvement, and a company is interposed so that the separate legal personality of the company will defeat the right or frustrate its enforcement*". Per Lords Sumption and Neuberger, the principle can be invoked where "*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*". *Gilford v Horne*, is an example of the "*evasion*" principle and a true instance of piercing the corporate veil.

The other SCJs were more circumspect. Lord Clarke was of the view that this distinction between concealment and evasion should not be definitively adopted because it had not been the subject of detailed submissions. Lord Mance was attracted by the principles set out by Lords Sumption and Neuberger but was not prepared to rule out that there might be other situations where the veil could be pierced. Lady Hale and Lord Wilson were doubtful as to whether the cases could all be classified according to the two categories identified by Lord Sumption. Lord Walker thought that piercing the veil was just a label for a range of situations where the separate legal personality of a company was disregarded, from which it was not possible to derive any "*coherent principle or rule*."

Fraudulent and Wrongful Trading

In *Saloman*, Lord Watson observed (emphasis added):

> "*the unpaid creditors of the company … could have informed themselves of the terms of purchase by the company, of the issue of debentures to the appellant, and of the amount of shares held by each member. In my opinion, the statute casts upon them the duty of making inquiry in regard to these matters. Whatever may be the moral duty of a limited company and its share-holders, when the trade of the company is not thriving, the law does not lay any obligation upon them to warn those members of the public who deal with them on credit that they run the risk of not being paid.*"

Thus those who dealt with limited companies did so at their peril. *Caveat emptor* if paying a company in advance for goods or services supplied by the company, and *caveat venditor* if supplying a company goods or services on credit.

The statutory position shifted slightly in favour of creditors in 1929 with the introduction of controls on 'fraudulent trading'. If a company was being wound up and any part of its business was carried on with intent to defraud creditors then, on the application of the liquidator, the court could declare that any persons who were knowingly parties to the carrying on of the business in that manner were liable to make such contribution to the company's assets as the court thinks proper.

In 1982 the Cork Report – a comprehensive review of insolvency law – found that this fraudulent trading jurisdiction was inadequate to deal with irresponsible trading for which the report's authors considered directors should be held personally accountable. They recommended (amongst other things) increasing the accountability of people who worsened or benefitted from company insolvencies.

In the Insolvency Act 1986 the fraudulent trading jurisdiction was preserved (in section 213). A new provision, section 214, addressed 'wrongful trading'. Section 214 applies where a director of a company (defined to include a shadow director) knows or ought to conclude that there is no reasonable prospect that the company will avoid going into insolvent liquidation. On the application of the liquidator, the court may require that director to make such contribution to the company's assets as it thinks proper, unless the court is satisfied that, once that situation arose, the director "*took every step with a view to minimising the potential loss to the company's creditors as … he ought to have taken*".

Section 238 gives an administrator or liquidator a right to apply to the court for an order avoiding any transaction at an undervalue which the company has entered into in the two years before the administration or liquidation if the company was at that time, or became as a result of the transaction, unable to pay its debts as they fell due. If the transaction is with a connected person there is a rebuttable presumption that the company was unable to pay its debts at the relevant time.

The Factual Background to *Palmer Birch*

Palmer Birch v Lloyd & Anor [2018] EWHC 2316 (TCC) is a decision of the TCC (Russen HHJ) from July 2018. The judgment opens with the following passage:

> *"This claim reveals the perils of contracting with an undercapitalised limited liability company, with no guarantees from the individuals associated with it, as HHL was plainly one such company. The claim also reveals less directly the potential pitfalls for those individuals who choose to operate through the medium of such a limited company which proves not to be good for its contractual obligations …"*

Seizar Holding Limited ("SHL") was a Cypriot company owned by Michael Lloyd. In 2010 SHL acquired a large property called "*Hillersdon House*" together with substantial grounds and outbuildings (the "Property"). According to the judgment: "*the reality of the position is that the Property was acquired by SHL for Michael, for him to use as its home once it had been refurbished and he had decided to return from living abroad*" (at the time Michael was not resident in England and was not UK domiciled for tax purposes).

