BETWEEN TORT CREDITORS AND SHAREHOLDERS OF CLOSELY HELD COMPANIES: ANOTHER LOOK AT THE DOCTRINE OF SHAREHOLDER IMMUNITY*

Introduction

Globally, the registered company is unquestionably recognized as the dominant and most widely used business form.[1] Possessing a separate personality from its founders/members, it can borrow money, acquire property, litigate in its name, and generally, its securities are freely transferable.[2] But its most outstanding feature is the fact that by default, its members are immune from its liabilities and obligations, making it naturally suited for large business endeavours and multinational enterprise.[3] And perhaps with the fraud exception, the principle of shareholder immunity has remain unassailed in many Commonwealth countries ever since it received judicial approval in the celebrated case of *Salomon v Salomon and Co Ltd*.[4] There is however ongoing debate among legal scholars, whether shareholder immunity should apply where a corporate tort is committed by a closely held company.[5] One reason for this call is the assertion that unlike contract or voluntary creditors, tort or involuntary creditors, are not in a position to adequately protect themselves ex ante against corporate actions that give rise to those torts, in the first place, or to contract out of the implications of incorporation.[6]

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[1] See W.B. Truitt, *The Corporation* (Greenwood 2006) 32

[2] See LCB Gower, 'The English Private Company' (1953) 18 *Law and Contemporary Problems*, 543. See also ss.37 and 115 of the Companies and Allied Matters Act (CAMA) Cap C.20 Laws of the Federation of Nigeria (2004). See also *NNPC v Integrated Gas Nigeria Ltd* (1999) 8 NWLR. (pt. 613) 119 at 129.

[3] 'Shareholder immunity' is used in this article rather then the widely used 'limited liability' in order to buttress the fact that where a company's shares are fully paid up for, its members do not have any form of liability whatsoever, to creditors of the company, and therefore enjoy 'total' rather than 'limited' liability.

[4] See Jennifer Payne, 'Lifting the Corporate Veil: A Reassessment of the Fraud Exception' (1997) 56 Cambridge Law Journal, 284.

[5] For purposes of this article, a firm is closely held when it is either a family owned firm or one in which the management and ownership are vested in the same persons to a point that obscures the distinction between the company and its members as envisaged by law. See also J.H. Matheson, 'The Limits of Business Limited Liability: Entity Veil Piercing and Successor Liability Doctrines' (2005) 31 *Wm. Mitchell L. Rev.* 411 2004-2005. One reasons will primarily advocate this is because distinguish closely held firms rather than on publicly traded firms is because apart from the economic advantages of the stock exchange, the costs associated with tracing and enforcing corporate liability on a large number of dispersed shareholders would be very difficult, if not impossible, especially as the shares may have been sold, and unlimited liability may be applicable only to persons who were shareholders at the time a particular tort occurred.

[6] A person, who obtains judgment against a company by being a victim of corporate tort, becomes a tort creditor. But because the circumstances which gave rise to the tort can hardly be said to have been consensual, he is regarded as an involuntary creditor of the company. In this regard, see P.I. Blumberg et al, *Blumberg on Corporate Groups* (2nd ed 2010) at 57; D W Leebron, 'Limited Liability, Tort Victims, and Creditors' (1991) 91 *COLUM. L. REV.* 1565; H Hansmann and R Kraakman, 'Toward Unlimited Shareholder Liability for Corporate Torts' (1991) 100 *Yale Law Journal* 1879 at 1903; See PB Oh, 'Veil Piercing Unbound' (2010) Vol 89 Texas Law Review at 87.

This article notes that industrial activity is bound to increase in Nigeria, following reforms that have been put in the power sector and other sectors. But because industrial activities are mainly carried out through the corporate platform, corporate torts are bound to increase in Nigeria. Increase in corporate torts will lead to calls by plaintiffs for Nigerian courts to disregard the corporate veil in order to impose unlimited tort liability. It is to this extent that this article will contend for special veil piercing rules to be devised by Nigerian courts, over and above the fraud exception. In order to justify its position, this article will first explore the economic and practical factors that underpin shareholder immunity, and the reasons why contract creditors are restrained from proceeding against corporate shareholders. It will thereafter contend that the framers of shareholder immunity did not intend for the principle to apply to shareholders of closely held firms which commit a tort, but rather intended for it to be applicable to contract creditors of publicly traded firms.

This article is divided into five parts. Part one reviews the corporate personality principle, while part two analyses the economic and legal justifications behind shareholder immunity. Part three compares veil piercing principles different jurisdictions, using Australia, America, the United Kingdom, and Nigeria, as case studies, while part four makes a case for special veil piercing rules for tort creditors. Part five concludes the article.

***Salomon v Salomon*, corporate personality, and the principle of shareholder immunity**

The statutory recognition of the company's separate legal personality[7] whose members were by default immune from its liabilities and obligations, was given judicial approval by the decision of the House of Lords in the case of *Salomon v Salomon and Co Ltd*.[8] In that case, one Aron Salomon, a leather merchant, sold his business to a newly formed Salomon and Co Ltd for 39,000 pounds. The company had 20007 ordinary shares of one pound each. Salomon was paid 9000 pounds in cash, and was allotted 20001 ordinary shares of one pound each. His wife and five sons held one share each of the remaining six shares, as his nominees. His two eldest sons were directors in the company, while Salomon was managing director. The rest of his credit was secured with a floating charge over the

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[7] For instance see the 1855 Limited Liability Act and the English Companies Act of 1862. For the current position in Nigeria and in England, see ss. 37 of CAMA and section 16 of the English Companies Act 2006, respectively.

[8] [1897] A.C 22.

company's assets. In essence the business was a closely held one man company, the rest of the shareholders being mere nominees of the controlling shareholder and members of his immediate family.

The company soon ran into difficulties and was put into liquidation, but its remaining assets, were not sufficient to satisfy its unsecured creditors. The liquidator resisted Salomon's claim for repayment of his loan, in his capacity as a secured debenture holder, as that would leave the unsecured creditors without any form of compensation. The liquidator argued rather that the company was Salomon's agent, and for that reason, he should be personally responsible for its debts. Salomon instituted an action at the court of first instance. The matter was heard by Vaughan Williams J, who found that the company was an agent of Salomon, and his alias, and was therefore entitled to be indemnified him as its principal.

The Court of Appeal upheld the decision of the lower court but on the ground that Salomon was the company's trustee. On a further appeal to the House of Lords, the agency and trust arguments were rejected. Rather the court took a literalist approach to section 18 of the English Companies Act of 1862, under which the company was incorporated, and held that a registered company either had a separate personality or it did not. If it did, then Salomon could not have owned the company, which was to be treated as being separate from its members. Lord Macnaghten was of the view that a:

> …company is at law a different person altogether from the subscribers…; 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'.[9]

Concurring, Lord Halsbury held that *'The statute enacts nothing as to the extent or degree of interest which may be held by each of the seven shareholders or as to the proportion of interests or influence possessed by one or the majority over the others'*. Since *Salomon v Salomon and Co*, it is now established in our jurisprudence that a company enjoys a distinct personality from its members who can only have interests in it. Furthermore, it cannot be owned by its members, neither are they its trustees or its agents,[10]

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[9] At 51

[10] See also *Lee v Lee's Air Farming Ltd* (1960) 3 ALL E.R 420, and *Kate Enterprises Ltd. V Daewoo Nigeria Ltd.* (1985) 2 NWLR. (pt. 5) 116.

