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Company Law: The Corporate Veil

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The bedrock of the company law is the principle of separate legal entity, that a company is a legal person distinct from its owner, immaterial of whether its owner comprises a single person or a close-knit family. The *locus classicus* is the famous case of *Salomon v A Salomon & Co Ltd* [1897] AC 22. The idea is to encourage the growth of businesses and entrepreneurship by limiting personal liability of business owners.

However, the principle is frequently abused, and wrongdoers have figured out creative ways to hide themselves behind the illusory veil, that is the company. In response, the law has evolved to recognise exceptions to this principle, which will come to be known as the doctrine of piercing the corporate veil. The United Kingdom Supreme Court's decision in *Prest v Prest & others* [2013] 4 All ER 673 (Prest) marks the watershed in the judicial development on this topic.

Recently, our Federal Court in the case of *Ong Leong Chiou & anor v Keller (M) Sdn Bhd & Ors* [2021] 3 MLJ 622 (Keller) had the chance to clarify the legal position in Malaysia on this topic. This alert will discuss the findings and impact of *Keller*.

Background Facts

This case involved the Melawati Mall project and a series of subcontracting, starting from the main contractor (Bina Puri Holdings Bhd) to Perfect Solution Sdn Bhd to PS Bina Sdn Bhd and finally to Keller (M) Sdn Bhd, the last of which would carry out the actual work. For purposes of this discussion, the focus will be on Perfect Solution, PS Bina and Tony Ong who is the managing director of both companies.

On 13.9.2013, Keller was invited to submit a quote for the piling works for the project. Following that, Keller received two blank bills of quantities. The second page of the second bill was missing but it is crucial, because it stated that the earth bore works will not be paid for. The fact that Bina Puri

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will not pay for the earth bore works, while unknown to Keller, was known to Tony Ong.

On 21.10.2013, PS Bina issued a letter of award to Keller, which represented that earth bore works would be paid for. On 4.11.2013, Tony Ong represented to Keller's managing director that he would procure Bina Puri's guarantee for the costs of the earthworks incurred by Keller.

Keller had proceeded to carry out, amongst others, the earth bore works for the project and had incurred around RM 7 million to that end. Unsurprisingly, neither did Perfect Solution nor did PS Bina pay for the earth bore works, which culminated in the suit by Keller to recover the sum.

The High Court & Court of Appeal's Decisions

The High Court found the fact that earth bore works will not be paid was deliberately concealed from Keller to ensure that Keller would continue with and complete the earth bore works. This was aggravated by the repeated assurances and representations by Tony Ong that the earth bore works will be paid. On this premise, the High Court found that Tony Ong had utilised Perfect Solution and PS Bina to practice fraud or equitable fraud on Keller. Accordingly, the High Court lifted the corporate veils of PS Bina and Perfect Solutions, and held Perfect Solution, PS Bina and Tony Ong to be jointly and severally liable for Keller's claim. This was affirmed and endorsed by the Court of Appeal.

Commentary: The Federal Court's Decision

The crux of Perfect Solution and Tony Ong's contention before the Federal Court is that the courts below were wrong to have pierced the corporate veil and found them liable. Ultimately, the Federal Court agreed with the conclusion of the courts below, that Perfect Solution and Tony Ong were liable for Keller's claim, albeit on a slightly different reasoning. The difference lies in the Federal Court's analysis of the law on the disregarding of the corporate veil, which heavily featured the reasoning in the *Prest* case.

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If there has been any doubt as to the applicability of *Prest* in Malaysia, it is now put to rest with the Federal Court's decision in *Keller*. The Federal Court in its judgment had expressly adopted the analysis in *Prest* – thereby incorporating the concealment principle and evasion principle into the realm of Malaysian company law. This means that when the court is confronted with the question of whether to disregard the separate personality of company and to pierce the corporate veil, the court will first have to analyse and ascertain the nature of the wrongdoing that was complained. Next, the court will have to determine whether the wrongdoing falls within the purview of the concealment principle or the evasion principle.

