A NOTE ON THE APPLICATION OF ENTERPRISE THEORY TO THE PROBLEM OF PHOENIX COMPANIES

by Lynden Griggs*

The problems associated with the activities of phoenix companies have recently been documented by the Australian Securities Commission. This note is to raise a possible answer to this problem by a 'reverse lifting of the corporate veil' - through the adoption of the enterprise model of corporate form. This question is raised in the context of an English Court of Appeal decision, Creasey v. Breachwood Motors [1993] BCLC 480; 10 ACLC 3,052. This case, the facts of which are similar to the activities of archetypal phoenix company, represents an opportunity to demonstrate the benefits of an enterprise model in providing one possible solution to this vexed problem.

Introduction

"[I]n order to preserve the legal essence of limited liability, there has to be a more efficient and inexpensive way to stop dishonest directors operating phoenix companies and to preserve assets so money can be returned to creditors."[1]

"It seems to me, that complete control, or as the Americans put it, lack of separateness, should be a sufficient basis for going past limited liability in the case of subsidiaries or controlled companies."[2]

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1 N Coburn, "The Phoenix Reexamined" (1998) 8 *Australian Journal of Corporate Law*321 at 326.

2 A Rogers, "Reforming the Law Relating to Limited Liability" (1993) 3 *Australian Journal of Corporate Law* 136 at 139.

There is no doubt that one of the areas of concern of ASIC and the business community generally has been, and remains, the activities of phoenix companies.[3] A number of organisations, regulators, academics have commented on the need for reform of this area. These include the Victorian Law Reform Commission,[4] the Australian Securities and Investment Commission[5] and numerous commentators.[6] No solution has yet been found for this phenomena. This article examines this aspect from a different angle - perhaps in the attempt, finding a solution from a perspective not readily apparent - this being the corporate veil. Does this doctrine which has been the subject of much academic comment[7] provide a solution to a problem

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3 For an example of where the activities of a phoenix company resulted in criminal action see M Chandler, "Builder used 'phoenix companies in fraud, court told" *Australian Financial Review*, 15 May 1998.

4 VLRC Report, *Curbing the Phoenix Company*, Victorian Government Printer, Reports 1-3, Melbourne, 1993-5.

5 ASC Research Series, *Insolvent Trading and Phoenix Companies*, 95/01.

6 For example see n1; R Tomasic, "Phoenix Companies and Rogue Directors" (1995) 5 *Australian Journal of Corporate Law* 474; N Coburn, "Outmanoeuvring the Phoenix Company" (1997) 17 Proctor 24; R Marshall, "Phoenix Pty Limited and "uncommercial transactions" under the Corporations Law" (1996) 34 *Law Institute Journal* 40; I Mcilwraith, "Fighting the Phoenix" (1995) *The Bulletin* 3 October 78; D Milman, "Curbing the Phoenix syndrome" (1997) *The Journal of Business Law* 224; R Tomasic, "Developments and Events: Phoenix Companies and Corporate Regulatory Challenges" (1996) 6 *Australian Journal of Corporate Law* 19; I Fletcher, "Curbing the Phoenix syndrome" [1997] *Journal of Business Law* 224.

7 The doctrine of corporate veil has been examined in a number of areas, including tax, family law, corporate groups, criminal law. Just some of the extensive literature on this area includes R Schulte, "The future of corporate limited liability in Australia" (1994) 6 *Bond Law Review* 64; L Gallagher & P Ziegler "Lifting the corporate veil in the pursuit of justice" [1990] *Journal of Business Law* 292; S Fridman, "Removal of the Corporate Veil: suggestions for law reform in *Qintex Australia Finance Ltd v. Schroders Australia Ltd*"(1991) 19 *Australian Business Law Review* 211; R Baxt, "The corporate veil in tax law: the legal perception of companies as separate entities" (1984) 1 *Australian Tax Forum* 239; R Barrett, "Skirting the Corporate Veil" (1998) 72 *Australian Law Journal* 286; R Baxt, "The corporate veil remains" (1998) 16 *Companies and Securities Law Journal* 49; L Griggs, "The veil of incorporation: when will it be lifted" (1996) 26 *Queensland Law Society Journal* 575; S Chesterman, "The corporate veil, crime and punishment: *The Queen v. Denbo Pty Ltd* and Timothy Ian Nadenbousch" (1994) 19 *Melbourne University Law Review* 1064; R Baxt, "Tensions between commercial reality and legal principle: should the concept of corporate veil be re-examined?" (1991) 65 *Australian Law Journal* 352; S Ottolenghi, "From Peeping Behind the Corporate Veil to Ignoring it Completely" (1990) 53 *Modern Law Review* 338; FA Gevurtz "Piercing Piercing: An Attempt to Lift the Veil of Confusion Surrounding the Doctrine of Piercing the Corporate Veil" (1997) 76 *Oregon Law Review* 853; M Olthoff, "Beyond the Form: Should the Corporate Veil be Pierced?" (1995) 64 *UMKC L. Rev.* 311.

