

CASE COMMENT: SALOMON VS. SALOMON CO. LTD (1897)

Pranali V Alugade***INTRODUCTION**

A company is a legal person in the eyes of the law. It is, of course not a natural person like a student or a professor, nevertheless, it has a personality of its own, often referred to as its 'Corporate Personality.' Thus, a company is an artificial person, and it is from this distinct feature of its personality that most other benefits of incorporation can be seen to flow. A company is a separate juridical entity, which is distinct from the members who compose it¹. In other words, a company after incorporation is considered to be a separate legal entity that is distinct from its shareholders, directors, and members who compose it.

The Salomon vs. Salomon Co. Ltd is a landmark case that established the principle of separate legal personality and revolved around the concept of limited liability and the distinction between a company's legal identity and that of its shareholders. This article provides a comprehensive analysis of the case by studying the intricacies of the case, right from the facts and issues involved to the legal difficulties, judicial pronouncement, and the principles laid down therein.

FACTS OF THE CASE

Mr. Aron Salomon ran a successful business as a leather merchant who manufactured leather boots or shoes as a sole proprietor. In 1892, he decided to convert this business into a limited company. He incorporated a limited company named Salomon Co. Ltd, along with his wife, daughter, and his four sons as members of the company, and Salomon being the Managing Director of the company.

Salomon Co. Ltd purchased the shoe business of Aron Salomon for the value of £39,000. The price was satisfied by £ 10,000 in debentures, conferring a charge over all the company's assets, £ 20,000 in fully paid up £ 1 shares, and the balance in cash. Seven shares were subscribed in

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¹ Prof. H.D Pithhwalla, Company Law, (C. Jamnadas &Co.)

cash by the members and the result was that Salomon held 20,001 shares out of 20,007 shares issued, and each of the remaining six shares was held by a member of his family²

Later on, within a year, the business of the company started to go into loss, went into liquidation and the company had to be wound up. On winding up, the statement of affairs was such that, the assets were £6,000, Debentures £10,000 (Salomon was the debenture holder) and unsecured creditors £7,000. Therefore, the total liability was around £17,000 and the assets were only £6000.³ In this case, the debenture recovery would be a priority against the unsecured creditors. Therefore, the assets of the company would go to the debenture holder i.e., Salomon in the present case. But as Salomon was the debenture holder, the unsecured creditors called upon a liquidator and alleged that the company was a sham, it was a “mere” agent of Salomon and he shall be liable personally to indemnify the debts of the company.

ISSUES IN THE CASE

- 1) Whether Salomon Co. Ltd was a legally incorporated company.
- 2) Whether Mr. Salomon was personally liable to pay the debts of the company.

JUDGEMENT

The instance case went through three courts until its final judgment was pronounced by the House of Lords, where it laid the principle of “Separate Legal Personality”.

TRIAL COURT: Broderip v. Salomon was the case before the Trial Court, and Judge Vaughan Williams ruled that Mr. Broderip's claim was legitimate. The judge was of the view that the Memorandum of Understanding (MOU) signed, was merely for the sake of dummy purpose.⁴ The signatories were the family members of the Salomon and the Company was merely an agent or ‘alias’ of his. He was the one who took care of all the affairs of the company and had control over everything related to the company. Therefore, Salomon was liable to indemnify and pay the debts of the company.

COURT OF APPEAL: The Court of Appeal upheld the decision of the Trial court on the grounds that Salomon had abused “incorporation and limited liability”. The court was of the

² Sumasri, ‘Case Study: Salomon v. Salomon & Co. Ltd’, (Legal Bots, 23 February 2023) <<https://legalbots.in/blog/case-study-salomon-v-salomon-co-ltd>> accessed on 22nd August 2023.

³ Ibid

⁴ Siddharth Dhawan, ‘Company- A separate entity- Salomon vs Salomon’, Volume 4 ISSN 2456-9706, Supremo Amicus, <<https://supremoamicus.org/wp-content/uploads/2018/06/v4g51.pdf>>, accessed 25th August, 2023.

view that it was not a company but a corporation made for illegitimate purposes. The formation of the company and all that followed it were a mere scheme to enable himself to carry on a business in the name of the company with limited liability.⁵ Hence, the Court of Appeal considered it a fraud and held that Salomon was liable to indemnify the debts of the company.

HOUSE OF LORDS: In a unanimous decision of the House of Lords, the decision of the court of appeal was overturned eliminating all the contentions against the appellant, Salomon. The House of Lords held that the company incorporated was in due procedure of law. The provisions of the Companies Act, of 1862(hereinafter referred to as Act), were duly followed. As per Section 6 of the Act⁶, there were seven persons who had subscribed their names and had complied with requisitions of the Act with respect to registration and formed an incorporated company with limited liability named, ‘Salomon Co. Ltd’. Therefore, there is no question of whether it was a legally incorporated company or not.

