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Life Without Salomon

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Life Without Salomon

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ABSTRACT

This study presents a quantitative assessment of Salomon case; a mythology has developed around the case that has resulted in the Salomon principle exercising an iron grip on company law. This research paper is an attempt to understand the causes and consequences of life without the Salomon case. It points that upon incorporation, a company becomes a separate entity and distinct from its members. The doctrine of corporate personality as establish in the case of Salomon v Salomon & Co Ltd[1] still remains relevant in today's business world. The rigid application of the principle in Salomon's Case to corporate groups has enabled corporate groups to structure themselves in ways that limit the tort liabilities of the group as a whole; thus raises important social, economic and ethical questions regarding the allocation of risk that are not addressed by the application of the Salomon principle. Thus, this article suggests that given the importance of the social, economic and ethical issues raised in cases of mass torts that consistently involve corporate groups, it is preferable that these issues are resolved by tort law.

Keywords: Salomon principle, corporate groups, liabilities, tort law.

[1] [1897] AC 22.

INTRODUCTION

Salomon case is the landmark case for a long time i.e. the keystone of modern company law. It is generally seen as a landmark decision. Life without Salomon's case seems inconceivable. The story of Salomon's case is, in fact, so well ingrained in our sensibilities that we all know the story of the unravelling of modern company law and the crucial role the decision by the House of Lords in Salomon v Salomon & Co Ltd[2] plays in that story. The rigid application of the principle in Salomon's Case to corporate groups has enabled corporate groups to structure themselves in ways that limit the tort liabilities of the group as a whole and so raises important social, economic and ethical questions regarding the allocation of risk that are not addressed by the application of the Salomon principle. This article suggests that given the importance of the social, economic and ethical issues raised in cases of mass torts that invariably involve corporate groups, it is preferable that these issues are resolved by tort law, which is concerned with the allocation of risk, thereby circumventing the dead hand of Salomon.

[2] [1897] AC 22.

ANALYSIS

THE WAY OF IMPORTANCE OF THE DECISION IN SALOMON CASE

The house of Lords decision in this case Salomon v Salomon & Co Ltd is accorded either to its determination of the question of whether a company is truly separate from its constituent shareholders or alternatively to its resolution in the affirmative of the legality of "one person" companies. Some commentators pointed to the importance of Salomon's case as in asserting an uncompromising literal approach to statutory interpretation.

In this case, the House of Lords had seen the truly modern implications of the corporate law for the first time. It also suggests its importance in the unraveling of the modern corporation's law, its landmark significance, is a fact that came after the event. The status of one person companies, the degree of separation of a company from its owners, the intentions of the founders of modern company law, the appropriate role of the State in corporate regulation and a host of other issues touched on by the Salomon case had been long debated in the commercial press and before specialist parliamentary committees. It needs to consider that, before the Salomon case the government recommendations recognized "one person" companies and the introduction of specific provisions in the Companies Act to provide for the different responsibilities of such corporations with respect to matters such as balance sheets and other obligations to the Registrar of Companies. Thus, even if the final decision in the Salomon litigation had been different there was a high likelihood that the government of the day would nevertheless have acted to confirm the legitimate status of such enterprises.

Basically, the importance of the Salomon case has two aspects. Firstly, it concerns the legal concept that a registered company is a separate legal entity and that is distinct from its shareholders and is to be treated as any other independent person with its own rights and liabilities. Moreover, the decision in Salomon was seen at the time, in narrower terms, as legitimizing the concept of the one person or private company[3], whereby a business controlled by an individual could be incorporated as a limited liability company that was separate from its shareholders with the result that the individual, as a shareholder, was protected from the

[3] 'The Private Origins of the Private Company: Britain 2013, Journal of Legal Studies

claims of creditors of the company.[4]Secondly, it signifies the evolution of company law. It is perhaps the most famous company law decision, in many respects it marks the beginning of the modem company law.

