

Lifting the corporate veil on the basis of an implied agency: A re-evaluation of *Smith, Stone and Knight*

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This article examines the scope of the principle in *Smith, Stone and Knight* that the corporate veil may be lifted on the basis of an implied agency between group companies. It argues that, on a proper assessment of the weight of judicial authority in Australia, the six criteria used in *Smith, Stone and Knight* to determine the existence of an implied agency should not be similarly applied outside of fact scenarios identical to *Smith, Stone and Knight*. In contrast, it is argued that a more principled use of *Smith, Stone and Knight* is to use the six criteria to justify lifting the corporate veil on the basis of avoiding a legal obligation or the existence of a sham. To demonstrate the difficulties associated with applying the six criteria in *Smith, Stone and Knight* as a general test for identifying an implied agency relationship this article will discuss recent developments in industrial law where *Smith, Stone and Knight* has been used to lift the corporate veil between related corporate employers.

Part 1 - Introduction

The separate legal entity principle exemplified in the famous *Salomon* decision¹ has recently been the subject of vigorous debate with the New South Wales government setting up a Special Commission of Inquiry into the James Hardie restructure and the establishment of a charitable fund to cover future asbestos-related tort claims arising out of asbestos previously made by James Hardie. During the hearings several submissions were put to the Commissioner regarding the proper application of the separate legal entity principle in relation to members of a corporate group. There have also been calls in the media for corporate law reform to increase statutory powers of lifting the corporate veil. In his final report, Commissioner Jackson did not express any concluded view on whether law reform was appropriate,² although he did state that the issues raised in the Special Commission demonstrated that "there are significant deficiencies in Australian corporate law".³ Although the Commissioner was speaking in the context of tort liability, the legal difficulties posed by the James Hardie restructure centre on the significance and durability of the separate legal status that exists between members of a corporate group. This article will consider the nature of the agency ground for lifting the corporate veil between members of a corporate group.

Although the *Salomon* principle has existed for more than 100 years, the boundaries of the principle have still not been adequately determined. Indeed, the uncertainty surrounding the scope of the available common law grounds for lifting the corporate veil

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¹ *Salomon v A Salomon & Co Ltd* [1897] AC 22.

² The Commissioner believed that the issue of law reform was more appropriately dealt with at the Commonwealth level, whilst the Commission was established under NSW law: Jackson D, "NSW Special Commission of Inquiry into Medical research and Compensation Foundation Final Report" at [30.66]: <http://www.cabinet.nsw.gov.au/hardie/Volume1.pdf> (viewed 1 October 2004).

³ Jackson, n 2 at [30.67].

represents a continuing problem for corporate law. Many categories have been suggested by academic commentators as grounds for lifting the corporate veil at common law including:⁴

1. fraud;
2. a sham;
3. avoiding legal obligations;
4. breach of fiduciary duty; and
5. agency.

This article is concerned with the proper application of the fifth ground, agency. The decision that is most frequently cited as an example of the agency ground for lifting the corporate veil is *Smith, Stone and Knight Ltd v Birmingham Corporation* [1939] 4 All ER 116 (hereafter *Smith, Stone and Knight*).⁵ The purpose of this article is to consider what the appropriate place of *Smith, Stone and Knight* is in modern Australian corporate law. This will be done by firstly determining the limits of the decision itself, and in particular what its precedent value is in identifying an implied agency that may justify lifting the corporate veil (hereafter referred to as the agency ground), and then examining the strength of the decision's subsequent application in Australia.

The agency ground has generally been accepted in Australia as constituting a valid ground for lifting the corporate veil, with case law⁶ and academic commentary⁷ using the *Smith, Stone and Knight* decision as an example of lifting the veil on the basis of agency. Despite the abundance of commentary acknowledging *Smith, Stone and Knight* as an example of the agency ground for lifting the veil, there is little critical analysis of the proper application of the case in Australian law. In the writer's view, the case should not be seen as providing general or broad authority for lifting the veil on the basis of agency.

⁴ See Ford HAJ, Austin RP and Ramsay IM, *Ford's Principles of Corporations Law* (11th ed, Butterworths, 2003) pp 123-129 ([4.250]); Farrar JH, Furey NE and Hannigan BM, *Farrar's Company Law* (3rd ed, Butterworths, 1991) pp 74-5; Ramsay IM and Noakes DB, "Piercing the Corporate Veil in Australia" (2001) 19 C&SLJ 250 at 253.

⁵ There were however decisions prior to *Smith, Stone and Knight* that discussed the possibility of the veil being lifted on the basis of agency including *Gramophone & Typewriter Ltd v Stanley* [1908] 2 KB 89 at 96 per Cozens-Hardy MR and *Inland Revenue Commissioners v Sansom* [1921] 2 KB 492 at 503 per Lord Sterndale MR. These decisions did not however lift the veil on the basis of agency and have not traditionally been cited as examples of an agency ground for lifting the veil.

⁶ *Spreag v Paeson Pty Ltd* (1990) 94 ALR 679; *ICT Pty Ltd & Buquebus International Ltd v Sea Containers Ltd* (1995) 39 NSWLR 640 at 657 per the Court; *Burswood Catering and Entertainment Pty Ltd v ALHMCU (WA Branch)* [2002] WASCA 354; *Eurest (Australia) Catering & Services Pty Ltd v Independent Foods Pty Ltd* (2000) 35 ACSR 352 at 360 per Hodgson CJ.

⁷ Griggs L, "The Veil of Incorporation – When Will it be Lifted?" (1996) 26 QLSJ 575 at 580; Baxt R, and Lane T, "Developments in Relation to Corporate Groups and the Responsibilities of Directors – Some Insights and New Directions" (1998) 16 C&SLJ 628 at 646; Murphy D, "Holding Company Liability for Debts of its Subsidiaries: Corporate Governance Implications" (1998) 10 Bond LR 241 at 253-5; Ramsay IM and Noakes DB, "Piercing the Corporate Veil in Australia" (2001) 19 C&SLJ 250 at 253; Tomasic R, Bottomley S and McQueen R, *Corporations Law in Australia* (2nd ed, Federation Press, 2002) p 45; Redmond P, *Company and Securities Law* (3rd ed, LBC, 2000) p 156; O'Donovan J, "Grouped Therapies for Group Insolvencies", in M Gillooly (ed), *The Law Relating to Corporate Groups* (1993, Federation Press) p 83, Halsbury's Laws of Australia-Corporations Title, Butterworths, at [120-3010].

This article will argue that the authoritative position given to the decision as a general basis for lifting the veil on the basis of agency is unwarranted. It is submitted that the case does not provide an appropriate example of how generally to identify an implied agency that may justify lifting the corporate veil and should therefore not be seen as creating any broader principle outside of its facts.

In order to determine what the proper role of *Smith, Stone and Knight* should be in modern Australian corporate law, this article will:

- a) provide an overview of agency principles and how they relate to the separate legal entity doctrine (discussed below in Pt 2);
- b) discuss the basis of the decision in *Smith, Stone and Knight* (discussed below in Pt 3);
- c) critique the legal reasoning in *Smith, Stone and Knight* (discussed below in Pt 4);
- d) analyse how the decision has been used by subsequent Australian courts (discussed below in Pt 5); and
- e) suggest a principled basis for the continued relevance of *Smith, Stone and Knight* in modern Australian corporate law (discussed below in Pt 6).

Part 2 – The relationship between agency principles and lifting the corporate veil

The relationship between agency law and corporate law is longstanding and uncontroversial, with agency principles used in many areas of corporate law. It is unclear however, where the boundaries of agency lie insofar as those principles may be used to lift the corporate veil. Lifting the corporate veil on the basis of agency involves examining the relationship between two or more separate legal entities and attributing the acts of one of the entities as the acts of the other entity. In light of the recent controversy concerning the James Hardie corporate group, this article will concern itself only with the potential for lifting the corporate veil on the basis of agency between companies in a corporate group structure. Although there is no reason that agency principles should not apply equally to an individual shareholder and the company he/she controls, it has been noted on several occasions that the courts are more reluctant to lift the veil between a company and an individual shareholder, than they are to lift the veil between group companies.⁸ It may also be noted that some commentators argue that the establishment of an agency between members of a corporate group does not represent lifting the veil at all, but rather merely represents the proper application of agency principles.⁹ However, the overwhelming majority of academic and judicial commentary in Australia operates on the

⁸ Ford HAJ, Austin RP and Ramsay IM, *Ford's Principles of Corporations Law* (11th ed, Butterworths, 2003) p 127 ([4.250]); Gower LCB, *The Principles of Modern Company Law* (4th ed, Stephens & Sons, 1979) p 124 (not repeated in later editions). See also *Gramophone & Typewriter Ltd v Stanley* [1908] 2 KB 89 and *IRC v Sansom* [1921] 2 KB 492; *Varangian Pty Ltd v OFM Capital Ltd* [2003] VSC 444 at [143] per Dodds-Streeton J. The question as to whether there should be a distinction between situations involving companies and individuals and situations involving members of a corporate group is not dealt with in this article.

⁹ See for example *Palmer's Company Law* (loose-leaf ed, Sweet and Maxwell) at [2.1519]; Welling BL, *Corporate Law in Canada* (2nd ed, Butterworths, 1991) pp 127-136; *Idoport Pty Ltd v National Australia Bank Ltd* [2004] NSWSC 695 at [144] per Einstein J.

basis that the agency principles used in *Smith, Stone and Knight* are an example of lifting the veil, and therefore this article assesses the position of the decision on that basis.

It is important to distinguish the various forms of agency that may be used to lift the corporate veil. The simplest form of agency involves an express agency agreement whereby one legal entity (such as a company) acts under the authority of another legal entity. In this situation, the veil lifting occurs because the law of agency recognises that a principal (the latter entity) is bound by, and responsible for, the acts of their agent (the former entity) within the scope of their authority. Therefore, the corporate veil that would ordinarily separate the two entities is lifted so as to make the principal responsible for the acts of the agent. A common example of this express agency occurs where a company wishing to sell its products in an unfamiliar market engages a local sales agent.

An agency relationship may also be implied between two parties based on the nature of their relationship.¹⁰ An implied agency may arise where the principal places the purported agent in circumstances where it is understood that the agent represents and acts for the principal.¹¹ The decision in *Smith, Stone and Knight* held that an implied agency existed between a parent and subsidiary company with the effect that the parent was considered by the court to own the business carried on by the subsidiary for the purposes of claiming compensation for disturbance caused to the subsidiary's business by the local council.

Part 3 - The decision in *Smith, Stone and Knight*

The facts in *Smith, Stone and Knight* concerned the relationship between a parent company (Smith, Stone and Knight Ltd), which was involved in paper manufacturing, and its subsidiary company (Birmingham Waste Co Ltd), which was involved in waste paper dealing. The parent had purchased a partnership business which it later incorporated into a subsidiary company. The subsidiary company was virtually 100% owned by the parent, which owned all of the shares in the subsidiary except for 5 shares which the directors of the parent held in trust for the parent company. The subsidiary had no assets and no employees except for a manager who had no authority to access the subsidiary's books. The subsidiary carried on its business using assets owned by the parent company.

