



COMPANY – A SEPARATE ENTITY (SALOMON V. SALOMON)

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ABSTRACT

This case note has been prepared highlighting the landmark judgment in the field of corporate law. *Salomon v. Salomon & Co. Ltd.* [1896] UKHL 1, [1897] AC 22 set the founding stone for the most essential feature of a company i.e. **Separate legal entity**. This paper initiates by describing the meaning of word ‘Company’ through various statutes and legal precedents. It also highlights the main characteristics of a company. Thereafter facts of the *Salomon’s* case are presented along with contentions of both the parties and issues involved in the case. A thorough interpretation of the decision of High Court, Court of Appeal and House of Lords is described in the latter part of this paper. Many case laws supporting and opposing the *Salomon’s* judgment are also emphasized upon. This case note concludes with the principles evolved through this landmark judgment along with its implication.

INTRODUCTION

A business can be conducted through many ways. An Individual can start business in a capacity of sole proprietor or through a partnership firm or starting his own company. In the modern era, the most

successful form of conducting business is in the form of a company. Before moving to the reasons why company is the most suitable form of business, it is important to understand the meaning of the term company.

The word “Company” is the combination of two words “Com” and “Panies”. The word “Com” means together or with and the word “Panies” means bread. The word company can be referred as an association of persons who took their meals together. It is an association of persons for some common objects. In simple terms company may be described to mean voluntary association of persons who come together for carrying on some business and sharing profits there from. A company in the broad sense may mean an association of individuals formed for some purpose.

Lord Justice Lindley said *a company is an association of persons who contribute money or monies worth to a common stock and employed in some trade or business and who share profit and loss arising there from. The common stock so contributed is the share capital of the company. The persons who form it are members. The proportion of capital which member is entitled is his ‘share’. The shares are always transferable although the right to transfer may be restricted.*¹

Professor Haney said *a company is an artificial person created by Law having separate entity, with perpetual succession and common seal.*¹

Talking about **separate legal entity**, unlike partnership, a company is distinct from the persons who constitute it. **Section 7(3) of**



the Companies Act 2013¹ says that on registration, the association of persons becomes a body corporate which shall be distinct identity by the name contained in the memorandum.

FACTS OF THE CASE

In this case, Mr. Salomon who carried on a business of shoe manufacturing sold his business for the sum of £38,782 to ‘Salomon & Co. Ltd’ which consisted of Salomon himself, his wife, daughter and four sons. The purchase consideration was paid by the company by allotment of 20,000 fully paid £1 share and £10,000 in debentures conferring a floating charge over all the company’s asset to Salomon and the balance in cash. One share of £1 each was subscribed for in cash by the remaining six members of his family. Salomon was the managing director of the company and he virtually held the whole of its stock, he had absolute control over the company. Only a year later, the company went into liquidation. On winding up the statement of affairs was roughly like this: Assets: £6,000, Liabilities: Salomon as debenture holder £10,000 and unsecured creditors £7,000. Thus the assets were running short of its liabilities by £11,000. The unsecured creditors claimed propriety over the debenture holder (Mr. Salomon) on the ground that a person cannot owe to himself and that Salomon and the company were the same person. They further contended that the company was mere “alias” or agent for Salomon, the business was solely his, conducted solely for him and by him and the company was mere sham, fraud, hence Salomon was liable to indemnify the against its trading debts.

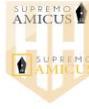
ISSUES INVOLVED

1. Is Company separate from its owner and management?
2. Is Mr. Salomon liable to pay to unsecured creditor?
3. Is ‘Salomon & Co. Ltd’ mere sham and fraud?
4. Does full control over ‘Salomon & Co. Ltd’ make Mr. Salomon personally liable for all the trading debts?

HELD

Firstly before the High Court, the case titled **Broderip v Salomon**¹ Vaughan William J, held the claim of Broderip valid against Mr. Salomon. According to him, ‘Salomon & Co. Ltd’ was just Mr. Salomon in another form. The signatories of the MOA of the company were also the family member of Mr. Salomon, hence they were only dummies. Mr. Salomon had full control over the affairs of the company and he should be liable towards all the trading debts before self payment of his own debentures.

