RHIZA & RICHARD

Re-examining the Exceptions to the 'Corporate Veil':

Ong Leong Chiou & Anor v Keller (M) Sdn Bhd & Ors
[2021] MLJU 393; [2021] 3 MLJ 622

The principle of 'corporate veil' is fundamental to the foundation of company law. It is a legal fiction propounded in the eminent case of *Salomon v A Salomon & Co Ltd (1897) AC 22* ('*Salomon*') being the idea that a company has a legal identity separate and independent from that of the individuals behind it, such as its directors, shareholders and investors. When a company is incorporated, there is in effect a 'veil' of incorporation which shields the owners. Its purpose is to restrict or limit personal liability of businesspersons and entrepreneurs in their acts on behalf of their companies by instituting corporate capacity and liability, thereby stimulating business initiatives and growth.

As expected, some will jump at the opportunity to misuse such a convenient legal protection to hide their misdeeds behind the façade of a 'company'. It is no surprise that certain legal exceptions to the principle of separate corporate personality are recognized to prevent abuse. The principle cannot be used for fraudulent, dishonest, or unlawful purposes. Courts are allowed to disregard or 'pierce' the corporate veil in primarily such circumstances to remove this identity, reveal the perpetrators and impose liability, though with only limited discretion to do so to safeguard the ruling in *Salomon*. The present appeal sought to challenge the well-established circumstances in which a corporate veil can be lifted or pierced.

The Salient Facts

In a shopping mall construction project, the main contractor sub-contracted works to a company ('B') who in turn sub-contracted to a company ('C') who then sub-contracted to a company ('R') who performed the actual works. An individual ('A') was said to be the 'mastermind' behind the companies B and C. Company R was the complainant in the present case and the respondent of this appeal. The contract between C and R for structural works to be done included earth bore works that would not be paid for but was represented otherwise by A on behalf of the newly incorporated C. Certain information regarding price and payment guarantee were requested but not provided to R but it relied on A's promises. Upon completion, the ownership of the assetless company C was transferred to some other party unrelated to the project.

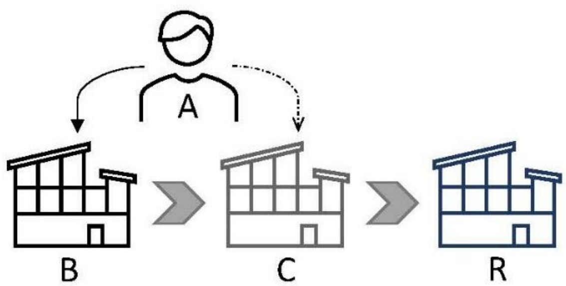

Figure 1 - The Parties

Figure 1 shows the relationship between the parties. R had a contractual relationship only with C. When C disappeared, R sought to recover payment for the earth bore works by asking the court to pierce the corporate veil of C and B to claim against A. The High Court found in favour of R who executed all the works involved, relying on A's representation that full payment for all works would be made. The parties A, B and C were found to be jointly and severally liable for R's loss and the corporate veils of B and C were ordered to be lifted in light of fraud. A and B appealed. The Court of Appeal affirmed the High Court's decision.

The Federal Court in the present appeal firmly rejected the appellants' request to revisit the findings of facts in the lower courts. It focused on considering and reviewing the doctrine of lifting or piercing a corporate veil and answering the legal questions presented.

The Challenge – *Prest*

The appellants, A and B, based their argument on the English Supreme Court case of *Prest v Prest and others* [2013] 4 All ER 673 ('*Prest*') which introduced a two-pronged approach to the doctrine of lifting or piercing the corporate veil. The *Prest* approach differentiates between '*lifting'* and '*piercing'* of the veil, corresponding respectively with the two prongs being (1) the concealment principle, a façade exception; and (2) the evasion principle, a fraud exception. This is further explained in the next section. The appellants argued that the lower courts' judgments were wrong because they did not follow *Prest* and had misapplied the test in allowing the piercing of the corporate veil. The appellants contended that the judges were therefore wrong in finding joint liability.

Separate from the matter above, the actual appeal questions that the Federal Court had to address were (1) whether the court can lift or pierce the corporate veil where there are two or more wrongdoers who injure or harm another ('joint tortfeasors'), and thus if the doctrine can be used to find wrongdoers jointly liable; and (2) whether the 'single economic unit' test, being the theory that the overall business operation of two or more entities works as a single economic unit rather than separate legal identities, applies only to Industrial Court matters concerning employers and employees. These issues did not give rise to any major discussion in the lower courts.

The Response – Two Different Tests

The main discussion in the Federal Court judgment concerns when companies will be disallowed from relying on the principle of separate legal personality and the sort of misuse by individuals that will allow the court to disregard the corporate veil. Much of the judgement delivered by Nallini Pathmanathan FCJ was an analysis of *Prest* to ascertain the correct and proper interpretation of the principles and limited circumstances justifying the piercing of the corporate veil. The crux of the Court's response is that there are two distinct ways in Malaysia to establish such a justification, being (1) by reason of fraud; and (2) the evasion principle in *Prest*.

1. Fraud

The learned Judge endorsed the famous old saying that *'fraud unravels everything'* and was of the view that the existence of fraud alone is sufficient to justify piercing the corporate veil. The Judge seemed to favour this first simpler, more well-established test that where the corporate personality is being abused for the purpose of wrongdoing, with facts evidently pointing towards fraud, this in itself justifies disregarding the corporate veil.