Closely allied to the separate personality principle of the company, is that of shareholder immunity, under which a company's shareholders are shielded from its liabilities and obligations, irrespective of the extent of their shareholdings in the company.[11] Thus, a company bears its liabilities alone and its creditors can only proceed against its shareholders, to the extent to which they are indebted to the company. In other words, shareholders with zero liability to the company, enjoy 'absolute' immunity from its liabilities and obligations. Shareholder immunity means that perhaps the potential loss of investment and nothing more, is perhaps the only risk associated with investing in a corporate form. But even that risk can be reduced by an effective portfolio management which may entail spreading investments among various economic sectors. But investment spread along multi-sectoral lines, would have been impossible without shareholder immunity, as investors would have been very reluctant to invest in companies they have limited knowledge of.[12]

Because it offered huge rewards for shareholders of successful companies, and while ensuring zero liabilities for its failures, shareholder immunity made the company the most preferable investment avenue for large economic activities, and the bedrock for the sustainability of the stock market. For the absence of shareholder immunity can actually *'…undermine clarity in the valuation of companies' assets given increased uncertainty over exposure to, and liability for, risks, particularly tort risks.'*[13] But it may be necessary to understand why corporate shareholders enjoy absolute immunity for its liabilities, while partners in a partnership, do not. And for that reason, it may be necessary to elucidate on the economic and legal justifications behind shareholder immunity.

Economic and legal justifications for shareholder immunity

Shareholder immunity arose in the nineteenth century England as a risk avoidance, and investment stimulation mechanism, geared towards providing funds for large business enterprises.[14] In essence, by offering

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[11] By virtue of ss 21 and 25 of CAMA, shareholders of a company may have unlimited liability for corporate debts. The fact however remains that shareholder immunity is the majoritarian default.

[12] See E. Ferran and L.C. Ho, *Principles of Corporate Finance Law* (Oxford 2014) 18; see also Leebron, 'Limited Liability, Tort Victims, and Creditors' 1597-1600; see also Henry G. Manne, 'Our Two Corporation Systems: Law and Economics', 53 VA. L. REV. 259 (1967) 262

[13] Henry Hansmann and Reinier Kraakman, "Toward Unlimited Shareholder Liability for Corporate Torts" (1991) 100 Yale Law Journal 1879 at 1903

[14] Gower notes that *'after lengthy and heated controversy in Parliament, Royal Commissions, Departmental Committees, the Press, and indeed in every forum of public and commercial opinion, Parliament under pressure from the Government of the day passed the Limited Liability Act, 1855…'* conferring limited liability on companies which completed registration under the 1844 Act. See LCB Gower, 'The English Private Company' (1953) (n 2) , 536. See also PI Blumberg, 'Limited Liability and Corporate Groups' (1986) 11 *Journal of Corporation Law* 573, 604.

protection to shareholders for corporate liabilities, it aimed at stimulating investment in the corporate form by persons who could not personally manage or monitor the companies in which they invested, and were therefore averse to being responsible for the company's liabilities.[15] It therefore enabled investors to fund the '…*activities of large corporations, receive dividends and capital gains on their investments, and yet remain immune to some of the costs of misconduct or misjudgment by their corporate agents.*'[16] In another sense, shareholder immunity externalized some of the risks associated with corporate failures, to corporate creditors, who were 'compelled' to bear them by virtue of the 'shield' which prevented them from suing the company's shareholders, except they could establish fraud or some element of criminality, on the part of the shareholders.[17]

But what is the justification for conferring immunity on shareholders, a right which incidentally, partners in a partnership, by default do not enjoy?[18] Scholars have sought to justify shareholder immunity on the basis that the management/ownership distinction envisaged by company law, creates room for potential agency problems,[19] which make it imperative for the law to protect investors, who in theory, do not manage the company. The corporate form is often contrasted with the partnership, under which by default, envisages a management/ownership merger, with little or no

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[15] See FH. Easterbrook and D.R. Fischel, 'The Economic Structure of Corporate Law' (1991) 41-43, see also See also J.H. Matheson, 'The Limits of Business Limited Liability: Entity Veil Piercing and Successor Liability Doctrines' (2005) 31 Wm. Mitchell L. Rev. 411 2004-2005, 415.

[16] R Green, 'New Directions in Corporate Law: Shareholders as Stakeholders — Changing Metaphors of Corporate Governance' (1993) 50 *Washington and Lee Law Review* 1409, 1415.

[17] P Blumberg, *The Multinational Challenge to Corporation Law: The Search for a New Corporate Personality* (1993) 11 J.Corp. L. 573, 139; see also Stephen M Bainbridge, thought out government policy one that adequately considers the predicament of tort creditors, and the social costs imposed by accident related torts on third parties, and on the other hand, considers the need for entrepreneurship via the corporate platform, which has seen firms provide potentials for employment and economic prosperity, 'Abolishing Veil Piercing' (2001) 26 *Journal of Corporation Law* 479, 489.

[18] It is quite instructive however that Part 4 of the Lagos State Partnership Law of 2003 (as amended in 2009), now provides for limited liability partnerships (LLPs). An LLP is a hybrid between the company and the partnership, although it is more like a company than a partnership because it has a separate legal personality, and its members enjoy limited liability, although they are taxed under the personal income tax regime, and not under the companies' law regime. Furthermore, LLPs, like other partnerships, are regulated by states' legislatures and are not necessarily regulated by CAMA, although the requirement for the acquisition of a business name, where necessary, and the requirement to incorporate as a company if they exceed 20 in number, are all regulated by CAMA. See ss 20 and s 573. See generally P. L. Davies and Sarah Worthington, *Principles of Modern Company Law* (9th edn, Sweet and Maxwell, Kindle version) at Locations 7640-7669. See also A Odeleye and B Oregbemhe, 'Review of LLPs under the Partnership Law of Lagos State' <www.internationallawoffice.com/Newsletters> accessed 30th January 2015. See also the LLP Act 2000 of the United Kingdom, and the US Revised Uniform Partnership Act 1997, which has been adopted by many states in the U.S. Compare the LLP with the limited partnership which was registered in England under the Limited Partnerships Act of 1907.

[19] These are problems which arise where managers pursue ends which are at variance with those of the shareholders who appointed them. In some cases it may manifest in fraud, conflict of interests and the abuse of office. In fact the corporate governance movement which arose from the early 1990s, are a reaction to abuses of corporate power by managers. For a comprehensive treatment of the agency problem, see R Kraakman et al, *The Anatomy of Corporate Law: A Comparative and Functional Approach*, (Oxford University Press, 2009).

agency problems, and hence the imposition of unlimited partner liability, for the debts of the business.[20] In other words, while the shareholder/management separation creates room for professional and dedicated management, it may also create agency problems.

