

# COMPANY LAW FOR PROPERTY LITIGATORS

*by*

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*Clear Channel UK Ltd v. Manchester City Council* [2006] 04 EG 168 (whether advertising hoarding licences are business tenancies);

*Coors Holdings v Dow Properties* [2007] NPC 37 (construction of rent review clause)

*Coleman v. Ibstock Brick Ltd* [2008] EWCA Civ 73 (mineral rights).

*Progress Property Co v. Moorgarth Group Ltd* [2008] EWCA Civ (whether undervalue transaction with shareholder ultra vires)

*Menolly v. Cerep* [2009] EWHC 616 (Ch) (construction of building contract and specific performance of development agreement)

*Colour Quest v. Total* [2009] EWHC 540 (trial of issues of liability arising out of explosion at Buncefield oil depot)

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## The consequences of corporate personality

The most fundamental idea of a company is that it is a legal entity in its own right. In this respect it differs from a partnership which has no separate personality to that of the individual partners. A company is different from and not to be identified with its shareholders

What follows from this is that the property, assets or liabilities of companies are not the property, assets or liabilities of their shareholders.<sup>1</sup> Even if the company has only one shareholder who is also its director, the shareholder is not personally liable for the company's debts. Nor can the shareholder be said to have any proprietary interest at all in property owned by the company.<sup>2</sup>

In certain circumstances the court will 'pierce the corporate veil', that is look behind the separate legal identity of the company and treat the shareholder and not company as responsible for its acts. However the circumstances in which it will do this are extremely limited. Two cases must be distinguished. First where the question is whether under a particular statute the assets or liabilities of a company are to be treated as those of its members, the question depends on the policy of the Act. The courts will very rarely construe an Act as designed to ignore corporate personality in this way.<sup>3</sup>

Secondly at common law there are limited circumstances in which corporate personality may be ignored in order to treat the assets and liabilities of the company as those of the shareholder. The precise circumstances in which this can occur are unclear. However there is only clear support for lifting the corporate veil where the corporate structure was a 'mere facade for concealing the true facts'. The mere fact that corporate personality has been used in order to enable the shareholders to have the economic benefit of ownership of the undertaking but without the disadvantages of personal liability is not enough.<sup>4</sup> It might nevertheless be possible to argue in a given case that the company has acted as agent for the shareholders but it is extremely unlikely that this would succeed on the facts.

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<sup>1</sup> *Salomon v. Salomon & Co* [1897] AC 22

<sup>2</sup> *Short v. Treasury Commissioners* [1948] 1 KB 116, 122

<sup>3</sup> See eg. *Lee v. Lee's Air Farming Ltd* [1961] AC 12

<sup>4</sup> *Adams v. Cape Industries plc* [1990] Ch 433

There are other cases which appear on their face to lift the corporate veil on the grounds of impropriety. Where a director of a company wrongfully diverts company assets into another company which he has set up, the courts have treated the director as personally liable on the grounds that the second company is a facade.<sup>5</sup> A better explanation for cases such as this however is that a director is in breach of duty as much by misappropriating a company asset for himself as for a third party. Accordingly it is not necessary to rely on the doctrine of piercing the corporate veil.

### **Reviving a company that has been dissolved**

The life of a company, like a natural person, can come to an end. In the case of a company it is called dissolution. But unlike a natural person there are circumstances in which it can be brought back to life again. There are two ways in which this might be done.

Where the company has been struck off for failure to file returns or the like<sup>6</sup> an application may be made to the Registrar of Companies to restore it.<sup>7</sup> The application may however only be made by a director or former member of the company<sup>8</sup> within six years of the dissolution<sup>9</sup> and with the consent of the Crown<sup>10</sup> since the property of a dissolved company vests in the Crown as bona vacantia.<sup>11</sup>

Where a company has been dissolved in other cases (such as following the conclusion of an administration or winding up) or where an application is made by any other person such as the owner of land in which the company had an interest or a creditor of the company, an application to restore the company to the register must be made to the court.<sup>12</sup> Again the application must generally be made within six years of

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<sup>5</sup> *Gencor ACP Ltd v. Dalby*[2000] 2 BCLC 734.