The case concerned a compulsory acquisition by the local council (Birmingham Corporation) of real property owned by the parent company but used by the subsidiary company to carry on its business under a yearly lease for a nominal sum.¹² The parent company sought compensation from the council for disturbance to the business operated by the subsidiary and the cost of moving that business to new premises. The dispute was referred to an arbitrator, whose award was challenged in court on the basis of alleged misconduct. The parent, rather than the subsidiary, sought compensation because the relevant statutory right to receive compensation for a compulsory acquisition did not

¹⁰ *Pole v Leask* [1861-73] All ER Rep 535.

¹¹ *Pole v Leask* [1861-73] All ER Rep 535 at 541 per Lord Cranworth.

¹² The lease fee was described in the report of the decision as a "departmental charge... a mere book keeping entry": *Smith, Stone and Knight Ltd v Birmingham Corporation* [1939] 4 All ER 116 at 118 per Atkinson J.

apply to yearly tenancies.¹³ The parent was described in the documents lodged with the court as the principal of the subsidiary, which it argued was a mere department of the parent, acting purely on its behalf. The parent asserted that it was entitled to compensation because it was the only entity that would incur loss as a result of the council's compulsory acquisition of the business.¹⁴

Establishing Agency

The key issue involved in the case was whether the parent had suffered any loss as a result of the council's compulsory acquisition of the property, causing disturbance to the subsidiary's business. Atkinson J decided that the relationship between the parent and subsidiary was really an agency relationship, with the business of the subsidiary being carried on an apparent basis only. There were many facts that influenced his Honour's reasoning including:¹⁵

1. the directors of the parent were also directors of the subsidiary but did not take a salary from their positions on the subsidiary's board;
2. the business purportedly carried on by the subsidiary company was purchased by the parent and never formally assigned to the subsidiary;
3. the subsidiary had no staff apart from a manager;¹⁶
4. the subsidiary's books were kept and maintained by the parent and were not the property of the subsidiary or accessible by the manager of the subsidiary;
5. the work purportedly carried out by the subsidiary was beneficially owned by the parent without any agreement to transfer the business to the subsidiary; and
6. the subsidiary was treated for accounting purposes as if it were merely a department of the parent, including, significantly, appropriating the profits of the subsidiary for payment to the parent (by direct payment rather than dividend).

In support of his view that the corporate veil could be lifted on the basis of agency, Atkinson J relied exclusively on a series of taxation cases.¹⁷ His Honour found that these cases stood for the proposition that the determination of whether a subsidiary was carrying on the business as the parent's business or as its own was a question of fact.¹⁸ Atkinson J then used the tax decisions to formulate six relevant criteria for answering this question of fact regarding whether the subsidiary was an implied agent for the parent. These now famous six questions were stated by his Honour as:¹⁹

¹³ *Lands Clauses Consolidation Act 1845* (UK) s 121.

¹⁴ *Smith, Stone and Knight Ltd v Birmingham Corporation* [1939] 4 All ER 116 at 118 per Atkinson J.

¹⁵ *Smith, Stone and Knight Ltd v Birmingham Corporation* [1939] 4 All ER 116 at 119 per Atkinson J.

¹⁶ It is unclear from the report of the decision whether the parent appointed the manager although Atkinson J presumed that was the case: *Smith, Stone and Knight Ltd v Birmingham Corporation* [1939] 4 All ER 116 at 119 per Atkinson J.

¹⁷ *San Paulo (Brazilian) Railway Co Ltd v Carter* [1896] AC 31; (1895) 3 TC 407; *Apthorpe v Peter Schoenhofen Brewing Co Ltd* (1899) 4 TC 41; *Jones (Frank) Brewing Co v Apthorpe* (1898) 4 TC 6 and *St Louis Breweries Ltd v Apthorpe* (1898) 4 TC 111.

¹⁸ *Smith, Stone and Knight Ltd v Birmingham Corporation* [1939] 4 All ER 116 at 121 per Atkinson J.

¹⁹ *Smith, Stone and Knight Ltd v Birmingham Corporation* [1939] 4 All ER 116 at 121 per Atkinson J. These six questions are widely cited in company law texts in Australia as indicia of an agency relationship that may allow the corporate veil to be lifted: see Lipton P and Herzberg A, *Understanding Company Law*

1. Were the profits treated as the profits of the parent?
2. Were the persons conducting the business appointed by the parent?
3. Was the parent the head and the brain of the trading venture?
4. Did the parent govern the adventure, decide what should be done and what capital should be embarked on the venture?
5. Did the parent make the profits by its skill and direction?
6. Was the parent in effectual and constant control?

On the facts before him, his Honour decided that all six questions could be answered in the affirmative, stating:²⁰

If ever one company can be said to be the agent or employee, or tool or simulacrum of another, I think the Waste company [the subsidiary] was in this case a legal entity, because that is all it was. There was nothing to prevent the claimants [the parent] at any moment saying: "We will carry on this business in our own name." They had but to paint out the Waste company's name on the premises, change their business paper and form, and the thing would have been done. If either physically or technically the Waste company was in occupation, it was for the purposes of the service it was rendering to the claimants, such occupation was necessary for that service, and I think that those facts would make that occupation in law the occupation of the claimants.

His Honour awarded the parent company compensation and concluded by saying "I have no doubt the business was the company's business and was being carried on under their direction."²¹

Part 4 - Critique of the decision

It is submitted that there are two primary reasons why the decision in *Smith, Stone and Knight* represents a poor example of lifting the corporate veil on the basis of agency and should not therefore be used in Australia for this purpose. Firstly, the six questions formulated by Atkinson J to identify the existence of an implied agency between members of a corporate group fail to adequately perform this task. This is because they are drafted in an imprecise manner with substantial overlapping between questions, particularly regarding the importance of control exercised by the purported principal. Secondly, it is submitted that Atkinson J failed to accord the *Salomon* decision its proper effect in circumstances where the separate legal entity status should not have been denied to the subsidiary company.

The six questions

There is no doubt that there is substantial overlap between these questions. The consistent theme involved in the six questions is the issue of control and dominance by the parent company over the affairs of the subsidiary. The difficulty with this is that control, even complete control, has never been allowed by the law to give rise to an agency

(11th ed, Lawbook Co, 2003) pp 45-6; Tomasic R, Bottomley S and McQueen R, *Corporations Law in Australia* (2nd ed, Federation Press, 2002) p 46; Farrar JH, Furey NE and Hannigan BM, *Farrar's Company Law* (3rd ed, Butterworths, 1991) p 75; Fisher S, Wiseman L and Anderson C, *Corporations Law* (2nd ed, Butterworths, 2001) p 43.

²⁰ *Smith, Stone and Knight Ltd v Birmingham Corporation* [1939] 4 All ER 116 at 121 per Atkinson J.

²¹ *Smith, Stone and Knight Ltd v Birmingham Corporation* [1939] 4 All ER 116 at 121-2 per Atkinson J.

relationship.²² Furthermore, the six questions describe a situation that is very common among small proprietary companies with a single shareholder, and among wholly owned corporate groups.²³ As one eminent jurist stated "[r]are indeed is the subsidiary that is allowed to run its own race".²⁴ This has led some commentators to state that it is really the first question (regarding the use of profits) which is the determinative element.²⁵ The difficulty with this however is that, following from the High Court's decision in *Industrial Equity Ltd v Blackburn* (1977) 137 CLR 567, separate entities are not entitled to lift the corporate veil by shifting funds from one separate legal entity to another. It therefore seems inappropriate to support lifting the corporate veil primarily on the basis that companies that would otherwise be separate entities have chosen to breach the principle from *Industrial Equity*. It is important however to view the precedent value of *Smith, Stone and Knight* in its factual context. In *Smith, Stone and Knight* the profits earned in the business did not belong to the subsidiary because the business being disturbed by the Council's compulsory land acquisition was actually owned by the parent rather than the subsidiary. This reinforces the veil that merely answering the six questions does not provide sufficient grounds for lifting the corporate veil.

In addition, the fifth question has also been implicitly criticized by the Full Federal Court,²⁶ where it was argued that Dr Edelsten was the dominant force behind a range of business ventures with the result that the property of these ventures should be treated as his property for the purposes of bankruptcy law. The Court dismissed this argument as follows:²⁷

Doubtless, the establishment of the practices and their relatively quick generation of substantial cash flows owed much to the experience, expertise and energy of Edelsten. However, to acknowledge that fact falls far short of identifying any part of the assets of the businesses which reflects, in its original or transmuted form, part of the property of Edelsten.²⁸

Therefore, it is not appropriate to view the six questions from *Smith, Stone and Knight* as providing a sound basis for identifying an implied agency that may lift the corporate veil.

The importance of *Salomon*

It is interesting to note that the cases relied on by Atkinson J to formulate the six questions were all decided within two years of the House of Lords' decision in

²² *Gramophone & Typewriter Ltd v Stanley* [1908] 2 KB 89; *IRC v Sansom* [1921] 2 KB 492; *Dennis Willcox Pty Ltd v FCT* (1988) 79 ALR 267 at 274; 14 ACLR 156; 19 ATR 1122 per Jenkinson J.

²³ *Donnelly v Edelsten* (1994) 49 FCR 384 at 390; 121 ALR 333; 13 ACSR 196 per the Court; *Bray v F Hoffman-La Roche Ltd* (2002) 118 FCR 1 at 22-3; 190 ALR 1 per Merkel J; *Varangian Pty Ltd v OFM Capital Ltd* [2003] VSC 444 at [142] per Dodds-Streton J. See also Ford HAJ, Austin RP and Ramsay IM, *Ford's Principles of Corporations Law* (loose-leaf ed., Butterworths, 2003) at [4.250].

²⁴ *Briggs v James Hardie & Co Pty Ltd* (1989) 16 NSWLR 549 at 572; 7 ACLC 841 per Rogers AJA.

²⁵ Pickering M, "The Company as a Separate Legal Entity" (1968) 31 MLR 481 at 494; Ford et al, n 4 at p 127 [4.250].

²⁶ *Donnelly v Edelsten* (1994) 49 FCR 384; 121 ALR 333; 13 ACSR 196.

²⁷ *Donnelly v Edelsten* (1994) 49 FCR 384 at 394; 121 ALR 333; 13 ACSR 196 per the Court.

²⁸ These comments sit comfortably within the decision of the House of Lords' decision in *Macaura v Northern Assurance Co Ltd* [1925] AC 619; (1925) 133 LT 152; [1925] All ER Rep 51.