But where agency problems result in corporate failure and liabilities, the personal funds of shareholders, would be exposed to corporate creditors, unless they are offered some form of protection.[21] Shareholder immunity is a trade off for the loss of shareholder control over corporate management.[22] Exposure of shareholders' personal funds for corporate liability would have discouraged investors from ploughing their personal funds into the corporate form especially where such investors do not personally manage such concerns. And because it would be difficult to convince investors to bear unlimited liability for the obligations of companies whose managers are not required to comply with their directives, company law proceeded to confer immunity on shareholders, as an incentive for further investment.[23] In other words, while agency problems which arise from the fusion of management/ownership can be said to justify shareholder immunity, the unlimited liability of partners, is justified on the presumption of a management/ownership fusion.[24]

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[20] S. 9 of the Partnership Law of Bayelsa State 1988 (Cap P1) tort liability in closely held firms, should be exception otherwise it would scuttle the rise of Niger's industrial development. In other to further from delving into serious economic activity like manufacturing and construction in other to beef up the insurance sector, and to require all firms, especially those who are tort prone, to compulsorily insure their workers, and their activities, as this would limit their exposure to insolvency. There may also be need to require that tort-prone firms be adequately capitalized, as they would equally reduce the extent to which such firms will suffer from insolvency. The capitalization requirement will spur shareholders of such firms to good governance, and would further reduce the 'perverse incentive' to spend less on tort prevention measures. Capitalization must not however be done to the detriment of start-ups and budding enterprises. In that regard, there will be need for a well

[21] As far back as 1932, Adolf Berle & Gardiner Means had argued that the separation of ownership from management would create problems. See A Berle and G Means, *The Modern Corporation and Private Property* (Transaction, 1932). See also Henry G. Manne, 'Our Two Corporation Systems: Law and Economics', 53 VA. L. REV. 259 (1967) 262; in this regard, see GG. Acheson and JD Turner, 'The Impact of Limited Liability on Ownership and Control: Irish Banking, 1877-1914' (2006) Vol. 59, The Economic History Review, 230.

[22] See RB Thompson, 'Piercing the Corporate Veil: An Empirical Study' (1991) 76 Cornell Law Review 1036, 1054.

[23] See s.63 CAMA

[24] A litany of literature exists on the agency problem. See L Bebchuk, et al, 'What Matters in Corporate Governance?' (2009) 22 Review of Financial Studies, 783-827, and V. Kammenan, 'Empire Building by Corporate Managers: The Corporation as a Savings Instrument' incentive to use the corporate form in a reckless and dangerous manner, will contend that the underlying economic and legal justifications behind the bare against contract creditors do not apply to apply to tort creditors as they do to contract creditors. It also argued that in contrast to closely held firms the virtual absence of agency problems, which further justifies shareholder immunity, are hardly present in closely held firms, because of the fusion of management and ownership. Nigeria courts should therefore in the interest of 'doing justice' exception to the imposition of unlimited tort liability for closely held firms, and even at that, only in special circumstances. It is therefore imperative that unlimited' (2000) 24. Journal of Economic Dynamics and Control, 127-42.

But despite the economic advantages which underlie its continued application, shareholder immunity can sometimes work hardship on corporate creditors and innocent third parties. This may happen where persons hide under the corporate 'shield' to commit fraud, or evade legal obligations. At other times, it may have unwittingly given rise to shareholder passivity, with its implications on weak corporate governance.[25] In this regard, Mendelson argues that it encourages 'socially costly corporate activity -risky activity selected because the corporation and its shareholders do not bear all the expected costs of the activity.'[26]

Shareholder immunity also removes the necessity for companies to invest in accident prevention measures, while encouraging excessive risk taking, which may result in oil spills, gas flaring, environmental accidents, and preventable disasters. In essence, it creates 'perverse incentives to spend too little on accident prevention and to invest too much in hazardous industries.'[27] For instance because incorporation of companies can be done with very relative ease, in order to minimize liability, a firm may elect to establish a fully owned/controlled subsidiary, and through the latter, operate recklessly in a high risk environment. While that in itself may not be illegal or wrong, the fact that the company's shareholders are not liable for its actions, may encourage corporate operations with minimal regard to life and property. At other times, a company may be operated in such a manner as to blatantly disregard the formalities created by the law to separate it from its members.

Statutory and judicial veil piercing have been used in the past to address the abuses to which the corporate form may be subjected to statutory veil piercing occurs where a statute imposes unlimited liability on a company's officers, employees, or members, for acts done in the name of the company. In other words, the legislature can *'...forge a sledge-hammer capable of cracking open the corporate shell.'*[28]For instance, a violation of a statutory requirement may justify the imposition of a fine or other penalties either on the company, its members, or persons responsible for the default in question.[29] Judicial veil piercing occurs where a court

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[25] See OA Monoh and MS Ukpong, 'Corporate Governance and its effect on the Nigerian Insurance Industry' (2013) 8 European Journal and Globalization, and Development Research, 483

[26] A Mendelson, 'A Control-Based Approach to Shareholder Liability for Corporate Torts', (2002) Vol. 102 Columbia Law Review, 1203, at 1204

[27] H Hansmann and R Kraakman, "Toward Unlimited Shareholder Liability for Corporate Torts" (1991) 100 Yale Law Journal The corporate platform, corporate torts are likely to rise in Nigeria. It is therefore imperative that Nigerian courts are prepared to deal some of the legal issues that may arise from corporate torts, one of which is the issue of unlimited tort liability. It is in this regard that this article has argued that unlimited tort liability for shareholders of closely held firms will serve to protect tort creditors on the one hand, and will reduce shareholders' 1879, 1882-4

[28] Per Devlin, J., in *Bank Voor Handel en Scheepvaart v. Slatford*, [1951] 2 All E. R. 779, 799.

[29] In this regard, see ss. 93, 246, and 336, 548, 506 of CAMA.

imposes unlimited shareholder liability by disregarding the principle of shareholder immunity. The rest of this article will however be devoted to the principles behind judicial veil piercing, in order to determine whether separate rules should be created for tort creditors of closely held companies.

Judicial Veil Piercing: principles and rationale

Judicial veil piercing occurs because as a general rule, the courts will not allow the corporate form to be used as an instrument of fraud, or for the perpetuation of criminality.[30] Thus a court may pull off the corporate 'mask' in order to see what really lies behind the company, and where necessary, hold the company's shareholders liable for its acts.[31] Thus in *Adeyemi v Lan and Baker (Nig.) Ltd* [32] Aderemi JCA held that:

there is nothing sacrosanct about the veil of incorporation...The decision in *Salomon v Salomon* must not blind one to the essential facts of dependency and neither must it compel a court to engage in an exercise of finding the parties as distinct from an artificial or fictitious one. Thus if it is discovered from the material before the court, that a company is the creature of a biological person be he a managing director or a director, and it is a devise or a sham-mask in the eye of equity, the court must be ready and too willing to open the veil of incorporation to see the characters behind it, if justice must be seen to be done.[33]

But because judicial veil piercing is essentially an equitable remedy, it does not apply in the realm of criminal law. In essence, a court will not lift the corporate veil in order to impose criminal liability on a shareholder, unless there is a clear written statutory authorization to that effect.[34] Thus in *State v Adeniji*, the Appellant was convicted by Desalu J of the Lagos State High Courts for stealing under section 390(3) of the Criminal Code Law of Lagos State.[35] The money in question was paid to Abbey Life and Pension Consultants Ltd, by the defunct Nigeria Airways Authority for an insurance scheme with the National Insurance Corporation of Nigeria (NICON). Aggrieved, the appellant appealed to

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[30] See *Alade v Alice (Nig) Ltd.* (2010) 19 NWLR. (pt. 226) at 116-117.
[31] *Littlewoods Stores v. IRC* (1969) 3 ALL ER. 855;
[32] (2000) 7 NWLR (pt. 663) 33.
[33] At 51.
[34] But see *Aminu Musa Oyebanji v The State* LPELR (2015) SC. 374/2011
[35] (1992) 4 N.W.L.R. Part 234, 248 at 260,

the court of appeal, and the main issue for determination was whether or not the court could lift the veil of incorporation in order to impose criminal liability on the appellant.

