

**Piercing the Corporate Veil:
The House of Lords Approves *Prudential v. Newman Industries (No. 2)***

By Robin Hollington Q.C.

Companies have, of course, been the essential vehicles for business activity since Victorian times. Business people find them very useful for a number of reasons, not least that they can limit personal liability to third party creditors, but they also find that they get in the way sometimes, usually when they want to sue somebody for having caused the company's insolvency and it is inconvenient to sue in the name of the company. It is not surprising that the ingenuity of their lawyers has been much exercised in finding reasons why their clients should be permitted to sue in a personal, rather than a corporate, capacity. But, as the House of Lords has recently confirmed in *Johnson v. Gore Wood & Co.* (14 December 2000, Internet transcript), the fundamental principle remains that only the company can sue in respect of a wrong done to the company. There is a well-established exception to the principle, namely that a derivative action may be brought by a shareholder on behalf of the company if he can bring himself within "the exceptions to the rule in *Foss v. Harbottle*", but that exception merely reinforces the principle that only the company can sue. What are the ramifications of that principle? Difficult questions of duty (i.e. to whom is a duty owed?), causation (i.e. was the breach of duty the cause of the loss?), and remoteness (i.e. is the loss too remote?) will invariably arise. But there is more to it than that.

It is useful first to have in mind the factual situations in which the principle commonly arises:

(1) The sole shareholder and director of a company is run over by a bus, and the company's business suffers as a result : can he sue for the damage done to the company? Of course he can : the company has no cause of action, so that there is no breach of the fundamental principle. These were the facts of *Lee v. Sheard* [1956] 1 Q.B. 192.

So it is clear that the shareholder can sue if *the company* has no cause of action.

(2) The company suffers loss as a result of a breach of contract by a supplier : can a shareholder sue for the diminution in the value of his shareholding? Of course he cannot : no duty was owed to him by the supplier, so that he has no cause of action.

So it is clear that the shareholder cannot sue if *he* has no cause of action.

(3) A company (through its sole shareholder) goes to the solicitor who has acted in the past for both the company and the shareholder about a transaction involving the company, and due to the solicitor's negligence the company suffers loss. Can the shareholder sue?

That is the difficult question : quite apart from the hurdles of duty, causation and remoteness of damage that the shareholder must overcome, it has been held by the House of Lords in the *Johnson* case, following the *Prudential* case, that his claim will not be allowed if the loss claimed by him is "merely a reflection of the loss suffered by the company". In the words of Lord Bingham:

"Where a company suffers loss caused by a breach of duty to it, and a shareholder suffers a loss separate and distinct from that suffered by the company caused by breach of duty independently owed to the shareholder, each may sue to recover the loss caused by breach of duty owed to it but neither may recover loss caused to the other by breach of duty owed to that other."

So, it works both ways : the company cannot recover loss which is merely a reflection of the loss suffered by the shareholder. As the House of Lords explained, this principle is not a ritualistic application of doctrine but it is underpinned by important policy considerations, namely that there should not be double recovery in respect of the same loss and funds intended for the benefit of an insolvent company's creditors should not be diverted to the shareholders.

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In applying the *Prudential* principle, the House of Lords disapproved of dicta in earlier Court of Appeal and Commonwealth decisions, where a more liberal view had been taken of the ability of a shareholder to recover loss connected with the company's loss. In particular, in *Christensen v. Scott* [1996] 1 N.Z.L.R. 273, the Court of Appeal of New Zealand held there was no rule of law that a shareholder cannot recover loss which is a reflection of the loss suffered by the company, but that it is up to the trial judge to protect against double recovery and diversion of assets to the prejudice of the company's creditors. It was a remarkable coincidence that Lord Cooke, who was a member of the Judicial Committee of the House of Lords that decided the *Johnson* case, had also been a member of the Court of Appeal of New Zealand that decided the *Christensen* case. The fullest analysis of the issues involved appears in the speech of Lord Millett in the *Johnson* case. He made it clear that the *Prudential* principle was rigid, not a matter for the trial judge to apply as a matter of discretion. He also noted that, on the facts of the *Johnson* case, the company had settled in earlier proceedings for less than it might have done, so that the shareholder's loss which was a reflection of the company's loss was *caused* by the settlement as opposed to the original wrongdoing. But he went to emphasise that there was more to it than causation and to refer to the policy considerations.

It is a shame that the House of Lords do not appear to have been referred to the other recent Court of Appeal decision in this field, namely *Walker v. Stones* [2000] 4 All E.R. 412.

It is one thing, however, to state the general principle and quite another to apply it to the facts of a particular case. The speeches in *Johnson* are somewhat obscure on the latter aspect, which is not surprising since the court was concerned with a strike-out application so that the application of the general principle could in cases of the slightest doubt be safely left to the trial judge. In allowing many of the heads of damage to go to trial, the House of Lords pointed out the formidable difficulties faced by the shareholder in overcoming the difficulties of causation, remoteness of damage, and the *Prudential* principle.

The *Johnson* case is also now the leading authority on the vexed principle of *res judicata*/abuse of process, which finds its origins in the judgment of Sir James Wigram V-C in *Henderson v. Henderson* (1843) 3 Hare 100, 114.