These two perspectives together, can observe the overall significance of the case. The importance of the separate legal entity concept in its own right is clear enough, but the fact that the case subsequently assumed its lofty status as a landmark company law case has made it difficult, and at times, virtually impossible, to challenge in principle. One of the core purposes of this paper is to revisit the decision in Salomon and to re-assess the mythology surrounding the case in light of its historical context, particularly the prior common law development of the separate legal personality concept, and the evolving commercial practices of 19th century Britain.

The most important modern consequences of this case is that the principle to corporate groups in situations where actions in tort have been brought against one or more companies within those groups.

Thus, the decision of Salomon case primarily concerns one person companies. Its subsequent application to corporate groups, with severe adverse effects, especially upon tort litigants and other involuntary creditors, was not contemplated by the courts or companies legislation at the time of the case.

THE GROWTH OF THE PRIVATE COMPANY

The separate legal entity concept was developed, both legal and commercial sense well before the Salomon case. Consequently, the status of Salomon as a landmark decision instrumental in the development of modern company law is difficult to justify. Nonetheless it can be said that Salomon confirmed the legitimacy of the 'one person' or 'private'[5] company. To assess the significance of the decision of Salomon case, it is important to gain an appreciation of the business context surrounding the case, especially the rise of the private and the 'one person' company. The minimum capital and disclosure requirements of previous

[4] Edward Manson, 'The Evolution of the Private Company' (1910).

[5] The term 'private' is used here as descriptive of a closed company restricted to a small number of shareholders.

legislation and enabled associations of at least seven members to incorporate. This made it much easier for small businesses to incorporate as limited liability companies.

The growth in company registration after 1870 highlighted two trends. Primarily, there was increased use of public companies to raise the necessary capital to implement technological and scientific advances and economies of scale. Secondly, there was also a large increase in registrations of private companies, as the realization sank in that limited liability could be utilized by closely held business enterprises in the increasingly volatile economic environment of the Great Depression of the last quarter of the 19th century[6]. The popularity of the private company form was that social and economic background to British business favored family controlled enterprise. In the 1880s there were speedily rising numbers of private companies such as Salomon & Co. Ltd, which took advantage of limited liability for their shareholders, but were not required to disclose their financial accounts. In that period of economic depression and falling profits, the business uncertainty seeks the protection of limited liability by incorporating a company and then entering into a sale of business to the company. The process of companies borrowing from the vendor of the business by means of a debenture secured by floating charge only needed to be registered at the company's registered office and other creditors could be kept unaware of the loan. by means of comparison, partnerships that borrowed had to publicly register details under the Bills of Sale Act 1878[7]. It was the effectiveness of this stratagem that was considered by the House of Lords in Salomon.

THE APPLICATION OF SALOMON'S PRINCIPLE IN CORPORATE GROUPS

As we have discussed, modern and subsequent commentary on the decision in Salomon was centred on the issue of the legitimacy of a private company. The implications that the decision might have for corporate groups, which is situations where a holding or parent company controlled a number of subsidiaries or related entities, did not appear to have been addressed.

It was only from the time of Salomon that corporate groups began to appear in the commercial scenery. Salomon was concerned with the legitimacy of the one-person company. Integrated corporate groups were relatively rare in the 1890s and so it was by no means certain

[6] 'freed the community at large from the tyranny of unlimited liability': Sir Francis B Palmer, 10th ed, 1892.
[7] Bill Of Sales Act 1878, the term of 'Bill Of Sale' is broadly defined in sec. 4

at the time that what became known as the principle in Salomon would be applied to company groups as they are understood today.

The another example of context of Salomon case is The Gramophone and Typewriter Ltd v Stanley[8]. In this case an English company which carried on business in the United Kingdom was the holder of all the shares in a German company. The German company made a profit and the question arose whether the profits of the German company were the profits of the English company such that the English company would be taxed on them. The court of Appeal proclaimed that none of the judgments referred directly to Salomon. This indicates that holding companies and their subsidiaries were clearly regarded as separate legal entities without the need to rely on Salomon as authority.

