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Madison Investment, Property and Advisory Company Limited v. Peter Kanyinji SCZ Selected Judgment No. 48 of 2018

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Madison Investment, Property and Advisory Company Limited v. Peter Kanyinji SCZ
Selected Judgment No. 48 of 2018
*Chanda Chungu*¹

Facts

The Managing Director of Perfect Milling Company was entitled to 25% gratuity of his basic salary at the end of his term as Managing director. However, when he launched a claim against Perfect Milling Company, the company was in bankruptcy and unable to pay. He then sued Madison Investment, claiming that they operated as a single economic unit under the Madison Group of Companies.

The High Court in a judgment delivered by Banda-Bobo J (as she was then) held that notwithstanding the principle that companies have a separate legal identity, the court is empowered to pierce it in certain circumstances to deduce who the actual owners are and attach liability to them in certain circumstances. In this case, the court held that Madison Investment had taken over the affairs of Perfect Milling and that they operated as one economic unit, for these reasons, Madison Investment was liable to pay the Managing Director his gratuity.

Holding

On appeal, the Supreme Court delivered a landmark judgment and lucidly provided an overview of the law relating to piercing the corporate veil. Malila JS (as he was then) held that:

The principle that should underpin any attempt to pierce the corporate view is therefore this; the courts will not allow the corporate personality to be used to protect individuals from wrong doing. Fraudulent actions will not be protected, nor will those where the limited company is simply being used as a façade, as a sham. However, the power to intervene and lift the veil must be exercised charily. There ought to be a hidden untoward intent.

The Supreme Court in analysing the principle of lifting the corporate veil where companies operated as a single economic unit thereby held that ownership and control of a company are not, of themselves, sufficient to justify the piercing the corporate veil. The court held that the court will only lift the corporate veil where it is alleged two entities are operating one where it shown that there was

concealment and evasion of an existing legal restriction or obligation coupled with the absence of other conventional remedies.

The Supreme Court was clear that the court should only lift the corporate veil where it is claimed that multiple companies operated as one where there is fraud or an attempt to conceal the true state of affairs or evade an existing obligation.

Therefore, the mere fact that Madison owned Perfect Milling was not sufficient justification to lift the veil to attach liability on Madison – something more, namely fraud or an evasion of an obligation needed to be shown. As a result, Madison was held to not be liable for the payment

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of the terminal benefits of Perfect Milling's former Managing director because there was neither fraud nor an evasion of existing obligation.

Significance

A company is in law regarded as a legal entity separate and distinct from the members who make it up. As an artificial legal person, a company will be entitled to deal with other persons — natural or artificial — in its own name and in its own right. Section 16 of the Companies Act provides that:

[a] company registered in accordance with the Companies Act, acquires a separate legal status, with the name by which it is registered, and shall continue to exist as a corporate until it is removed from the Register of Companies.

This provision does no more than codify the common law position that the proprietors of a business (shareholders or members) are separate from the company itself. As the Supreme Court held in this case, the corporate personality of a company is perhaps the most pervading of all fundamental principles of company law. This bedrock concept, under which an incorporated company is regarded as distinct from its shareholders, has been uncompromisingly observed and applied, for centuries. The concept has been given strong endorsement since about the House of Lords decision in *Salomon v. Salomon & Co.*²

In that case Salomon, a leather merchant, decided to convert his business into a private limited company where he, his wife and their children were shareholders in the new company. The company was regrettably oppressed by some financial difficulties and some unsecured creditors sought to recover their money directly from Salomon who was not only the majority shareholder, but also the managing director of the company. The House of Lords held that a company is at law, a different person from its owners. Furthermore, the court held that the shareholders of a company are not ordinarily liable for the debts of the company. They can only be liable to the extent and manner provided for in the Act or under common law.

The *Salmon* case is very important because it clarified the principle of separate legal personality of a company, even where the company may effectively have one significant shareholder. Lord Macnaughten made the following pertinent observation:

When the memorandum is duly signed and registered, though there be only seven share taken, the subscribers are a body corporate 'capable forthwith' to use the words of the enactment 'of exercising the functions of an incorporated company'. Those are strong words. The company attains maturity on its birth. There is no period of minority- no interval of incapacity. I cannot understand how a body corporate thus made 'capable' by statute can lose its individuality by issuing the bulk of its capital to one person, whether he be a subscriber to the memorandum or not. 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 person are managers, and the same hands receive the profits, the company is not in law the agent of the subscriber or trustees 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.

² [1897] AC 22.

What the above confirms is that notwithstanding the effect of a company's incorporation, in some cases the court will 'pierce the corporate veil' to enable it to do justice by treating a particular company for the purpose of litigation before it, as identical with the person or persons who control that company.

The concepts of separate legal personality of company and limited liability under company law operate as a shield to holding shareholders directly and personally liable for debts and other liabilities of the company. The wall or curtain separating the company from its individual shareholders and directors is commonly referred to as 'veil of incorporation'.