Secondly the Court of Appeal upheld the decision of Vaughan William J against Mr. Salomon but on different grounds. According to him Mr. Salomon abused the ‘limited liability and incorporation’ characteristics of a company. Lindley J held that Mr. Salomon is personally liable to indemnify all the trade debts of his company. He also mentioned that Mr. Salomon’s intention was to defraud his creditors.



When the matter was brought in front of **House of Lords**, they unanimously overturned the pronouncement of lower courts. All the arguments relating to agency and fraud against Mr. Salomon were rejected. They emphasized that nowhere in the Companies Act it is mentioned that subscribers of the Memorandum of Association should be independent from majority shareholders. Also 'Salomon & Co. Ltd' was formed fulfilling all the requirements of the statute. **Lord Halsbury LC** stated that if 'Salomon & Co. Ltd' was formed legally then it has its own separate identity different than Mr. Salomon.

PRINCIPLES EVOLVED

Decision of Salomon v. Salomon gave birth to the doctrines of separate corporate personality and limited liability. These doctrines are the fundamental pillars of modern time Company Law. The essence of separate corporate personality is that the corporation is a separate legal entity which is distinctive from its owners (shareholders). On the other hand limited liability means that the shareholders are only liable to pay amount which are due on their subscribed shares. Unlike partnership firms, companies can sue or can be sued in their own name.

Other concept which is established due the doctrine separate legal entity is "**Corporate Veil**". The Black's Law Dictionary defines piercing the corporate veil as follows: "*the judicial act of imposing personal liability on otherwise immune corporate officers, directors, or shareholders for the corporation's wrongful acts.*"¹ This definition reveals the main essence of veil

piercing. Once the court decides to disregard the statutorily imposed boundaries for corporate liability, it may hold personally liable different parties, such as the corporate officers, directors, or the shareholders of the company that might be either natural or legal persons. Hence, the spectrum of possible liable persons is fairly wide. **This leads us to the Exceptions of the Corporate Veil.** The doctrine of juristic personality of a company has been subject to certain exceptions. The courts have in many cases disregarded the corporate personality to look at the facts which actually exist behind the corporate veil. The advantages of corporate veil are allowed to be enjoyed only by those who want to make an honest use of company. In case of dishonest and fraudulent use of the facility of incorporation, the law lifts the corporate veil and identified the persons who are behind the scene and are responsible for the perpetration of fraud. In **Workmen of Associated Rubber Industry Limited v. Associated Rubber Industry Limited**¹ it was found that the sole purpose for the formation of new company was to use it as a device to reduce the amount to be paid by the way of bonus to workmen. Supreme Court upheld the piercing of the veil to look at the real transaction. Other important judgments where courts upheld the piercing of corporate veils are (1) New Horizon Limited v. Union of India¹, (2) PNB Finance Limited v. Shital Prasad Jain¹, (3) Gilford Motor Company v. Horne¹, (4) Daimler Company Limited v. Continental Tyre and Rubber Company¹ and many others.

IMPLICATIONS



The principles evolved in the Salomon's case was upheld in *Lee v. Lee Air Farming Limited*¹ in which Mr. Lee held all but one share in the company, and by articles was appointed as governing director of the company and chief pilot. Lee was killed while piloting the company's aircraft, and his widow claimed compensation for his death under the Workmen Compensation Act. The company opposed to claim on the ground that Lee was not the worker as the same person could not be employer and employee. It was held that there was valid contract of service between Lee and the company, and Lee was therefore, a worker. Hence his widow was entitled to workmen compensation.

In the Apex Court of India, principle of separate legal entity was first held in the case of *State Trading Corporation India v. Commercial Tax Officer*¹

indirectly it leads to the development of corporate legislation throughout the world.

CONCLUSION

The decision of House of Lords in the case of *Salomon v. Salomon & Co. Ltd* set a landmark in the field of corporate law. This case expressly shows that existence of a company is completely different from its owner. It laid down various principles relating to limited liability and juristic personality. There are however, many exceptions to it which are also upheld in many cases across the globe. At the end it can be concluded that *Salomon v. Salomon & Co. Ltd* was the founding stone of the most essential characteristic of a company i.e. separate legal entity and directly or