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Hillersdon House Source: Wikimedia Commons, author NH Savage

Rather than retain a contractor himself, or have SHL retain a contractor, Michael set about achieving the refurbishment of the Property in a more roundabout way. Shortly after SHL acquired the Property a £100 English company was created called "*Hillersdon House Limited*". All of HHL's shares were owned by Michael's brother, Christopher and, on paper, Christopher was HHL's sole director. The purchase price was funded by a loan to HHL from Bluecoat Trust Limited, another Cypriot company in which Michael was the sole shareholder. Whether Bluecoat Trust was granted a mortgage over the Property as security for that loan is not stated in the judgment.

Michael and Christopher prepared a business plan describing how HHL would lease the Property from HHL, refurbish it and then operate it as a corporate hospitality venue (in an interim hearing a different judge, HHJ Havelock-Allan, had observed, without deciding the point: "*I am inclined to agree with [counsel for PB] that the Business Plans demonstrate that the development of Hillersdon House was never a viable investment project and that HHL had no chance of ever being solvent independently of funds provided to it by Mr. Michael Lloyd, directly or through SHL*").

SHL then granted HHL a 21 year lease of the Property. HHL proceeded to retain construction professionals and also a contractor called "*Palmer Birch*" ("PB") to execute the refurbishment works. The judge observed that, thereafter:

> "*Christopher … permitted his brother to operate as a de facto director of HHL in controlling the construction project and adding to the scope of the Works. I say de facto director, rather than shadow director, because there was no question of Michael lurking in the shadows. Michael's decision-making in relation to the Contract was open and plain for all to see at the time, including Mr. Birch* [Mr. Birch's position is not expressly stated, but he represented Palmer Birch in connection with the project so was presumably one of the partners in that firm]"

HHL had no assets, save for the lease and £100 of share capital. Until such time as it began running the Property as a corporate hospitality venue (if that ever happened) it also had no source of revenue. Its only source of money with which to pay PB and others in connection with the work would be a series of loans which SHL would make to HHL. SHL would go on to lend HHL a total of around £7.3 million. Michael was the ultimate source of these monies.

HHL's interest in the Property was, to say the least, precarious. Until the work was completed and the Property opened for business, HHL had no way to pay SHL the rent which was accruing under the lease, no way to begin repaying SHL the millions which it had borrowed to refurbish the property and no way to pay the interest which was accruing on those loans. The lease provided for forfeiture if HHL entered into any kind of insolvency process or failed to pay monies due under the lease (whether demanded or not) within 21 days of their falling due. The reality seems therefore to have been that SHL could simply take back the property at will, and HHL's interest in the property would endure only for so long as SHL/Michael chose to ignore the sums which were outstanding.

According to the judgment, a reason why Michael did not retain contractors directly himself or have SHL retain contractors is said to have been because neither Michael nor SHL was UK registered for VAT:

> "*Michael was entirely open about how the interposition of the VAT registered HHL would lead to him recouping approximately £1m of the Contract costs from the Revenue. … he and Christopher had prepared a business plan for HHL, the accountancy advice being that it was necessary to produce one to demonstrate to HMRC that "HHL was a trading entity and it was to be used in support of HHL's claim for VAT rebates". In the witness box Christopher confirmed that assisting the accountants with "the VAT component" was a reason for preparing it. … whether or not HHL ever did commence trading upon completion of the building works, so as to fund what would no doubt be the very substantial running costs for the property or even to make a profit having borne them, there was an immediate financial advantage to Michael in having a significant part of the refurbishment costs funded by the Revenue. Neither he nor SHL could have made a VAT reclaim if either of them had contracted with PB. Of course, having derived that tax benefit, HHL went into liquidation before it had commenced business and even before the Contract works were completed*."

