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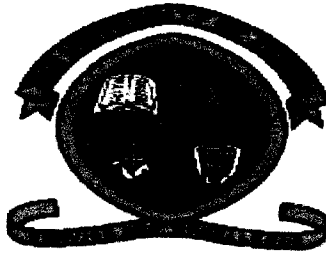
**A CRITICAL ANALYSIS OF THE CASE OF
KITWE SUPER MARKET LTD v SOUTHERN AFRICA TRADE LTD
2007/HK /243**

By

RICHARD MUMBA

(26129451)

**A DISSERTATION SUBMITTED TO THE UNIVERSITY OF ZAMBIA IN
PARTIALFULFILLMENT OF THE REQUIREMENTS FOR THE AWARD OF THE
BACHELOR OF LAWS
DEGREE (LL.B)**



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2007/HK/243

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ABSTRACT

In Zambia and even United States the concept of incorporation was adopted from English Company Law. The doctrine of the veil of incorporation was demonstrated in 1897 in the case of *Salomon v Salomon & Co. Limited*. The purpose of incorporation is to separate an individual from legal liability of the company. Once a company is incorporated it becomes a distinct and separate person from those that subscribed for its formation. The directors and shareholders of the company are therefore treated separately from the incorporated company, thus protecting the personal assets of owners and investors from lawsuits. The principle behind the veil of incorporation is what is referred to as limited liability that is that a company's creditors can sue the company in its name and directors and shareholders are only liable to the extent of the amounts unpaid on their shares.

This thesis discusses the case of **Kitwe Supermarket Limited v Southern Africa Trade Limited**¹, to determine whether non-disclosure by the Directors of the Plaintiff company's current registered office amounted to fraudulent trading necessitating the piercing the corporate veil and making the two Directors liable for the debt of the corporation.

Courts of law have erroneously deemed failure to disclose by the directors of the plaintiff company's current registered office a fraudulent trading. Hence there is an element of improper application of the principles related to the legal aspect of fraudulent trading

This research has made recommendations for the furtherance and strengthening of Zambia's jurisprudence. The recommendations cover all possible circumstances under which the corporate veil is threatened. In order to prevent lifting the corporate veil

¹ (2007) HK/243

therefore the Companies Act or a legislation should be enacted to provide for inclusion of formalities relating to holding initial meetings of directors and shareholders, prompt Corporate Tax payment, ensuring that there is prevention of mingling personal assets and those of the business, ensuring adequate business capitalization and display of the business name, just to mention a few.

DEDICATION

This research paper is dedicated to my beloved wife Bernadette Marigerita, children Buyamba, Lutanda, Dr Chibamba Ng'omalala Mumba, M'boo and my daughter-in-law Tikhale, grand-children Mubanga and Temwani. To my grandchildren, I would like to reiterate that there is no limiting factor to learning and that man with a bit of effort, acquires knowledge almost every day of his life. As for me I have just began learning how to learn. May The Almighty God continue affording you His love. I thank you for your tolerance and patience as I wish you lots of love.

ACKNOWLEDGEMENT

Firstly, I want to say how indebted I am to The Almighty God for bringing me this far, in all that I have done and failed to do, and above all for allowing me to continue with the programme.

My profound gratitude goes to Mr. Walubita Luwabelwa for his tireless surveillance of my dissertation, exceptional advice and his professional approach in order to bring this paper to an acceptable academic standard. In the same way, I would like to extend my sincere gratitude to Professor Mulela Margaret Munalula for her co-ordination of this project and her demonstration of just how best a piece of work can reasonably be done, and above all, for her dedication to duty.

May I also remember my friends and colleagues Haggi M Chomba, Makuwa Lusaka, Kenneth Mukela, Edward Chilufya, Henry Phiri, Eugene Chisenga, Michael Ndele, Mukela Situmbayeto, and William Musonda for both exciting academic and social interaction that I have enjoyed with them during this piece of work. I thank you all, and may the good Lord bless you abundantly.

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3. Foss v Harbottle, (1843) , 2 Hare 461, Foss and Turton: shareholders in a company called 'The Victoria Park Company
4. Investments Ltd v Winns Ltd, (1975) 2 SNWLR 666 at page 683
5. Prudential Assurance Company Limited v Newman Industries Limited, (No. 2) 1982
6. Macaura v Northern Assurance Company Limited, (1925) A.C. 619
7. Lee V Lees Air Farming Ltd, (1961)A.C 12 P.C
8. Underwood v Bank of Liverpool, (1924) 1 KB 775
9. Adams v Cape Industries Plc, (1990) Ch. 433
10. DHN Food Distributors v Tower Hamlets London Borough Council, (1976) 1 W.L.R 852
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14. Newstone Siulapwa v Food Corp Product Limited, (2002) Z.R. P.36
15. Gildford Motors V Horne Co. Ltd, (1933) I Ch 939
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17. Hayshem v Shayif & Anor, (2008) EWHC 2080 Mr. Justice Munby Friday 17th October 2008
18. VBT Capital Plc v Nutritek International Corp & Others, (2012) EWCA Civ. 808 (2013) UKSC 5, Lord Neuberger
19. McDowell & Co. Limited v C.T.O 1985, (1985) 2 Comp LJ 137 SC 114
20. Workmen of Association Rubber Industries Ltd v Association Rubber Limited, (1985) A SCC 114

DEFINITION OF WORDS

Alias	false or assumed identity
Consonant	in agreement or harmony with...
Sham false	a person or thing that is not what they are purported to be, bogus or false
Shell	outer covering
Dummy one	an object designed to resemble and serve as a substitute for the real one
Knavery	dishonest or unscrupulous
Sanctity	ultimate importance
<i>ratio decidendi</i> : (Latin: the reason for deciding) The principle of law on which the court reaches its decision	

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CHAPTER ONE

1.0 INTRODUCTION

1.1 A BRIEF OVERVIEW

A corporation or a limited liability company is a separate legal entity. A corporation is liable for its liabilities and not its owners, and a company can sue and be sued. The veil of incorporation can be lifted under common law through individual interpretations where it is employed for some illegal or fraudulent purposes, where it becomes necessary to determine the character of the company, where the trust or agency relationships are involved between a company and members, and where the interest of third parties are at stake. The corporate veil can also be lifted through statutory interpretation. Non-disclosure of the registered is not one of the grounds under which the corporate can be lifted. The companies Act not specific on this subject. Zambian laws are substantially based on the English received laws. In as far as the corporate veil doctrine is concerned; Zambia refers to the case of *Solomon v Salomon Co. Ltd* and the subsequent cases like *Macaura v Northern Assurance Co. Limited*¹. In *ZCCM & Ndola Lime Limited v. Sikanyika*², the Supreme Court for Zambia cited with approval the case of *Solomon v Salomon & Co Limited*.

The non-disclosure of the registered office may be legally fatal in that in the event of service of documents, the matter may be set aside for irregularity if service is made on a wrong registered office. The purpose of maintaining a registered office is to allow shareholders to view the records of the company or in the case of a public company the

¹ (2002) SCJ NO. 24

² (2002) ZR P36

public must have access to viewing records such as audited accounts before they can decide whether or not to invest in the company. The creditors and the state need to know, the whereabouts of the registered company.

In this thesis we will discuss the case of **Kitwe Supermarket Limited v Southern Africa Trade Limited**³, to determine whether non-disclosure by the Directors of the Plaintiff company's current registered office amounted to fraudulent trading necessitating the piercing the corporate veil and making the two Directors liable for the debt of the corporation.