Allowing the appeal, the Court of Appeal held that disregarding of the corporate personality of the company by the courts is an equitable intervention, and as such it would set a dangerous precedent for the courts to apply its equitable powers in criminal cases. And that applying the doctrine of lifting the veil for criminal matters would amount to applying equitable doctrines to ground a conviction in a criminal law. In the light of the decision of the Court of Appeal in *Adeniji v The State*, analysis in this article will be restricted to principles that are used to justify judicial corporate veil piercing.

Judicial veil piercing implies that judges recognize that it may sometimes be imperative to impose unlimited liability on shareholders in order to ensure that the ends of the law and of justice are not defeated by self-serving persons. Be that as it may, veil piercing should however be the exception and not the rule, or else there would be an undermining of the economic and practical considerations, which underpin shareholder immunity in the first place. It is therefore imperative that judges maintain shareholder immunity by respecting the company's corporate personality, even where to do so, may impose difficulties on corporate creditors and third parties. In the course of judicial veil piercing, there is however need to balance the interests of the company, its creditors, and its shareholders-and to that extent, formulation of clear and certain veil piercing rules, first as a restraint on activist judges, who may be driven by emotions rather than the law in veil piercing exercises. Secondly, clarity about veil piercing principles will assure investors that the protections offered by the law cannot be routinely discarded except in accordance with laid down principles of law aimed at the ends of justice.[36] The next segment will compare judicial attitudes in some jurisdictions in order to ascertain the extent to which these principles play out in practice.

USA and Australia

Courts in the USA are constantly faced with veil piercing cases than in Commonwealth countries, which has led the courts to create a *'laundry list'* attitude to the identification of relevant factors which justify shareholder liability.[37] Refusing to be tied down by iron clad veil piercing

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[36] P.B. Oh, 'Veil Piercing Unbound' (2010) 89 *Texas Law Review* 89 at 104.

[37] H. Henderson, 'Piercing the Veil on Corporate Groups in Australia: the case for Reform' (2009) 33 *MULR* 333, 335

rules, judicial veil piercing in the USA considers a broad range of factors like fraud,[38] misrepresentation, misuse of the corporate form,[39] agency, and the extent to which a company is actually separate from its controlling shareholders.[40] Other factors that are considered include the extent of its capitalization,[41] disregard of corporate formalities, and the extent to which a subsidiary is controlled by its parent company.[42]

Like the USA, it appears also that Australian courts do not have any distinctive veil piercing principle. According to Noakes and Ramsay, Australian *'…courts tend to take a fact-based approach to questions of piercing the corporate veil, and no particular trend is readily discernible from an overview of the cases.'*[43] In *Briggs v James Hardie & Co Pty*,[44] Rogers AJA observed that there is *'no common, unifying principle, which underlies the occasional decision of the courts to pierce the corporate veil. Although an ad hoc explanation may be offered by a court which so decides, there is no principled approach to be derived from the authorities.'*[45]

Also in *Commissioner of Land Tax v Theosophical Foundation Pty Ltd*,[46] Herron CJ, observed that:

Authorities in which the veil of incorporation has been lifted have not been of such consistency that any principle can be adduced. The cases merely provide instances in which courts have on the facts refused to be bound by the form or fact of incorporation when justice requires the substance or reality to be investigated…[47]

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[38] *Blair v. Infineon Technologies A.G.*, 720 F. Supp. 2d 462 (D. Del. 2010)
[39] *Laguna v. Coverall North America, Inc.*, 2009 WL 5125606, at *3 (S.D. Cal. 2009).
[40] *Blair v Infineon Technologies A.G.* (n 38 above)
[41] In *Minton v Cavaney* (1961) 56 Cal. 2d 576, Associate Justice Roger. J. Traynor of the Supreme Court of California held that *'the equitable owners of a corporation, for example, are personally liable…when they provide inadequate capitalization and actively participate in the conduct of corporate affairs'*. The action was instituted following the drowning of Mr. Minton's daughter, in a public swimming pool owned by Mr. Cavaney.
[42] In C. S. Krendl and J.R. Krendl, ' Piercing the Corporate Veil: Focusing the Inquiry' (1978) 55 *DENVER L.J.* 1, 52-55 the authors listed thirty one factors that are considered by American courts in deciding whether or not to pierce the corporate veil.
[43] DB Noakes and IA Ramsay, 'Piercing the Corporate Veil in Australia' (2001) 19 Company and Securities Law Journal 250-271
[44] (1989) 16 NSWLR 549
[45] Ibid at 549
[46] (1966) 67 SR (NSW) 70, 18
[47] (n f) at 19

The American and Australian approach gives room for judicial maneuvering and a measure of discretion for judges to do justice as the merits of each case requires. But the lack of certainty in this regard has given rise to assertions that judicial veil piercing in America is unprincipled, with resultant uncertainty for corporate practitioners and shareholders.[48]

England

Prior to the celebrated case of *Adams v Cape Industries Plc.*, English courts pierced the corporate veil in a variety of circumstances which included fraud,[49] sham[50], trust,[51] single economic unit,[52] public policy in order to determine the character of a company, etc.[53] But since *Adams v Cape Industries Plc.*, it appears that English courts have narrowed the grounds under which the courts may pierce the corporate veil to the fraud/sham exception. The court in that case was called upon to treat Cape Industries Plc. which was registered in England, as one and the same as its American subsidiaries, in order to hold the latter liable for obligations of the former. The plaintiffs in that case relied on the agency argument, and the single economic unit theory, propounded by Lord Denning in *DHN Food Distributors Ltd v. Tower Hamlets London Borough Council*.[54]

The trial court however rejected the DHN case, and relied rather on *Woolfson v. Strathclyde Regional Council*[55] by restating that because subsidiaries are not in the eyes of the law agents of their parent firms, they cannot be presumed to have a general power to bind them. Nor can they be treated as a single economic unit for purposes of liability. The court clarified the English position that the corporate veil can only be pierced in England by the courts where the company has been used as a sham, or as an instrument of fraud.