that continues to threaten the very existence of limited liability?[8] The first part of the article will examine the definition of what is meant by a phoenix company, and then to briefly consider what is the corporate veil, particularly in the context of the enterprise theory of the firm[9] and then to examine these aspects against an intriguing English decision[10] which indirectly raises the very issue under discussion - the use of the corporate veil to provide a solution to the problem of the phoenix company.

What is a phoenix company?

A phoenix company is usually an entity, probably with little by the way of asset backing and which is governed by individuals who have arguably abused the corporate form by ending the existence of one company and creating another to avoid the payment of debt.[11] An example is provided by Tomasic[12] where a real estate company ceased trading on one day with substantial debts - the company being placed in liquidation. On the same day another company received a real estate licence - the second company having the same directors, the same address, the same staff and the same telephone number.[13]

The Australian Securities Commission has suggested that a phoenix company has the following characteristics:

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[8] See the comments by Coburn, above n1 at 321. The problem of the corporate veil was also raised by F Costigan *Report of the Commission on the Activities of the Federated Ship Painters and Dockers Union,* Canberra, AGPS, 1984; see also A Freiberg, "Abuse of the Corporate Form: Reflections from the Bottom of the Harbour" (1987) 10 *University of New South Wales Law Journal* 67.

[9] A concept most commonly associated with P Blumberg, "The Continuity of the Enterprise Doctrine: Corporate successorship in United States Law" (1996) 10 *Florida Journal of International Law* 365; P Blumberg, "National Law and Transnational Groups and Transactions: Survey of the American Experience" (1995) 5 *Australian Journal of Corporate Law* 295.

[10] *Creasey v. Breachwood Motors Ltd* [1993] BCLC 480; (1992) 10 ACLC 3,052.

[11] See the comments by Coburn, n1 at 322. As noted by the then Attorney General The Honourable Michael Lavarch MP, *Attorney-General's News Release*, 97/95, 28 October 1995 "The phenomenon is known as the 'phoenix company' problem: where a company is wound up leaving unpaid debts and, soon afterwards, a second company with the same operators takes up the business of its predecessor."

[12] Tomasic, "Phoenix Companies and Rogue Directors: A Note on a Program of Law Reform", (1995) 5 *Australian Journal of Corporate Law* 474.

[13] n12 at 474-5, quoting from the Victorian Law Reform Commission Report, *Curbing the Phoenix Company*, Victorian Government Printer, Melbourne, 1994 at xi.

- An incorporated entity that fails or is unable to pay its debts;
- Acts in a manner which intentionally denies unsecured creditors equal access to the entity's assets in order to meet unpaid debts; and
- Within 12 months another business commences which may use some or all of the assets of the former business, and is controlled by parties related to either the management or directors of the previous entity.[14]

Most readers will initially appreciate the difficulty in applying the concept of lifting the corporate veil to this scenario - the first company is no longer in existence.[15] What this article will outline is the opportunity to use the 'continuity of enterprise' doctrine[16] to visualise both corporations as part of a group enterprise. The solution is then to impose liability on the second entity for the debts of the first - some may describe it as a reverse lifting of the corporate veil.[17] Arguably what is also needed is to identify the "lack of separateness' between the individuals and the corporations - this fact being demonstrated by the continuity of the enterprise: this identification resulting in the privilege of limited liability flowing from the concept of the separate entity being removed, resulting in the imposition of personal responsibility on the controllers.[18]

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[14] ASC Research Series, "Insolvent Trading and Phoenix Companies 95/01 at 39.

[15] It must be noted at this stage that the any response to the problem of the phoenix company must balance the need to remedy this abuse against excessive regulatory control which stifles entrepreneurial activity. See the comments by Tomasic, n12 at 475.