The project did not go to plan. The detail is not material but, suffice to say, that the original contractual completion date had been 31 July 2013. The Architect/Contract Administrator initially appointed by HHA awarded PB various extensions of time and increases to the contract price and that Michael was unsatisfied with these decisions. The work remained unfinished in January 2014 at which time a revealing letter from the Architect/Contract Administrator to Michael attributed the delay and cost to "*a large amount of additional work included in the project during the course of the Contract … Of course, as Client you may introduce as many changes as you wish but the ensuing delays and frustration experienced by the Contractor cannot be attributed* *to the Consultants.*" A new Architect/Contract Administrator was appointed, but they proceeded, to Michael's great dissatisfaction, to award PB yet further extensions of time and increases to the contract price. Towards the end of the contract those architects too were dismissed, and a third new Architect/Contract Administrator appointed.

By early December 2014 Michael (HHI's only potential source of funding) found himself short of cash, partly due to his having to pay a divorce settlement. Michael's remaining money seems to have been tied up in a property development in Kenya (called "*Buffalo Mall*"), and a planned sale of his interest in that development had been unexpectedly delayed. Hence the judge found that: "*by early December 2014 the position appeared to be one where any further funding of the project by Michael or SHL was dependent upon the receipt of the Buffalo Mall monies*."

With the work apparently nearing completion, Palmer Birch submitted two invoices due on 15 December and 20 January 2015. HHL failed to pay these so that, by late January 2015, HHI owed Palmer Birch around £444,000. At trial the defendants accepted that this money was properly due, and that its failure to pay these invoices had been a breach of contract. The only way HHI would be able to pay these invoices would be if Michael received the Buffalo Mall monies, and then advanced HHI the funds it needed to pay PB.

On 5 January 2015, the day before the second invoice, Michael instructed PB to suspend works (although the contract did not give HHL any right to do this).

At around this time Michael had some negotiations with PB about the possibility of Michael giving PB a personal guarantee of HHI's obligations in exchange for PB not immediately commencing claims against HHI (presumably by way of adjudication). Michael's advisers told him not to sign the guarantee as "*it undermines substantially the purpose of trading via a limited liability company.*"

The judge held that: "*By no later than the end of January 2015 Michael and Christopher (whose involvement was necessary because he was the sole appointed director of HHL) had decided that the preferred route for getting rid of the existing and further contemplated financial claims by PB under the Contract, with SHL continuing to enjoy the benefit of the Works to date, was the liquidation of HHL. By no later than that time, they decided and colluded to act accordingly*."

On 22 April 2015 HHI gave notice purporting to terminate PB's contract. At trial the defendants accepted that HHI had no right to terminate, and so that this was a repudiatory breach of the contract. The same letter stated that HHL had no means of repaying its debts (i.e. those owed to SHL), that it was inevitable that HHL would be placed into liquidation and that "[i]*n the event of a liquidation there will be no distribution to* [PB]".

On 12 May 2015 Michael registered a new £1 company called "*Country Sporting Experience Limited*" ("CSEL"), of which he was the sole shareholder and director.

On 28 May 2015, Michael wrote to his bankers regarding his anticipated receipt of the Buffalo Mall monies stating "*the liquidation of HHL will mean that the last two invoices from the builder will not be paid nor any further sums for delay. I intend to pay all other creditors so the total cost to complete will be circa [£]600,000*."

On 3 June 2015 Michael received the Buffalo Mall monies. On 25 June 2015 HHL entered into creditors' voluntary liquidation. A statement of affairs presented at that meeting showed an estimated deficiency of over £11 million. PB claimed to be owed around £1 million.

It appears that, in response to HHL's liquidation, SHL terminated HHL's lease of the Property and granted a new lease to CSEL. CSEL, using Buffalo Mall monies supplied by Michael, completed the refurbishment of the Property.

Why no Claim under the Insolvency Act 1986?

The judge observed: that HHI "*very arguably was never solvent during its short life*." PB did not, it seems, seek to have the liquidator claim against Michael under section 214 of the Insolvency Act 1986.