Salomon.²⁹ The significance of this point may be gleaned from the following statement: "the person who, in the strictest sense, makes the profits by his skill or industry, however distant may be the field of his adventure, is the person who is trading".³⁰ It is beyond argument that that this statement could not apply to Australian company law after *Salomon*.³¹ Indeed, a similar statement was expressly rejected in the *Salomon* decision.³² This point was noted by Toulson J sitting on the Queen's Bench:³³

I do not accept [the] submission that as a matter of general approach the court should ask whether the company was carrying on business as its owner's business or its own business, *using as guidance the sub-questions posed by Atkinson J*, and should determine the question of agency accordingly. On that approach, *Salomon's* case would surely have been decided differently. [emphasis added]

His Honour then quoted the following passage from the *Salomon* Court of Appeal decision (which was overturned by the House of Lords on appeal):³⁴

The question—as was put to counsel during the argument—is, Whose was this business in fact after the formation of the company? There really was no attempt to deny that it was the business of Salomon. The pretended sale to the company was an utter fiction. The company had no funds or property whatever except what it took under this alleged sale and 7l. payable on the subscription shares. It borrowed no money. The 10,000l. debentures were issued in part of the nominal price. The only security for them was the value of the assets of this business. The company paid nothing to Salomon for the purchase. They had nothing to pay with. There was no pretence of a bargain between the company and Salomon as vendor. There was no independent director to protect the company in the transaction. In truth, there was no purchase and sale at all. The business remained Salomon's. He carried it on in the name of the company.

In light of the above quote from the Court of Appeal's decision in *Salomon*, it is open to argument that Atkinson J's formulation of the six questions for determining an implied agency could be construed as an attempt to revive the Court of Appeal's decision in *Salomon*. This further supports the view that the six questions in *Smith, Stone and Knight* should not be seen in modern Australian corporate law to provide a principled basis for identifying an implied agency that will justify lifting the corporate veil. It is appropriate at this stage to make it clear that the writer is not stating that implied agency can never lift the corporate veil. Rather, it is submitted that *Smith, Stone and Knight* does not represent a good example of a case where agency may lift the veil. This is because Atkinson J was not justified in using the six questions as demonstrating an implied agency to lift the veil. The six questions represent are too imprecise to justify veil lifting and represent an inappropriate divergence from the authority of *Salomon*. As a result of the above analysis, it is submitted that the precedent value of *Smith, Stone and Knight* is extremely limited and the decision should be confined to its peculiar fact situation. The

²⁹ *San Paulo (Brazilian) Railway Co Ltd v Carter* [1896] AC 31; (1895) 3 TC 407; *Apthorpe v Peter Schoenhofen Brewing Co Ltd* (1899) 4 TC 41; *Jones (Frank) Brewing Co v Apthorpe* (1898) 4 TC 6; *St Louis Breweries Ltd v Apthorpe* (1898) 4 TC 111.

³⁰ *San Paulo (Brazilian) Railway Co Ltd v Carter* [1896] AC 31; (1895) 3 TC 407 at 410 per the Lord Chancellor.

³¹ Pickering M, "The Company as a Separate Legal Entity" (1968) 31 MLR 481 at 494.

³² *Salomon v A Salomon & Co Ltd* [1897] AC 22 at 53 per Lord Macnaghten.

³³ *Yukong Line Ltd of Korea v Rendsburg Investments Corp of Liberia (The Rialto) (No 2)* [1998] 4 All ER 82 at 92; [1998] 1 WLR 294; [1998] 1 Lloyd's Rep 322 per Toulson J.

³⁴ *sub nom Broderip v Salomon* [1895] 2 Ch 323 at 345 per Kay LJ.

UK Court of Appeal has stated that "the facts [in *Smith, Stone and Knight*] were so unusual that they cannot form any basis of principle".³⁵ The exceptional nature of the facts involved in *Smith, Stone and Knight* render it inappropriate to use the decision as formulating general principles for identifying an agency relationship capable of lifting the corporate veil.³⁶ Put simply, it is submitted that the six questions have extremely limited use outside of factual scenarios similar to *Smith, Stone and Knight* which is recognised in the above statement by the UK Court of Appeal.

Having argued that the sole application of the six questions stated by Atkinson J in *Smith, Stone and Knight* does not provide a robust general test for determining the existence of an implied agency that may justify lifting the corporate veil, it is now appropriate to examine how the decision and the six questions have been used in subsequent Australian cases.

Part 5 – Reception of *Smith, Stone and Knight* into Australian corporate law

In order to determine what place *Smith, Stone and Knight* has, and should continue to have, in Australian corporate law it is now appropriate to examine how the decision has been received by Australian courts and commentators. In assessing the reception that *Smith, Stone and Knight* has had in Australia, it should be noted that academic commentators have stated that the six questions were never intended to constitute a rule of law.³⁷ It is interesting therefore that some courts have used the questions in a manner that equates to the application of a legal rule.³⁸

Reception into Australian law

Academic commentary

There is a high degree of academic acceptance in Australia of the proposition that *Smith, Stone and Knight* supports agency as a ground for lifting the veil.³⁹ The six questions are consistently cited as criteria for establishing the existence of an implied agency relationship between members of a corporate group that may justify lifting the corporate veil. In the writer's view, the authoritative position that the decision is often given is unjustified. At best, the case represents an extremely limited example of the agency ground for lifting the corporate veil because the decision involved an extraordinary fact scenario which renders it inappropriate for formulating general principles.⁴⁰ Furthermore, the writer submits that Australian consideration of the decision demonstrates that it

³⁵ *Maclaine Watson & Co Ltd v Department of Trade and Industry* [1988] 3 All ER 257 at 310-1 per Kerr LJ (the appeal to the House of Lords was dismissed: *JH Rayner (Mincing Lane) Ltd v Department of Trade & Industry* [1989] 3 All ER 523).

³⁶ The purpose of this article is not to attempt to provide a definitive statement as to when an implied agency may lift the corporate veil, but rather to make the point that the decision in *Smith, Stone and Knight* is not a good example of when this may occur.

³⁷ See Tomasic et al, n 19, p 46; Welling, n 9, pp 130-1.

³⁸ *Spreag v Paeson Pty Ltd* (1990) 94 ALR 679 at 711 per Sheppard J; *Australian Liquor, Hospitality and Miscellaneous Workers Union, Western Australian Branch v Burswood Catering and Entertainment Pty Ltd* (2002) 82 WAIG 544 at [68] (appeal dismissed, *Burswood Catering and Entertainment Pty Ltd v ALHMWU (WA Branch)* [2002] WASCA 354).

³⁹ See above n 7.

⁴⁰ *Maclaine Watson & Co Ltd v Department of Trade and Industry* [1988] 3 All ER 257 at 310-1 per Kerr LJ.

should be seen not as authority for the agency ground of lifting the veil, but rather as a collection of relevant factors that may be taken into account when deciding on lifting the veil on other, more principled grounds such as avoiding a legal obligation or a sham.⁴¹

Judicial Consideration

The decision that seems to provide the greatest support for *Smith, Stone and Knight* in Australia is *Spreag v Paeson Pty Ltd* (1990) 94 ALR 679 (hereafter *Spreag*), where Sheppard J of the Federal Court specifically applied *Smith, Stone and Knight* to hold a parent company liable for the misleading and deceptive conduct of its wholly-owned subsidiary.⁴² It is submitted however, that the decision in *Spreag* to apply *Smith, Stone and Knight* should not be seen as providing any broad or general support for using the six questions to justify lifting the corporate veil on the basis of agency. It is submitted that the precedent value of *Spreag* should be limited on the basis that it involved very similar facts as *Smith, Stone and Knight* and therefore should not be seen as endorsing the application of the six questions outside of similar fact scenarios. In both cases, the subsidiary companies were ghost entities with no assets and no employees, and with the parent companies completely disregarding the separate legal entity of the subsidiaries.⁴³ It is suggested that the exceptional fact scenarios present in both cases limits the value of Sheppard J's acceptance of *Smith, Stone and Knight* in Australia, and particularly does not provide a basis for the decision, or the six questions to be used as a broad, general basis for lifting the corporate veil. As noted above, the Court of Appeal in England has previously noted the exceptional facts involved in *Smith, Stone and Knight*.⁴⁴ This comment was referred to in the New South Wales Court of Appeal as spelling the "death knell of the usual arguments by which the effects of incorporation are sought to be displaced by application of agency principles by creditors of the subsidiary".⁴⁵

It may also be possible to criticise the reasoning of Sheppard J. Consider the following statement:⁴⁶

The decisions in the *Industrial Equity, Dennis Willcox and Sharrment* cases emphasise that *Salomon's case* is still good law. ***Nevertheless, no case suggests that Atkinson J's decision in the Smith, Stone and Knight case was wrong and the question is whether the present case can be said to fall within the principles propounded in it.*** In other words, what answer should be made, having regard to the facts in this case, to the six questions which Atkinson J asked himself? [emphasis added]

This statement represents the core reasoning of Sheppard J's justification for applying *Smith, Stone and Knight*. That is, 'because no case has ever suggested that the decision is wrong'. It is respectfully submitted that his Honour has failed to accord due weight to comments made by Kitto J in *Hobart Bridge Co Ltd v FCT* (1951) 82 CLR 372; 25 ALJR

⁴¹ See below Pt 6.

⁴² *Spreag v Paeson Pty Ltd* (1990) 94 ALR 679 at 711-712 per Sheppard J. This has been generally accepted by academic commentators: see Baxt R, and Lane T, "Developments in Relation to Corporate Groups and the Responsibilities of Directors – Dome Insights and New Directions" (1998) 16 C&SLJ 628 at 646.

⁴³ *Bray v F Hoffman-La Roche Ltd* (2002) 118 FCR 1 at 20; 190 ALR 1 per Merkel J.

⁴⁴ *Maclaine Watson & Co Ltd v Department of Trade and Industry* [1988] 3 All ER 257 at 310-1 per Kerr LJ.

⁴⁵ *Briggs v James Hardie & Co Pty Ltd* (1989) 16 NSWLR 549 at 575; 7 ACLC 841 per Rogers AJA.

⁴⁶ *Spreag v Paeson Pty Ltd* (1990) 94 ALR 679 at 711 per Sheppard J.

225 (hereafter *Hobart Bridge*).⁴⁷ In *Hobart Bridge*, Kitto J emphatically rejected an argument put on behalf of the taxpayer that the profits of a subsidiary company, 90% owned by the parent company, should be treated as the profits of the parent on the basis of the degree of control that the parent exercised over the subsidiary. His Honour stated that the argument invited "the Court to blur distinctions which are real and significant".⁴⁸ This strikes at the heart of the ratio in *Smith, Stone and Knight* and the use of the six questions to determine an implied agency for the purpose of lifting the corporate veil. The decision in *Hobart Bridge* has been applied and commented on favourably on numerous occasions.⁴⁹ Furthermore, Sheppard J's dismissal of the Full Federal Court's decision in *Dennis Willcox Pty Ltd v FCT* (1988) 79 ALR 267 (hereafter *Dennis Willcox*) is particularly puzzling. Consider the following statement from *Dennis Willcox*:⁵⁰

Neither the circumstance that a company is completely subject to the ownership and the direction of another person nor the circumstance that that other person exercises directorial control of the activities of the company in ways which minimise the manifestations of the company's separate legal identity will justify, in my opinion, a conclusion that acts in the law formally done by the company are to be regarded, for purposes of the kind here in question in relation to Australian income tax law, as acts in the law done by that other person.