[16] This being based on the enterprise theory of the firm - see P Blumberg, "The Continuity of the Enterprise Doctrine: Corporate Successorship in United States Law" (1996) 10 *Florida Journal of International Law* 365.

[17] I cannot take credit for this solution. For example it should be noted that R Tomasic, n12 at 480 raises this very possibility: "Furthermore, with the rise of enterprise notions of the corporation, rather than entity notions of the corporation, it is timely to reconsider the contemporary relevance of the dogma based upon the decisions following *Salomon v. Salomon & Co Ltd.* That dogma has constrained the development of modern corporate law. Just as various appeal court judges have in recent times pointed out that many of the much revered early corporate law cases have reached the end of their usefulness, so too it is appropriate to consider a similar approach to dealing with the root causes of phoenix companies and the disqualification of directors."

[18] See generally M H Whincup, "Inequitable Incorporation - the abuse of a privilege" (1981) 2 *Company Lawyer* 158.

> Under this doctrine, a successor company that is a separate legal entity is made liable for the obligations of its predecessor where "the successor has the same stockholders as the predecessor and conducts the same business with the same management, facilities, employees, products, and trade names." In other words, all that has changed is the legal form; as a matter of commercial substance, there is identity.[19]

The problems of phoenix companies cannot be underestimated. The estimated loss associated with the activities of phoenix companies is in the vicinity of $1.3bn in Australia; furthermore 18% of small and medium size enterprises claim to have been adversely impacted by phoenix activities and that up to 9000 registered businesses are affected by this type of corporate abuse.[20]

What is the corporate veil

Most readers will be aware of what is meant by the corporate veil and have an appreciation of the decision of the House of Lords in *Salomon v. Salomon & Co Ltd.*[21] Given this I will only briefly recite the facts, so as to set the framework for what follows.[22] Salomon decided in 1892 to convert his then business, (being conducted as a sole trader) to a limited liability company. The subscribers to the memorandum were himself, his wife and five children. It was accepted that he controlled the company. The company purchased the business, the purchase price being satisfied by the issue of shares and secured debentures - these debentures being issued to Salomon. Due to economic difficulties the debentures were mortgaged to one Broderipp. The company ultimately collapsed with assets of only 6000 pounds. Broderipp was repaid 5000 pounds and Salomon claimed the remaining 1000 pounds as a secured creditor ahead of unsecured creditors owed some 11,000 pounds. The liquidator sought to have the claim of Salomon rank later than that of the unsecured creditors. Despite losing at first instance[23] and in the Court of Appeal[24] Salomon succeeded in the

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[19] D Prentice, "Veil Piercing and Successor Liability in the United Kingdom" (1996) 10 *Florida Journal of International Law* 469 at 480.

[20] Coburn, n1 at 322-3.

[21] [1897] AC 22.

[22] For a recent discussion as to whether Salomon would have succeeded today, see LS Sealy, "Modern Insolvency Laws and Mr Salomon" (1998) 16 C&SLJ 176.

[23] Before Vaughan Williams *J Broderipp v. Salomon* [1895] 2 Ch 323.

[24] This decision also contained at [1895] 2 Ch 323.

House of Lords. The company was a separate entity and the fact that control was exercised by one individual was irrelevant.[25]

> The company is at law a different person altogether from subscribers to the memorandum; and, though it may be that after incorporation the business is precisely the same as it was before, and the same persons are managers, and the same hands receive the profits, the company is not in law the agent of the subscribers or trustee for them.[26]

This decision of the House of Lords has recently been endorsed by the Federal Court in *Repatriation Commission v. Harrison.*[27] In that case Mr and Mrs Harrison had applied for certain government pensions. These pensions were subject to an assets test. The Harrisons were the sole shareholders and directors in two family companies whose only assets were debts owed to them by the Harrisons. The Administrative Appeals Tribunal held that the amounts owed to the companies should not be taken into account in determining the pension entitlement. There was no real value in the companies as the entities were, in economic terms, no different to the natural persons. This decision was appealed by the Repatriation Commission, arguing that the AAT had lifted the corporate veil and treated the legal position as the same as the commercial situation. Tamberlain J. upheld the appeal and remitted the matter back to the Administrative Appeals Tribunal.