Conceded that narrowing instances under which the corporate veil can be pierced in cases of fraud as was done in *Adams v Cape Industries Plc.*, creates investor certainty and strengthens the doctrine of limited liability. But such a narrow approach ignores the vast array of abuses to which

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[48] PB Oh (n 6) 104.
[49] *Merchandise Transport Ltd v British Transport Commission* (1976) 1 WLR. 852.
[50] *Jones v Lipman* (1962) 1 WLR. 832
[51] *The Abbey, Malvern Wells Ltd v Ministry of Local Government and Planning*
[52] [1951] Ch. 728.
[53] *DHN Food Distributors Ltd v. Tower Hamlets London Borough Council* [1976] 3 All ER 462 (Court of Appeal).
[54] *Daimler Co. Ltd v Continental Tyre and Rubber Co.* (1916) A.C 307.
[55] [1976] 3 All ER 462 (Court of Appeal)
[56] (1978) 38 P & CR 521, HL

the corporate form can be subjected to, by unscrupulous persons-who can only be dealt with by judicial ingenuity, and a multi-faceted veil piercing approach. It is suggested that courts be allowed to determine cases on their merits while looking out for certain signposts which may guide them in arriving at a decision whether or not to pierce the corporate veil.

Nigeria

Nigeria is not an industrialized country. As at 2003, manufacturing accounted for less than 5 per cent of its exports.[56] Currently it accounts for about 10 per cent of her GDP, and the sector employs about 12 per cent of Nigeria's labour force.[57] For a country with over 160 million people, Nigeria's overall industrial steel consumption is about 10 kilogrammes, below the world average of 150 kilogrammes.[58] Weak industrial activity explains why Nigeria does not grapple with industrial torts as much as advanced countries like the United Kingdom, the U.S.A, or Australia. While veil piercing is the most litigated aspect of American corporate law because of her level of industrialization,[59] there are relatively few veil piercing cases in Nigeria. In fact suits against shareholders of insolvent closely held firms, for corporate torts, has not, to the knowledge of the author, arisen.[60]

But Nigeria's status as an agrarian and oil dependent economy is fast changing. Reforms that have been put in place by the government since Nigeria returned to civilian rule in 1999, have resulted in some increase in manufacturing, fabrication, and construction.[61] Today, manufacturing, as opposed to petroleum, is fast becoming the main driver of Nigeria's economy.[62] Also, local content policies in the petroleum,

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[56] See Per Heum and others, 'Enhancement of Local Content (n 58, chapter 2), 11.

[57] National Bureau of Statistics, 'Manufacturing' (2013) <http://www.nigerianstat.gov.ng/sectorstat/sectors/manufacturing> accessed 25 April 2014.

[58] Ruth T. Nesoba, 'Poor Funding, Bane Of Steel Sector's Growth' The Nation (Abuja, 6 October 2012) <http://www.leadership.ng/nga/articles/36663/2012/10/06/poor_funding_bane_steel_sectors_growth.html?quicktabs_3=1> accessed 20 November 2012.

[59] R.B. Thompson, 'Piercing the Corporate Veil: An Empirical Study' (1991) Cornell L.R. 1036, 76

[60] That notwithstanding, there are a number of actions that have been brought in foreign courts, against multinational oil firms for torts committed by their agents, in Nigeria. But most of these actions have been instituted not necessarily because the subsidiary was insolvent, but on the belief that Nigerian courts would not grant fair hearing to the complainants. For instance, the Ogoni people of the Niger Delta Region of Nigeria, have in times past, instituted actions against oil giant, Shell in the UK, the Netherlands, and in the USA (under the Alien Tort Claims Act of 1789- *Jon Gambrell, 'Nigerian villages sue Shell in UK court over spills' Boston.com (23 March 2012)* *<http://www.boston.com/business/articles/2012/03/23/nigerian_villages_sue_shell_in_uk_court_over_spills/>*

[61] See, National Bureau of Statistics, 'Manufacturing' (2015) www.nigerianstat.gov.ng/sectorstat/sectors/manufacturing, accessed 5 October 2014.

[62] see also H Edeh, 'Manufacturing Sector Now Nigeria's Main Economic Driver, says Rencap' *BusinessDay*(14th July 2014) www.businessdayonline.com/2014/07.nabkyacxniubg-sector-now-major/

telecommunications, maritime, and construction sectors, have given an impetus to local industries to reinvent themselves in order to play an active role in Nigeria's emerging economy.[63] But as industrialization is almost always channeled through the corporate form, there are bound to be incidences of corporate torts which may result in actions against not only companies, but their shareholders also, especially where such firms are closely held. Actions against shareholders for corporate torts, which throw up new challenges for Nigerian courts. In that regard, it is therefore imperative that Nigerian courts be prepared to erect veil piercing rules to address corporate torts, which are likely to result from corporate activities.

Generally, Nigerian courts will pierce the corporate veil in order to prevent fraud, or where it is necessary to do so in the interest of justice.[64] The Nigerian position in relation to fraud was captured by Galadima JSC in *Akin-Wunmi Alade v Alic Nigeria Ltd*[65]where the learned justice held that:

The consequences of recognizing the separate personality of a company is to draw a veil of incorporation over the company. One is therefore generally not entitled to go behind or lift this veil. However, since a statute will not be allowed to be used as an excuse to justify illegality or fraud it is a quest to avoid the normal consequences of the statute which may result in grave injustice that the Court as occasion demands, have to look behind or pierce the corporate veil.

The interest of justice approach means that each case is treated on its merits in order to determine whether the justice of each case warrants the piercing of the corporate veil. It is proposed that Nigeria should however follow the UK approach by limiting the veil piercing criteria to that of fraud, in order not to create an avalanche of exceptions under which the corporate veil will be lifted. This will result in uncertainty, which may discourage corporate investment, with attendant negative implications on the economy. Unlike the UK approach as embodied in *Adams v Cape Industries Plc* however, this article will propose that the interest of justice criteria should be applicable only where an insolvent closely held company has committed a tort, which leaves tort creditors without it is

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[63] Currently Nigeria's local content policy is embodied in the Nigerian Oil and Gas Industry Content Development Act. For a fuller treatment of this policy, see Lawrence A. Atsegbua, 'The Nigerian Oil and Gas Industry Content Development Act 2010: an examination of its Regulatory Framework' (December 2012) OPEC Energy Review at 485, 494, see also Pereowei Subai, Toward a Functional and Number Industry: A Critical Analysis of Nigeria's Petroleum Industry Reform (PhD Thesis Newcastle University, 2014).
[64] *Adeyemi v Lan and Baker (Nig.) Ltd* (n 32); see also *Alade v Alice (Nig) Ltd* (2010) 19 NWLR. (pt. 226) at 116-117 see also *International Offshore Construction Ltd v Shoreline Lifeboats Nigeria Ltd.* (2003) 16 NWLR. (Pt. 845) 157 CA.
[65] Ibid 111

compensation. In order words, as long as the firm's assets are able to pay its debts, the interest of justice criteria should not be used to impose unlimited tort liability on shareholders of closely held firms. Even at that, unlimited tort liability should only be imposed where certain factors exist, which makes it imperative for the courts to call upon shareholders to bear the burdens of the company. Where those factors cannot be said to exist, shareholder immunity should continue to apply to shareholders of closely held firms. The next segment will analyse in detail the arguments for unlimited tort liability for shareholders of closely held firms, and will seek justify why in certain instances, the same should be applied to Nigeria as an emerging economy.