The legislation did not impose any requirements regarding the independence of shareholders, the size of their stakes, their individual thoughts or intentions, or the power balance within the company’s structure. Hence, the House of Lords concluded that the business belonged to the company, not to Salomon alone.⁷

In the end, to put a lid on the matter, Lord Macnaghten stated, “The company is at law a different person altogether from the 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. Nor are the subscribers as members liable, in any shape or form, except to the extent and in the manner provided by the Act.”⁸

PRINCIPLES ENUMERATED

The decision of the case, Salomon vs. Salomon Co. Ltd enumerated the principles of, a) Separate Legal Entity/Corporate Personality and, b) Limited Liability.

SEPARATE LEGAL ENTITY/ CORPORATE PERSONALITY: The essence of this principle is that the company has its own separate legal entity or corporate personality which is distinct

⁵ Salomon v Salomon & Co Ltd [1896] UKHL 1 (1897) 22 AC, < <https://www.translex.org/310810> >

⁶ Companies Act, 1862.

⁷ Shruti Pandey, “Salomon Vs. Salomon & Co. Ltd. (1896): Case Analysis”, (Legal Upanishad, 2023) < <https://legalupanishad.com/salomon-vs-salomon-co-ltd-1896-case-analysis/>> accessed on 25th August, 2023.

⁸ Salomon v Salomon & Co Ltd [1896] UKHL 1 (1897) 22 AC

from that of its members, directors, shareholders, etc. The fundamental attribute of corporate personality, from which all other consequences flow is that the corporation is a legal entity distinct from its members. Hence, it is capable of enjoying rights and being subject to duties that are not the same as those enjoyed or borne by its members. In other words, it has a “legal personality” and is often described as an artificial person in contrast with a human being, a natural person.⁹

LIMITED LIABILITY: Limited liability is where a shareholder of a company limited by shares is liable only up to the unpaid amount on the shares held by him. For instance, if a shareholder holds one share of the face value of Rs. 100, on which Rs. 80 has already been paid up, then in this case, his maximum liability on that share is Rs.20 irrespective of whatever may be the liabilities of the company.

It is considered that a corporate form of business is far superior to and much safer than that of a partnership firm as far as the monetary risk is concerned. A partner of a firm is personally liable for all the liabilities of the firm to an unlimited extent. But that of the shareholder of a company is only limitedly liable. Therefore, investors will consider the corporate form of business as an ideal form of business to invest, as they are secured by the principle of limited liability.¹⁰

ANALYSIS AND CONCLUSION

The case of *Salomon v. Salomon & Co. Ltd.* solidified the legal principle of corporate personality and limited liability in the context of company law. It established the precedent that a company is a separate legal entity from its shareholders, and shareholders are generally shielded from personal liability for the company's debts.

This principle has become a cornerstone of modern company law. These important doctrines have had extensive connotations for the administration of a company, protection of minority shareholders, and use of defrauding.¹¹ However, it's worth noting that while the case established the general rule of limited liability, there are situations in which the corporate veil can be pierced or lifted, leading to shareholders being held personally liable. This typically occurs in cases of fraud, improper conduct, or where the company is being used for an illegal

⁹ Vasundhara Majithia, Yamini Rajora, 'Lifting Of Corporate Veil' (Lawctopus.com April 8, 2015) <www.lawctopus.com/academike/corporate-veil-2/> accessed 25th August, 2023.

¹⁰ Prof. H.D Pithawalla, *Company Law*, (C. Jamnadas & Co.)

¹¹ Ayush Upadhyay, 'Salomon vs Salomon Co. Ltd, Case Analysis', (lawfoyer.in, 7th July, 2023), <www.lawfoyer.in/salomon-v-salomon-co-limited> accessed 26th August 2023.

purpose to evade legal obligations. Overall, the case has provided important protections for shareholders and creditors and has helped to promote economic growth and investment.¹²

In the end, it can be concluded that the Salomon v. Salomon & Co. Ltd case remains a crucial precedent and can be considered as the founding stone of the most essential characteristic of a company i.e., separate legal entity, and directly or indirectly it leads to the development of corporate legislation throughout the world.



¹²Salomon v. A Salomon and Co. Ltd. (1897) ; Principles Of Separate Legal Personality And Limited Liability For Companies' (legalvidhiya.com, 7th April, 2023) < <https://legalvidhiya.com/salomon-v-a-salomon-and-co-ltd-1897-principles-of-separate-legal-personality-and-limited-liability-for-companies/>> accessed 26th August, 2023