> The separate legal existence and identity of corporate entities from that of their shareholders and corporators or directors is well-settled in corporations law and, subject to limited exceptions, it currently represents the law of Australia.[28]

In essence what Tamberlain J. has done is reiterate the importance, the continuing recognition and acceptance of the separate entity doctrine and the limited circumstances when the corporate veil can be lifted.[29] Indeed it

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[25] For a recent discussion of this case from a jurisprudential perspective see N James, "Separate Legal Personality: Legal Reality and Metaphor" (1993) 5 *Bond Law Review* 217.

[26] [1897] AC 22 at 51.

[27] (1997) 24 ACSR 711.

[28] n27 at 715.

[29] For a comment on this case see R Baxt, "The Corporate Veil Remains" (1998) 16 *Companies and Securities Law Journal* 49 at 50: "What is important is the fact that *Salomon's case*, 100 years old in 1997, is still a key feature of our corporate law at a time when the Commonwealth Treasurer is suggesting that we need to rationalise the approach to corporate law and make it more economically viable."

can be said that the Salomon principle has an 'iron grip' on company law.[30]

The grounds for lifting the corporate veil have traditionally been put into a number of categories. They may be listed as follows:

- where there has been fraud;
- in cases of agency;
- where there is a breach of a contractual obligation;
- in times of war;
- where there is a trust;
- where there is a group of companies;
- in cases of tort; or
- where there is a statutory basis for lifting the corporate veil.[31]

However what can be said about Australia is that there is no broad underlying rationale as to when the corporate veil can or will be lifted.[32] While some would argue[33] that the corporate veil will be lifted when it is just and equitable, this ground does not appear to have been adopted by the courts.[34] This can be contrasted with the approach accepted in the United States of America where the courts have considered the matter with an "infinitely greater degree of flexibility and realism than the English approach'[35] and have stated that:

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30 Prentice, n19 at 474. Prentice was referring to the iron grip that Salomon has on English company law. It is suggested that the *Repatriation Commission v. Harrison* indicates that the same statement can be made in respect of Australian company law.

31 R Tomasic, J Jackson & R Woellner, *Corporations Law, Principles, Policy and Process*, 3rd edition, Butterworths, Sydney, 1996 at 108.

32 See further on this aspect Griggs, n7 at 581. This is unlike the position in the United States where the corporate veil can be lifted where the legal entity is used to defeat public convenience, justify wrong, protect fraud, or defend crime (*United States v. Milwaukee Refrigerator Transit Co* [1905] 142 Fed 247 at 255) or where the controller has an undue degree of direct control over the corporation (*Taylor v. Standard Gas & Electric Co* [1939] 306 US 307; Pepper v. Litton [1939] 308 US 295).

33 See Gallagher & Ziegler, n7.

34 See the comments by Tomasic, Jackson & Woellner, n31.

35 Whincop, n18 at 160.

> If any general rule can be laid down, in the present state of authority, it is that a corporation will be looked upon as a legal entity as a general rule, and until sufficient reason to the contrary appears; but when the notion of legal entity is used to defeat public convenience, justify wrong, protect fraud, or defend crime, the law will regard the corporation as an association of persons.[36]

Additional United States authority permits the corporate veil to be lifted where there is an undue degree of direct control over the corporation.[37] Recent Australian authority has suggested, (in *obiter* comments) that the American approach should be considered in this jurisdiction.

> It may be that the rule is or should be that the Court only regards a corporation which is a quasi partnership as a legal entity until sufficient reason to the contrary appears and that sufficient reason is where to continue to treat the legal entity as a separate entity would defeat public convenience, justify wrong, protect fraud or defend crime: see *United States v. Milwaukee Refrigerator Transit Co*...However in view of the way in which other questions in this case have turned out, it is not necessary to take this matter further.[38]

At the present time the resolution as to whether there is a broad underlying principle appears unresolved.[39] However it can be summarised that:

> Australian courts have, as a general rule, been reluctant to depart from the principle in Salomon's case and lift the corporate veil. This has

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[36] *United States v. Milwaukee Refrigerator Transit Co* (1905) 142 F. 247 at 255. See also *Stap v. Chicago Aces Tennis Team, Inc* (1978) 379 N.E.2d 1298 at 1301 where it was said: "For the doctrine traditionally known as 'piercing the corporate veil' to apply, two requirements must be met - (1) there must be such unity of interest and ownership that the separate personalities of the corporation and the individual no longer exist; and (2) circumstances must exist that adherence to the fiction of separate corporate existence would sanction a fraud or promote injustice."