It is submitted that these comments strike at the very heart of the six questions proposed in *Smith, Stone and Knight* (which focus overwhelmingly on control). It could be argued that the above statement by Jenkinson J (who delivered the judgment of the court in *Dennis Willcox*) should not be seen as an attack on *Smith, Stone and Knight*, but rather merely as part of his Honour's decision to distinguish that case on the basis of different facts.⁵¹ However, the above quote is drafted in very general terms, which creates the impression that his Honour was attempting to provide a statement of broad application. It is at least arguable that the above statement demonstrates that the Full Bench in *Dennis Willcox* had serious doubts concerning the general application in Australia of the six questions in *Smith, Stone and Knight* but did not want to go so far as explicitly stating that they thought the decision was incorrect. In light of these authorities at the time of the decision in *Spreag*, it should have been imperative for Sheppard J in *Spreag* to provide some principled basis for overcoming the criticism rather than simply stating that the criticism did not overturn the decision in *Smith, Stone and Knight* and then going on to assume that the decision must therefore be correct. There appears therefore to be a lack of solid support for *Smith, Stone and Knight* and its six questions in Australia except for, at its highest, situations involving very similar fact scenarios, although, even this is not without doubt in light of the criticisms of the six questions outlined above. It is therefore appropriate to search for alternate authority that provides general support for the

⁴⁷ See also *Dennis Willcox Pty Ltd v FCT* (1988) 79 ALR 267 at 274; 14 ACLR 156; 19 ATR 1122 per Jenkinson J.

⁴⁸ *Hobart Bridge Co Ltd v FCT* (1951) 82 CLR 372 at 386; 25 ALJR 225 per Kitto J.

⁴⁹ *Pioneer Concrete Services Ltd v Yelnah Pty Ltd* (1986) 5 NSWLR 254 at 268; 11 ACLR 108; 5 ACLC 467 per Young J; *Hadoplane Pty Ltd v Edward Rushton Pty Ltd* [1996] 1 Qd R 156 at 160 per Pincus JA; *Commonwealth Bank of Australia v Ridout Nominees Pty Ltd* [2000] WASC 37 at [57] per Wheeler J.

⁵⁰ *Dennis Willcox Pty Ltd v FCT* (1988) 79 ALR 267 at 274; 14 ACLR 156; 19 ATR 1122 per Jenkinson J.

⁵¹ Certainly, Jenkinson J qualifies his discussion of *Smith, Stone and Knight* with the phrase "Without questioning the reasoning of [*Smith, Stone and Knight* and *DHN*]": at ALR 272.

proposition that *Smith, Stone and Knight* may be used in Australia to lift the veil because of an implied agency relationship.

According to some academic commentators,⁵² support for *Smith, Stone and Knight* in Australia may also be found in the case of *Hotel Terrigal Pty Ltd (in liq) v Latec Investments Ltd (No 2)* [1969] 1 NSW 676 (hereafter *Latec Investments*), where Else-Mitchell J of the NSW Supreme Court specifically applied *Smith, Stone and Knight*.

Latec Investments considered whether a transfer by a mortgagee corporation exercising a power of sale over property to its wholly owned subsidiary should have been set aside under the Court's equitable jurisdiction. Else-Mitchell J decided that the transfer of property to the subsidiary company by the parent mortgagee was an improper exercise of power. Part of his Honour's reasoning was based on the decision to lift the corporate veil between the parent mortgagee and its subsidiary on the basis of an implied agency. However, it is submitted that the decision should not be seen as providing strong support for *Smith, Stone and Knight* in Australia, as the veil lifting by his Honour was concerned primarily with achieving the goal of Equity in providing justice to both parties in a mortgage transaction. Furthermore, it is open to argument that his Honour misapplied *Smith, Stone and Knight*.

In the writer's view, the decision in *Latec Investments* should not be seen as a legitimate application, or approval of, *Smith, Stone and Knight's* use of the agency ground for lifting the veil as the decision contains no analysis of *Smith, Stone and Knight*, and ignores any pre-existing criticism of the agency ground for lifting the veil.⁵³ This is demonstrated by the following passage, which reproduces in full his Honour's comments regarding the case:⁵⁴

These matters appear to me also to rebut the independent corporate personality rule laid down in *Salomon v Salomon & Co*, because they show the subsidiary company to have been in fact an agent, and not a true independent corporate [citing *Smith, Stone and Knight*]. In these circumstances, and regardless of the question of the price of the proposed sale, *it would stultify the jurisdiction of the Equity Court* [the decision occurred before the *Supreme Court Act 1970* (NSW)] to say that the transfer had any effect at all, and in my opinion the plaintiff's equity of redemption can be asserted against [the defendants] in the same manner and to the same extent as though there had been no transfer. [emphasis added]

The proposition that this decision represents a positive affirmation of *Smith, Stone and Knight* in Australia may be criticised on several grounds. Firstly, in the writer's view the decision does not represent a correct application of *Smith, Stone and Knight*. His Honour placed emphasis on the following facts:⁵⁵

⁵² Ford HAJ, Austin RP and Ramsay IM, *Ford's Principles of Corporations Law* (practitioner ed, Butterworths, 2003) at [4.250]; Farrar et al, n 2, p 75. Note that some commentators have only given passive support for this proposition such as Tomasic R, Jackson J and Woellner R, *Corporations Law: Principles, Policy and Process* (4th ed, Butterworths 2002) pp 159-60; Tomasic R, Bottomley S and McQueen R, *Corporations Law in Australia* (2nd ed, Federation Press, 2002) pp 46-7.

⁵³ *Hobart Bridge Co Ltd v FCT* (1951) 82 CLR 372 at 384-7; 25 ALJR 225 per Kitto J.

⁵⁴ *Hotel Terrigal Pty Ltd (in liq) v Latec Investments Ltd (No 2)* [1969] 1 NSW 676 at 680 per Else-Mitchell J.

⁵⁵ *Hotel Terrigal Pty Ltd (in liq) v Latec Investments Ltd (No 2)* [1969] 1 NSW 676 at 680 per Else-Mitchell J.

- a) Southern Hotels Pty Ltd (the subsidiary transferee) was a wholly owned subsidiary of Latec Investments Ltd (parent transferor/mortgagee);
- b) both companies shared the same directors;
- c) it was the directors of the parent who chose the subsidiary as the intended transferee without, as appears from the reported decision, any negotiation between the two companies; and
- d) the transfer was not completed by final payment until one year after the transfer.

It is submitted that these factors alone are insufficient to justify an application of *Smith, Stone and Knight*. In applying the six questions, which his Honour did not do, there is nothing to indicate that the subsidiary company was disregarded as a separate legal entity as was the case in *Smith, Stone and Knight*.⁵⁶ The subsidiary company had separate assets, separate books, and was a pre-existing company with its own business prior to the transfer.⁵⁷ This factual scenario is markedly different from *Smith, Stone and Knight*, where the purported agent had no assets and no employees. The large differences in material facts between the decisions, combined with the fact that *Smith, Stone and Knight* had not previously been applied in Australia, called for a considered discussion of the applicability of the case. This however, was not done as the decision was mentioned only briefly without any further analysis.

Secondly, it is clear from a full reading of his Honour's reasons that the primary consideration in his decision was to do equity between the parties. His Honour, prior to the passage extracted above, stated that:⁵⁸

I am satisfied that the purpose of this sale was only a step in a scheme devised by the directors of Latec Investments Ltd to acquire the hotel free from any interest of Hotel Terrigal Pty Ltd and its other shareholders and one reason for this course was the desirability of reducing or rationalizing the competition between that hotel and the Hotel Florida which was the property of [another] wholly owned subsidiary of Latec Investments Ltd.

It is submitted that this passage demonstrates that his Honour was concerned with doing equity between the parties under the law of mortgages rather than providing positive acceptance of *Smith, Stone and Knight*, which prior to *Latec Investments* had never been applied as ratio of any Australian decision in the 30 years between the decisions. Else-Mitchell J was concerned about the seemingly self-interested actions of the directors of Latec Investments and the appearance of a breach of their duty as mortgagees to exercise their power of sale for a proper purpose.⁵⁹ When these considerations are combined with the fundamental failure by Else-Mitchell J to consider any aspect of *Smith, Stone and Knight*, including the now famous six questions, it is reasonable to view *Latec*

⁵⁶ *Bray v F Hoffman-La Roche Ltd* (2002) 118 FCR 1 at 22-3; 190 ALR 1 per Merkel J.

⁵⁷ *Heytesbury Holdings Pty Ltd v City of Subiaco* (1998) 19 WAR 440 at 452; 100 LGERA 223 per Steytler J.

⁵⁸ *Hotel Terrigal Pty Ltd (in liq) v Latec Investments Ltd (No 2)* [1969] 1 NSW 676 at 679 per Else-Mitchell J.

⁵⁹ *Hotel Terrigal Pty Ltd (in liq) v Latec Investments Ltd (No 2)* [1969] 1 NSW 676 at 679-80 per Else-Mitchell J.

Investments as not providing adequate support for the application in Australia of the six questions in *Smith, Stone and Knight* to lift the corporate veil on the basis of agency.⁶⁰

In the writer's view, the above analysis demonstrates that the two decisions traditionally seen as providing sufficient support for the use of the six questions in *Smith, Stone and Knight* to lift the corporate veil in Australia, that is, *Latec Investments* and *Spreag*, fail to adequately fulfil this role. It is therefore appropriate to consider whether there is any alternative authority to justify using the six questions to determine the existence of an agency relationship that may lift the corporate veil.

Alternative support for *Smith, Stone and Knight*

There have been several decisions from many jurisdictions across Australia that contain comments supporting the acceptance of *Smith, Stone and Knight* as a ground for lifting the veil on the basis of agency. It is appropriate to consider these decisions in order of judicial status.