Reasons for this are never stated, but one can speculate. For Michael to be liable to contribute to HHI's assets, it would be necessary to identify both: (i) a point at which Michael knew or ought to have concluded that there was no reasonable prospect that HHI would avoid going into insolvent liquidation; and (ii) some step which he thereafter failed to take to minimise the potential loss to HHI's creditors. Michael knew in January 2015 that HHI's insolvent liquidation was inevitable, because it was then that he decided that he would not advance it any more money, even once the Buffalo Mall monies became available.

It is not obvious as to what steps he could be said to have failed to take after January 2015 to minimise the potential loss to creditors. Presumably such steps must be ones which the director could have taken *qua* director – i.e. something he could have caused the company to do or omit to do, and so Michael's omission to advance further monies to HHI would not qualify. PB's work was suspended and he did not order any additional work after that date, so he did not increase the company's indebtedness to PB. It could, perhaps, be argued that he should have caused HHI to repudiate PB's contract right away, rather than waiting until 22 April 2015, since by repudiating and PB terminating PB would come under a 'duty' to mitigate its loss, redeploy its workers and plant elsewhere, and thus reduce PB's loss and HHI liability to PB.

The jurisdiction conferred by section 214 of the Insolvency Act 1986 is primarily compensatory rather than penal (e.g. *Re Balls Builders Ltd* [2016] Bus LR 555 at para 241-2). Hence a director will generally only be ordered to contribute that amount by which the net deficiency in the company's assets was increased by the director's conduct after the date on which he should have realised that there was no real prospect of the company avoiding insolvent liquidation. Any steps which Michael took, or failed to take, after the end of January probably only increased HHI's indebtedness or reduced HHI's assets by a modest amount. Further, the jurisdiction in section 214 is only to order that the director contribute to the company's assets, for the benefit of all the company's creditors. On liquidation HHI owed PB around £1 million but had other debts of around £11 million, mostly owed to SHL, and so the bulk of anything Michael was ordered to contribute would go straight back to SHL. The loans which SHL had advanced were not, of course, liable to be set aside since they were not transactions at an undervalue.

Whatever the reasons, PB chose to try a different strategy.

Palmer Birch's Claim for Inducing Breach of Contract

PB claimed against Michael on various bases, but it is the bases on which PB succeeded which are of interest.

PB alleged that Michael:

> "*10.1 … procured or induced breaches of contract by HHL in that on his instructions or as a result of his demand payments due to Palmer Birch under the Contract … were not paid;*

> *10.2 … procured or induced a breach of contract by HHL in that on his instructions or as a result of his demand HHL acted in repudiatory breach of contract by refusing to allow Palmer Birch to complete the works and purporting to terminate the Contract when HHL was not entitled to do so*."

PB was thus claiming that Michael had committed what Lord Hoffmann called "*the Lumley v Gye tort*" in the leading case of OBG Ltd v Allan [2008] 1 AC 1, and what the judge in *Palmer Birch* called the "*inducement tort*." That tort is committed when one "*procures*" or "*induces*" (Lord Hoffmann referred to "*acts of encouragement, threat, persuasion and so forth*") a breach of contract (or some other duty), with the intention of causing that breach.

There is a distinction drawn in the case law between the requirement for "*inducement*" on the one hand and mere prevention on the other. The most relevant example is to be found in *Stocznia Gdanska SA v Latvian Shipping Company & Ors* [2002] EWCA Civ 889. Latreefers failed to pay instalments due under certain shipbuilding contracts, prompting the yard to terminate. The yard claimed against Latreefers, but also against its parent, Latco, since Latreefers was insolvent. The yard argued that Latco had induced Latreefers to breach its contract. The appeal judgment describes how at first instance (<u>emphasis</u> added): "[t]*he judge appears to have made a distinction between Latreefers being requested to break its contract, which the judge found did not occur, and it being requested "to do nothing" on the basis that it would not be receiving funds with which to pay, which did occur. That is a narrow line, <u>but would make sense if Latreefers could not pay without being provided with funds</u>.*" In other words Latco was under no obligation to provide Latreefers with funds, and mere failure to do so did not cross the line from mere prevention to "*inducement*".