1.2 STATEMENT OF THE PROBLEM

Courts of law have erroneously deemed failure to disclose by the directors of the plaintiff company's current registered office a fraudulent trading. Hence there is an element of improper application of the principles related to the legal aspect of fraudulent trading.

The mischief that must be cured is the treatment of non-disclosure of the relocation of the supermarket as fraudulent trading. This will be illustrated in several decided cases which will show clearly what is meant by fraudulent trading.

1.3 OBJECTIVES OF THE STUDY

The objective of this study is to analyze the application of fraudulent trading. Further, the object is to see to what extent the court is prepared to pierce the corporate veil when it feels that fraud is or could be perpetrated behind the veil. The common law courts have

³ (2007) HK/243

shown willingness to pierce the corporate veil in situations when separate corporate legal entity is simply a sham for the purpose of fraudulent trading.

The concept of disclosure is another objective to consider. When looking at this we will consider consequences behind non-disclosure of a company's direct Registered Office as required by our Company's Act.

There will be need to compare the concept of fraudulent trading and the concept of disclosure to see where they meet in any way as the basis of lifting the corporate veil as was the argument in the Kitwe Supermarket case. This thesis will require the application of jurisprudence both from Zambia and English legal systems to determine whether the court in this case was on firm ground in coming up with its *ratio decidendi*. The thesis will take an in-depth critic of legal issues and the arguments presented by both parties.

The system objectives will require;

- a) To investigate the various statutory provisions that the court may consider the discretion of power to lift the veil.
- b) To critically analyze whether the court correctly applied legal principles in this particular case for future speedy and balanced arrival at fair judgment.
- c) To propose recommendations for legal reform of the jurisprudence relating to lifting the corporate veil.

1.4 SIGNIFICANCE OF STUDY

It is of great importance to prevent unnecessary piercing of the corporate veil simply on the basis of fraudulent trading which is not clearly defined in the Companies Act.⁴ This will protect and safeguard the interests of employees, employers, suppliers and the state

⁴ The Companies Act Chapter 388 of the Laws of Zambia

to a large extent. Hence the research will endeavour to ensure that there are no gaps or lacunas especially in section 383(1) of the companies Act, by clearly defining what amounts to fraudulent purpose or trading. It is important to limit the doctrine of disclosure to matters where directors may with intention to deceive or disadvantage their creditors, workers, and the public at large who may have developed confidence dealing with the company for a long time.

This research will make a distinction between this work and that which has already been undertaken by previous researchers. Dissertations already done will be obtained from secondary source of information which will include text books from libraries, internet, and articles critiquing pieces of work or journals. In this light for example we have the following writers to refer to:

- a) **Mwanchela M Kakubo**. "Justification for Piercing the Corporate Veil" 2011 (LLM Thesis University of Cape Town). The writer puts forward what could be the justification for the purpose of piercing the corporate veil and gives several examples in which corporate veil could be lifted. He discussed the protection of the shareholders by the virtue of the principle of separate legal personality which affords them of protection for the company's actions or responsibilities. His research mainly dealt with the approach taken by labour courts to identify the true employer before piercing the veil of incorporation. This research seeks to establish whether non-disclosure of the registered office is one of the legal grounds for piercing the corporate veil.
- b) **Munalula V Lishimba**. "Corporate Law in Zambia – Its impacts on members, creditors and workers" (LLM Thesis University of Zambia 1981).

In this thesis the writer discusses the impact of company law in Zambia by bringing into focus the shareholders, creditors and workers and how they are affected by actions of corporate entities protected by the veil of incorporation.

- c) **Nigel Kalonde Mutuna**, “Corporate personality a concept that has little relevance”. (LLB Dissertation University of Zambia 1983/84).

The thesis discusses how corporate personality can be irrelevant when there are circumstances where the veil of corporation can be lifted. This research concentrates on non-disclosure of the registered office as one of the considerations for lifting the corporate veil in Zambia as compared with what is obtaining in England.

- d) **Salome Mukungule Chomba**, Piercing the Corporate Veil: A comparison between Zambia and Namibia: Companies Act 2004 of Namibia 2006 University of Zambia.

In her thesis, Salome tries to compare the two statutes of Zambia and Namibia and highlights the similarities. In this research the grounds of piercing corporate veil in Zambia is compared with the English jurisdiction.

- e) **Orn Philip**, “Piercing the Corporate Veil: A discussion on Principles of Limited Liability (LLM Thesis University of Lund (2009), Sweden.

Philip discusses the concept of corporate veil as the practice of disregarding the limited liability characteristic for a corporation in order to make its shareholders, either individuals or parent corporations’ answer for the corporation’s liabilities. The courts in the United States commonly employ the instrumentality theory, as well as

the alter ego and identify the doctrines these principles provide courts with methods of establishing whether the corporation can be considered a deception. Metaphors used include “sham”, “shell”, “dummy”, or “alias”.⁵ In this research all these concepts are considered to establish the basis of lifting the corporate veil in circumstances where there is non-disclosure of the registered office.

- f) **Yan Zhaoxin**, “Doctrine of Disregard of Corporate Veil: The Institute of Disregard Corporate Personality Judicial Application Native Studies”. 2009 U.K.

Yan says, in the present condition of authorities, a corporation will be looked upon by the courts as a legal personality, for ordinary business transactions as a general principle and until adequate reason to the contrary appears. The fiction will be disregarded and the law will look to see the men and facts behind the fiction whether it is employed to defraud creditors, to evade an existing obligation, to circumvent a statute or perpetuate monopoly, or to protect knavery and crime.⁶ In this research non-disclosure of the registered office is to establish if it is one of the circumstances for piercing the corporate veil.

Morse has written about ‘Company Law’,⁷ and has talked about the doctrine of piercing the corporate veil which is a similar concept obtaining in Zambia. The other two scholars, Alan Digman and John Lowry have also written about Company Law,⁸ relevant to the English and Zambian jurisdictions..

⁵ Orn Philip: Thesis on Piercing the Corporate Veil 2009 Sweden

⁶ Yan Zhaoxin; A Thesis on Doctrine of Disregard of Corporate Veil U.K 2009

⁷ Geoffrey Morse, Edid A. Marshall and Richard Morris, Company Law Thirteenth Edition, Liverpool Charlesworth’s 1987

⁸ Alan Digman and John Lowry, Company Law, London, The University of London, 2006

1.5 METHODOLOGY

This research will be a qualitative one and it will involve desk research. Further, it will require looking up information primary sources for example Zambian legislation e.g. the Companies Act or the Taxation Act, the British legislation , legislation from other Commonwealth countries, case law etc. The secondary sources will be from the books that have been written, scholar articles, internet and various commentaries and scholars publications on corporate veil.

1.6 Chapter Outline

Chapter 1

This chapter has given a brief overview of the problem. It has outlined the significance of the study and the intended objectives. A literature review of leading works in this area has been provided including a chapter outline.

Chapter 2

This chapter will deal with the law while referring to the issues in the case before us. This will involve analysing the arguments by both the plaintiff and the defendants with reference to the legal matters that arose in case of **Kitwe Supermarket Ltd v South Africa Trade Limited**.

Chapter 3

This chapter of the dissertation will make a comparison with one jurisdiction, in this case with the English jurisdiction.