The High Court

The highest level of judicial acceptance has occurred in the High Court in the trial decision of Williams J in *Griffiths Hughes Pty Ltd v FCT* (1951) 84 CLR 13; 25 ALJR 434 (hereafter *Griffiths*). In that case, his Honour cited *Smith, Stone and Knight* as authority for the proposition that "the conception of one company carrying on business not on its own account but as the mere agent or branch of another company is by no means novel."⁶¹ His Honour's decision was affirmed on appeal by the full bench of the High Court,⁶² however their Honours did not refer to *Smith, Stone and Knight*. It is submitted that the statement by Williams J is limited in its authoritative value as it was clearly *obiter dictum* with little relevance for modern Australian company law. This is supported by the fact that the appeal to the Full High Court did not refer to *Smith, Stone and Knight*, and in the 52 years since *Griffiths* was decided, it has not been commented on in any decision that the writer's research has disclosed. The comments of Williams J in *Griffiths* may also be distinguished on the basis that the tax legislation involved in the case conferred a statutory ground for lifting the corporate veil between members of a corporate group for the purposes of income tax assessment.⁶³

State Supreme Courts

In Victoria, the decision in *Linfa Pty Ltd v Citibank Ltd* [1995] 1 VR 643 (hereafter *Linfa*) may be seen as supporting the application of *Smith, Stone and Knight* for lifting the veil on the basis of agency. In that decision, the Court agreed to lift the veil between a parent and subsidiary for the purposes of ordering discovery. *Linfa* may easily be distinguished however, because the relevant legal question concerned whether documents of a subsidiary company were within the "control" of its parent company for the purposes of ordering discovery. It is beyond question that the law of discovery involves the

⁶⁰ This analysis is supported by the Full Federal Court's decision in *Dennis Willcox Pty Ltd v FCT* (1988) 79 ALR 267 at 273-4; 14 ACLR 156; 19 ATR 1122 per Jenkinson J (with whom Woodward and Foster JJ agreed).

⁶¹ *Griffiths Hughes Pty Ltd v FCT* (1951) 84 CLR 13 at 19; 25 ALJR 434 per Williams J.

⁶² The appeal case was also reported at (1951) 84 CLR 13.

⁶³ *War-time (Company) Tax Assessment Act 1940* (Cth), s 17.

determination of questions about control over documents.⁶⁴ In the realm of company law however, it is also beyond question that control is insufficient to justify lifting the veil on the basis of agency. Therefore, the *Linfa* case is not an appropriate authority to provide general support for *Smith, Stone and Knight*. Furthermore, Hedigan J specifically described his discussion of the case as unnecessary, thereby demonstrating that any support would be mere *obiter dicta*.⁶⁵

Support for the case may also be taken from an unreported decision of the Victorian Supreme Court which, in a dispute relating to compensation for breach of contract, allowed damages to be claimed by the controller of a corporation on the basis of lifting the veil on the basis of agency.⁶⁶ This decision may be distinguished on the basis that his Honour Fullagar J did not consider *Smith, Stone and Knight* or any of the other agency cases mentioned above. It cannot therefore be said to provide strong support for the application of *Smith, Stone and Knight* in Australia.

In New South Wales, there have been several practice and procedure cases which have cited *Smith, Stone and Knight* as authority for lifting the veil on the basis of agency.⁶⁷ One recent example occurred in the unreported decision in *Century Medical v THLD Ltd* [1999] NSWSC 731 (hereafter *Century Medical*), which concerned an application for an extension of time to file further documentary material. It is submitted that these procedural cases should not be seen as providing general support for *Smith, Stone and Knight* because they usually consider preliminary questions of law and proper procedure, without discussion of the substantive merits of veil lifting. This was explicitly recognised by Einstein J in the following passage from *Century Medical*:⁶⁸

To my mind, it is particularly important to treat the subject notice of motion as dealing with a pleading point or matter going to pleadings. This is not an occasion in which evidence of the underlying facts is appropriate to be examined or to be examined in any real detail. The question is quite simply whether or not the pleading in the form now sought to be propounded offends against the necessary requirements for a pleading before the Commercial list.

In Queensland, a decision of the Land Court may provide some support for the application of *Smith, Stone and Knight* in Australia.⁶⁹ In that case, Smith P cited *Smith, Stone and Knight* and *DHN Food Distributors Ltd v London Borough of Tower Hamlets* [1976] 3 All ER 462 (hereafter *DHN*), as authority for the proposition that commercial realities and fairness in compensation assessments should not be restricted by narrow legal concepts such as the corporate veil. It is submitted however, that the precedent value of this decision is questionable on the basis of its strong support for the *DHN* case

⁶⁴ See *General Rules of Civil Procedure 1996* (Vic) Ch 1 O29(2), O29(2); Williams NJ, *Williams Civil Procedure Victoria* (loose leaf ed, Butterworths) at [I 29.01.225]; Bailey DL, and Evans EK, *Discovery and Interrogatories Australia* (loose leaf ed, Butterworths) at [17, 050]-[17, 070].

⁶⁵ *Linfa Pty Ltd v Citibank Ltd* [1995] 1 VR 643 at 649 per Hedigan J.

⁶⁶ *Ampol Petroleum (Victoria) Pty Ltd v Findlay* (unreported, VSC, Fullagar J, 30 October 1986) BC8600141 at 28. This decision was cited in Ramsay and Noakes, n 4 at 254-5.

⁶⁷ There is also the majority decision in *Salim v Ingham Enterprises Pty Ltd* (1998) 55 NSWLR 7 at 11-12 per Stein JA (with whom Handley JA agreed) which supports the agency ground. That decision may be distinguished on the basis that it did not refer to any of the previous agency cases such as *Smith, Stone and Knight* or *Spreag*.

⁶⁸ *Century Medical v THLD Ltd* [1999] NSWSC 731 at [29] per Einstein J.

⁶⁹ *Wanless v Brisbane City Council* (1987) 11 QLCR 252.

which has been heavily criticised by various courts in Australia and in the UK, and according to some judges, may be inconsistent with High Court authority.⁷⁰

It is clear that the proposition that *Smith, Stone and Knight* has been generally accepted in Australia as providing a general agency basis for lifting the corporate veil must be seriously doubted. To further clarify why it is inappropriate to use the decision to support the lifting of the corporate veil in Australia on the basis of agency, judicial comment critical of the decision will now be considered.

Judicial disapproval of *Smith, Stone and Knight*

There are several appellate-level decisions that specifically question the validity of using the six questions in *Smith, Stone and Knight* to justify lifting the corporate veil on the basis of an implied agency.⁷¹

In the Queensland decision in *Hadoplane Pty Ltd v Edward Rushton Pty Ltd* [1996] 1 Qd R 156, Pincus JA who, whilst not referring to *Smith, Stone and Knight* specifically, relied on Kitto J's comments in *Hobart Bridge*, noted above, opposing the proposition that an implied agency may be used to lift the corporate veil. His Honour stated "in my view, the tendency of Australian authority is against 'lifting the veil' in such circumstances."⁷²

In addition, the New South Wales Court of Appeal has disagreed with the proposition that *Smith, Stone and Knight* may be used to lift the veil on the basis of agency.⁷³ The Court suggested however that elements of control may be used to support veil lifting on the basis of the company constituting a sham or façade.⁷⁴

Lower court disapproval

The decision of Young J in *Pioneer Concrete Services Ltd v Yelnah Pty Ltd* (1986) 5 NSWLR 254 (hereafter *Pioneer Concrete*), which held that the separate legal personality of a company is to be disregarded only if the court can see that there is, in fact or in law, a partnership between companies in a group, or that there is a mere sham or façade in which that company is playing a role, or that the creation or use of the company was designed to enable a legal or fiduciary obligation to be evaded or a fraud to be perpetrated, would seem to go against assertions that *Smith, Stone and Knight* may be used to justify lifting the veil on the basis of agency.

A unanimous Appeal Bench of the Administrative Appeals Tribunal also provides support against using *Smith, Stone and Knight* to lift the corporate veil on the basis of agency.⁷⁵ After quoting extensively from *Smith, Stone and Knight* and *DHN*, the full bench stated that the decisions had been heavily criticised in both Australia and in the

⁷⁰ Cf *Industrial Equity Ltd v Blackburn* (1977) 137 CLR 567 as discussed in *Pioneer Concrete Services Ltd v Yelnah Pty Ltd* (1986) 5 NSWLR 254 at 267; 11 ACLR 108; 5 ACLC 467 per Young J and *Hadoplane Pty Ltd v Edward Rushton Pty Ltd* [1996] 1 Qd R 156 at 160 per Pincus JA.

⁷¹ The High Court's decision in *Hobart Bridge Co Ltd v FCT* (1951) 82 CLR 372; 25 ALJR 225 and the full Federal Court's decision in *Dennis Willcox Pty Ltd v FCT* (1988) 79 ALR 267; 14 ACLR 156; 19 ATR 1122, both of which criticise the basis of the six questions, have already been referred to above.

⁷² *Hadoplane Pty Ltd v Edward Rushton Pty Ltd* [1996] 1 Qd R 156 at 160 per Pincus JA.

⁷³ *James Hardie & Co Pty Ltd v Hall (as administrator of Putt)* (1998) 43 NSWLR 554 at 579-584 per Sheller JA (with whom Beazley and Stein JJA agreed).

⁷⁴ See discussion below in Pt 6.

⁷⁵ *Re BHP Petroleum (Timor Sea) Pty Ltd & Minister for Resources* (1997) 46 ALD 117.

UK, and concluded on the basis of this criticism that lifting the veil for agency in that case would be "going against the weight of Australian authority".⁷⁶

On the basis of the analysis above, it is submitted that the weight of judicial authority in Australia does not support the general use of the six questions in *Smith, Stone and Knight* for lifting the corporate veil on the basis of agency.⁷⁷ The better view is that the courts are very cautious about the use of *Smith, Stone and Knight* in Australia, and are unlikely to rely on the decision outside of virtually identical fact scenarios.

Further judicial commentary

Aside from decisions that directly support or oppose *Smith, Stone and Knight* as authority for lifting the veil in Australia, there are also a large number of decisions that have commented on the case without necessarily endorsing it.⁷⁸ The most significant of these cases is the NSW Court of Appeal's decision in *Briggs v James Hardie & Co Pty Ltd* (1989) 16 NSWLR 549 (hereafter *Briggs*), a negligence case that granted an extension of time to the relevant limitation period to bring an action against related corporations.⁷⁹ The Court of Appeal was made up of Hope and Meagher JJA and Rogers AJA, each of whom delivered separate written reasons. This case has been extensively cited in subsequent cases around Australia, making it appropriate to consider what value it adds to the debate concerning the application of *Smith, Stone and Knight*. This will be done by considering the two main judgments separately.

Hope JA

While his Honour did not deal specifically with *Smith, Stone and Knight*, he did consider whether an agency relationship would be sufficient to allow a plaintiff an extension of the limitation period for bringing an action against related corporations. It is submitted that the following passage demonstrates that his Honour's decision should be seen in the same light as the procedural cases (such as *Century Medical*) considered above:

a plaintiff is entitled to bring an action against two defendants if he has evidence to establish a prima facie case against one of the defendants, and also has evidence pointing to the possibility of the other defendant being liable ... Applying this principle I am satisfied that even if the applicant did not succeed in establishing the existence of evidence upon the basis of which it could be held that the subsidiary was the agent of either of the principal companies, that the corporate veil could be lifted to make either of those companies liable, or that those companies were otherwise liable in negligence, he did establish that there was a possibility that that evidence existed.⁸⁰

Therefore, according to Hope JA, as long as there was a *possibility* that evidence existed that may prove the existence of an agency the extension of time should be granted. In the

⁷⁶ *Re BHP Petroleum (Timor Sea) Pty Ltd & Minister for Resources* (1997) 46 ALD 117 at 149-51 per the Full Bench.