In *Palmer Birch* the court observed:

> *"On the assumption that there was no contractual obligation upon the parent company to fund (owed to the subsidiary) it is difficult to see how the conclusion in Stocznia Gdanska SA v Latvian Shipping Co could have been otherwise when the judge had found there to have been no inducement of the subsidiary by the parent in the form of an instruction or request. The law of tort cannot ride roughshod over long-established company law principles which reflect a company's separate personality, and its own limited liability, unless factors of inducement (for the purposes of this economic tort) or unlawfulness (for the purposes of the other two addressed below) justify it doing so. In this case the defendants lay great store by the principle in Salomon …"*

The judge identified that it was thus necessary to assess (emphasis added) "whether – *as in Stocznia Gdanska SA v Latvian Shipping – this is simply a case of the contracting party lacking the monies to comply with its contractual obligations and the defendant, who is said to have committed the inducement tort, <u>being neither under any obligation to provide those funds</u> nor under any guarantee-based liability."*

The court found that the claim in paragraph 10.1 of PB's pleading was not made out. Michael had not instructed HHL not to pay the invoices. The first unpaid invoice had fallen due in December. It went unpaid because HHL did not have enough money to pay it, and what funds it did have were used to pay other creditors (<u>emphasis</u> added):

> "*though HHL was from the outset of its life dependent upon Michael (either personally or through SHL) providing funding for the Works, <u>there was no obligation to fund</u> beyond that which had already been complied with under the terms of the £5m loan from SHL by the time Invoice 34 was submitted*."

Yet the judgment continues:

> "*However, HHL's repudiatory breach of the Contract on 22 April 2015 … was one actively brought about by Michael as a result of the decision, reached by no later than the end of January 2015, to bring about the liquidation of HHL but not, with that event, the cessation of any further refurbishment of the Property. By 22 April 2015 Michael may have had enough of PB but there was no reason why HHL should have done so. HHL had been in place as the chosen development vehicle for 3 years and at a fairly early point in that period had commissioned further works which meant that their initial cost of £5.115m was significantly exceeded. It is evident from Michael's dealings with [his bankers] up to and including April 2015 that he was to be the source of the additional funding required to see the Works through to completion. Subject to the process of their evolution since January 2012, those Works were specified by the Contract which was HHL's contract. The circumstances were therefore such that Michael could and, on the basis of the previous 3 years, <u>would have been expected to make that funding available to HHL</u> as the chosen development vehicle through which all previous available funding had necessarily been channelled as the Works proceeded (and expanded). … by pressing on with the decision to liquidate … Michael did cross the line from prevention to inducement. And he did so by purporting to speak for HHL as if he was the Client under the Contract. This is not, therefore, a case where the alleged inducer can say that the breach would in any event have taken place without any inducement on his part.*
>
> *By causing HHL to repudiate the Contract, when the funds which were then made available to CSEL could instead have been made available to HHL in time to enable it to perform the Contract and to meet its contractual obligations, <u>Michael's conduct was not a reflection of HHL's separate corporate personality but an abuse of it</u>. The point is illustrated by the fact that the liquidation of HHL, the inevitability of which had been identified as the ground for the purported termination on 22 April 2015, did not occur until 25 June 2015, by which time the Buffalo Mall monies were available to see the project through.*
>
> *If the fine dividing line in this case between prevention and inducement turns upon the ability to categorise Michael's actions as a diversion of funds away from HHL then, on the particular facts of this case and even in the absence of any unperformed contractual obligation to fund HHL, he was guilty of that. Although those funds did not reach HHL's bank account, they could and should have done so. Whereas a simple finding that Michael could have made the funds available to HHL, but simply chose not to, might arguably leave PB on the wrong side of that fine line, my further conclusion that he <u>should in the circumstances have done so</u> sustains their claim under paragraph 10.2 …. In my judgment, to conclude otherwise … would mean that my … finding [that by the end of January 2015 Michael decided to get rid of PB's, with SHL continuing to enjoy the benefit of the Works to date by putting HHL into liquidation] was of no real consequence for the purposes of that claim. Given the terms of that finding, so far as it concerns the part played by Michael as the principal beneficiary of the Works, that would be a surprising conclusion when, but for the decision referred to in that finding, HHL would have received the Buffalo Mall monies to fund the ongoing Works under its Contract*."