[37] *Taylor v. Standard Gas & Electric Co.* (1938) 96 F.2d 693; reversed on other grounds (1939) 306 U.S. 307.

[38] *Mesenberg v. Cord Industrial Recruiters* [1996] 14 ACLC 519 at 528.

[39] For further discussion of this see L Gallagher & P Ziegler, n7; M H Whincup, n18; L Griggs, n7; W Lawrence Fletcher, "Piercing the Corporate Veil: It Can Work in Reverse" [1982] 33 *Mercer Law Review* 633; FG Rixon, "Lifting the Veil between Holding and Subsidiary Companies" [1986] 102 LQR 415.

occurred only in relatively rare situations *and it is not clear when the courts will do so.*[40]

If we accept this premise that there is no widely accepted rationale for piercing the corporate veil,[41] what alternatives exist to resolve the problems of phoenix companies. The alternative in the next part of the article outlines a resolution dependant upon an acceptance of the enterprise theory of the firm. This will be discussed and then followed by consideration of *Creasy v. Breachwood Motors*[42] - a decision which may provide the impetus for the recognition of a different foundation for lifting the corporate veil, a ground which may support an alternative solution to the problem of phoenix companies.

The Enterprise Theory of the Firm

There is no accepted basis for the theoretical foundation of corporate personality. While the courts have adopted the idea of an entity based upon the satisfaction of legal requirements,[43] academic writers have sought to go behind this and argue for a understanding and an appreciation of something more substantive than simply equating the corporation as a legal entity alongside natural persons.[44] Blumberg, as one of the principal advocates of

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40 P Lipton & A Herzberg, *Understanding Company Law*, 8th ed., LBC Information Services, Sydney, 1999 at 32 (author's emphasis). See also R Tomasic & S Bottomley, *Corporations Law in Australia*, Federation Press, Sydney, 1995 at 62: "Some writers assert that the case law resolves itself into a number of categories which provide distinct grounds for lifting the corporate veil or disregarding separate legal status. Other commentators, critical of this approach, venture a wider rationale based on notions of justice, or of seeking a balance between competing interests." (citations deleted).

41 J Payne, "Lifting the Corporate Veil: A Reassessment of the Fraud Exception", [1997] 56 CLJ 284 at 290 considers that the grounds of justice exception is 'probably, non existent'.

42 [1993] BCLC 480.

43 As demonstrated by *Salomon v. Salomon & Co Ltd.* [1897] AC 22.

44 For example see S Bottomley, "Taking Corporations Seriously: Some Considerations for Corporate Regulation" (1990) 19 *Federal Law Review* 203; M Wolff, "On the Nature of Legal Persons" (1938) 54 *Law Quarterly Review* 494; P Blumberg, "The Corporate Personality in American Law" (1993) 19 *Indian Socio-Legal Journal* 23; D Wishart, *Company Law in Context*, Oxford University Press, Auckland, 1994; W Bratton, "The New Economic Theory of the Firm: Critical Perspectives from History" (1989) 41 *Stanford Law Review* 1471; D Considine, "The Real Barriers to Regulation of Corporate Groups" (1994) 2 *Asia Pacific Law Review* 37; G Tuebner, "Enterprise Corporatism: New Industrial Policy and the Essence of the Legal Person" (1988) 36 *American Journal of Comparative Law* 130; P Austin, "Legal Personality of Corporations: An Australian View" (1993) 19 *Indian Socio-Legal Journal* 44.

this approach[45] makes the following comment:

> With courts still enthralled by nineteenth - century formalistic jurisprudence and focusing solely on the fact that the successor through the purchase of assets is considered a different juridical entity, insulation from liability results inexorably from application of entity concepts of law. Given this preoccupation with legal forms, these courts simply ignore the most obvious economic realities, such as the fact that in many cases, the same enterprise or business may be involved with little or no change, except ownership.[46]

To establish an enterprise based approach the following indicia are seen to be required:

- control within the business;
- economic integration;
- financial relations between the businesses;
- sharing of administrative responsibilities;
- interrelated employee programs; and
- do they have a common public persona?[47]

In essence these aspects concentrate on the business, financial or economic realities of the firm, rather than the notion of the legal entity as such.[48]

To some extent this notion of enterprise law has been adopted to lift the corporate veil in the case of group structures. For example in *DHN Food Distribution Ltd. v. London Borough of Tower Hamlets*[49] the English

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45 For a selection of his writings on this area see Blumberg, n44; Blumberg, n16; "National Law and Transnational Groups and Transactions: Survey of the American Experience" (1995) 5 *Australian Journal of Corporate Law* 295.