⁷⁷ The writer argues therefore that the comment in French HL, *Guide to Corporations Law* (4th ed, Butterworths, 1994) p 25, that the criticism of *Smith, Stone and Knight* contained in *Dennis Willcox*, goes against the trend of judicial acceptance of the agency ground, is now incorrect.

⁷⁸ See for example *Donnelly v Edelsten* (1994) 49 FCR 384 at 394-5; 121 ALR 333; 13 ACSR 196 per the Court.

⁷⁹ The significance of the *James Hardie* decision lies in the fact that it is often cited, both in cases and also academic commentary, when considering whether to lift the corporate veil.

⁸⁰ *Briggs v James Hardie & Co Pty Ltd* (1989) 16 NSWLR 549 at 554; 7 ACLC 841 per Hope JA.

company law context however, it would be insufficient to justify lifting the veil on the basis that evidence possibly exists.

The more significant decision, for the purposes of seeking support for *Smith, Stone and Knight* was given by Rogers AJA.⁸¹

Rogers AJA

It is suggested that his Honour's decision does not support the application of *Smith, Stone and Knight* in Australia as a ground for lifting the veil on the basis of agency. There are several reasons for this. Firstly, the decision primarily involved a consideration of the relevant procedural rules for allowing an extension of time under the statutory limitation period. As discussed above, the applicable test in these situations is not as strict as the test is for lifting the veil is at a full trial. As his Honour stated:⁸²

The process ... is one of screening. The application is not a preliminary trial of the issues. The standard to satisfy is not that required to allow a case to go to the jury. It is only proof of the availability of the evidence which is required rather than the evidence itself ... Most importantly for present purposes, a special rule applies in case of multiple defendants where it is sufficient to prove the existence of evidence showing the possibility of a case against a particular defendant being made out.

Secondly, the decision concerned the law of negligence. There is an important distinction in the rationale for veil lifting involved in negligence cases and non-negligence cases. A plaintiff in negligence needs to establish that the defendant is responsible under the decisions stemming from the neighbourhood principle in Lord Atkins' famous judgment in *Donoghue v Stevenson* [1932] AC 562. The core of this principle is the ability to look beyond strict legal forms (such as contract or business structures) to determine whether a reasonable person would have acted differently and is therefore liable in negligence. It is submitted that the neighbourhood relationship described in *Donoghue v Stevenson* implicitly asserts the power to lift the corporate veil if needed to compensate an injured plaintiff for a negligent act or omission by the defendant. There is however, no similar power applicable in non-tort related company law disputes.⁸³ Indeed, Rogers AJA in *Briggs* seemed highly critical of any relationship between facts which are relevant to negligence and the principles coming from *Smith, Stone and Knight*. He stated:⁸⁴

Control and dominance by a holding company of a subsidiary do not in themselves increase the risk of injury to tort victims ... The failure of a corporation to comply with usual corporate formalities, such as shareholders' and directors' meetings, useful as it may be as an indicator in an action for debt, has nothing to do with a claim by a pedestrian who has been hit by a motor vehicle owned by an insolvent subsidiary and either uninsured or inadequately insured. The factors of shareholder control and dominance by a parent corporation may be equally irrelevant in determining in actions in tort whether the parent should be held liable.

⁸¹ His Honour Meagher JA dissented by holding that "there is ... in my view, no evidence at all to which the applicant could point which would justify a finding of agency": *Briggs v James Hardie & Co Pty Ltd* (1989) 16 NSWLR 549 at 556; 7 ACLC 841 per Meagher JA.

⁸² *Briggs v James Hardie & Co Pty Ltd* (1989) 16 NSWLR 549 at 564-5; 7 ACLC 841 per Rogers AJA.

⁸³ See Edmundson P, and Stewart P, "Liability of a Holding Company for Negligent Injuries to an Employee" (1998) 6 TLJ 123; *CSR Ltd v Young* (1998) Aust Torts Reports 81-468 at 64,953 per Giles AJA.

⁸⁴ *Briggs v James Hardie & Co Pty Ltd* (1989) 16 NSWLR 549 at 578-580; 7 ACLC 841 per Rogers AJA.

It is submitted that, applying his Honour's language in support of the writer's contentions, the above analysis should "spell the death knell for the usual arguments by which the effects of incorporation are sought to be displaced by application of agency principles".⁸⁵

It is interesting to note that the issue of whether tort liability is sufficient to lift the corporate veil has arisen 15 years later, again because of activities concerning the James Hardie corporate group. The New South Wales government has recently established a Special Commission of Inquiry investigating James Hardie's conduct in establishing a charitable foundation to assist victims of asbestos-related illness, contracted from exposure to asbestos formerly produced by James Hardie. In the submissions to the Special Commission that have been made publicly available, it has been argued that the corporate veil should be lifted to make James Hardie, which has undergone a significant restructure to become a Dutch company, responsible for tort claims made against members of its corporate group resident in Australia. There are several methods that could achieve this veil lifting, although the publicly available submissions argue for special legislative measures. In the writer's view, it should be possible to rely on general tort principles as discussed above.⁸⁶ The difficulty of course, is proving that the asset rich parent company owed and breached a duty of care owed to the employees and customers of its subsidiary. This issue however, lies outside of the scope of this article, which is to consider whether *Smith, Stone and Knight* may properly be used to support the lifting of the corporate veil on the basis of an implied agency.⁸⁷

Before leaving the discussion of *Briggs*, one further point needs to be raised. Rogers AJA made a curious comment after quoting from *Dennis Willcox*. His Honour stated "it may be argued that [Jenkinson J in *Dennis Willcox*] distinguished decisions, such as that of Atkinson J [in *Smith, Stone and Knight*], by reference to principles of Australian income tax law."⁸⁸ This comment seems curious because the decision of Atkinson J in *Smith, Stone and Knight*, and the famous six questions, were based wholly upon British tax cases.⁸⁹ It is submitted therefore, that the criticisms of *Smith, Stone and Knight* in *Dennis Willcox* should not be dismissed merely because they arose in a taxation decision.

In light of the above consideration, it is submitted that the *Briggs* decision provides no general support for *Smith, Stone and Knight* as the basis for lifting the veil in Australia because of an implied agency relationship.⁹⁰ It seems therefore, that there is no

⁸⁵ *Briggs v James Hardie & Co Pty Ltd* (1989) 16 NSWLR 549 at 575; 7 ACLC 841 per Rogers AJA.

⁸⁶ This conforms with Recommendation 14 of the Companies and Securities Advisory Committee (since renamed the Corporations and Markets Advisory Committee), Final Report, Corporate Groups (published May 2000), [http://www.camac.gov.au/camac/camac.nsf/byHeadline/PDFFinal+Reports+2000/\\$file/Corporate_Groups_May_2000.pdf](http://www.camac.gov.au/camac/camac.nsf/byHeadline/PDFFinal+Reports+2000/$file/Corporate_Groups_May_2000.pdf) (viewed 1 October 2004).

⁸⁷ The writer intends to discuss lifting the corporate veil on the basis of tort liability in light of the James Hardie debate in a future publication.

⁸⁸ *Briggs v James Hardie & Co Pty Ltd* (1989) 16 NSWLR 549 at 572; 7 ACLC 841 per Rogers AJA.

⁸⁹ *San Paulo (Brazilian) Railway Co Ltd v Carter* [1896] AC 31; (1895) 3 TC 407; *Apthorpe v Peter Schoenhofen Brewing Co Ltd* (1899) 4 TC 41; *Jones (Frank) Brewing Co v Apthorpe* (1898) 4 TC 6; *St Louis Breweries Ltd v Apthorpe* (1898) 4 TC 111.

⁹⁰ As noted above, the *Briggs* decision may well assist in situations involving tort liability rather than agency.

principled basis to support the use of the six questions in *Smith, Stone and Knight* to establish a general agency that will be sufficient in Australia to lift the corporate veil.

Recent developments-appellate application of *Smith, Stone and Knight*?

In view of the large amount of criticism surrounding the application of *Smith, Stone and Knight*, as discussed above, it was surprising that a recent appellate court decision appeared to unequivocally support the application of the six questions in *Smith, Stone and Knight* to lift the corporate veil in an industrial dispute. The recent decision by the Western Australia Industrial Appeal Court in *Burswood Catering and Entertainment Pty Ltd v ALHMWU (WA Branch)* [2002] WASCA 354 (hereafter *Burswood*),⁹¹ has in the writer's opinion, attempted unsuccessfully to approve *Smith, Stone and Knight* for use in industrial disputes in Australia. The decision in *Burswood* dismissed an appeal against an earlier decision of the Full Bench of the Western Australian Industrial Relations Commission in Court session⁹² which lifted the corporate veil between a parent company (BRM) and its wholly owned subsidiary (BCE), both entities in the Burswood Casino Group of companies.

The facts of the case relate to the creation by BRM of a wholly owned subsidiary company (BCE) for the purposes of pursuing catering contracting work both inside and outside the Casino complex. The Commission justified lifting the veil on the basis of what it saw as the evident intention of BRM, which was to avoid the binding force of a collective bargaining agreement that had recently been certified, with BRM's consent, by the Commission in settlement of an industrial dispute that had existed between BRM and the union representing its catering staff at the Casino. When BRM established BCE, many but not all of the BRM catering staff became employees of BCE on different terms and conditions than they had enjoyed whilst working for BRM. BCE took over much of the work previously carried out by the BRM catering staff. This change in work was greatly facilitated by a major renovation of the Casino's food and beverage area. Once the renovations were completed BCE took over much of the newly configured eating area in the Casino.

The Union applied to the Commission for an order making a new award that applied to the staff working for BCE. The terms and conditions of the proposed award were similar to those that applied under the collective agreement between the Union and BRM. In determining whether to create a new award between BCE and the Union the Commission considered whether the workers employed by the subsidiary company BCE should be governed by the same terms and conditions as the workers employed by the parent company BRM. In support of its application to the Commission to make a new award in settlement of an industrial dispute the Union submitted that the corporate veil should be lifted because BCE was an agent of BRM,⁹³ and had incorporated BCE in an attempt to avoid its legal obligations under the collective agreement by establishing BCE to engage

⁹¹ *Burswood Catering and Entertainment Pty Ltd v ALHMWU (WA Branch)* [2002] WASCA 354. Some of the discussion under this section is based on an earlier, although less detailed, comment by the writer, "Lifting the corporate veil in industrial disputes" (2004) 22 C&SLJ 69.