Analysis of the case for unlimited tort liability in closely held firms

It is the position of this paper that Nigerian courts should impose unlimited tort liability on shareholders of insolvent closely held firms. This is because firstly, there is a virtual absence of agency problems in such firms, and secondly, because the assumptions under shareholders enjoy immunity from suits by contract creditors, do not apply to tort creditors.[66]

See generally H. Hansmann and R. Kraakman, (n 27) 1789; D. Leebron, 'Limited Liability, Tort Victims, and Creditors' (1991) 91 *Columbia Law Review* 1565; J Alexander, 'Unlimited Shareholder Liability Through a Procedural Lens' (1992) 106 *Harvard Law Review* 387; R B Thompson, 'Unpacking Limited Liability: Direct and In essence, it is important to appreciate the fact that shareholder immunity, was meant primarily to apply to contract creditors, especially in publicly traded firms, but was never meant to apply to tort creditors of closely held firms. In fact, had the framers of the shareholder immunity properly considered the distinctions which exist between tort creditors and contract creditors, it is doubtful if they would have provided for a blanket shareholder immunity, to apply with equal force to closely held and publicly traded firms.[67]

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[66] See generally H Hansmann and R Kraakman, (n 27)1789; D Leebron, 'Limited Liability, Tort Victims, and Creditors' (1991) 91 Columbia Law Review 1565; J Alexander, 'Unlimited Shareholder Liability Through a Procedural Lens' (1992) 106 Harvard Law Review 387; R B Thompson, 'Unpacking Limited Liability: Direct and Vicarious Liability of Corporate Participants for Torts of the Enterprise' (1994) 47 Vanderbilt Law Review 1; R Carroll, 'Corporate Parents and Tort Liability' in M Gillooly (ed), The Law Relating to Corporate Groups, 1993, Ch 4.

[67] *In this regard, Professor Thompson observes that "Because the market-related reasons for limited liability are absent in close corporations and corporate groups, the most important justification for limited liability is permitting parties in a consensual relationship to use the corporate form to allocate the risks of the transaction and the enterprise."* Robert B Thompson, 'Unpacking Limited Liability: Direct and Vicarious Liability of Corporate Participants for Torts of the Enterprise' (1994) 47 Vanderbilt Law Review 1, 39.

admitted that the call to impose unlimited shareholder liability for corporate torts in closely held firms, is a call to deviate from more than age-old tradition of maintaining the sanctity of the corporate personality and the sub concept of shareholder immunity. The reason however for this call is that in closely held firms, the arguments that justify shareholder immunity do not exist in cases of corporate torts. Thus for the purposes of liability, Nigerian courts should seek to maintain a balance between the interests of tort victims vis a vis those of shareholders by recourse to the original intendment behind the conferment of shareholder immunity, which was noted earlier, was to stimulate corporate investment by risk aversed investors, who do not personally manage the business.

Two significant advantages will arise from unlimited tort liability: the first is social and the other is personal. On the one hand, unlimited tort liability will compel shareholders to ensure that management invests in tort prevention measures, take out adequate insurance and monitor management more closely. The result will be reduction in corporate recklessness, which will ultimately translate in a safer environment for all. The second is premised on the basis that a tort creditor requires additional protection over and above that of a contract creditor, if he is to enjoy the fruits of any judgement that may be awarded to him as a result of being a corporate tort victim. The precariousness of a tort creditor is brought out more fully at times of corporate insolvency, since his claim will be subordinate to prior and secured claims against the company, a factor which increases the likelihood that he may be unable to recover his compensation should the company's assets be unable to satisfy its creditors.

This article therefore argues that in view of Nigeria's status as an emerging economy, and with the potential of increased manufacturing and industrial activities, her courts should devise special veil piercing rules to cater for the needs of corporate tort victims, since this group of persons, as will be shown below, are most vulnerable to the consequences of corporate recklessness and negligence. In other words, although it may be imperative and practical for shareholder immunity to be the default concept of company law, it may be necessary, especially in closely held firms, to disregard a shareholder's immunity in exceptional instances.

Support for a separate veil piercing regime for corporate torts can be found when one considers that where a tort is committed or a contractual

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[68] Officers, employees, and agents of the company. See also ss 65-67 CAMA.

breach occurs, a distinction is made between corporate agents[68] and corporate members, with regards to liability. In essence, corporate agents are immune from third party actions for a company's breach of contract, except where it can be established that they induced the breach.[69] Thus the company alone is liable for its contractual breaches, and its agents will only be liable where they personally undertake to be so liable,[70] or where liability arises by virtue of statutory provisions or operation of law.[71]

But perhaps recognizing the need to create additional redress platforms for tort victims, and the further need to discourage actions which result in corporate torts, the law does not confer any immunity on corporate agents who were party to the commission of a tort, irrespective of whether they were working for a disclosed principal. Rather joint and several liability are imposed on the company and its employees or officers for corporate torts.[72] This gives tort victims three options: either to proceed against the company, or agents, or both the company and its agents. Furthermore, where the action is brought against the company only, as is usually the case, the company may seek indemnity from its agents or officers. Thus if a company's agents do not enjoy immunity for corporate torts which they were a part of, should not shareholders of closely held firms bear unlimited tort liability especially where special circumstances require that they do so? There is need for further elucidation on the justification of the factors which justify unlimited tort liability for closely held firms, and that will be the focus of the next segment of this work.

The virtual absence of agency problems in closely held firms: a justification of unlimited tort liability

The call for unlimited tort liability closely held firms, was earlier premised on two grounds, one of which is the absence of agency problems in such firms, in contrast to publicly traded firms.[73] In other words, why should shareholders of a closely held firm which fuses management and ownership

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[69] In fact the inducement of a breach of a contract amounts to a tort and it is no surprising that the law takes an exception to the general employee/officers immunity in this case. See A. Aruns, 'Liability for Inducing a Corporation to Breach its Contract' (1957) 43 C.L.R. 55.
[70] S.66 of CAMA.
[71] See for instance s.67 of CAMA which recognizes that liability may attach to a person employed by the company as an officer or as an auditor by virtue of the operation of a rule of law with respect to any negligence, default, or breach of trust. In such cases, such persons shall be personally liable and generally any provision in the articles exempting such persons from liability shall be void.
[72] See *Anyaele v. Chukwu (Osondu) Ltd v. Salen Boneh Ltd* (2000)5 NWLR, Part 656 at 348-349; *Okeke V. Pemu & Ors. Ltd.* (2005), Part 915 4 N.W.L.R at 263. See also Jennifer Payne, 'The Attribution of Tortious Liability between Director and Company' (1998) Journal of Business Law 153, 159; and R Grantham and C Rickett, 'Directors' 'Tortious' Liability: Contract, Tort or Company Law?' (1999) 62 Modern Law Review 133, 139;
[73] P I Blumberg, 'Limited Liability and Corporate Groups' (n 14); see also H. Henderson, 'Piercing the Veil on Corporate Groups in Australia,(n37) 335.

enjoy immunity for corporate torts, when partners by default bear unlimited liability, given the management/ownership fusion in both cases? If as was noted earlier, unlimited partner liability is justified on the management/ownership fusion, then shareholders of closely held firms, which fuses management/ownership, should not enjoy immunity, at least not for corporate torts.