However, the veil of incorporation is not an unassailable right or privilege. As Malila JS (as he was then) of the Supreme Court observed in the case of *Madison Investment, Property and Advisory Company Limited v. Peter Kanyinji*:³

Notwithstanding the significance of observing the distinction between the corporation and its owners, courts ought to be careful to ensure that there is some limit to the protection given by the notion of separate corporate personality so that business dealings remain honest.

Therefore, although a company is in law regarded as a separate and distinct entity from the members comprising it, there are instances when it is justified to abandon the notion of corporate personality and to peer behind the façade of separate legal personality to see the human persons behind the legal persona for the purpose of holding them accountable for the actions of the company. This is called lifting or piercing the corporate veil.

The *Peter Kanyinji* decision is crucial because it guided on the basis when the corporate veil would be lifted namely under the evasion principle and the concealment principle. The evasion principle was explained by Malila JS in *Madison Investment, Property and Advisory Company Limited v. Peter Kanyinji*⁴ as follows:

The evasion principle is premised on an individual or entity being under an existing legal obligation which he or it seeks to avoid by using the corporate personality which is under the control of the individual or entity.

Therefore, under the evasion principle, where a company seeks to avoid an obligation, the court will be justified in lifting the veil. An example of where the corporate veil was lifted in such circumstances was in the case of *Swallow Freight Services (Zambia) Limited v. Kapili Transport Company Limited*.⁵ In that case, Kapili Transport had provided services to Swallow Freight. When the latter failed to pay, Kapili Transport managed to obtain a default judgment for the payment of the sum due. Subsequently, there was a consent order to manage the way the amount would be paid. When the amount was not paid, Kapili Transport sought to execute but when the sheriffs went to Swallow Freight's offices, they found no valuable assets as the company had fraudulently discontinued business and operations to avoid liability. The Supreme Court held that the shareholders fraudulently and intentionally did not want the company to meet its liabilities and as such the veil could be lifted to hold the shareholders personally liable.

³ Selected Judgment No 48 of 2018.

⁴ SCZ Appeal No. 010/2016.

⁵ SCZ Appeal No. 81 of 2006.

Under the second principle, the concealment principle, the Supreme Court of Zambia in *Madison Investment, Property and Advisory Company Limited v. Peter Kanyinji*,⁶ explained that:

...these will apply where the corporate personality is used to hide the true state of affairs. It did not rest on a finding of impropriety; it is the fact of concealment, simple and pure. The court will be entitled to look into the legal relationship between the company and the individuals behind it.

The above illustrates that where there is evidence of a party seeking to conceal the true situation of their entity, the court may lift the corporate veil.

Lastly, in some instances, courts had been willing to lift the veil on the basis that a group of companies was not a group of separate persons, but a single economic unit. In *DHN Food Distributors Ltd v London Borough of Tower Hamlets*,⁷ a subsidiary company of DHN owned land which LBTB issued a compulsory purchase order on. Lord Denning provides as follows:

This group is virtually the same as a partnership in which all three companies are partners. They should not be treated separately so as to be defeated on a technical point.... They should not be deprived of compensation which would justly be payable for disturbance. The three companies should, for present purposes, be treated as one and the parent company, D.H.N., should be treated as that one.

The court held that DHN was able to claim compensation because it and its subsidiary were a single economic unit. However, in the Supreme Court case of *Madison Investment, Property and Advisory Company Limited v. Peter Kanyinji*:⁸ the court noted that this case has not been widely approved nor applied consistently. As such lifting the corporate veil under the single economic unit is not a guarantee and should only be done if the conduct falls under concealment or evading an obligation.

The *Peter Kanyinji* case is crucial because it outlines that the evasion and concealment principles are the only broad bases which justify the lifting of the corporate veil in appropriate circumstances. In *Madison Investment, Property and Advisory Company Limited v. Peter Kanyinji*,⁹ Malila JS (as he was then) on behalf of the Supreme Court confirmed the specific instances where a court would be justified in piercing the corporate veil These are:

- (a) Where the veil of incorporation is being used for some fraudulent or improper purpose
- (b) Where it becomes necessary to determine the character of the company
- (c) Where a trust and agency relationship is involved
- (d) Where the interests of third parties are at stake.

The Supreme Court (per Malila JS) was adamant to limit qualifying fraud to that occurring only in the context of statute. It stated as follows:

⁶ Selected Judgment No 48 of 2018.

⁷ [1976] 2 KB 336.

⁸ Selected Judgment No 48 of 2018.

⁹ SCZ Appeal No. 010/2016.

...fraud and improper conduct do indeed provide a basis for lifting the corporate veil...we must clarify that such fraud and improper conduct as to justify the lifting of the corporate need not only arise in the context of a statutory prescription.

The court thereby held that claims to lift the corporate veil for fraud are not limited to the context of section 175 of the Corporate Insolvency Act. It rather affirmed that fraud or improper conduct will justify the lifting of the corporate veil even outside any statutory provision.