The Judge had no difficulty finding fraud in the present case involving A, B and C. It was clear the scheme was fraudulent, justifying liability being imposed on all the parties involved. The reasoning adopted by the Court was that B and C were utilized by A to enable the debt due to R to be evaded by B which was the first sub-contractor in the chain of contracts. Since works were actually completed by R, it was intended by A for B to enjoy the profits of the project without paying R the full costs of all the works. C was used as a 'sham' company to ensure R could not take action against A and B, but the fact that A was the one who induced R to contract with C shows an abuse of the corporate personality. Such a fraudulent scheme engineered by A was found to warrant lifting or piercing the corporate veil and led to the finding of joint and several liability.

2. Evasion Principle in Prest

That said, the learned Judge did not reject the two-pronged approach put forward in *Prest*. The Judge was welcoming of its adoption in Malaysia as a separate and different theory distinguishing between the concealment and evasion principle. The test expounded in *Prest* allows the '*piercing'* of the corporate veil *only if* the evasion principle is invoked.

Briefly, the evasion principle involves persons deliberately avoiding personal obligations by plotting a pretense of a corporate identity to manipulate another. This principle allows *piercing* of the veil to reveal the 'sham' to impose liability against the controller and any other related parties. It is essentially a fraud exception to the separate corporate personality principle, which does not seem to be different from the first general 'fraud' test. However, the Court made it clear that for this principle to apply there must be a legal right against the person in control of the company which exists independently of the company's involvement, and the company exists merely to block the right to enforce an action against that person.

On the other hand, the concealment principle is a façade exception, describing situations where a company is used as a deceptive front or 'face' to mask the actions of the persons behind. This principle does not involve piercing the corporate veil but merely *lifting* it to look behind the 'façade' of the corporation to unfold the truth. Wrongdoers under this principle do not have prior personal obligations towards a person whom they intend to cause damage to, therefore would require other legal principles such as the agency theory to impose liability.

Principle	**Concealment**	**Evasion**
Description	Façade, deceit	Sham, fraud
Obligation	Right exists via company's involvement	Existing personal independent legal right / obligation
Corporate Veil	Lift	Pierce

Table 2 - The Prest Principles

Table 1 contains a summary of the *Prest* principles. In practice, a particular situation may come under one or the other or both. Most of the time, there would be no difference in the outcome of a case regardless of its category. The difference lies in the reasoning adopted by the court in imposing liability on company owners. Applying to the facts of the present case, the appellants argued that the evasion principle was not invoked but again and unsurprisingly it was no struggle for the Judge to find that it was in fact applicable. The Judge explained that A, who was the controller of B, deliberately interposed C as a 'sham' company between B and R to evade liability of payment for the earth bore works. A was personally involved in the formation of the contract between C and R hence he is personally liable.

In exploring the possibilities of the *Prest* principles, the Judge said that the concealment principle would be used to unfold the truth behind B whilst the evasion principle would justify piercing the veil of C. Ultimately, the Court accepted the doctrine in *Prest* as an 'alternate rationale' but not without reservation. In both the UK and the Malaysian jurisdictions, the courts have yet to fully accept the two-pronged approach due to the dangers of forcing every factual scenario into two mere categories and seeking to exclude all other possible situations. Nevertheless, the veil of incorporation may be disregarded generally when there is fraud or when a corporation is set up to avoid an existing obligation or liability.

In substance and in practicality, it is the purpose and intent of a person for which he incorporates a company that matter. The Judge summarized in relation to the principle of separate corporate personality:

> *"[99] …the limitation of liability envisages that such future conduct of the company's business is to be conducted honestly and with integrity – the law is predicated on that assumption. Once honesty is abandoned and the company is utilized as a vehicle for dishonest conduct, or fraud, or unconscionable conduct, then the basis for the separate corporate personality is jeopardized and undermined."*

Leftover Matters

The two legal questions posed to the Federal Court was left at the end of its judgment, with the issues dismissed as being immaterial.

Firstly, the Judge held the concept of 'joint tortfeasorship', concerning injury caused to a person or property by two or more persons, was of no relevance in the present case involving a monetary loss arising out of fraud. The trial findings were premised not on tort principles but on fraud and unconscionable conduct on the part of A apart from a contractual claim against C. Secondly, the Judge held the lower courts did not use the term 'single economic unit' as a test to justify the lifting of the corporate veil but merely as a description of how the parties A, B and C were acting in support of the finding of fraud. The issue of whether the test would apply only to Industrial Court cases did not relate to the present case at all and was a purely academic exercise of which the Judge was reluctant to answer. In any event, the 'single economic unit' test alone cannot justify lifting the corporate veil and the law in relation to fraud and abuse of corporate personality is to be applied equally in any court.

Moving Forward

The Federal Court gave a clear reaffirmation of the principle of lifting or piercing the corporate veil based on fraud, being the main established test capable of justifying the court disregarding the veil of incorporation, but doubts continue to exist in relation to the approach in *Prest*. There is yet to be a resolution on the doctrine of veil piercing and the two prongs as the Judge had, at the same time, accepted the analysis of it and conceded its uncertainties in admitting that it ought not to be applied too rigidly.

In effect, this means that the doctrine in *Prest* will potentially be revisited and yet again be requiring clarification in a further case in future.

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