Concealment principle does not in reality pierce the veil of incorporation, but allows the court to look beyond the facade, that is the company, in order to determine the true facts and the real actors hiding behind the veil. For cases falling under the concealment principle, the existence of the company serves as a mere distraction which the court will ignore in its quest to uncover the truth. Once the truth and the real actors are identified, the court will apply the legal principle of substantive law to determine whether liability subsists against the real actors.

Keller is a good example. In *Keller*, Tony Ong was cautious to shield himself from legal liability. As such, he had used Perfect Solution to subcontract to PS Bina who then subcontracted to Keller – a fine example of making assurance double sure. Applying the concealment principle, the Federal Court was not at all distracted by the separate legal personalities of Perfect Solution and PS Bina – and found out the truth, that this is simply a case of Tony Ong defrauding Keller. It is on this basis that the Federal Court held Perfect Solution, PS Bina and Tony Ong to be jointly and severally liable to Keller, without having to pierce the corporate veils of Perfect Solution and PS Bina. This is where the Federal Court diverged from the High Court – whilst the High Court had decided to pierce the veils, the Federal Court found no necessity to do so.

Evasion principle, on the other hand, allows the court to pierce the veil of incorporation. This principle will be engaged if there is a legal right or liability owed by the controller of the

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company, and which exists independently of the company's involvement, and the company is interposed so that its separate legal personality will defeat the right or frustrate the enforcement thereof.

The case of *Gilford Motor Co Ltd v Horne* [1933] Ch 935 best illustrates the evasion principle. Mr Horne was the managing director of Gilford Motor. Under his employment contract, he was not to engage in any competing business in a specified geographical area for five years after the end of his employment. Subsequently, he left Gilford Motor and formed a company to carry out competing business in that specified geographical area. The company being a legal entity separate from Mr Horne was, strictly speaking, not bound by Mr Horne's employment contract. Its existence defeated Gilford Motor's rights and the enforcement thereof against Mr Horne, who sought to evade his liability by hiding behind the corporate veil. As such, the court had pierced the veil and issued an injunction against the company in favour of Gilford Motor.

Whilst the theoretical basis of *Prest* and *Keller* is sound, its utility in the practical world remains to be seen. In *Prest*, the court said that the 'the concealment principle is legally banal'. This downplays the intricacies involved in its application. In the modern commercial world, a parent company may set up numerous companies within a group, which may share common management, common directors, common staffs and even common physical office. Arguably, the real actors are the top management in the parent company, and the true fact is that the subsidiary companies are really just there to compartmentalise the risks. Yet, this is permissible under the law. In fact, it is the foundation of the principle of separate legal personality – to limit liability.

The question then becomes, where should the line be drawn? When could the court invoke the concealment principle and unmask the real actors? From the judgment in *Keller*, it appears that the Court will do so if the company is utilised as a vehicle for dishonest conduct, fraud or unconscionable conduct. If this is true, it may mean that had Tony Ong innocently believed that the earth bore works will be paid, the court would not be entitled to look behind the veils of Perfect Solutions and PS Bina and to hold him liable

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for acts done in his capacity as the companies' director. After all, his acts as a director 'must, for all practical purposes, be the acts of the company itself'.

Further, the Federal Court also added a disclaimer, that 'it would be premature to bar or foreclose the categories of cases in which the corporate personality may be either disregarded or the veil be pierced.' Now, if that disclaimer meant anything, it meant that even though 126 years have passed since *Salomon*, the law on the piercing of the corporate veil is still far from settled. However, the law cannot be faulted, because the law is always playing catching up with the infinite number of permutations of possible uses of companies for unlawful end. That is the legal reality. For now, the defendants post-*Keller* will have to focus on the state of mind of the defendants and to negate any hint of dishonesty or unconscionability, in order to prevent the court from looking behind the veil and to avoid liability.

Authored by Hayden Tan, an Associate with the firm's Dispute Resolution practice.

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