It is not easy to reconcile this approach with *Saloman* and *Prest*. HHL's sole asset was its 21 year leasehold interest in the Property. By providing for that lease to revert to SHL upon HHL's default or upon an insolvency event (an entirely routine, boilerplate clause, exactly what one would have expected to see in any lease). By that, entirely lawful, clause Michael achieved a similar result to what Saloman achieved with his, entirely lawful, debentures, namely putting that asset beyond the reach of other creditors in the event of HHL's insolvency.

For clarity, suppose Michael had simply loaned HHL 100% of the money required to buy the property plus a further (say) £7 million to cover the expected cost of the works, all secured by way of a mortgage over the property. HHL then retained PB and the other professionals. The £7 million is exhausted. HHL is put into liquidation. Michael would get the house (HHL's only asset) with the benefit of all the unpaid-for work and PB would get nothing (i.e. the same result as under Michael's scheme). It can be seen that the position is exactly the same as Saloman. The fact that Michael gets the benefit of the unpaid for work does not serve to distinguish Michael's case. A tanner supplies some leather to Saloman on 30 days credit just before Saloman goes into liquidation. The liquidator sells the leather. The money realised from that sale goes to Saloman under the debentures. The tanner, an unsecured creditor, gets nothing. Saloman gets the benefit of the tanner's work which the tanner has not been paid for just as Michael gets the benefit of PB's work which PB has not been paid for. It can be seen that, in truth, the only difference between Palmer Birch and Saloman might be that Michael is solvent even without the house, where Saloman (described in the report as a 'pauper') apparently had nothing except what he stood to be paid under the debentures.

In the judgment, considerable emphasis is placed upon the fact that Michael decided in January to put the company into a creditors' voluntary liquidation and waited until May to do so. But did that really matter? To get the Property back, it would not, in fact, have been necessary to do that. Michael/SHL could have got its property back without taking that step by simply terminating the lease on the ground that HHL had defaulted on the rent payments. HHL, having no assets, would have been unable to avail itself of the equity of redemption (i.e. would have been unable to pay what was outstanding and thus keep the property). Equally Michael/SHL could just have done nothing, allowed PB to pursue its claims against HHL. When/if PB obtained an adjudication award and HHL failed to pay, PB would have had to initiate insolvency proceedings and Michael/SHL could have relied upon that as grounds for terminating the lease, with the exact same result.

It is not easy to see why the judge in *Palmer Birch* thought, on the one hand, that "*there was no obligation to fund*" but then, a few paragraphs later, concluded that Michael liable on the ground that he "*would have been expected to do so*" and that he "*should in the circumstances have done so*."

Who 'expected' him to do so, and according to what principle did that 'expectation' give rise to a legal right on the part of PB? Presumably the expectation which was thought to be relevant was that of Mr Birch. The judge said of Mr Birch that he (<u>emphasis</u> added):

> "*Did strike me as somewhat naïve in his approach to Michael Lloyd's perceived responsibility for honouring the Contract. But, even then, his statements to the effect that he was left in no doubt by Michael that it was his project and his money and decision-making behind it have every support in Michael's own evidence, <u>save for the singular fact that it was HHL's name on the Contract, not Michael's</u>. And, despite Mr Birch's efforts in early 2015, Michael was not a guarantor either. Mr Birch told me that he did not really think he was entering a contract with a company but a contract with Michael. I do not doubt that he may genuinely have regarded Michael as the client, given their discussions before PB entered into the Contract, but that is one piece of evidence I certainly cannot act upon*."