Chapter 4

This chapter will make a critique of the case and make proposals based on the arguments from both the plaintiff and the defendants with reference to cases both in the Zambian and the English legal system.

Chapter 5

This chapter will give a general observation using jurisprudence both in Zambia and the English legislations to show whether the court was on firm ground in coming up with its *ratio decidendi*.

Recommendations for legal reform will also be given.

CHAPTER TWO

2.0 INTRODUCTION



2.1 A Brief History of Corporate Veil

Zambia follows the same corporate personality which was created by statute since the first half of the 19th Century.¹ The full significant of the provision was not appreciated until the famous case of *Salomon v Salomon & Co. Ltd.*,² in which Lord Halsbury LC stated (at 30-31): ‘....it seems to me possible to dispute that once the company is legally incorporated it must be treated like any other independent person with its rights and liabilities appropriate to itself, and that the motives of those who took part in the promotion of the company are absolutely irrelevant in discussing what those rights and liabilities are.’

Both **Kitwe Super Market Limited** and **Southern Africa Trade Limited companies** are incorporated or formed in accordance with the Companies Act of the Laws of Zambia.³ Once a company is incorporated, it becomes a legal personality, a juristic entity, separate and distinct from its members and shareholders,⁴ and enjoys or suffers the same merits or demerits. Once a company is incorporated it becomes a separate legal personality separate and distinct from its members who may have subscribed to its formation.

¹ John Dewey, *The Historic Background of corporate Legal Personality* 1926 and Warner Fuller, *The Incorporated Individual: A study of One Man Company* 1938

² (1897) A.C. 22

³ The Companies Act, Chapter 388 of the Laws of Zambia

⁴ Amin George Forji, *The Veil Doctrine in Company Law* September 28th. 2007

The rule in **Foss v Harbottle**,⁵ states that in order to address a wrong to a company or to the property of the company, or to enforce rights of the company, the proper plaintiff is the company itself, and the court will not ordinarily entertain an action brought on behalf of the company by a shareholder. It must be noted in the case of **Kitwe Super Market Ltd** that its legal personality is separate from the two directors, until sufficient reason to the contrary appears when the law will disregard the corporate veil

By limited liability is meant that the liability of members is limited to unpaid up amounts on shares. In the case of companies limited by guarantee, members are only liable up to amounts they have undertaken to pay in the event of the company winding-up. Nevertheless a company does not enjoy a limited liability in its dealings with outsiders. In the case of **Kitwe Super Market Limited v Southern Africa Trade Limited**, the plaintiff must simply pay the debt owing to the defendants.

Since a company is a separate legal entity, it can be sued and can sue in its name to enforce rights. Of course there are instances when members can sue on behalf of the company. This simply means, although members may die or change in certain circumstances, a company continues for a foreseeable future. A company being a separate legal person can own and dispose of property. A corporate entity is entitled to pursue its own actions independent of its shareholders. It means also that a

⁵ (1843) , 2 Hare 461, Foss and Turton: shareholders in a company called 'The Victoria Park Company

company can contract legally with its members. An individual can be its principal and can also be its employee. A company often has a separation of powers between management and shareholders. According to Samuels JA, in *Winthrop Investments Ltd v Winns Ltd*⁶, he said:

The shareholders may have, ultimate control, because they can alter the articles or remove the directors: but they cannot interfere in the conduct of the company business where management, as here, is vested in the board....they have no general power to transact the company's business, or to give effective directions about its management.

2.2 The Salomon Veil

The veil of incorporation established in the case of *Salomon v Salomon & Company Ltd*⁷ is a fundamental principle of law which has consistently been adhered to for many centuries that a company is an independent legal person distinct from its members who came together and subscribed to the memorandum. It was observed in the Salomon case that a "company is at law a different person altogether from the subscribers to the memorandum and though it may be that after incorporation, the business is precisely the same as it was before and the same persons are managers and the same hands receive the profits the company is not at law the agent of the subscribers or a trustee for them. Nor are the subscribers as

⁶ (1975) 2 SNWLR 666 at page 683

⁷ (1897) A.C 22

members liable in any shape or form except to the extent and manner provided in the Act.”⁸



It was held by Blayney J in the decision of the English Court of Appeal in **Prudential Assurance Company Limited v Newman Industries Limited**⁹, that :

The plaintiffs shares are merely a right of participation in the company on terms of the Articles of Association. The shares themselves, his right of participation, are not directly affected by the wrong doing. The plaintiff still holds all the shares as his own absolutely unencumbered property.

A separate legal entity concept can be seen in a number of situations. In **Macaure v Northern Assurance Company Limited**¹⁰, the appellant was the owner of a timber estate which he had assigned to a company called Irish Canadian Saw Mills limited. He had a majority shareholding in the company. He insured the timber in his own name. The timber was destroyed by fire, hence he claimed on the policy. The insurance company repudiated liability on grounds that the appellant has no insurable interest in the timber. The timber was not his; it belonged to the Irish Canadian Saw Mill Limited. This demonstrated that the company was a legal person different from individual persons who subscribed shares to incorporate the company.

⁸ Ibid Lord Macnaghten

⁹ (No. 2) 1982

¹⁰ (1925) A.C. 619

Another interesting case law can be formed in the case of **Lee V Lees Air Farming Ltd**¹¹, in which there is an illustration of refusal to lift the veil. Lee had formed the company for the purpose of carrying on his business of aerial topdressing. He had owned all shares in the company and was the sole governing director. In addition, he was employed as the chief pilot of the company. Under insurance against liability to pay compensation under the workmen's compensation Act, he crashed in the plane and died. The lower court ruled that the widow could not be compensated as her husband was not considered as a worker or servant of his own company. The decision of the lower court was reversed by the higher court holding that Lee and his company were distinct legal entities in a contractual relationship in which he worked as *qua* chief pilot and a servant of the company. The principle of the corporate personality allowed him to be master and servant at the same time and has the advantage of both worlds.

An incorporated company is a legal person with independent existence. A company can file suits against others in its own name. No action can be maintained in the company name without its authority nor can a shareholder or director be an appropriate plaintiff in action to redress any transgressions against the company.

In **Foss v Harbottle**¹², it was held that since the company's board of directors was still in existence and since it was still possible to call a general meeting of the company, there was nothing to prevent the company from obtaining redress in its

¹¹ (1961) A.C. 12 P.C

¹² (1843), 2 Hare 461

corporate character and the action by the plaintiff could be sustained. For a wrong committed against the company, the appropriate person to sue is the company itself and not a shareholder or anybody else. A company entity is entitled to pursue its own action independent of its shareholders.

A corporation or limited liability company has rights and obligation distinct from its directors or shareholders. As a separate entity it is eligible to own a bank account separate from its directors and shareholders. In **Underwood v Bank of Liverpool**¹³, Underwood, a merchant, had a banking account at the defendant's bank. The company had a separate account at another bank. He later converted himself into a limited company. He received several cheques, some crossed and others uncrossed. He endorsed these cheques as "ALU Limited-ALU Sole director," and paid into his own account with the defendant, instead of paying them into the company's account with the other bank. An action was brought by the company on behalf of the debenture holder for conversion of the cheques. It was held that the defendant bank was negligent as the company was a separate legal entity and entitled to all the cheques to be deposited in its own bank account and not in the personal account of Underwood.