46 Blumberg, n16.

47 For a detailed analysis of these points see Blumberg, "National Law and Transnational Groups and Transactions: Survey of the American Experience", (1995) 5 *Australian Journal of Corporate Law* 295 at 302ff.

48 As commented by Blumberg, n16 at 367: "These new doctrines, focusing on the economic realities of the enterprise rather than on the corporate entity, are the 'continuity of the enterprise' and 'the product line' doctrines....Continuity of the enterprise has received a much wider range of application and must be recognised as the development of a new doctrine of relational law resting on enterprise principles. As such, it has significant jurisprudential implications."

49 [1976] 1 WLR 852; 1 All ER 462.

Court of Appeal indicated that a group structure involving three companies should be treated as a 'single entity;'[50] that the court was entitled to 'look at the realities of the situation and to pierce the corporate veil.'[51] This decision has since been distinguished and doubted by the House of Lords[52] as well as questioned by the High Court of Australia.[53] Furthermore it has been recently stated that there was no overriding principle that companies within a corporate group were to be treated as one economic entity - reiterating that each company was an independent legal entity.[54] A recent Australian empirical study into corporate groups has also reinforced this view by indicating that courts are no more prepared to lift the corporate veil in a group structure than in any other form of enterprise.[55] The traditional view can thus be summarised as follows:

> We do not accept as a matter of law that the court is entitled to lift the corporate veil as against a defendant company which is the member of a corporate group merely because the corporate structure has been used so as to ensure that the legal liability (if any) in respect of particular future activities of the group (and correspondingly the risk of enforcement of that liability) will fall on another member of the group rather than the defendant company. Whether or not this is desirable, the right to use a corporate structure in this manner is inherent in our corporate law.[56]

It is this traditional view that causes difficulties in relation to the problem of phoenix companies. If we are to impose liability on the second entity within the phoenix situation then it is imperative that we accept that the first and second corporation are involved in the one enterprise, thus attaching liability for the first companies debts on the now trading second entity.

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[50] [1976] 1 WLR 852 at 867.

[51] n50 at 861.

[52] *Woolfson v. Strathyclyde Regional Council* [1978] SC (HL) 90.

[53] *Industrial Equity Limited and Others v. Blackburn and Others* (1977) 137 CLR 567.

[54] *Adams and Others v. Cape Industries plc and another* (1990) BCLC 479 at pp. 508-524. D Prentice, n19 at 483 argues that one of the reasons why "English law is unwilling to pierce the corporate veil or to develop a more sophisticated doctrine of enterprise liability relates to its treatment of corporate groups." Contrast the United States position *National Bond Fin. Co. v. General Motors Corp* (1964) 238 F. Supp 248; *Angelo Tomasso, Inc. v. Armor Constr. & Paving Inc* (1982) 447 A 2d 406; *Goulding v. Ag-Re-Co Inc* (1992) 599 N.E.2d 1094.

[55] See the comments by I Ramsay & G Stapledon, *Corporate Groups in Australia*, Centre for Corporate Law and Securities Regulation, Faculty of Law, University of Melbourne, 1998.

[56] *Adams v. Cape Industries* [1990] 1 Ch. 433 at 544.

This new model of considering the phoenix situation rests on the notion that there has been an insufficient alteration in the internal and external relationships of the business to justify a recognition that because the corporate form is altered, there should be a change in legal duties.[57]

> [T]he continuity of the enterprise doctrine is an expansive doctrine, which would enforce liability in the successorship area by focusing on the continuity of the business without requiring continuity of the shareholders and management. It is an innovative doctrine of enterprise liability and relational law; so long as the same business is involved, the liabilities of a business run with the business, notwithstanding a change in ownership.[58]

What elements are needed to apply this doctrine? Four can be identified:

1) the continuation of the business;
2) the dissolution of the first entity;
3) the second entity assuming some or all of the first corporation's obligations; and
4) the second entity representing itself as the continuation of the first business.[59]

The next part of this article will examine these principles against a backdrop of the English decision in *Creasey v. Breachwood Motors Ltd.*[60] This facts of this case and the manner in which it was resolved, may indirectly provide support for the introduction of a doctrine of enterprise law.