⁹² *Australian Liquor, Hospitality and Miscellaneous Workers Union, Western Australian Branch v Burswood Catering and Entertainment Pty Ltd* (2002) 82 WAIG 544.

⁹³ *Smith, Stone and Knight* was cited in support of this argument.

in similar work previously performed by BRM under higher employment conditions.⁹⁴ The Commission agreed with these submissions and, in the interests of protecting the equity between the employees performing similar work for the parent and subsidiary companies, granted an order imposing a new award on BCE covering similar terms and conditions as employees performing similar work for BRM enjoyed. The Commission considered that the new award was necessary to settle the industrial dispute between BCE and the Union.⁹⁵

The Commission justified their decision to lift the veil based on the following findings of fact:⁹⁶

1. BCE was incorporated less than one month after the conclusion of the previous collective agreement.
2. Relevant BRM staff were then made redundant.
3. BRM staff were offered employment either with BCE on reduced terms or to continue with BRM, but in different employment.
4. Existing employees of BRM were offered what was effectively the same work for BCE but at lesser remuneration.
5. When BCE was incorporated the Union was not told of its creation or its purpose.
6. During the process of finalisation of the collective agreement, representatives of BRM indicated that they wished to forge a better relationship with the [union] without telling the [union] of the plans for the incorporation of BCE [i.e. to perform some of the catering services previously provided by BRM].

The Commission's reliance on *Smith, Stone and Knight* is demonstrated by the following passage:⁹⁷

Having considered all of the evidence it our view that the corporate veil should be lifted. If the questions set out by Atkinson J are asked, it is apparent from the uncontradicted evidence set out above that each question must be answered in the affirmative.

It is submitted that the Commission's reliance on the six question in *Smith, Stone and Knight* was misplaced. In the writer's view, the power of the Commission to lift the veil arose not from the common law ground of agency, but rather from the broad discretionary powers given to industrial tribunals, and indeed many administrative tribunals, to come to the most equitable and fair decision.

⁹⁴ *Gilford Motor Co Ltd v Horne* [1933] Ch 935 was cited in support of this argument.

⁹⁵ *Australian Liquor, Hospitality and Miscellaneous Workers Union, Western Australian Branch v Burswood Catering and Entertainment Pty Ltd* (2002) 82 WAIG 544 at [68].

⁹⁶ *Australian Liquor, Hospitality and Miscellaneous Workers Union, Western Australian Branch v Burswood Catering and Entertainment Pty Ltd* (2002) 82 WAIG 544 at [40]-[41]. This list is taken from n 91.

⁹⁷ *Australian Liquor, Hospitality and Miscellaneous Workers Union, Western Australian Branch v Burswood Catering and Entertainment Pty Ltd* (2002) 82 WAIG 544 at [68].

The *Industrial Relations Act 1979* (WA) provides guidance to the Commission in arbitrating industrial disputes. The section most relevant to the current discussion is s 26 which reads as follows:

26. Commission to act according to equity and good conscience

(1) In the exercise of its jurisdiction under this Act the Commission-

(a) shall act according to equity, good conscience, and the substantial merits of the case without regard to technicalities or legal forms;

(b) shall not be bound by any rules of evidence, but may inform itself on any matter in such a way as it thinks just;

(c) shall have regard for the interests of the persons immediately concerned whether directly affected or not and, where appropriate, for the interests of the community as a whole;⁹⁸

...

Pursuant to this power it is appropriate for Commission to disregard the formalities of the corporate form if needed to obtain a just and equitable decision. Prior to the decision in *Burswood*, the power to lift the corporate veil was considered in *Adelaide Timber Company Pty Ltd v The West Australian Timber Industry Industrial Union of Workers (South-West Land Division)* (1990) 71 WAIG 325 (hereafter *Adelaide Timber*), where Commissioner Fielding stated “the Commission was not determining existing legal rights and obligations but legislating to create new rights and obligations. In these circumstances, I would have thought it within the scope of s 26(1)(a) of the *Industrial Relations Act 1979* (WA) [extracted above] for the Commission to have regard to the seemingly close relationship between the two companies”.⁹⁹ Furthermore, the joint judgment in *Adelaide Timber* stated that:¹⁰⁰

Whilst it should not be lightly pierced, the corporate veil should not be allowed in proper circumstances in an administrative tribunal such as this to prevent the Commission acting according to equity, good conscience and the substantial merits of the case (i.e. where it is used to justify wrong, protect fraud, or bring about an inequity which otherwise would not have been occasioned).¹⁰¹

These statements seem entirely appropriate where specialist tribunals exercise power under statutory directions to ignore legal formalities if need to come to a just and equitable decision. However, the comments made in *Adelaide Timber* could not be treated as providing appropriate guidance to a supreme court or federal court deciding on whether, as a matter of company law, the *Salomon* principle can be avoided because of an agency relationship, as indicated by the six questions in *Smith, Stone and Knight*. This is strongly supported by a decision of the NSW Court of Appeal where Sheller JA stated "a

⁹⁸ The Commission is specifically directed to these considerations under *Wage Fixing Principle 10* (WA).

⁹⁹ *Adelaide Timber Company Pty Ltd v The West Australian Timber Industry Industrial Union of Workers (South-West Land Division)* (1990) 71 WAIG 325 at 333.

¹⁰⁰ *Adelaide Timber Company Pty Ltd v The West Australian Timber Industry Industrial Union of Workers (South-West Land Division)* (1990) 71 WAIG 325 at 331 per Sharkey P and Halliwell SC.

¹⁰¹ See also *Old Ferry Company Pty Ltd v Bertelli* (1999) 79 WAIG 2547 at 3548 per Sharkey P.

court could not disregard the principle of *Salomon* merely because it considered it just to do so."¹⁰² In conclusion therefore, any support for the application of the six questions in *Smith, Stone and Knight* that decisions such as *Burswood* and *Adelaide Timber* might appear to provide should be strictly limited by the statutory framework within which industrial courts and tribunals operate.

A more fundamental criticism of using the *Burswood* decision to support the application of *Smith, Stone and Knight* in Australia derives from the scope of the Commission's legal reasoning. With respect, it is submitted that reliance on the six questions in *Smith, Stone and Knight* was misplaced. There are several important factual differences between *Smith, Stone and Knight* and *Burswood* which render it inappropriate to simply answer each of the six questions and then rely on those answers *as the basis* for lifting the veil. In *Burswood*, BCE had separate staff to its parent BRM, compared with *Smith, Stone and Knight* where the subsidiary had no staff aside from a manager, without power to inspect or control the company's books. Although BCE's staff were made up largely from former BRM employees, the employees were genuinely employed by BCE, and the situation did not involve BRM imposing its servants onto the newly established BCE. BCE also owned separate assets to BRM, including genuine business contracts outside of its dealings with its parent. Collectively, these important factual differences demonstrate that in *Burswood*, the boundaries of the separate parent/subsidiary relationship were not breached in any manner comparable to *Smith, Stone and Knight*. It should be noted that the writer does not argue that the result in *Burswood* was incorrect or unfair. Clearly the power to lift the veil was available under the relevant statutory powers of the Commission. Rather, it is submitted that the Commission's strict and slavish application of the six questions in *Smith, Stone and Knight* as the primary reason for lifting the veil was inappropriate owing to the marked factual differences between the cases.

Furthermore, the Commission's use of *Smith, Stone and Knight* seems to be entirely unnecessary, using a chain of legal reasoning supported by the decision in *Gilford Motor Co Ltd v Horne* [1933] Ch 935 (hereafter *Gilford Motor*), which would have yielded the same conclusion, on arguably more principled basis. In *Gilford Motor* the corporate veil was lifted on the basis that Horne had attempted to avoid his legally binding obligations by establishing a company to carry on work that he was prevented from doing personally owing to an enforceable restraint of trade. On its face, this ground for lifting the veil would have seemed the ideal basis for the decision in *Burswood*, particularly in light of the relevant facts which the Commission used to base its decision to lift the veil, which clearly point to an intention on behalf of BRM to avoid its obligations under its industrial agreement with the union. However, the *Gilford Motor* case was only mentioned in passing, with the entire reasoning on the veil lifting point devoted to applying the six questions in *Smith, Stone and Knight*.¹⁰³

¹⁰² *James Hardie & Co Pty Ltd v Hall (as administrator of Putt)* (1998) 43 NSWLR 554 at 580 per Sheller JA (with whom Beazley and Stein JJA agreed). See also *Adams v Cape Industries plc* [1990] Ch 433 at 537; [1991] 1 All ER 929; [1990] 2 WLR 657 per the Court.

¹⁰³ *Australian Liquor, Hospitality and Miscellaneous Workers Union, Western Australian Branch v Burswood Catering and Entertainment Pty Ltd* (2002) 82 WAIG 544 at [61].

The appeal from the Commission's decision to the Western Australian Industrial Appeal Court was dismissed. The leading judgment was given by the presiding judge Scott J who, after quoting extensively from the Commission's decision, stated:¹⁰⁴

In my view, it cannot be said that, taking all of the matters into account, the Commission in Court Session was in error in looking behind the corporate veil and determining that BCE was an agent of BRM. Indeed, in my view, that conclusion was inevitable.

It is submitted that the decision on appeal to the Industrial Appeal Court is disappointing because the Appeal Court merely accepted the reasoning of the Commission without any analysis of the proper application of *Smith, Stone and Knight*, including the Commission's use of the six questions, or whether the ground for lifting the veil following *Gilford Motor Co* was appropriate. In the writer's view, the decision in *Burswood* should not be seen as providing general support for the application of *Smith, Stone and Knight* in Australia. It is submitted that the discussion and application of the six questions in *Burswood* does not progress the common law of lifting the corporate veil outside of the decision's industrial law context. Although the *Burswood* case represents a valid application of the general power of industrial courts and tribunals in Western Australia to come to a just and equitable decision for both employers and employees, it does not add to the jurisprudence concerning establishing an agency sufficient to lift the corporate veil outside of industrial law.

Having argued that the six questions in *Smith, Stone and Knight* do not provide a general test that may be used to identify the existence of an agency relationship that will justify lifting the corporate veil on the basis in Australia, it is now appropriate to examine what the proper scope of the decision should be in modern Australian company law.

Part 6-Salvaging *Smith, Stone and Knight*

This article has not argued that an implied agency may never justify lifting the corporate veil, but rather that the six questions in *Smith, Stone and Knight* do not provide a *general ground* for establishing an implied agency that will justify lifting the corporate veil. As discussed above in Part 3, the six questions focus too heavily on the concept of control, and are too imprecise to be used as the sole criteria for establishing an implied agency sufficient to justify lifting the corporate veil. Rather, it is submitted that a more appropriate role for the six questions is in considering whether the arrangements between corporate bodies may be justified on some basis other than implied agency, such as indicating that the existence of a sham, or in industrial contexts, avoiding a legal obligation as discussed above.