The concept of separate legal personality applies equally with groups of companies. One of the leading Judges, Lord Justice Slade in the case of **Adams v Cape Industries Plc**¹⁴, described subsidiary companies as being separate legal entities with all the rights and liabilities which attach to separate legal entities albeit in one sense being creations of their parent companies. The court of appeal held that an

¹³ (1924) 1 KB 775

¹⁴ (1990) Ch. 433

English trading company should only be treated as having present and a possible a party to an action abroad if it had established a fixed place of business there at its own cost and either it or its representative had carried on business there for more than a minimum time. Cape industries marketed its products in the United States, but did not establish a fixed place of business here. The corporate veil could not be pierced merely because a group of companies operated as a single economic unity in terms of business reality.

In contrast to Cape Industries case, in **DHN Food Distributors v Tower Hamlets London Borough Council**¹⁵, the trading premises were compulsorily acquired. But given that the premises in question were owned by a wholly owned subsidiary of the company, the local authority employed the **Salomon** principle to contend that the business of the owner had not been disrupted. The Court of Appeal, led by master of Rolls Lord Denning unanimously held that it was entitled to look at the realities of the situation and left the corporate veil. The same question of single economic unit arose in the case of **Amaka Agricultural Development Company Ltd v Madison Insurance Co. Ltd.**¹⁶

2.3 The **Earliest Recognition of the Principles of Corporate Personality**

Although the principle of corporate personality appears to have been more referred to the **Salomon case**, it is a principle which came up much later as compared to the

¹⁵ (1976) 1 W.L.R 852

¹⁶ 2000/HP/0665

Indian case referred to as **Kondoli Tea Co. Limited**¹⁷. If allowed to compare, the Indian case came up eleven years than the Salomon case. In *Re. Kondoli Tea Company* eight gentlemen were owners of the Tea Estate which they transferred to a company they had incorporated. They owned all the shares in the company. On the transfer of the Tea Estates to the company, they sought exemptions from payments of certain transfer costs including the *advalerom* stamp duty. Their main argument was based on the fact that the transfer of the Tea Estate was from their hands to their hands as they were the sole owner of the company to which the estate was transferred and that they were not entitled to pay stamp duty.

The holding of the court was that the company that was incorporated was a separate legal entity from the eight individual's that owned the Tea Estates.

2.4 Recognition of Separate Corporate Legal Entity in Zambia

The separate legal personality in Zambia can be seen from several cases. The decided cases in our courts have cited with approval the case of **Salomon v Salomon and company**.

For example in the case of **ZCCM and Ndola Lime Ltd v Sikanyika and others**¹⁸. The Supreme Court of Zambia cited with approval the case of Salomon and company. The court held that the change of ownership of shares in the company could not result in the corporation entity becoming a new employer. In this

¹⁷ (1886) I.L.R. E.R 13 Calcutta 43

¹⁸ (2002) Z.R. SCJ No. 24

particular sense our courts have recognized the principle of a company as separate legal entity or persona. In **Newstone Siulapwa v Food Corp Product Limited**¹⁹, it was emphasized that an incorporated company has separate legal personality from those owning it.

2.5 **Liability on shareholders of an insolvent company**

The issue arises when a plaintiff seeks to impose liability on shareholders of an insolvent company.²⁰ In the case of **Kitwe Super Market Limited**²¹, the liability of shareholders will be limited to unpaid amounts on their shares, but if this notion is abused to defeat public convenience, justify wrong, protect fraud, or defend crime, the law will regard the corporation as a mere association of persons.

The armour or protective means of personal immunity generally shields people doing business as a corporation from corporate obligations. This principle of corporate veil has been described as **an antiquated doctrine** in that the protection can be pierced and personal liability imposed when a controlling shareholder operates the corporation as an “alter ego” for wrongful purposes or as a sham or facade used to evade creditors or commit fraud.²²

In Salomon case, the court stated that the principle was to be applied provided that there was “no fraud and no agency” and only ‘if the company was real one and not

¹⁹ (2002) Z.R. P.36

²⁰ Mark Cohen, The Cohen Law Group P.C. 1942, Brief History of Piercing the Corporate Veil, 18.04.2010

²¹ U.S v Milwaukee Refrigerator Transit Co., 142F.247 9C.C.E.D Wisc. 1905)

²² A statement by Hinkson, Mark R. Wisconsin Lawyer, Vol. 79, No. 2 February 2006

a fiction or a myth.”²³ As earlier alluded to, a company is treated as a separate legal entity distinct from its promoters, directors, members and employees and this is the more reason why we have the concept of the corporate veil separating those parties from the corporate body. The doctrine of piercing the corporate veil was **created to prevent injustice**.²⁴ As such the application of the doctrine has always been fact-specific and open-ended. Justice requires a flexible legal standard that allows room for weighing equality and policy considerations.

2.6 Piercing the corporate veil in Zambia

In Zambia, we have several circumstances that lead to the lifting of the corporate veil. It will be worth while to look at the sections of the Act that deal directly with those circumstances.

The companies Act provides lifting the corporate veil under express statutory provides and it is under those instances where the directors, members or officers of the company will be personally liable apart from the liabilities related to the company. This situation does not interfere with the corporate status meaning the legal personality is maintained. Legal personality will be disregarded to prevent some injustice being perpetuated against third parties and in turn protect the violation of the statutory law or common law.²⁵

²³ Lord Halsbury LC

²⁴ Lynn Gallagher & Pecar Zieggler , Lifting the Corporate Veil in Pursuit Justice, 1990. Bus.L, 292, 293

²⁵ Supra Note 1 page 1

2.6.1 Membership falling below the minimum

It is a requirement that in the private company, there should be a minimum of two shareholders. In a public company the minimum number is fifty. Section 26 (1) of the Companies Act stipulates that if at any time the number of members of the company is reduced below two and it is seen that it carries on business for more than six months without the minimum number of membership, a member or director of the company who was aware of the fact that fewer than two members carried on business shall be severally liable for the payment of debts and liabilities of the company incurred after the end of the period of six months. Of course this will be in addition to the liability of the company already incurred.

Section 47 of the Act imposes criminal sanctions on each member or officer of the private company. In respect of the public company, it must have a minimum of two members and **at least make an offer to act least fifteen persons. Section 26(1) applies also** to the public company.²⁶

2.6.2 Operating before issuance of Certificate of Incorporation

A public company may not operate until the certificate is issued and that the minimum capital requirement has been complied with or satisfied. Section 15 of the Act provides that a public company shall not transact in any business or exercise any borrowing powers or incur any indebtedness until and unless the Registrar has issued it with the certificate under this provision.²⁷

²⁶ Supra Note 3

²⁷ Supra Note 3

2.6.3 Fraudulent Trading

In terms of section 383 of the Act, it is provided that were in the process of winding up of the company, the court may on the application by the liquidator or a member of a company make an order that any person who was knowingly a party of carrying on business with a fraudulent purpose will be held liable for a debt or liability of a company.

The court will not allow the corporate veil to be pieced, except in certain circumstances and will act 'reluctantly,' 'cautiously,' or only in 'exceptional circumstances.'²⁸ The offence of fraudulent trading makes a person guilty under section 384 of the Act.²⁹ There must be proof that there was intention to defraud the defendant company.