Creasey v. Breachwood Motors Ltd

Creasey had brought an action for wrongful dismissal against his ex-employers, Breachwood Welwyn Ltd. Welwyn lodged a defence but some

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57 As stated by Blumberg, n16 at 371: "The mere continuation exception rests on the conclusion that the purported transfer is only a manipulation of corporate forms without a sufficient change in substantive relationships to justify a change in legal duties."

58 Blumberg, n16 at 375.

59 These factors were identified in the American decision of *Turner v. Bituminous Cas Co.* (1976) 244 N.W.2d 766 at 879. See also *Pietz v. Orthopedic Equip Co.* (1989) 562 So. 2d 152; *Turner v. Wean United Inc.* (1987) 531 So. 2d 827.

60 [1993] BCLC 480; (1992) 10 ACLC 3,052.

time later informed Creasey that it was insolvent. Breachwood Motors then took over the business of Welwyn, assuming all liabilities with the exception of the claim of Creasey. The same two people were the shareholders and directors of the two enterprises. When Welwyn was dissolved, Creasey sought an order substituting Motors for Welwyn. The English Court of Appeal refused to lift the corporate veil on the ground of fraud, instead basing their decision on the ground that it was necessary in order to achieve justice.[61]

The purpose of this paper is not to attack the grounds on which the decision was made[62] but to examine its facts against the indicia of enterprise liability. The basis for this is that in many respects this scenario fits the phoenix syndrome - that of an incorporated entity that fails or is unable to pay its debts; acts in a manner which intentionally denies unsecured creditors equal access to the entity's assets in order to meet unpaid debts; and within 12 months another business commences which may use some or all of the assets of the former business, and is controlled by parties related to either the management or directors of the previous entity.[63] Would or could enterprise liability have provided a different basis for judicial reasoning to find a satisfactory solution to this scenario.

The facts as summarised by the Court[64] afforded an excellent basis for utilisation of the enterprise doctrine. Welwyn had ceased to trade on 30 November 1988, on 1 December 1988 Breachwood Motors had taken over all of Welwyn's assets and was trading under the same trade name and at the same address with the benefit of Welwyn's goodwill and customers. Motors paid off the liabilities of Welwyn, with the exception of the contingent, and later, actual liability to Creasey. As a result of the action of the two common directors and shareholders, Creasey found himself with a judgment against Welwyn, an insolvent company, the assets of which had been transferred to Motors - this latter entity refusing to meet the judgment in favour of Creasey.

Despite this evidence the Court of Appeal did not find in favour of Creasey on the basis of successor liability or enterprise law, rather finding

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61 For a discussion of criticism of this case see Payne, n41.

62 This is done by Payne, n41 at 287-9.

63 To use the definition from the ASC Research Series, "Insolvent Trading and Phoenix Companies, 95/01 at 39.

64 See [1993] BCLC 480 at 485.

that the veil should be lifted on the dubious ground[65] that as the affairs of Welwyn and Motors had been intermixed, the interests of justice dictated the lifting of the corporate veil.

The approach which I suggest examines this factual scenario from a different perspective. The question of what is the legal entity and can its veil of incorporation be lifted becomes irrelevant. Rather it opens an analysis of what is the enterprise and who is responsible for the obligations that have been incurred.[66] This avenue rejects the strictures of the High Court approach which excludes a "unity of enterprise" theory based on control.[67] Instead it suggests the "tension between the realities of commercial life and the applicable law in circumstances such as those in this case"[68] be recognised.

Conclusion

The real advantage of this enterprise model,[69] is not just in providing a

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[65] See the comments by Payne, n41 at 290: "A fraud is no less of a fraud because a pre-existing company is used and an intentions no more of an intention because a wholly new company did not need to be set up for the purpose. The existence of the legal right needs to pre-date the use of the corporate vehicle, not the incorporation of that vehicle. *Creasey v. Breachwood* should have been decided on this basis rather than the much less satisfactory, and indeed probably non-existent, ground of justice."