Unlimited tort liability: establishing the distinctions between tort creditors and contract creditors

Another reason why Nigerian courts should be willing to impose unlimited tort liability on shareholders of closely held firms is the fact that there is a marked distinction between contract creditors and tort creditors, and the fact that the former have opportunities and advantages which the latter do not have. It was noted earlier that by barring creditors from suing shareholders, the principle of shareholder immunity externalizes some of the risks associated with corporate failure to corporate creditors. But a closer look at the factors which justify the externalization of risks, are essentially applicable only to contract, and not tort creditors. It may therefore be necessary to expatiate on the factors which bar creditors from suing corporate shareholders in order to explain why they do not apply to tort creditors as they do to contract creditors.

Creditors are barred from suing shareholders for corporate liabilities on the basis of three assumptions: first is the voluntary assumption by creditors, of default risks, that without immunity, the losses which shareholders may suffer in the event of insolvency, are by far in excess of what creditors would suffer, and that when compared to shareholders, creditors are better cost avoiders, with ample opportunities to mitigate ex ante, against default risks.[74]

In the first instance, corporate theory assumes-rightly or wrongly-that creditors are fully aware of implications of corporate personality, shareholder immunity, and of the financial standing and credit standing of companies with which they contract.[75] Thus they are deemed to have

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[74] S M Bainbridge, 'Abolishing Veil Piercing' (n 17) 479, 508

[75] In practice however, the presumptions which undergird the continuous application of limited liability against voluntary creditors do not always apply to all of them. For instance, small creditors like suppliers of goods and services, or employees, are not often in a position to bargain with the company, or take adequate steps to protect their credit. Thus suppliers of working tools to a multinational oil firm like Shell would presume the creditworthiness of the firm, and would often consider it a privilege to be able to supply materials to such a firm. Such suppliers would not be able to demand for the financial statements of the company, or that the prospective credit be guaranteed by the shareholders of the company, who in many cases, may run into millions. Conceded that some of the above presumptions may justify the continuous application of limited liability against large creditors like Banks and financial houses, may not apply to small voluntary creditors.

willingly undertaking to bear whatever risks may be associated with transacting with the company. The theory of voluntary assumption of risks that therefore means that creditors cannot challenge the corporate 'shield' which protects shareholders, except where shareholders have defrauded third parties via the use of the corporate form, or where the company is a sham, established to evade legal obligations.[76] The absence of any form of consensus, and the often unplanned, and unanticipated nature of corporate torts however, removes any pretension as to the voluntarily assumption of tort risks by potential tort creditors. In this regard, Millon argues that because '…*relations with tort creditors are neither consensual nor contained in a standard form contract, the 'majoritarian default' term of limited liability has no relevance to tort creditors.*'[77] It is this absence of consensus, and the fact that tort creditors are not in a position to protect themselves ex ante prior to the tort, that makes Muchlinsky to argue that externalisation of corporate risks to tort creditors 'forces' the poorer risk taker to assume the burden of the risk, contrary to well understood notions of efficient risk allocation.[78]

The bar against creditors has also been justified on the basis that the risks borne by creditors in the event of corporate insolvency, are lesser than what shareholders would have had to bear in the absence of shareholder immunity.[79] For instance, all a creditor may lose in the event of corporate insolvency is what remains unpaid of his credit and interest, while a shareholder stands to lose all of his personal assets, in the absence of immunity. But again, that line of argument does not apply to tort creditors, who may have suffered the loss of life, health, or limb by virtue of a corporate tort, and are thus often in a worse situation than shareholders who only stand to lose their money. Thus, when weighed against corporate shareholders of closely held firms, the loss of a tort creditor, especially where bodily harm is involved, is arguably more than what a shareholder would suffer even if unlimited tort liability is imposed on him by law.[80]

Finally, shareholder immunity is justified on the basis that in comparison to shareholders, creditors are better cost avoiders, with better opportunities to mitigate corporate insolvency risks, and therefore insolvency risks should be transferred to them as best cost avoider. A contract creditor

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[76] See *Public Finance Securities Ltd v Jefia* (1998) 3 NWLR. (pt. 543) 602.
[77] See D Millon, 'Piercing the Corporate Veil, Financial Responsibility, and the Limits of Liability'(2007) 56 Emory L.J. 1305, 1381.
[78] P. Muchlinsky, 'Limited liability and Multinational Enterprises: a Case for Reform?' (2010) 34 Cambridge Journal of Economics, 915, 923.
[79] For a more detailed analysis of the reallocation of shareholders' risks to creditors, see Posner, 'The Rights of Creditors of Affiliated Corporations' (1976) 43 U.Chi.L. Rev, 499, and F.H. Easterbrook, 'Limited Liability and the Corporation' (1985) U.Chi. L. Rev, 89, at 91
[80] See generally, Henderson, 'Piercing the Veil on Corporate Groups in Australia(n37) 335

can for instance, resort to insurance, contract out of shareholder immunity, demand for a stake in management,[81] or charge higher interests as a trade off for higher default risks.[82] Tort creditors however cannot mitigate the risks associated with corporate insolvency. But contract creditors can mitigate the risks associated with corporate default, because they lack opportunities to contract out of shareholder immunity, or at least take steps to mitigate them, means that blanket immunity should not apply to protect shareholders in all cases.[83] It is in recognition of this distinction, and the options open to contract creditors, that the court in the United States stated '*the prevailing view of courts and commentators, regardless of ideological stripe, long has been that contract creditors should have less success with veil-piercing because of the opportunity to assess and insure themselves from risk.*'[84]

Some scholars have proposed insurance as a viable alternative to unlimited tort liability in closely held firms.[85] For instance, companies in the oil and gas industry may be required to take out insurance policies against well blow out, oil spillage, accident, and other likely incidents which persons may suffer by virtue of their dealings with those companies. While a media company for instance may be required to take out mandatory insurance against defamation, since that is one of the most likely torts it may commit, while a company in banking may take out insurance to protect against the tort of fraudulent conversion of customers funds. But the truth remains that even if companies are required to insure heavily against potential tort liabilities, not all torts can be conceivably covered by an insurance policy. There is also the fact that the policy may not adequately compensate mass tort victims, especially where their claims against the company are substantial.[86] There is also the issue of widespread poverty, ignorance, and the undeveloped nature of insurance in Nigeria, means

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[81] Taking advantage of section 41(3) of CAMA for instance, a prospective creditor may require that he be given the right to appoint and fire a company's management board.
[82] Henderson, 'Piercing the Veil on Corporate Groups in Australia (n37) 335.
[83] This is not always the case however, as employees in a high risk environment may be aware of the dangers associated in working in that environment, and are thus in a better position to negotiate in advance in order to mitigate against such risks. They are also in a position to take out an insurance policy, or at least to take steps to better protect themselves. But since on a general note, a tort could be committed on an innocent bystander or by virtue of an oil spill which destroys a farmer's economic crops, there is nothing that can be said to be consensual or voluntary about the tort.
[84] PB Oh (n 6) at 107.
[85] In this regard, see F.H. Easterbrook and D.R. Fischel, 'The Economic Structure of Corporate Law ' (1991) 47-49.
[86] P. Muchlinsky, 'Limited liability and Multinational Enterprises: a Case for Reform?' (2010) 34 Cambridge Journal of Economics, 915, 923, and Vanessa Finch, 'Personal Accountability and Corporate Control: The Role of Directors' and Officers' Liability Insurance' (1994) 57 Modern Law Review 880, 888-9.

that the viability of that option has to be deferred to the nearest future.[87]

Some scholars have advocated for a blanket unlimited tort liability, with Leebron arguing that shareholder immunity '*cannot be satisfactorily justified for tort victims*'.[88] However, in view however of its economic importance, this article argues that unlimited tort liability should only be resorted to as a last option, and only in cases of corporate insolvency. In other words shareholder immunity should be retained as the default rule, subject only to the fraud exception, and to the interest of justice exception. Thus dispersed shareholders of publicly traded companies should enjoy absolute immunity by default, because of the enormous economics of the stock market, and the difficulties of enforcing a judgement on dispersed shareholders.[89] But for closely held firms, Nigerian courts should be ready to utilize the 'interest of justice' exception to impose unlimited tort liability, where certain 'special factors' exist, and where no other course of action are available to tort creditors. The next segment will suggest what those 'special factors' should be.