Sham or façade

As demonstrated above, there is ample authority to support the view that dominion and control do not provide a sufficient basis for lifting the corporate veil. It is submitted however, that these elements may be indicative of the ostensibly separate entities

¹⁰⁴ *Burswood Catering and Entertainment Pty Ltd v ALHMWU (WA Branch)* [2002] WASCA 354 at [40] per Scott J.

constituting a sham or façade.¹⁰⁵ This contention may be supported by deviating slightly from a common justification given to the agency cases discussed above.¹⁰⁶ The learned authors of *Ford's Principles of Corporations Law* for example, rationalise *Smith, Stone and Knight* in the following manner:¹⁰⁷

Where a company is the ostensible executor of some function but, not having been provided by its controller with resources necessary to do so as an independent entity, relies on the resources of its controller, the controller is liable to be treated as the true executor of the function.

That is more likely to happen where the controller is a parent company of a wholly-owned subsidiary than where the controller is an individual. The denial of resources might be failure to provide adequate proprietors' capital or loan money, or failure to equip it to run its own business by loan of personnel or other resources or to give it a reasonable chance of independently obtaining credit or resources from third persons.

The rationale provided in *Ford* is certainly supported by the traditionally cited agency cases.¹⁰⁸ These decisions, however, all involved ghost companies with no assets, no employees and no real independent identity. It seems reasonable therefore, to suggest that these cases demonstrate that the lack of resources provided by the parent entity to the purported agents indicates what is commonly thought of as being an entirely different basis for lifting the veil – a sham or mere façade. To build on the analysis in *Ford*, and combining it with elements of Atkinson J's six questions, the fact that the subsidiary entities are denied adequate resources indicates that the companies were never intended to be separate legal entities.¹⁰⁹ In other words, the subsidiary company that is denied resources is really a sham company or mere façade, which justifies a lifting of the veil.

The Full Federal Court has defined a sham as being:¹¹⁰

something that is intended to be mistaken for something else or that is not really what it purports to be. It is a spurious imitation, a counterfeit, a disguise or a false front. It is not genuine or true, but something made in imitation of something else or made to appear to be something which it is not. It is something which is false or deceptive.

¹⁰⁵ Support for this may be found in *James Hardie & Co Pty Ltd v Hall (as administrator of Putt)* (1998) 43 NSWLR 554 at 583-4 per Sheller JA (with whom Beazley and Stein JJA agreed) and *Cook v Pasmenco Ltd* [2000] VSC 534 at [32] per Hedigan J.

¹⁰⁶ *Smith, Stone and Knight Ltd v Birmingham Corporation* [1939] 4 All ER 116 and *Spreag v Paeson Pty Ltd* (1990) 94 ALR 679. See also *Re FG (Films) Ltd* [1953] 1 All ER 615; [1953] 1 WLR 483.

¹⁰⁷ Ford HAJ, Austin RP and Ramsay IM, *Ford's Principles of Corporations Law* (practitioner ed, Butterworths, 2003) at [4.250]. A similar argument was raised by Gower in 1979 in Gower LCB, *The Principles of Modern Company Law* (4th ed, Stephens & Sons, 1979) p 130 (not repeated in later editions).

¹⁰⁸ *Smith, Stone and Knight Ltd v Birmingham Corporation* [1939] 4 All ER 116; *Re FG (Films) Ltd* [1953] 1 All ER 615; [1953] 1 WLR 483 and *Spreag v Paeson Pty Ltd* (1990) 94 ALR 679. Ford's rationale was also approved in *Heytesbury Holdings Pty Ltd v City of Subiaco* (1998) 19 WAR 440 at 452; 100 LGERA 223 per Steytler J; *Idoport Pty Ltd v National Australia Bank Ltd* [2004] NSWSC 695 at [144] per Einstein J.

¹⁰⁹ The decision of the UK Court of Appeal in *Adams v Cape Industries plc* [1990] Ch 433 at 539-541; [1991] 1 All ER 929; [1990] 2 WLR 657 per the Court, indicates that the motive involved in establishing the separate legal entities is an important factor in determining whether or not the incorporation was a sham. The same point was made in *Idoport Pty Ltd v National Australia Bank Ltd* [2004] NSWSC 695 at [144] per Einstein J.

¹¹⁰ *Sharrment Pty Ltd v Official Trustee in Bankruptcy* (1988) 18 FCR 449 at 454; 82 ALR 530 per Lockhart J. See similar comments in *ICT Pty Ltd & Buquebus International Ltd v Sea Containers Ltd* (1995) 39 NSWLR 640 at 655 per the Court.

In addition to Atkinson J's six questions, it is submitted that the following factors may indicate a sham or façade sufficient to lift the corporate veil:¹¹¹

- where separate books are not kept;¹¹²
- the subsidiary has no separate assets;¹¹³
- the subsidiary employs no staff;¹¹⁴ and
- the entities involved have the same directors and shareholders.¹¹⁵

This view is supported by a unanimous decision of the Full Federal Court, where the Court considered whether the veil should be lifted between various entities and Dr Edelsten for the purposes of establishing a breach of bankruptcy laws. The Court stated:¹¹⁶

The question, therefore, was whether the acquisition or creation of the businesses of 24 hour medical centres as the property of the VIP Group was a sham; it being agreed and intended that the legal and beneficial ownership of those businesses should be and remain in Edelsten. Some support for an affirmative answer to that question might have been afforded had the conclusion been open that Edelsten had at all times treated the businesses and assets as his own. However, the evidence accepted by the learned trial judge negates that conclusion.

This supports the view that the control and dominance elements contained in Atkinson J's six questions may be used in Australia not as the basis of an agency ground for lifting the veil, but rather, as relevant criteria for assessing the sham or façade ground for veil lifting. The above rationale may be one explanation as to why Gower, an early proponent of a view similar to that expressed in *Ford*, in the 1992 edition of his classic company law text did not repeat his earlier advocacy of the under-capitalization rationale of *Smith, Stone and Knight*. Furthermore, he stated "there is no presumption of any ... agency relationship and in the absence of an express agreement between the parties it will be very difficult to establish one".¹¹⁷

The recent debate surrounding the conduct of members of the James Hardie corporate group has also raised the issue as to whether Australian law should follow the lead of United States law concerning lifting the corporate veil. In factual situations similar to that which occurred in *Smith, Stone and Knight*, the US law provides several doctrines that

¹¹¹ These factors must be read collectively, any evidence that discloses an independence between the entities will prevent a sham or façade argument from succeeding: see for example *Kodak Ltd v Clark* [1903] 1 KB 505, where the existence of an independent shareholder holding 2% of the subsidiary company's share capital was sufficient to prevent the veil from being lifted between the parent and subsidiary.

¹¹² *Bray v F Hoffman-La Roche Ltd* (2002) 118 FCR 1 at 22; 190 ALR 1 per Merkel J; *Eurest (Australia) Catering & Services Pty Ltd v Independent Foods Pty Ltd* (2000) 35 ACSR 352 at 360 per Hodgson CJ.

¹¹³ *Bray v F Hoffman-La Roche Ltd* (2002) 118 FCR 1 at 22; 190 ALR 1 per Merkel J.

¹¹⁴ *Re FG (Films) Ltd* [1953] 1 All ER 615 at 616; [1953] 1 WLR 483 per Vaisey J.

¹¹⁵ *Re FG (Films) Ltd* [1953] 1 All ER 615; [1953] 1 WLR 483; *Bray v F Hoffman-La Roche Ltd* (2002) 118 FCR 1 at 22; 190 ALR 1 per Merkel J.

¹¹⁶ *Donnelly v Edelsten* (1994) 49 FCR 384 at 392; 121 ALR 333; 13 ACSR 196 per the Court.

¹¹⁷ Gower LCB, *The Principles of Modern Company Law* (5th ed, Sweet and Maxwell, 1992) p 132. An identical statement appears in later editions: PL Davies, *Gower and Davies' Principles of Modern Company Law* (7th ed, Sweet and Maxwell, 2003) p 187.

may allow the corporate veil to be lifted between members of a corporate group, particularly the doctrine of under-capitalization and the alter ego doctrine.¹¹⁸ Neither of these doctrines has been applied in Australian corporate law, although the publicly available submissions to the Special Commission of Inquiry into Medical Research and Compensation Foundation, established by the New South Wales government to investigate the conduct of James Hardie in restructuring its organisation and the establishment by it of a charitable fund to satisfy future tort claims, have supported their introduction.¹¹⁹ In his final report, Commissioner Jackson found that these doctrines offered little assistance to the victims of asbestos-related illness pursuing claims against James Hardie. Aside from the specifics of the James Hardie matter, it is submitted that the introduction of these doctrines may well benefit the state of our corporate law by providing greater legal certainty without the need to rely on *Smith, Stone and Knight* as a justification for lifting the corporate veil on the basis of agency, which as the above commentary demonstrates, is not based on sound legal precedent. The facts in *Smith, Stone and Knight* and the other agency cases, particularly the under-capitalization of the subsidiary companies, seem on the face of it to fit within the bounds of the US doctrines. The policy question as to whether the use of US doctrines in Australian corporate law is appropriate, and how it may benefit the victims of asbestos-related disease in the James Hardie matter, are however outside of the scope of this article.

Conclusion

This central contention of this article has been that the six questions in *Smith, Stone and Knight* should not be used as general authority for lifting the corporate veil on the basis of an implied agency. Several reasons for this contention have been discussed, although primarily they consist of errors in legal reasoning and misuse of precedent in the decision itself and apparent subsequent confusion concerning the proper application of the decision in Australian corporate law. This article has also attempted to provide a more principled use of the decision by utilizing the six questions to support the determination of the existence of a sham. One may hope that the James Hardie dispute may provide the impetus for some much needed clarification on the vexed issue of when the corporate veil may be lifted. It remains to be seen whether clarification will come in the form of statutory reform¹²⁰ or from litigation that will surely follow from the actions of James Hardie given the NSW government's preference for not introducing a statutory scheme for dealing with claims against Hardie companies. In either case, the time is ripe for clarification of the nature and scope of the common law principles regarding lifting the corporate veil in Australian corporate law.

¹¹⁸ For consideration of these doctrines see Fletcher WM, *Fletcher's Cyclopaedia of Private Corporations* (Westlaw, subscription service) at [41.10], [41.33] <http://www.westlaw.com/signon/default> (viewed 22 July 2004).

¹¹⁹ The Commission's website contains the publicly available submissions: http://www.lawlink.nsw.gov.au/Lawlink/Corporate/ll_corporate.nsf/pages/MRCF_submissions viewed 1 October 2004.

¹²⁰ It should be noted that at the time of writing various senior shadow federal ministers of the Australian Labour Party had indicated in the media that, if elected, corporate law may be changed to address the issues in James Hardie: See Senator Stephen Conroy's media release dated 24 September 2004, listed on the ALP website: <http://www.alp.org.au/media/0904/mcsg210.php> (viewed 1 October 2004).