[66] It should be noted that a different approach was utilised in *CSR Ltd v. Wren* (Unreported, Court of Appeal NSW, 18 December 1997) where a holding company was found liable in tort for illness suffered by an employee of a wholly owned subsidiary. It was held that the holding company's liability was primary as it directly owed a duty of care to the subsidiary's employee. See the comments by Barrett, n7.

[67] See *Industrial Equity Ltd v. Blackburn* (1977) 137 CLR 567; *Walker v. Wimborne* (1976) 137 CLR 1; Barrett, n7.

[68] *Qintex Australia Finance Ltd v. Schroeders Australia Ltd* (1991) 9 ALCC 109 at 110.

[69] Consider the application of the enterprise model to the situation outlined in *Patrick Stevedores Operations No 2 Pty Ltd v. MUA* (1998) 153 ALR 643; 16 ACLC 1,041. As noted at 648-650 (ALR), the reorganisation of this entity involved the employer companies selling their stevedoring businesses to Patrick Operations No 2 for a price of $314.9million. The employer companies thus disposed of their property, plant, equipment and all contractual interests save those relating to their employees. The businesses of the employer companies were reduced to the provision of their employees labour to the stevedore. These labour supply agreements gave the stevedoring company the right to terminate the agreement without notice if there was any interference with, delay in or hindering of the supply of labour. Obviously the security of tenure of the employees employment was significantly reduced. The monies paid were used to discharge debts and to buy-back shares.

The importance of this in the context of corporate veil is that the company with any assets was a separate entity to the organisation to which the employees were contracted. The corporate veil unless lifted would prevent any claim against Patrick Operations No. 2. In the context of this discussion could the firms have been considered to have been in the same enterprise and thus responsible under the 'continuity of enterprise' doctrine.

solid foundation or theoretical framework to lifting the corporate veil in cases of control,[70] but to dealing with the problem[71] of the phoenix company - that entity that arises from the ashes of the first business. Traditional lifting of the corporate veil will achieve little. An examination of the derivation of the second entity will only lead to the finding that the first company is dissolved. Instead what is focussed upon is the enterprise that incurred the debts rather than the entity that carries on the business. It would provide an answer, which is justifiable, logical and which provides for a degree of certainty so as to be applicable in a system of stare decisis. Furthermore this approach is not so drastic as to necessitate reform to the system of limited liability.[72] Limited liability has been described as one of the greatest ideas of English law[73] and primarily responsible for the development of the modern economy.[74] But today this concept of limited liability tied in with the notion of the separate legal entity has spawned an "unpredictable economic vandal"[75] resulting in significant losses to Australian business.[76] The answer to this problem may lie in the adoption of the enterprise model of the corporate entity. This would have provided a satisfactory policy base on which to attach liability to the second entity in Creasey - a reverse lifting of the corporate veil.

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[70] It should be noted that it has been estimated that on average each listed company has 28 controlled entities, with the median figure being 11 controlled entities. See Ramsay and Stapledon, above n55 at v.

[71] The *Corporate Law Economic Reform Program Bill 1998* (if enacted) will provide a different solution to the problem of phoenix companies. Under the proposed legislation (s206A) upon application by ASIC, the Court may disqualify a person from managing a corporation for up to 10 years if in the last 7 years the person has been an officer of 2 or more corporations that have failed and the court is satisfied that the manner in which the corporation was managed was wholly or partly responsible for the corporation failing and that the disqualification is justified. A corporation will be deemed to have failed if the corporation ceases to carry on business and the creditors are not fully paid or are unlikely to be fully paid.

This legislation may assist in controlling the problem but it won't provide a remedy as such when it does occur.

[72] See Rogers, n2. He concludes at 140 by asking the question: "Does limited liability serve a socially and economically useful purpose for ninety percent of incorporated companies? Should it not be restricted to public companies and such others as may be able to convince the regulatory authorities that they require that privilege for the purpose to their trade."

[73] Lordl Wilberforce, "Law and Economics", in The Lawyer and Justice, (ed BW Harvey), London, 1978 at 75.

[74] Coburn, n1 at 321. Contrast the comment of Rogers, n2 at 137: "[I]t is difficult to see that, by receiving the privilege of limited liability, they did anything for the prosperity of the Australian colonies."

[75] Coburn, n at 322-3.

[76] These losses are detailed in ASC Research Series, n5.