Even though Salomon did not deal with a corporate group, it later came to be applied in diverse circumstances involving groups of companies where a subsidiary was held to be a separate legal entity from its parent company and other companies in the group[9]. Conceivably, the most problematic area where the Salomon principle has been applied to corporate groups is where tort claimants seek to recover damages from a holding company or companies in a group other than the tort fear company. An agency relationship between a holding company and its subsidiary was construed in Smith, Stone and Knight Ltd v Birmingham Corporation[10] where a local government authority sought to compulsorily acquire land occupied by a wholly-owned subsidiary. In Spreag v Paeson Pty Ltd,[11] a subsidiary which held practically no assets made a number of misleading and deceptive statements regarding a product it advertised and sold that were in contravention of the Trade Practices Act 1974[12] and other consumer protection provisions. The strong hold exercised by the Salomon principle in the context of liability within corporate groups was reasserted in the United Kingdom case Adams v Cape Industries PLC[13].

CORPORATE GROUP TORT LIABILITY

The conflict raised by the application of Salomon principle to corporate groups is basically heightened where the creditors concerned are tort creditors, as important public policy

[8] [1908] 2 KB 89.
[9] , Ebbw Vale Urban District Council v South Wales Traffic Area Licensing Authority [1951] 2 KB 366.
[10] [1939] 4 All ER 116.
[11] (1990) 94 ALR 679
[12] Competition and Consumer Act 2010 section 18.
[13] [1990] 1 Ch 433

issues then arise concerning who should bear the losses resulting from negligent or risky behaviour[14]. The holding company anticipates that, should substantial liabilities accrue in the future from the carrying on of such risky activities, the other companies in the group will be insulated from liability on the basis that they are separate legal entities.

The application of the Salomon principle to corporate groups is especially problematic because holding companies have the freedom to establish subsidiaries and decide upon the size and financing of the various legal entities in the group, and to draw the boundaries between them[15].

Recent developments in tort law have seen a number of cases where the duty of care has been extended to impose liability on holding companies for injuries caused to employees of their subsidiaries[16]. These cases indicate that the Law of negligence and corporate law have contradictory responses in cases of corporate group tortfeasors. The law has been more responsive than company law to the social, economic issues raised in tort cases. The application of tort law in these circumstances recognizes that holding companies are generally able to control the business activities of their subsidiaries, implement appropriate risk management strategies and reduce the risk of harm to employees and users of their subsidiaries' products. The principle in Salomon generally presents an impossible obstacle. The main aims of tort law are compensation of deserving victims. The social and economic issues raised in the cases discussed above are better resolved by tort law principles which directly address these issues, rather than according to corporate law principles which developed in a very different context and for entirely different purposes.

[14] Briggs v James Hardie & Co Pty Ltd (1989) 16 NSWLR 549.
[15] Lynn M , 'The death of liability' 1996, Law journal.
[16] CSR Ltd v Wren (1997) 44 NSWLR 463

CONCLUSION

After the above discussion, we can see that the Salomon decision is a landmark case of modern company law. Salomon V Salomon & Co Ltd[17] is a marker of relatively a different sort than is usually considered to be the case the decision in Salomon brought about no significant change in the direction of the law or commercial practice, because the concept of a company having a legal personality separate from its shareholders; had already been largely developed in both legal and commercial sense by the time the case was decided. Corporate groups were little known at the end of the 19th century and thus it was not within the contemplation of the Law Lords who handed down the decision in Salomon. The application of the Salomon principle to corporate groups has enabled the controllers of corporate groups to limit tort liabilities to certain companies in the group and thereby insulate the rest of the group from actual and potential liabilities. The importance of social and economic issues rose in cases of mass torts involving corporate groups and preferable these issues are resolved by torts law rather than the dead hand of Salomon.

Life without Salomon may now be inconceivable. We can live perhaps on romantic dreams that life without Salomon may also have been better, but given the nature of vested interests surrounding the corporate form at the end of the 19th century that seems unlikely.

[17] 1897] AC 22.

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