<sup>6</sup> see s.1000 Companies Act 2006

<sup>7</sup> s.1024 CA 2006

<sup>8</sup> s.1024(3) CA 2006

<sup>9</sup> s.1024(4) CA 2006

<sup>10</sup> s.1025(3) CA 2006

<sup>11</sup> s.1012 CA 2006

<sup>12</sup> s.1029 CA 2006

the dissolution.<sup>13</sup> The effect of restoration is that the company is deemed never to have been struck off or dissolved and the court can give consequential directions for putting the parties in the same position as if the company had not been dissolved.<sup>14</sup> However if the Crown, in which property has vested as bona vacantia in the meantime has disposed of property, that disposition is not set aside but the Crown is required to pay the net proceeds of sale to the company.<sup>15</sup>

Under the former law there was a distinction between a company which ceased to exist after being wound up and a company which was removed from the register by an administrative act of the Registrar. On restoration, acts done in the meantime in the former case (such as for example bringing or defending proceedings) were not retrospectively validated whereas in the latter case they were.<sup>16</sup> Although the point remains undecided the better view is probably that this distinction has been eliminated by the Companies Act 2006 and that in all cases such acts are retrospectively validated.<sup>17</sup>

In a similar way to the liquidator's power to disclaim onerous property on a winding up<sup>18</sup>, the Crown may disclaim onerous property which is vested in it on dissolution and there are similar provisions as to the effect of such disclaimer and as to the power of the court to make a vesting order.<sup>19</sup>

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<sup>13</sup> s.1030(4) CA 2006

<sup>14</sup> s.1032 CA 2006

<sup>15</sup> s.1034 CA 2006

<sup>16</sup> *Top Creative Ltd v. St. Albans District Council* [2000] 2 BCLC 379

<sup>17</sup> But cf. *Gower & Davies: Principles of Modern Company Law* 8<sup>th</sup> ed p1233 fn.132

<sup>18</sup> ss.178-182 Insolvency Act 1986

<sup>19</sup> ss.1012-1018 CA 2006

## **When does a company know or intend something?**

One difficulty posed by attributing legal personality to a company is that it is not immediately obvious how a company is to know or intend something. This is relevant for example to establishing the grounds of opposition to a new business tenancy under s.30(1)(f) and (g) of the Landlord and Tenant Act 1954. The courts have developed rules of attribution of knowledge and intention which seek to chart a way between two extremes. On the one hand one might create a wide rule of attribution depending on the principles of vicarious liability and agency. On the other hand one might limit it to what the principal organs of the company, that is the board of the directors or the shareholders in general meeting, knew or intended.

The test was originally formulated as one of seeking to identify who was the directing mind and will of the corporation.<sup>20</sup> But the most recent formulation requires one to consider who, as a matter of construction of the statute in question, is to be regarded as the controller of the company for these purposes.<sup>21</sup>

## **When does an act done purportedly on behalf of a company bind the company?**

There are no special formalities required to be observed by a company entering into a contract. It may do so by writing using its common seal (if it has one) or by a person acting on its behalf.<sup>22</sup> A document is executed by a company if its seal is affixed to it, if it is signed by a director in the presence of a witness or if it is signed by two directors or by a director and the secretary.<sup>23</sup> If a document purports to be signed in this way then in favour of a purchaser (which includes a lessee and mortgagee) for good faith for valuable consideration who acquires an interest in property the document is treated as being properly executed.<sup>24</sup>

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<sup>20</sup> *Lennard's Carrying Co Ltd v Graham & Sons* [1957] QB 159

<sup>21</sup> *Meridian Global Funds Management Asia Ltd v. Securities Commission* [1995] 2 AC 500

<sup>22</sup> s.43 CA 2006

<sup>23</sup> s.44 CA 2006

<sup>24</sup> s.44(5) CA 2006

It was formerly a concern of third parties dealing with companies that the transaction might be void on the basis that the company did not have capacity to enter into the transaction. The objects clause in the memorandum of association of companies was drafted in wide terms in an attempt to overcome this problem but it still proved on occasion to be a trap for unwary. It is no longer possible for a transaction to be struck down on this ground (save in the case of charities as to which special provision is made<sup>25</sup>) and it is specifically provided that the validity of an act done by a company cannot be called into question on the ground of lack of capacity by reason of anything in the company's constitution.<sup>26</sup>

The question of when an act purportedly done on behalf of a company binds a company depends in the main on general principles of agency and of vicarious liability. The company will therefore be responsible for acts of persons with actual or ostensible authority to act on its behalf and of employees in relation to acts which are sufficiently connected with their employment. Even if the act is unauthorised however the company in general meeting or by a unanimous resolution of its shareholders may ordinarily ratify it.

One complication however arises from the fact that at common law a third party dealing with a company is treated as having constructive knowledge of the company's articles and thus of any restrictions contained in it as to the authority of the agent purportedly acting on behalf of the company. The effect of this rule has been ameliorated both by statute and at common law however.