2.6.4 Disclosure of the change of Registered Office or Address

A Registered office under section 190 (1) of the Act, is referred to as the place, the physical address of which was indicated in the application and notices must be served on this office and any improper services of documents will render the matter to be set aside as required by the Companies Act.³⁰ The company may change its registered office or registered address by lodging a notice with the registrar as required under Section 190 (2).³¹

²⁸ Leonard v McMorris, 63 p.3d 323 (Colorado. 2003)

²⁹ Supra Note 3

³⁰ The Companies Act Chapter 388 of the Laws of Zambia

³¹ Supra Note 3

In the case of the Kitwe **Super Market Ltd v Southern Africa Trade Ltd**, the plaintiffs John Coutlis and Helen Coutlis owned the previous trading premises in their own names before relocating to undisclosed trading offices. The question that remains is whether there was **intention to defraud** the defendant company.

2.6.5 **Failure to Lodge Resolution with Registrar of Companies**

The Act shifts personal liability on the members or officers if it is established that there was failure on their part to lodge resolution with the Registrar of companies. Under section 8 of the Act, if a company passes a special resolution approving its articles it should within 21 days lodge the same with the registrar together with a copy of each paragraph of the articles affected by the amendment to the registrar. In event of failure to comply with those provisions makes every officer guilty of an offence under section 380. The company that fails to furnish such information renders itself or its officers liable to prosecution.³²

2.6.6 **Misstatement in the Prospectors**

A Prospectus is document initiated by a public company inviting offers for the purchase of shares by various investors. This document must be accurate from the very start in as far as information is concerned. Section 129 of the Act states that there are civic liabilities for misstatement or omission in the prospectus to pay damages³³.

³² Supra Note 1

³³ Supra Note 13

2.6.7 Failure to pay Tax under Income Tax Act

The Income Tax also provides instances when the corporate veil can be pierced for the failure to honour tax payments under section 103.³⁴ The Director General would disregard the distinct legal personality of a parent or a subsidiary company. Under this Act, any person who was the director, secretary or manage will be liable to persecution. The court will lift the corporate veil in all circumstances where a company is formed to avoid meeting legitimate statutory obligations such as paying tax.

This example was illustrated in the case of **Gildford Motors V Horne**³⁵ in which the court of Appeal held that the former directors could not escape the restraint of Trade Provisions by hiding behind the company formed as a mere sham or cloak allowing him to commit a breach of covenant.

2.6.8 Under Common Law individual interpretations

The veil of incorporation may be lifted on the ground of illegal or fraudulent purposes, where it is necessary to determine the character of the company, where there is a trust or agency relationship between a company and members and where the interest of third parties is at stake. The court will pierce the corporate veil

³⁴ The Income Tax Act Chapter 323 of the Laws of Zambia

³⁵ (1933) 1 Ch 939

under common law through individual interpretation of these four circumstances as provided by law.



2.7 **British System on piercing the corporate veil**

In English Courts, it has been observed with interest the difficulties they face in arriving at judgment through such metaphorical terms such as “Mere Fraud”, “Sham”, “Dummy”, “After Ego”. This confusion extends to countries like United States and Australia. Zambian courts too face similar situations more so that they follow English laws in a majority cases.

2.8 **Circumstances which lead to the lifting of the corporate veil in Britain.**

Under the British system, the corporation veil can be lifted under the common law, mainly through individual interpretation of case law. As earlier cited the courts will lift the corporate veil on the merit of the facts of each case. Hence case law gives courts valuable guidance when passing judgments. In 1985 a judgment of the court of Appeal declared that: “In our view the cases show that the court will use its power to pierce the corporate veil if it is necessary to achieve justice irrespective of the legal efficiency of the corporate structure.”³⁶

The court of Appeal in the case of **Adams v Cape Industries Plc**³⁷, held that the English Courts will not treat a trading corporation incorporated under the law of one country as present within the jurisdiction of another unless it has established and maintained at its own expense a fixed place of business there for more than a

³⁶ Gower, L.B.C page 125 Fifth Edition 1992

³⁷ Supra Note 9, page 4

minimum time there or carried on its business there for more than a minimum time.



There are at least four examples under the British system when the veil can be lifted under common law through individual interpretations as follows:

- (a) The corporate personality can be lifted where this is employed for some illegal or fraudulent purposes.
- (b) The veil can be lifted where it becomes necessary to determine the character of the company.
- (c) The corporate veil can be pieced where the trust or agency relationship are involved between a company and members.
- (d) Further the veil may be lifted where the interests of the third parties are at stake.

2.8 CONCLUSION

A company is a person in law and therefore must have domicile and nationality. A company nationality is determined by reference to the country of registration. Section 190 (1) provides that a registered office is the physical address where all communications and notices must be communicated. In the case of service of documents the matter may be set aside for irregularity. Further, Section 190 (2) provides for notification of the change of postal address or change of the registered office specifying the date of change.

There is also civil liability under Section 26 of the Companies Act where the company ceases to have at least two members. Finally, Section of the Companies Act provides for civil liability for fraudulent trading by a person who was a party for carrying on business for fraudulent purposes. It seems there must be cogent evidence that there was non-disclosure of the change of the registered office for the purpose of fraudulent trading.

CHAPTER THREE

3.0 INTRODUCTION

This chapter will delve into the legal principle that exists between the corporation or the limited liability company and those that subscribed to the company formation. Consideration will also be made in respect of the group of companies and when the parent and the subsidiary companies can be treated as a single economic unit or separate legal entities. Further. The chapter will also look at lifting the corporate veil under Statutory Provisions, under Common Law through individual interpretations, alternative approaches against abuse of limited liability and finally the tests the court considers before lifting the corporate veil.

3.1 Legal Principle Between the Company and Owners

When the company is lawfully incorporated, it attains a legal personality and identity which is separate from its directors or shareholders. In other words, it becomes a separate legal person and possesses separate legal rights and liabilities.

In many circumstances, the courts are very hesitant to pierce the corporate veil in order to make the directors or shareholders in their individual capacity liable for the debts and obligations of their respective companies.

3.2 Legal Principle between Group of Companies

The legal principle above also applies to those groups of companies in that the parent and the subsidiary companies are treated as separate legal entities in

respect of which the corporate veil can only be lifted where there is sufficient evidence that the company is a sham or façade or where an Act of Parliament provides for this situation¹.

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3.3 Willingness of Courts in England to lift the veil

The courts in England however, may be willing to lift the corporate veil where the relevant test has been satisfied.. In England, the court in exceptional cases may exercise its discretion to pierce the veil. In the latest case of Caterpillar Financial Services (UK) Limited v Saenz Corporation Limited, Mr. Karavis, Egerton Corp. & others², the applicant which was a financial institution advanced loans to the first and second defendant companies for the purpose of the acquisition and construction of two yachts. The first and the second defendants defaulted under the loan agreements. The claimant made demands on the first and second defendants and subsequently terminated the loan agreement.

Demands were also made on each of the guarantors of the loans. Throughout the proceedings, the guarantor had asserted that the property was owned by the fourteenth defendant company and that he had no beneficial interest in it. The claimant, in its application had maintained that had it been presented with these facts, it would not have considered advancing the loans without sufficient security from the company, which would have allowed the claimant to pursue the company and ultimately enforce a judgment against the property in the event of default.

¹ Claire Milne Partner Corporate and Commercial Piercing the Corporate Veil

² (2012) EWHC 2888 (COMM), 5 September, 2012 Mr. Justice Eder

The tenth and sixteenth defendants were alter ego corporate vehicles of the third defendant, who directed and controlled the actions of the companies³. This allowed a judgment to be obtained against the defendant to be enforced against certain assets of the company, because the relevant test had been satisfied by the court. The Guarantor was receiving bank documents on behalf of the company showing the guarantor was directing and controlling the company.

