Can Directors and Shareholders be held liable for acts committed by the Company?

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In this article, Dr Luke Mizzi and Emma-Marie Sammut analyse the situations allowing for the lifting of the corporate veil. The rest of the article can be found in Id-Dritt XXX.

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1. Introduction

Good corporate governance is a fundamental pillar of company law. There are several mechanisms in place to ensure that those entrusted with the administration of the company and the members of such company act with the utmost due diligence and respect to the statutory obligations in place. Directors and members alike must act in good faith and exercise those actions that are considered to be in the best interest of the company.

This article will give a brief explanation on the notion of the corporate veil and how it is employed in instances where the law, or the courts, require that the separate identity of the company and its members is to be ignored, effectively putting aside the principles established in ***Salomon vs Salomon***.[1] This will be the foundation for the discussion relating to the duties of the directors in relation to the management of the company, as well as in protecting the interests of the company. Moreover, a director's position renders him liable to be subject to creditors and shareholders alike and, therefore, is held at a higher esteem in terms of responsibility than any other member of the company. Indeed, a director's liability comprises effective and thorough due diligence, attention and care in respect to any activities pertaining to the assets and dealings of the company.

Moreover, if the circumstances so warrant, the lifting of the corporate veil may also apply in instances where shareholders act in bad faith. However, such instances are foreign to the current statutory mechanisms in place. Instances where shareholders may be held liable for their actions may only find their basis elicited through case law. The courts would adjudicate as the circumstances of the case so dictate.

2. The Corporate Veil: Explained

The landmark English judgment of ***Salomon vs Salomon***[2] established the principle of separate judicial personality and today, represents a fundamental pillar of company law principles. Notwithstanding, this doctrine has created several problems and has often been the subject of abuse by parties who use the corporate form to protect them from any wrongdoings.

The law, by way of exception, occasionally ignores the separate identity of the company and its members. This is known as the lifting of the corporate veil. Professor Muscat broadly classifies two exceptions when the corporate veil is lifted and refers to them as statutory exceptions and judicial exceptions.[3]

[1] *Salomon vs A Salomon & Co Ltd* [1896] UKHL 1, [1897] AC 22.
[2] Ibid.
[3] Andrew Muscat, '*Principles of Maltese Company Law*', Malta University Press (ed. 2 Vol II) (2019) 333,334.

Statutory inroads are easily established. It is through legislation, which in some way directly or indirectly affects companies, that a clear picture of instances in which the corporate veil may be lifted is provided. However, the circumstances in which a Maltese court is prepared to lift the corporate veil and depart from general principles are more difficult to identify and categorise.[4]

2.1 Statutory Inroads

The Companies Act[5] may be regarded as the main body of legislation which specifically caters for those instances in which the 'veil' may be lifted. Such laws, however, do not aim to neutralise the separate personality of the company, but instead seek to penalise any wrongdoings on behalf of the company's 'constituents'. The provisions, in fact, mainly relate to the management of the company and not to its shareholders. Statutory inroads, therefore, may be viewed as providing an exception to the rule that a mandatary should not be held responsible for the acts of the principal.

2.1.1. Number of shareholders falls below two

A company is not validly established unless the Memorandum of Association is entered into and subscribed to by at least two persons. Nonetheless, an exception exists in the case of single member companies, where a single member would satisfy the specific requirements. If the number of members falls below two for a period longer than six months, the company may be subject to being dissolved or wound up by the court.[6]

If within those six months, the remaining member continues to carry out business activities, that member may be held unlimitedly and jointly and severally liable with the company for those obligations contracted within that six-month period, until the date the company is dissolved or until the situation is rectified. Liability arises only if it can be proven that the remaining member was aware that he was the sole member of the company. In such an instance, the 'veil' is to be lifted and the sole member is to be held liable.[7]Despite this, however, the separate legal personality of the company would successfully remain intact.

It is not the company being put into liquidation which gives rise to an exception to separate legal personality, but if the number of members is reduced to below two for six months and the sole remaining member continues to trade, knowing that the company lacks the statutory requirement for members. This requirement of knowledge was added by virtue of Act IV of 2003. Prior to this, a member was to be held liable even without knowledge of the company's

[4] Ibid.
[5] The Companies Act (Chapter 386 of the Laws of Malta).
[6] Ibid, Article 214(2)(b)(i).
[7] Ibid, Article 214(4).

membership deficit. Moreover, it is to be noted that the liability of the sole member does not substitute that of the company. Rather, the sole member becomes jointly and severally liable together with the company as a legal entity in its own right.

2.1.2. Fraudulent trading

If any business of the company has been carried out with the intention of defrauding creditors, or for any fraudulent purpose, the court may hold any person who was knowingly party to that fraud responsible, without any limitation for the liability of debts of the company.[8]

A wrongdoer may be held liable not only for contractual obligations undertaken by the company, but also for any form of obligation, including liability in tort and statutory claims against the company, whether it was liquidated or not. Such liability is not restricted to debts and liabilities of the company incurred before or after the fraud. However, liability is not automatic but upon application. Despite this, liability may be invoked against any person, including directors, managers and shareholders.

This provision was considered to be quite difficult to use in practice because it can only be invoked in the process of a winding up, and the onus of proving fraud is quite high. Essentially, this remedy does not really involve an exception to the principle of the separate legal personality of the company. The company continues to be regarded as a separate juridical person and to be liable for its obligations independently of the liability attached to the wrongdoer. Nevertheless, the wrongdoer is considered to be personally responsible for his actions.

Prior to the introduction of the Companies Act, there nevertheless existed a remedy. This is the criminal sanction; a person knowingly participating in a fraud, whether as a principal or as an accomplice, would be committing a criminal offence under the Criminal Code. At first glance, therefore, the provision in the Companies Act may not have been required, but in reality, the civil sanction is far wider.

[8] Ibid, Article 315.

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