Stop Abusing the Protection of Wages on Insolvency Fund!
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Peter, an employee at a restaurant in East Point City, went to work as usual in the morning, only to find that his employer's business had folded. He and his colleagues sought help from the Labour Department, saying the restaurant, which had operated for about a year, owed wages to them. When Peter and his colleagues contacted their employer, Alex, he alleged that he was just a shareholder of a private company which employed Peter and his colleagues and he was not liable to pay them any unpaid wages. As a result, Peter and his colleagues had to claim their unpaid wages from the Protection of Wages on Insolvency Fund (Insolvency Fund) under the Protection of Wages on Insolvency Ordinance (Cap. 380).

The Insolvency Fund was set up in 1985 for workers to claim back pay when their employers go bankrupt. Unpaid workers can apply for payment of up to four months' outstanding wages up to a maximum of $36,000. They can also apply for payment of one month's wages in lieu of notice to a maximum of $22,500 and a severance payment of up to $50,000 plus half of the remaining balance. Peter and his colleagues finally got their unpaid wages from the Insolvency Fund.

However, this is not the end of the story. A few weeks later, Peter found that Alex had opened another restaurant using a similar name at the same location. Peter's colleagues were glad to be employed by this new restaurant as they were getting better pay. Alex's case is not unusual in Hong Kong. It seems that the Insolvency Fund is abused by some restaurant owners who set up different limited companies to run their restaurants.

In law, registered companies are recognized as having their own legal personality and can exist separate and distinct from their members and managers. This basic legal idea was confirmed in *Salomon v Salomon and Co. Ltd.* [1897] AC 22 – probably the most famous case in company law. Though it is a UK case, its principle is recognized in Hong Kong company law.

The case concerned a man who ran a shoe-making business as a sole trader but who then sought to convert the business into the form of a limited company. As the company is a separate legal entity from its owners, the company had to pay Mr. Salomon for the value of the business transferred to it from Mr. Salomon. The company paid him partly in shares in itself and partly by way of a secured loan from Mr. Salomon to it, which it promised to repay at a later date. Before the company had repaid its debt to Mr. Salomon, it went into insolvent liquidation. Mr. Salomon claimed all the assets of the company to repay the loan but the other unsecured creditors considered that the whole set up was a fraud, and that Mr. Salomon and the company were, in reality, the same legal person. Thus, Mr. Salomon should not have priority in getting his loan back. However, the court did not agree:

Lord Halsbury said: "...it seems to me impossible to dispute that once a company is legally incorporated it must be treated like any other independent person with rights and liabilities appropriate to itself, and that the motives of those who took part in the promotion of the company are absolutely irrelevant in discussion what those rights and liabilities are."

The decision in the Salomon case makes it clear that a company has most of the rights of a human person, one of which is the ability to sue and to be sued in court. This is confirmed by section 5A(1) of the Companies Ordinance, which provides that a company has the capacity and the rights, powers and privileges of a natural person.

In the case of *Foss v Harbottle* (1843) 67 ER 189, the court made it clear that when a legal wrong is done to the company or its property, it is the company that should take legal action, not the shareholders personally (though the court also decided that there were some exceptions to this rule).

Unlike a human person, a properly registered company can, in theory, live forever. This doctrine of perpetual succession is confirmed by section 16(2) of the Companies Ordinance which provides that, from the date of incorporation, the founder members, together with such other persons as may from time to time become members of the company, is a body corporate capable of having perpetual succession. This means that when the owner of a share dies, the company can continue and the deceased member's share is simply transferred to another person. Thus, even though the owners of the company change, the company is unaffected.

However, if a company is used as a means to commit fraud or to violate legislation, the court may lift the corporate veil.

In *Gilford Motor Co. v Horne* (1933) Ch.935 Mr. Horne was employed as a director of Gilford Motor and one of the terms of his employment restricted him from seeking business from Gilford's customers once he left the employment. Having left the company, Mr. Horne set up a new company, which employed him and his wife. Acting on behalf of the new company, he sought to get business from Gilford's customers. The court held that the new company was a sham and ordered both the new company and Mr. Horne not to approach Gilford's customers.

Lord Hanworth said: "I am quite satisfied that this company was formed as a device, a strategem, in order to mask the effective carrying on of a business by Mr. E B Horne."

In a recent Hong Kong case, *Lee Sow Keng Janet v Kelly McKenzie Ltd. and Others* [2004] 3 HKLRD 517, Linkwaters Investment Ltd traded in the name of Kelly McKenzie as an employment consultant agency. Ms Lee was employed by Linkwaters and worked as a personnel consultant. Under her employment contract, Ms Lee's employment could be terminated at any time by either of the parties giving two months' written notice to that effect or on payment of two months' salary in lieu of notice. Ms Lee gave written notice to terminate her employment on 27 October 1997 with the effective date of termination being 26 December 1997. On 12 December 1997, two weeks before the expiry of the two-month notice period, Ms Lee was summarily dismissed by Kelly McKenzie. Ms Lee then commenced High Court proceedings against Linkwaters for outstanding commission and obtained judgment in default against Linkwaters. However, Linkwaters failed to make any payment to satisfy the judgment debt; Ms Lee then successfully petitioned for the company's winding up on 12 February 2001.

Subsequent to Linkwater’s winding up, Ms Lee discovered that a private company, Kelly McKenzie Ltd, had been incorporated by A and B, who were the previous controlling shareholders and directors of Linkwaters, one month after she had given notice to Linkwaters to terminate her employment contract. Ms Lee believed that Kelly McKenzie Ltd was a sham and a facade established by A and B to avoid payment of commission and other emoluments owed to her by Kelly McKenzie.

In this case, the court found that the accounts of Linkwaters showed its annual turnover ranged between $6.5 million and $7.7 million for the years ended 31 March 1994 to 31 March 1998. The company was plainly profitable and it would not be unreasonable, in those circumstances, to infer that there was value attached to its goodwill. The court further pointed out that Linkwaters’ trading under the name of Kelly McKenzie should not be overlooked. It is no mere coincidence that the name of the new company was Kelly McKenzie Ltd.

The court then held that, taking all the circumstances into account, it was perfectly justified in lifting the corporate veil. The whole point of the exercise where the facts so warrant is to go behind the veil or facade to identify the person or persons in control: the real question is one of control. In this case, the judge found, with ample evidence to support this, that A and B "orchestrated" the entire "show" including the deliberate decision not to defend Ms Lee’s action against Linkwaters and ultimately letting Linkwaters go into liquidation, the diversion of the goodwill and business of Linkwaters to the new company and the depletion of the accumulated profits of Linkwaters through dividend payments to ensure that Linkwaters had no funds with which the judgment debt could be satisfied. Thus the intention to evade liability on the part of A and B could not have been clearer.

From this case, we see that if a company is used as a sham to evade an existing liability, the court may lift the corporate veil and treat the company and its shareholders as one entity. As a result, the shareholders may be liable for the debts of the company. The whole point of lifting the corporate veil is to look behind the facade to establish who exercises real and actual control of a company. Therefore, if a restaurant owner uses a private company to evade his obligation to pay his employees and abuses the Protection of Wages on Insolvency Fund, the court may lift the corporate veil and hold the restaurant owner liable to pay the unpaid wages. This may be one of the solutions to preventing abuse of the Insolvency Fund by restaurant owners, although the ultimate solution may be to modify the provisions of the Protection of Wages on Insolvency Ordinance (Cap. 380).