There are three situations where the veil is lifted by the court: application of the terms of a statute or a contract or as a matter of common law.

3.4 Statutory Lifting of the Corporate Veil

The British Companies Act 2006⁴ governs and deals with every aspect of company law, but it does not provide for lifting the corporate veil. Instead of making shareholders personally liable, it prefers to enlarge the scope of the rules where directors and other officers are made liable for their wrongful acts.

In parallel with the British Companies Act 2006, ss 213-217 of Insolvent Act 1986⁵, and s. 15 of the Company Directors Disqualification Act,⁶ deals with these figures of a company by imposing liabilities where there is a wrongful or fraudulent trading, improper re-use of an insolvent company's name or breaching of a disqualification order⁷.

³ Paul Dean, Partner, Paul, Dean @hfw.co, assisted by Trainee Nicola Arthur, HFW Maritime

⁴ The British Companies Act 2006 Chapter 46 of the Laws of England

⁵ The Insolvency Act 1986 Chapter 45 of the Laws of England

⁶ The Company Directors Disqualification Act 1986 s. 15

⁷ L.S Sealay and David Milman, Company Directors Disqualification Act 1986: EC Regulation on Insolvency

The courts have tendency of reserving the separate legal personality of companies especially after *Solomon v Solomon & Co. Ltd*⁸, which has entrenched the limited liability principle for all companies, be it large or small. Tendency which was consolidated in *Macaura v Northern Insurance Ltd*⁹ and *Lee v Lee's Air Farming*¹⁰.

3.5 At Common Law

The judicial decisions based on neither a statute nor the terms of a contract, the doctrine of limited liability is challenged by more general arguments such as the single economic unit, the company being a façade or sham, the agency argument the interests of justice and impropriety. These arguments were discussed in *Adams v Cape Industries*¹¹ and held that each company in a group of companies is separate legal entity possessed of separate rights and liabilities.

By contrast, in *DHN Food Distributors Ltd v Tower Hamlets London Borough Council*¹² the court held that the group of companies should be treated as a single economic entity and that compensation for disturbance of business should be paid to the owner even though it was just the owner of the land but not the vehicle.

⁸ (1897) A.C. 619

⁹ (1925) A.C. 619

¹⁰ (1961) A.C. 12

¹¹ (1990) 2 W.L.R. 659

¹² (1976) 1 W.L.R. 852

3.6 Alternative Approaches

One of the alternative approaches against abuse of limited liability would be putting the doctrine of the lifting of the corporate veil on a statutory footing so that the courts would have a guide to follow instead of establishment rules, that might be preventing the flexibility of the courts while facing the complex issues which would not be foreseen by the terms of the statutes. This would be less harmful than having ambiguous rules. Moreover, a statutory provision would encourage the courts against the Solomon principle when it requires.

The courts of England take into account a number of tests before they can consider whether to pierce the veil or not. These tests were recently demonstrated in *Hayshem v Shayif & Anor*¹³ and *VB Capital Plc v Nutritek International Corp & Others*¹⁴.

3.7 Tests that are considered by Courts in before lifting the corporate veil

i. Ownership and Control

The court would consider ownership and control which will not in themselves be sufficient to permit the veil to be pierced. There must be something more that the guarantor is doing. For example in the case of a guarantor is doing. For example in the case of a guarantor, the court must prove that he was able to receive bank documents on behalf of the company. The court in certain circumstances must prove that there is a connected third party and to do so will be in the interest of justice.

¹³ (2008) EWHC 2080 Mr. Justice Munby Friday 17th October 2008

¹⁴ (2012) EWCA Civ. 808 (2013) UKSC 5, Lord Neuberger

ii. **Impropriety by the Directors**

In the case of impropriety by directors or shareholders, there must be sufficient evidence that they have been directly involved in the financial malpractices to the detriment of the company and other with interest in the company. Impropriety alone is not adequate evidence of financial irregularities by directors or shareholders. There must be impropriety, so linked in order to conceal a liability through the use of the company set up or structure.

iii. **Intention of the Wrongdoers**

The court will also consider the intentions of the wrongdoers before piercing the corporate veil. It must be shown that they controlled the company to the extent that it was applied as a façade to conceal their financial malpractices to disadvantage those with direct interest in the company.

iv. **Company being Used as a Facade**

The court will want to see that the company was being used as façade at the time of the relevant transaction and remedy will only be granted in respect of a particular and known wrong being perpetuated by directors or shareholders.¹⁵

In order to show that the corporate structure has been engaged as a device to camouflage impropriety, the impropriety must first be identified by the court.

¹⁵ 'Corporate Veil' : When will it be pierced, where the relevant test has been satisfied, the courts have shown

willingness to pierce the veil. Paul Dean

3.8 Conclusion

This chapter has shown that the court will allow the claimant to obtain judgment against assets that were intentionally placed out of their reach. These cases will remain exceptional in the English situation. The arguments based on lifting the corporate veil have only been allowed by the courts in England in very rare cases where there has been proof of evidence that the company has been operating as a sham for improper purposes.

The next chapter looks at the circumstances under which the court will lift the corporate veil both in the English and the *Zambian* legal systems.

CHAPTER FOUR

4.0 INTRODUCTION

The court¹ will only pierce the corporate veil where circumstances show cogent evidence that the corporation owners are involved in disadvantaging their clients¹.

There must be intention on the part of the directors or shareholders of the company to deny their clients of what is legally due to them.

The current position in England is that creditors are protected by Statutory Provisions concerning the lifting of the veil. Parliament in England has always authorised to enact exceptions to the Salomon principle and has done so several times. The courts therefore have to accept that even though the principle of separate entity may cause injustice, unless Parliament in its Act provides so, the court should not interfere. A crucial exception enacted by Parliament in the United Kingdom is section 213 of the 1986 Insolvent Act.²

4.1 Disclosure requirements

On the question of non-disclosure by the directors of the plaintiff company's registered office in accordance with section 190 (2) of the Act,³ there is indication that the directors were found, but there is no evidence to show that they were about to flee from the country in which case this would have amounted to fraudulent act.

¹ "...where the notion of legal entity is used to defeat public convenience, justify wrong, protect fraud or defend crime, the law will regard the corporation or association of person." *U.S v Milwanke Refrigerators Transit Co.* (1905) 142 Fd 247, 255

² Anna Farat & Denis Micho Germany & Cardiff respectively 2011-2013

³ The Company Act Chapter 388 of the Laws of Zambia

4.2 **Mixing company asset with those of the directors**

The argument by John Countlis that the premises at which they carried on business were ⁴never owned by the plaintiff company, but by the two of them as director in their private capacities is correct. If this is the case, then their company Kitwe Supermarket Limited can be assumed to have been renting the premises from the two directors. This clearly shows that an incorporate company is a separate legal person with entity separate from those who own the corporation⁴. The two directors are not supposed to mix company assets with their own personal assets. The separate legal entity as was demonstrated in the Solomon case is similar to the cases below.

In *Macaura v Northern Assurance Co. Limited*⁵, the owner of the Timber Estate assigned it to a company known as the Irish Canadian Saw Mills Limited in which he was virtually the sole shareholder. The timber was lying on his land. He insured the timber in his own name against fire. The timber was destroyed by fire.