It seems that what is being said here is that, as a matter of fact, Mr Birch did genuinely believe that he was contracting with Michael, not with HHL. The reference to HHL's name on the contract leaves some doubt as to whether that is the conclusion that is being drawn. There are in fact, a number of indications that Mr Birch knew PB was dealing with a company with a legal personality distinct from Michael, that Michael was under no obligation to fund that company and that Michael might *not* fund that company. Most obviously, if Mr Birch thought that his contract was with Michael personally, why did he ever feel the need, in January 2015, to ask Michael to provide a personal guarantee for HHL's outstanding debt?

The judge seems to conclude the passage by saying that (evidence of) Mr Birch's belief/ state of mind is something which the judge considers he "*cannot act upon*". Eighty paragraphs later the court does seem to "*act upon*" it, by holding Michael liable to PB on the ground that Mr Birch "*expected*" Michael to fund HHL.

Note that it was never part of PB's pleaded case that it had contracted with Michael rather than with HHL. This is apparent from an earlier, reported at [2017] EWHC 914 (TCC), where the judge refers to what were at that time PB's original Particulars of Claim, not the Amended Particulars of Claim which were in place by the trial. It is evident that, from the outset, PB's case was always that its contract was only with HHL, and that Michael's liability was in tort.

PB also does not seem to have alleged any kind of misrepresentation or promissory estoppel. There is, for example, no suggestion that Michael (say) represented to PB that he would, or that he was obligated to, fund the work. Nor that PB entered into the contract in reliance on such a statement, or (say) continued with the work in reliance on such a statement, in circumstances where PB would lawfully have been entitled to terminate or suspend performance. Given the absence of any contract, representation, or estoppel it is not obvious how a mere 'expectation' on PB's part that Michael would supply HHI with the necessary funds can have created (in effect) a legal obligation on Michael's part to do so, a legal obligation, moreover, which was owed to and capable of being enforced by, PB.

As for the suggestion that Michael "*should in the circumstances have* [funded HHI]", those "*circumstances*" were that Michael was under no legal obligation. The highest one can put it might have been to say that Michael had a *moral* duty but, to paraphrase Lord Watson in *Saloman* "*whatever may be the moral duty of a limited company and its share-holders … members of the public who deal with them on credit … run the risk of not being paid*."

The judgment is replete with a sense of sympathy for PB and of reproach for Michael – the references to Mr Birch's naïveté and to Michael having subsidised his project at the expense of the revenue for example. There is also a long section in the judgment which is very critical of Michael's evidence, much of which was shown to be untrue or contradictory and particularly of the fact that Michael had falsely sought to downplay his involvement in HHI's affairs, motivated by "*his anxiety to ensure that … for the period when he was not domiciled in the United Kingdom, he should not be too closely associated with the affairs of a company of which, on advice, he had deliberately not become a director or a shareholder*" (i.e. presumably with a view to avoiding tax). A further point to be aware of is that there was a separate much simpler claim being made against Michael in this case, which he denied but which the judge held to have been true, that Michael, or someone acting on his instructions, had burned the locks off shipping containers being used by PB and taken a large quantity of construction materials which belonged to PB and which Michael had never paid for. The judgment records PB's counsel having put it to Michael in cross examination that he was, therefore, "*not only a liar, but a thief*."

Whatever one's view of Michael's character, and focusing solely on the question of whether he was properly liable for the company's debts, one "*cannot help thinking that* [he] *has been dealt with somewhat hardly in this case*" (to borrow Lord MacNaghten's phrase from *Saloman*). PB, it should not be forgotten, was entering into a contract under which it was to be paid in excess of £5 million and with scope to be paid far more. PB was a firm "*specialising in the refurbishment of large houses*" like Hillersdon House. One might expect should have been accustomed to dealing with wealthy people like Michael Lloyd or Aaron Saloman who, on professional advice, arranged their affairs so as to "*carry on business in the name of a company with limited liability*" as they were entitled to do, and with the benefits that entails.