By statute it is now provided that 'in favour of a person dealing with a company in good faith, the power of the directors to bind the company, or authorised to do so, shall be deemed to be free of any limitations under the company's constitution.'<sup>27</sup> Further it provides that a person is not to be regarded as acting in bad faith merely because he knows that the act is outside the power of the directors under the articles. The section is however subject to limitations. It does not apply to charities<sup>28</sup> or to dealings between

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<sup>25</sup> s.42 CA 2006

<sup>26</sup> s.39 CA 2006

<sup>27</sup> s.40 CA 2006

<sup>28</sup> s.42 CA 2006

the company and its directors or persons connected with those directors.<sup>29</sup> It is also limited to capacity affecting the power of the directors and so would not appear to have any application where the third party has not been dealing with the directors but with some other person purportedly acting on the company's behalf although, in such a case, if the person in question purported to act as a director reliance might be placed on another statutory provision which states that the acts of a person acting as a directors are valid despite any defect in this appointment, or that he was disqualified from or had ceased holding office or that he was not entitled to vote on the matter in question.

If these statutory provisions cannot be relied on, the so called *Turquand* rule<sup>30</sup> might assist the third party. This provides that if on the face of the articles of association authority might have been conferred on the person purporting to do the act in question then the third party is entitled to assume that that authority had in fact been conferred. This helps the third party where the articles provide that something can be done only if a resolution is passed but does not assist where it contains an absolute prohibition on it being done. The rule does not apply where the third party is on notice of the defect in question.

### **Other circumstances in which transactions with third parties may be set aside**

There are other circumstances in which transactions with third parties may be set aside. If the transaction involves a transfer of assets by the company to a shareholder and the transaction is at less than market value then if there are not sufficient distributable profits to justify the distribution the transaction might be treated as a dressed up distribution of capital and would be void on the basis that it would infringe the common law and statutory rules as regards maintenance of capital.<sup>31</sup>

There have been long standing statutory rules preventing a company of its subsidiary from giving financial assistance directly or indirectly to a person acquiring or proposing to acquire shares in the company. Breach of the provision constitutes a

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<sup>29</sup> s.41 CA 2006

<sup>30</sup> *Royal British Bank v. Turquand* (1856) 6 E & B 327

<sup>31</sup> *Aveling Barford v. Perion* [1989] BCLC 626. As to the scope of the rule see *Progress Property Company Ltd v. Moorgarth Group Ltd* [2009] EWCA Civ 629. As to the statutory remedy see s.847 CA 2006.

criminal offence and renders the agreement unenforceable and any transaction entered into pursuant to potentially void. The question of when an agreement does amount to financial assistance is an exceedingly difficult one and has been the subject of much authority. However for practical purposes the rule is now of much less relevance since the Companies Act 2006 abolished the rule for private companies and it now applies only in respect of the public companies.<sup>32</sup>

The Insolvency Act 2006 contains provisions for setting aside transactions at undervalue or which amount to preferences and which are entered into up to two years before the onset of insolvency.<sup>33</sup> Even if the company is not and does not become insolvent provision is made to set aside transactions which are designed to defraud creditors.<sup>34</sup>

Provision is also made to set aside substantial property transactions entered into between the company and directors or persons connected with them without specific approval of the shareholders<sup>35</sup> although a third party who has acquired rights in good faith, for value and without notice of this contraventions and who is not party to the arrangement will be protected.<sup>36</sup>

### **Effect of directors' breach of duty**

A breach of duty by a director will give the company a claim to compensation against that director on ordinary principles.

However where the director is in breach of fiduciary duty (and not simply his duty of care) the company may alternatively claim any profit he has derived through the breach. A claim may similarly lie against any third party who was involved in the breach or who received any benefit derived from the breach under the principle of dishonest assistance or knowing receipt.

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<sup>32</sup> ss677 et seq. CA 2006

<sup>33</sup> ss.238-240 IA 1986

<sup>34</sup> s.423 IS 1986

<sup>35</sup> ss.190 & 195 CA 2006

<sup>36</sup> s.195(2)(c) CA 2006

In addition the company has a proprietary tracing claim in respect of the property and its proceeds that were disposed of by a director of a company in excess of his powers or in breach of fiduciary duty.