The court held that the owner as a mere shareholder in the company has no insurable interest in the timber which was insured⁶. The timber belonged to the Irish Canadian Saw Mills Co. Limited. Lord Summer stated: "It is clear that the plaintiff had no insurable interest in the timber so insured, it was not his, it belonged to the Irish Canadian Saw Mills Co. Ltd. He had no lien of security in the timber and though it lay on his land by his permission.

⁴ Vaughan William at first instance, *Broderip v Solomon* (1895) 2 Ch 323, 329 "Either the company was a legal entity or it was not. If it was, the business belonged to it and not to Mr. Solomon. If it was, there was no person and nothing to be an agent at all."

⁵ (1925) AC 619

⁶ *Tate Access Floors Inc v Boswell* 1991 ch. 512 per Browne-Wilkinson V-C at 531, "If people choose to conduct their affairs through the medium of corporations, they are taking advantage of the fact that in law those corporations are separate entities..."

In Zambia the common law courts have followed the same reasoning. In *ZCCM & Ndola Lime Ltd v Sikanika & Others*⁷, the Supreme Court for Zambia cited with approval the case of *Solomon*. The court held that the change of ownership of shares in the company cannot result in the corporation entity becoming a new owner. In other words therefore, the court recognized the doctrine of a company as separate legal entity. In the case of *Newstone Siulapwa and Others v Food Corp. Products Limited*⁸ the applicant workers sought a declaration that there has been change of employers without their consent when all the shares were held by the food corporation after purchase of Zamhort Products (Z) Limited. The workers applicants contended that there had been disadvantageous conditions and therefore the employers were in of the contract and claim damages.

Ngulube C.J, stated that the change of ownership of shares in the company cannot result in the corporate entity becoming new employer, therefore recognizing the principle of separate legal person.

In United States and in particular in Colorado⁹, they have the following steps for maintaining personal asset protection and avoiding piercing the corporate veil.

i. **Separate Existence of Business from Owners**

Owners of a corporations and Limited Liability Companies must take steps to show that the business exists separately from the owners. The two are separate

⁷ (2002) ZR SCJ No. 24

⁸ (2002) ZR P36

⁹ Lidstone Jr H.K 2010, Colorado Limited Liability Company Act Article 80 Title 7

legal entities with separate legal right to own property and maintain actions in their individual names.



ii. **Corporations must adhere to Strict Formalities**

Corporations and limited liability companies have strict formalities they must follow. They must create and regularly update bylaws, issue shares of stock to owners (shareholders) and maintain a stock transfer ledger, hold both an initial and annual meetings of both directors and shareholders, undertake any annual filings required by the state, in a timely manner, pay the necessary filing fees.

Recommended formalities includes issuing membership certificates to owners, keeping a membership transfer ledger, and holding both initial and annual meetings of the members and managers, if your limited liability company is manager-managed.

iii. **Documentation of Major Business Actions**

The maintenance of documents for major business decisions is necessary. For example, it important to keep a record of signed contracts that the company entered into for future reference. There is need to keep formal business documents for at least seven years.

iv. **Avoid mingling Company Assets with those of the Company**

Don't comingle business and personal assets. Keep business assets separate from the assets of the owners. Have a business checking account and business credit

card and only use these for business expenses. Also keep assets such as equipment and property separate.

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v. **Ensure adequate business capitalization.**

The business will need finances, equipment and items necessary both starting and continuing operations. Keep in mind, this capital needs to be designated to your business and not to you as an individual.

Companies go bust due to the lack of adequate Business Capitalization. A company must have money to buy company replacement of equipment and assets for the start of and to continue operating. The company may save this money, accept money from others and make them business owners or raise money through a business loan facility. In absence of adequate capital a company may not survive. This capital is directly designed to your business and not to the company directors or shareholders.¹⁰

vi. **Make your corporate or limited liability company status known.**

It is important to create business cards that display the name of your Corporation and Limited Liability Company. The name must clearly be displayed for easy identification. It is a legal requirement to display the business name. The business name must be displayed in a conspicuous place of the registered office. If there is any change in the place of registered office, it is a requirement that the Registrar of Companies is notified in accordance with the law.

¹⁰ Ruth Carter, Avoiding Piercing the Veil August 9, 2012, How to Avoid Piercing Corporate Veil and Maintain Personal Asset Protection for your LCC, HR and Payroll Software www.sageVIRpayroll.com/Zambia SageHR and Payroll Systems Are Made for Business in Zambia

vii. **Payment Control System**

Make purchases and pay invoices via a business checking account or credit card.

There must be a creation of invoices in the company name to send to clients.

viii. **Contracts and Leases should be in the Company Name**

Also, any contracts, leases and or documents you sign should be in the company name.

ix. **Prompt Corporate Tax Payment**

A company should always ensure payment of Corporate Tax timely and must not permit tax evasion as this is very serious crime under tax law of any country.

It is necessary to comply with filing annual returns and pay appropriate corporate tax

If a judge cannot distinguish between what belongs to the business and what belongs to the owner and the owners cannot provide proof that all formalities have been followed it may be deemed that you're acting more like a sole proprietorship or general partnership than a corporation or a limited liability company.

4.3 **Exception: Veil Lifting on Fraudulent Trading**

The question in the Kitwe Supermarket case is whether the sale of stock in trade at discounted prices and sale of any assets was done dishonestly. One may be inclined to think that may be they were raising funds to meet their debts. Is there any evidence of money being remitted into their offshore accounts? If the answer is yes, then we can say they intended to avoid paying the defendant. If the answer is no, then we cannot say there was intention to disadvantage the defendant. There

is no doubt courts will pierce the corporate veil where there is evidence of fraud, but they are very cautious in arriving at such a decision.



In the **Kitwe Supermarket case**, the plaintiff is under a legal duty to disclose how they were applying the proceeds of sale, as the defendant company was an interest party wishing to recover its huge debt from them.

There was an incorrect argument on behalf of the plaintiff company in *Ethiopia Airline v Sunbird Safari*,¹¹ that the court refused to pierce the corporate veil on alleged fraudulent activities of the directors but only proceeded on the ground that the business was carried on by less than two members as required by section 26 (1) of the Act¹². In actual fact the 3rd respondent who was the managing Director of the respondent company was held personally liable for allowing the company to trade fraudulently through their 1st respondent. The corporate veil was lifted and the managing director was made personally liable for debts and obligation of the company.

The law will lift the corporate veil under statutory provisions and under judicial interpretations.

a) Under Statutory Provision

The Companies Act provides that, at any particular time the number of members should not fall below two. Section 26(1) of the Act provides for this requirement.

¹¹ (2007)ZR 235

¹² The Companies Act Chapter 388 of the Laws of Zambia

Fraudulent trading is a criminal offence, punishable under section 383 of the Act¹³ or under section 103¹⁴. In *McDowell & Co. Limited v C.T.O 1985*¹⁵ it has been held that the taxpayer cannot be allowed to run away with any sham transaction.

b) Under Judicial Interpretation

Where a company is formed for illegal or fraudulent purpose, the corporate veil will be lifted. In *Workmen of Association Rubber Industries Ltd v Association Rubber Limited*,¹⁶ the court disregarded the existence of a separate legal entity for the purpose of computing bonuses due to the employees. In this case, the company which was making a fair amount of profits formed a subsidiary company in order to split the profits of the company so as to reduce its liability to pay bonuses to its employees.

Further, in *Guildford Motors v Horne Co. Ltd.*¹⁷, it was held by the court of Appeal that the director could not escape the restraint of trade provisions by hiding behind the company formed as a mere sham or cloak for purpose of enabling him to commit a breach of covenant.