There are several references in *Palmer Birch* to Michael's counsel having sought to characterise PB's 'inducement' claim as an "*ill-conceived*" or "*impermissible attempt to pierce the corporate veil*." The court never really seems to have engaged with this point. There is a reference in the judgment to "*the general impregnability of corporate veils*" and also the following reference to *Prest* (emphasis added):

> "*In Prest … Lord Sumption reminded us that a corporate veil may be pierced only to prevent an abuse of corporate legal personality and that it is not an abuse for those behind a company to rely upon the incidents of its limited liability. He made that observation in relation to both contractual and non-consensual liabilities (<u>albeit pre-existing ones rather than ones that can be said to arise only when and because the company's own resources do not match the extent of its legal liability</u>). It is difficult to reconcile an allegation that a member or other person financially interested in the company has committed the inducement tort merely by failing to fund the company's further contractual performance, without more, when there is no obligation upon him to do so, with the basic concept of limited legal liability*."

Elsewhere in the judgment there is a strong suggestion that the court considered Michael's inducement tort liability to be an instance of veil piercing (passage already quoted above "*the law of tort cannot ride roughshod over long-established company law principles which reflect a company's separate personality, and its own limited liability, unless factors of inducement (for the purposes of this economic tort) … justify it doing so*."

It should be said that there is no reference in any of the judgments in *Prest* to the inducement of tort as an instance of piercing the corporate veil. Liability imposed by that route is hard to characterise as an instance of piercing the veil because the separate legal personality of the company is not disregarded. Rather the legally distinct nature of the tortfeasor and the company are necessary ingredients of the tort because the tortfeasor must "procure" that the company commit the wrong.

According to Lords Sumption and Neuberger the corporate veil may be pierced only where "*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*." Michael's use of the company does not fit at all with that description. He did not owe PB a pre-existing obligation and then seek to use HHL to evade it. Michael created HHL. HHL retained PB to carry out works to the property and agreed to pay PB for doing so. Prior to that point, there was no obligation owed to PB and the only person who undertook any obligation to PB was HHL.

Finally, it is not at all clear that a 'veil piercing' remedy was justified in *Palmer Birch*. *Prest* strongly suggests that veil piercing is available only in a situation where the law does not provide any other means of recourse. In the circumstance where a company is unable to pay its debts parliament has chosen to set out in statute (sections 213 and 214 of the Insolvency Act 1986) the precise extent of the recourse which creditors are to have against *de facto* directors like Michael.

Concluding Remarks

The problem of credit and security is one which should be at the forefront of parties' minds when they come to negotiate their contracts. In the construction context employers typically have retentions and/or performance bonds to protect them against a contractor's insolvency. As for contractors, most contracts will provide for them to be paid for the work as it progresses so that, at any one time, there should in theory be relatively little payment outstanding for work done to that point, and statutory adjudication provides a means whereby disputes about payments can very swiftly be resolved. Ideally any retention will be set at a level where the retention really represents profit, and the payments made as the contract progresses are sufficient to cover the contractor's costs. Managing that process efficiently and rigorously is probably the best protection against an employer's insolvency.

It is, of course, relevant to consider what assets the employer has, particularly whether it owns any interest in the property on which the work is to be carried out, and how secure that interest is. But this offers limited protection since any property the employer does own will usually be the subject of a mortgage and, insofar as it is not, the employer might well borrow further against that property during the life of the contract.

In his description of the case (quoted at the beginning of this article) the judge described the Palmer Birch case as "*reveal*[ing] *the perils of contracting with an undercapitalised limited liability company, with no guarantees from the individuals associated with it*." In fact, the case probably downplays those perils, or makes them look a lot less perilous, by giving the impression that, when such a company becomes insolvent, a well behaved contractor may be able to recover from its solvent owner. In that respect, the case should probably be treated with considerable circumspection. It is safest always to assume that, in the event of insolvency, the employer company will be as empty of assets as a bad child's stocking on Christmas morning.