A contract entered into by company with a third party in breach of the directors' duties is voidable by the company subject to the rights of those dealing with the company in good faith.<sup>37</sup> A contract entered into by the directors in excess of their powers is void though a third party might be able to rely on protection afforded by s.40 of the Companies Act 2006 to dealings with directors.<sup>38</sup>

The Companies Act 2006 has codified the duties owed by directors to companies.<sup>39</sup> These statutory duties replace the common law rules but were not intended to effect any significant change in the nature of those duties<sup>40</sup>. The codification does not extend to the civil consequences of breach however to which the common law rules still apply.<sup>41</sup>

## **Company Charges**

There are two particular issues in relation to company charges which require special treatment.

First, companies frequently have floating charges over their assets. Although there is no conceptual problem in an individual granting a floating charge there would be insuperable obstacles in complying with the Bills of Sale Acts 1878 to 1882<sup>42</sup> and accordingly in practice floating charges are confined to companies to which the Bills of Sale Acts do not apply. The essential characteristic of a floating, as opposed to a fixed charge is that, until 'crystallisation' the company remains free to deal with the assets the

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<sup>37</sup> *Criterion Properties plc v. Stratford UK Properties* [2004] BCC 570

<sup>38</sup> *Guinness v. Saunders* [1990] 2 AC 663

<sup>39</sup> see ss. 170-177 CA 2006

<sup>40</sup> s.170(3), (4) CA 2006

<sup>41</sup> s.178 CA 2006

<sup>42</sup> which require inter alia that all the chattels the subject of the charge be specified in detail in a schedule

subject of the charge in the ordinary course of business.<sup>43</sup> Crystallisation occurs when a winding up order is made, and administrative receiver is appointed, the company ceases to carry on business, the debenture holder takes possession or any other event provided for in the charge.

In the absence of any express restriction contained in the floating charge, the company may create subsequent fixed charges which have priority to it. Any such express restriction is strictly construed and, even if it does prohibit a subsequent fixed charge, this will not bind a subsequent chargee of the legal estate without notice of the restriction. Notice of the floating charge whether given expressly or constructively by registration does not in itself constitute notice of the restriction on further charges. It is common to seek to effect notice of the restriction by including notice of it in the particulars of the charge registered at the Companies' Registry but it is uncertain whether or not this is effective.

Parliament has intervened to prevent floating charges having the priority over other creditors that other secured creditors have. Whether or not the company is in the course of being wound up, preferential creditors<sup>44</sup> have a prior claim to the assets the subject of a floating charge<sup>45</sup> and a certain proportion of the remainder goes to the unsecured creditors.<sup>46</sup> To prevent the directors getting any advantage from creating a floating charge when insolvency is in prospect there are restrictions on the validity of floating charges created within 12 months of the commencement of a winding up or of an administration order.<sup>47</sup>

Parliament has also intervened to restrict the usual remedy of a chargee to appoint a receiver. A chargee under a floating charge created after 15 September 2003 may not generally<sup>48</sup> appoint an administrative receiver (as a receiver appointed under a floating charge is called<sup>49</sup>) but instead is given a right to appoint an administrator.<sup>50</sup>

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<sup>43</sup> *Re Spectrum Plus Ltd* [2005] 2 AC 680

<sup>44</sup> being mainly claims by employees

<sup>45</sup> s.754 CA 2006

<sup>46</sup> s.176A IA 1986

<sup>47</sup> s.245 IA 1986

<sup>48</sup> See ss.72A-72H IA 1986 for the exceptions

<sup>49</sup> see s.29 IA 1986

Chargees under floating charges created before that date may take either course. The Insolvency Act 1986 contains detailed provisions regulating both the positions of administrative receivers and administrators.

The second aspect of company charges that requires particular treatment is Part 25 of the Companies Act 2006 which contains provisions requiring a company to register certain charges (which include both fixed and floating charges) with the Registrar of Companies. Only charges created by the company need be registered and so interests that arise by operation of law (purchaser's or vendor's liens for example) or interests that are not by way of charge (such as contractual liens) do not need to be registered. Charges over certain choses in action such as over company shares are also not included.

If a charge is not registered within 21 days of its creation it is void as against the liquidator, administrator or a creditor.<sup>51</sup> Although the creditor loses its security any money lent pursuant to the charge becomes immediately repayable.<sup>52</sup>

An application to the court may be made for late registration.<sup>53</sup> This application will usually succeed unless the company is already insolvent although it will be granted on terms that it is not to prejudice the rights of third parties acquired in the meantime.

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<sup>50</sup> IA 1986 Sch B1 para 14(1)

<sup>51</sup> s.874 CA 2006

<sup>52</sup> s.874(3) CA 2006

<sup>53</sup> s.873 CA 2006