Towards unlimited tort liability: factors to be considered

As noted above, Nigerian courts should be reluctant to impose unlimited tort liability on shareholders of closely held firm which is managed in a way that indicates compliance with corporate formalities and company law requirements. Where however there is a blatant disregard of corporate formalities, then they should impose unlimited tort liability, where refusal to do so would leave tort creditors without adequate compensation. It is therefore proposed that shareholders of closely held firms should only enjoy immunity to the extent to which they comply with corporate formalities, respect the corporate personality of the firm, since the immunity they enjoy is founded on the separateness of the company's personality.

More than a century after *Salomon v Salomon*, it remains a fact that the average private company remains a one man business.[90] Its share structure

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[87] It is interesting to note that Nigeria, with over 166 million people, has only 0.5 per cent insurance penetration, see 'Nigerian Insurance Industry: Business Day' (12th August, 2014) http://businessdayonline.com/2014/08/the-nigerian-insurance-industry/ accessed 9th September 2015.

[88] DW Leebron, 'Limited Liability, Tort Victims, and Creditors' (1991) 91 *Columbia Law Review*, 1565, at 1601; see also H. Hansmann and R Kraakman, "Toward Unlimited Shareholder Liability for Corporate Torts" (n6)

[89] In fact David Millon has observed that *'...argument for limited liability may be less compelling as to shareholders of close corporations than as to those of publicly held companies.'* See David Millon, 'Piercing the Corporate Veil (n 77) 1381.

[90] It is perhaps in recognition of this fact that England now allows for single member companies. See Companies (Single Member Private Limited Companies) Regulations 1992; and the English Companies Act 2006.

usually consists of a 'principal' shareholder, on whose behalf the rest shareholders hold shares on trust. The overwhelming control which are exerted over such firms by the 'principal' shareholder, increases the likelihood that corporate formalities will be disregarded, resulting in co-mingling of assets, neglect to hold statutorily required meetings, and the making of regular filings with the Corporate Affairs Commission. In order to checkmate such abuses, and to create a further avenue for tort creditors to be compensated in the event of insolvency, it is imperative that the courts impose unlimited tort liability where such firms are insolvent. The possibility therefore, of exposing their personal assets to the insolvency risks of the firm, will motivate controlling shareholders to either respect corporate formalities and observe the ethos of good governance, or alienate themselves from the management of the firm entirely.

Equally important is for the court to determine the intention behind the incorporation of the company in the first place. While shareholder immunity should be maintained where a firm was established for purely structural and organizational purposes as in the *Adams* case, it should be disregarded where there is evidence that the corporate form is abused by dominant shareholders.[91] In order to determine what constitutes abuse however, the court should consider a wide range of scenarios which should include the extent to which the firm was capitalized. Thus where parent firm/dominant shareholder establish an undercapitalized subsidiary, and lends it money secured with a charge over the firm's assets, and through that subsidiary, operate recklessly in a high risk environment, if a tort arises from the activities of such firm, the courts should hold that there has been an abuse of the principle of *Salomon v Salomon*. In that regard, it should impose unlimited tort liability on its shareholders, but only to the extent that the firm is insolvent. In this regard it is important to observe that although in the *Salomon* case, the firm was undercapitalized and heavily indebted to the controlling shareholder, the corporate veil was maintained to protect shareholders from contract creditors, not tort creditors. In fact it is very likely that the House of Lords in that case may have come to a different conclusion had the liquidator acted in the interests of involuntary rather than voluntary creditors.

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[91] See *Jones v Lipman* (1962) 1 WLR. 832.

One reason why the extent of capitalization should be considered is because it is likely to motivate the adequate capitalization of such firms. Another important factor that should be considered is the extent of shareholder's involvement in management. Because company law envisages a separation of ownership from management, courts should be more willing to impose unlimited tort liability where there is evidence of undue shareholder involvement and control on management. Thus, shareholders who usurp managerial roles should be made to compensate tort creditors of such firms, in the event that the company is insolvent. Other factors that should be considered include misrepresentation, siphoning of corporate funds by controlling shareholders, illegality, and misrepresentation.[92]

Conclusion

As the Nigerian economy continues to grow on the wings of various reforms that have been put in place, the manufacturing industry, as noted earlier, is set to rise.[93] And since industrialization is often implemented via the corporate platform, corporate torts are likely to rise in Nigeria. It is therefore imperative that Nigerian courts are prepared to deal some of the legal issues that may arise from such torts, one of which is the issue of unlimited tort liability. It is in this regard that this article has argued that unlimited tort liability for shareholders of closely held firms will serve to protect tort creditors on the one hand, and will reduce shareholders' incentive to use the corporate form in a reckless and dangerous manner. It argued that the underlying economic and legal justifications behind the bare against contract creditors, do not apply to apply to tort creditors as they do to contract creditors. It also argued that in contrast to publicly traded firms, the virtual absence of agency problems, which further justifies shareholder immunity, are hardly present in closely held firms, because of the fusion of management and ownership.

Nigeria courts should therefore limit the 'interest of justice' exception to the imposition of unlimited tort liability for closely held firms, and even at that, only in special circumstances. It is therefore imperative that unlimited tort liability in closely held firms, should be exception otherwise it would scuttle the rise of Nigeria's industrial drive by scaring entrepreneurs from

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[92] In this regard, see JM Landers, 'A Unified Approach to Parent, Subsidiary, and Affiliate Questions in Bankruptcy'(1975) 42 U. CHI. L. REV. 589, 620, 621.

[93] National Bureau of Statistics, 'Manufacturing' (n 61).

delving into serious economic activity like manufacturing and construction.

In other to further the limit recourse to unlimited tort liability, it may be imperative for the Nigerian government to beef up the insurance sector, and to require all firms, especially those who are tort prone, to compulsorily insure their workers, and their activities, as this would limit their exposure to insolvency. There may also be need to require that tort-prone firms be adequately capitalized, as they would equally reduce the extent to which such firms will suffer from insolvency. The capitalization requirement will spur shareholders of such firms to good governance, and would further reduce the 'perverse incentive' to spend less on tort prevention measures. Capitalization must not however be done to the detriment of start-ups and budding enterprises. In that regard, there will be need for a well thought out government policy: one that adequately considers the predicament of tort creditors, and the social costs imposed by accident related torts on the one hand, and on the other hand, considers the need for entrepreneurship via the corporate platform, which has significant potentials for employment and economic prosperity.