4.4 Avoid piercing the corporate veil

A limited liability concept is a means of protection of company owners against piercing the corporate veil. There is every risk of the owners standing to lose this

¹³ The companies Act Chapter 388 of the Laws of Zambia

¹⁴ The income Tax Act Chapter 323 of the Laws of Zambia

¹⁵ (1985) 2 Comp LJ 137 SC 114

¹⁶ (1985) A SCC 114

¹⁷ (1933) 1 Ch 939

status if they don't take the necessary steps to maintain the protection to remain unshaken. There is separate and distinct difference between the owners and corporations or limited companies. These companies are incorporated so that they have the legal protection of owing assets in their own legal capacities, although this cannot be absolutely guaranteed. The following are some of the protections of legal entities.

4.5 **CONCLUSION**

The court will be more inclined to pierce the corporate veil in circumstance where it cannot distinguish between the assets belonging to the business and what belongs to the owners in their personal capacity. Further, the court will pierce the corporate where there is no proof that all formalities have been followed as provided for by the law. The court may deem these actions as though they are of a sole proprietor or a general partnership than a corporation or a limited liability company. Piercing the corporate would result in applying your personal assets to make good your plaintiff who may have made the claim on your company.

CHAPTER FIVE

5.0 English and Zambian Jurisdictions Compared

Both under the English and Zambian jurisdictions piercing the corporate veil are either through the statutory provisions or under the common law individual interpretations. The English Companies Act¹ provides for the limited liability of corporation and not for piercing the corporate veil. Instead in English law, the Insolvency Act² provides for circumstances under which the corporate veil can be lifted. Section 213 of this Act specifically states that “(i) If in the course of winding up of a company it appears that the business of the company has been carried out with intent to defraud creditors of the company or creditors of any other person, or for any fraudulent purpose, the following has effect:

(ii) The court, on the application of the liquidator may declare that any persons who were knowingly parties to the carrying on of the business in the manner above-mentioned are to be liable to make such contributions (if any) to the company’s assets as the court thinks proper.”³

In Zambia, the Companies Act and the Income Tax Act provide provisions under which company’s veil can be lifted. Under Section 383⁴ and the Income Tax Act⁵, corporation veil can be lifted, if one was knowingly a party to the carrying on of business with fraudulent purpose. The word fraudulent purpose can be construed as carrying on business with the intention to deny creditors or creditors of any

¹ The Companies Act 2006

² The Insolvency Act 1986

³ Re Maidstone Building Provision Ltd (1971) 1 WRL 1085

Re Augustus Bernette & Son Ltd (1986) BCLL 170

Re Patrick Lyon Ltd (1933) Ch 786 Maugham J

“actual dishonesty involving, according to current notions of fair trading among commercial men, real moral blame.”

⁴ The companies Act Chapter 388 of the Laws of Zambia

⁵ The Income Tax Act Chapter 323 of the Laws of Zambia

other person. This statement is similar to that which is contained in the English Insolvency Act. The court on the application of the liquidator may declare that any persons who were knowingly parties to be carrying on the business in the manner amounting to fraudulent trading be liable to make contributions to the company's assets as they think proper. In the case of *Kitwe Supermarket Limited v Southern Africa Trading Ltd*, lifting or piercing the corporate veil was based on non-disclosure of the relocation of the registered office as required under Section 190 (2) of the Act. The court did not consider circumstances that made the plaintiff company to relocate to another place, because if they tried to do that, they would have found out that the true position. The other consideration could have been the intention of the plaintiff company. In the English situation, there are tests that are applied before the corporate veil is lifted.

5.1 Observations on Lifting the Corporate Veil

Firstly, ownership and control of a company are not sufficient in themselves to allow the veil to be pierced, there must be something more. Lifting the corporate veil must be on the evidence of impropriety, but impropriety alone is insufficient. There must be evidence that the impropriety is linked to avoid or conceal a liability through the use of the company set up or structure.

For the court to pierce the corporate veil in the UK the wrongdoers' intentions may be considered and it must be shown that they controlled the company and used it as a façade to conceal the wrong doing. The court would want to prove that the company was being used as a façade at the time of the relevant transactions and a remedy will only be provided in respect of the particular wrong that has been committed. In order to show that a corporate structure has been as a

device to conceal impropriety, the impropriety must first be identified by the court.

5.2 **RECOMMENDATIONS**

Considering the various circumstances that contribute to the lifting of the veil it is prudent to pass a legislation that would provide protection to company assets. The importance of this assertion is that any move by the court to pierce the veil would take into account the omissions that may have been committed by the shareholders or the directors. These factors should be clearly stated in the Act to avoid ambiguity when the courts are interpreting the law. In this light therefore the following factors will be of great help.

5.2.1 **Important Formalities**

The law must state clearly that a company must adhere to important formalities by updating company by-laws related to such as holding initial and annual meetings of both directors and shareholders.

5.2.2 **Payment of Appropriate Corporate Tax**

A company must pay appropriate corporate tax and submit annual returns promptly in order to protect it from payment of penalties which not even allowable when computing corporate profits liable to tax. Most companies wind up due to incurring unnecessary expenses which can be easily avoided. Tax avoidance is allowable and legal while tax evasion is illegal and attracts penalty.

5.2.3 Mingle of Personal Assets with those of the Company

There is need not to mingle personal assets with those of the company. A company is a legal person and can hold assets and liabilities in its own name it can sue and be sued just like a natural person.

5.2.4 Display of Company's Name

The business name of the company must be displayed in a conspicuous place of the registered office. This a name under which the business of the company is conducted.

5.2.5 Documentation of Business Actions

All business actions must be documented for future reference and must be maintained for a stipulated legal period.

5.2.6 Ensure adequate Business Capitalisation.

A company must maintain adequate finances to buy new equipment or replace absolute assets for efficient of operation of the company business.

Failure to comply with the above restrictions the court will have a cogent reason to lift the corporate veil.

The factors above are not exhaustive and require further research by comparing with what is obtaining in other countries. Courts in the United Kingdom and the United States of America follow similar steps outlined above.

5.3 CONCLUSION

As a general rule, a corporation or a limited liability company is a legal person. When the notion of a legal entity is used to defeat public convenience, justify wrong, protect fraud, or defend crime, the law will regard the corporation as a mere association of persons. The doctrine of piercing the corporate veil exists to prevent abuse of the legal personality where it is used as a vehicle for fraudulent activities. In the case of **Kitwe Supermarket Limited v Southern African Trading Limited**, the court relied on the non-disclosure of the company's registered office as a reason for lifting the corporate veil. The Companies Act does not clearly state non-disclosure of the registered office as one of the reasons for lifting the corporate veil. Contact can be made through the postal address which the court did not look at. There was no consideration of whether the plaintiff company had intention to defraud the defendant company.

The court overlooked the action taken by the plaintiff especially in the circumstances of the economic hardships that the majority companies were going through. One would be interested to know what happened after the court ordered lifting the corporate veil. The question is, did Southern Africa Trading limited recovered in full the total value of their debt after the judgment had been passed? If the answer is in the affirmative, the next question is, where did the funds come from to have made good their debt. The possibility could be that the two directors were all out to raise money to pay their debt. The court did not exhaust all possible reasons that may have attracted lifting the corporate veil. It is good law if piercing the corporate veil is based on the actual intention by the directors to defraud their creditors or creditors of any other person.

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