CONSUMERS – THE UNWITTING VICTIMS OF CORPORATE ABUSE: HOLDING ROGUE DIRECTORS TO ACCOUNT IN THE CLOSELY-HELD COMPANY

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ABSTRACT

Every year in the UK, thousands of consumers are exploited by rogue traders who operate in the home repair and improvement (HRI) market. Many consumers lack even rudimentary levels of knowledge about the work or costs involved in HRI projects, and are often susceptible to being persuaded by high pressured selling techniques. Rogue trading causes significant consumer detriment, not just in financial terms, and also negatively affects legitimate businesses operating in this market.

This thesis suggests that consumers are in particular vulnerable to exploitation by individual rogue traders who incorporate their business, in the form of small private limited companies, referred to as `closely-held companies'. This is because the misfeasant director is also the company's controlling shareholder.

Automatically on incorporation, the two cornerstones of UK company law – limited liability and separate corporate personality – shield rogue directors from being held accountable for their bad faith conduct towards consumers and limit their liability, qua shareholder, in the event of corporate failure. This enables rogue traders intent on consumer exploitation to do so without fear of their personal wealth being at risk if the consumer seeks redress. Many consumers believe that limited liability conveys respectability and longevity; this ignorance of the law increases consumers' vulnerability and their need for protection from exploitation by closely-held HRI companies. Although consumer law offers vital protection in many respects, it cannot overcome the difficulties created by the doctrine of privity of contract. As a consequence, UK company law has placed consumers in a more vulnerable position, yet offers them no commensurate legislative response against those responsible for causing their losses. This thesis therefore aims to expose any deficiencies in the law in order to identify the potential for law reform, with a view to closing this lacuna created by company law.

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"Wisdom is not wisdom when it is derived from books alone"

(HORACE – poet and philosopher)

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Consumers – the unwitting victims of corporate abuse: holding rogue directors to account in the closely-held company

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LIST OF ABBREVIATIONS

Legislation

CA 2006	Companies Act 2006
CA 1985	Companies Act 1985
CCRs 2013	Consumer Contracts (Information, Cancellation and Additional Charges) Regulations2013 SI 2013/3134
CDDA 1986	Company Directors Disqualification Act 1986
CPA 1987	Consumer Protection Act 1987
CPARs 2014	Consumer Protection from Unfair Trading (Amendment) Regulations 2014
CPRs 2008	Consumer Protection from Unfair Trading Regulations 2008
CRA 2015	Consumer Rights Act 2015
EA 2002	Enterprise Act 2002
IA 1986	Insolvency Act 1986
JSCA 1844	Joint Stock Companies Act 1844
JSCA 1862	Joint Stock Companies Act 1862
LLA 1855	Limited Liability Act 1855
MCA 1973	Matrimonial Causes Act 1973
POCA 2002	Proceeds of Crime Act 2002
SSGCRs 2002	Sale and Supply of Goods to Consumers Regulations 2002
SGA 1979	Sale of Goods Act 1979 (as amended)
SGSA 1982	Supply of Goods and Services Act 1982 (as amended)
UCPD	Unfair Commercial Practices Directive 2005/29/EC
UCTA 1977	Unfair Contract Terms Act 1977
UCTCR 1999	Unfair Terms in Consumer Contracts Regulations 1999
UK	United Kingdom

Other

ACCA	Association of Chartered and Certified Accountants
HRI	Home Repair and Improvement Market
BEIS	Department for Business, Energy and Industrial Strategy

BERR	Department for Business, Enterprise and Regulatory Reform (later DTI)
BIS	Department for Business Innovation and Skills (later BEIS)
CA	Court of Appeal
CAS	Citizens Advice Service
CCAS	Consumer Codes Approval Scheme
CD	Consumer Direct (part of the OFT)
CLRSG	Company Law Review Steering Group
CMA	Competitions and Markets Authority
CTSI	Chartered Institute of Trading Standards (formerly the TSI)
DTI	Department for Trade and Industry (later BIS)
EMS	Entity Maximisation and Sustainability
EU	European Union
HMCTS	HM Courts and Tribunals Service
LAATSN	Local Authority Assured Trader Scheme Network
LATSS	Local Area Trading Standards Service(s)
NAO	National Audit Office
NTS	National Trading Standards
HL	House of Lords
ESV	Enlightened Shareholder Value
IP	Insolvency Practitioner
JSC	Joint Stock Company
OFT	Office of Fair Trading
SC	Supreme Court
SME	Small and Medium-Sized Enterprise
SNO	Stop Now Order
TSO	Trading Standards Officer

CHAPTER 1

INTRODUCTION

Every year in the United Kingdom (UK), thousands of consumers are exploited by rogue traders who operate in the home repair and improvement (HRI) market. Many consumers lack even rudimentary levels of knowledge about the work or costs involved in HRI projects, and are often susceptible to being persuaded to enter such contracts by high pressured selling techniques. Rogue trading causes significant consumer detriment, not just in financial terms, and also negatively affects legitimate businesses operating in this market.

The government's focus has mainly been on the bad faith conduct of those opportunistic, unincorporated rogue traders who cold-call at consumers' homes. However, less focus has been given to individual rogue traders who incorporate their business. Yet, this thesis asserts that consumers are even more vulnerable to exploitation by small private limited companies, referred to as `closely-held companies'. One of the main reasons for this is because the misfeasant director is often the company's controlling shareholder. It is these `rogue directors' who form the focus of this thesis.

Automatically on incorporation, the two cornerstones of UK company law – limited liability and separate corporate personality – shield rogue directors from being held accountable for their bad faith conduct towards consumers and limit their liability, qua shareholder, in the event of corporate failure to as little as one penny. This enables those rogue directors intent on consumer exploitation to do so without fear of their personal wealth being at risk if the consumer seeks redress; rather than suing the human constituencies responsible for any breach of contract, consumers instead must sue the company itself, and the company may often be under-capitalised.

Many consumers believe that limited liability conveys respectability and longevity; this ignorance of the law increases consumers' vulnerability and their need for protection from exploitation by closely-held HRI companies. Although consumer law offers vital protection in many respects, it cannot overcome the difficulties created by the doctrine of privity of contract and the cornerstones of modern company law.

By allowing individuals to incorporate their business, with minimal capital requirements, UK company law has placed consumers in a more vulnerable position when dealing with rogue directors, yet offers them no commensurate legislative response against those responsible for causing their losses. This thesis therefore aims to expose any deficiencies in the law in order to identify the potential for law reform, with a view to closing this lacuna created by company law.

This Chapter will start by setting out the general background to the problems consumers face when they are exploited by rogue traders operating in the HRI market. Key terms will be defined in order to ensure that the reader is able to clearly ascertain the narrow focus of this thesis, namely the vulnerability of consumers to exploitation by rogue directors of closely-held HRI companies who abuse the corporate form for their own self-enrichment. The research objectives will then be discussed, together with an outline justifying these and showing how these might be achieved. The methodology for this thesis will then outline the areas being researched and the reasons for this research, together with a discussion of the legal research methods used. A detailed literature review will then examine both the policy considerations at play in shaping company law in the UK, and the theoretical debate about the need for consumer protection. The Chapter will conclude by outlining the structure of the thesis with a brief overview of the content for each chapter.

1.1 General Background to the Exploitation of Consumers by Rogue Traders Operating in the Home Repair and Improvement Market

The exploitation[1] of consumers in the home repair and improvement (HRI) market, namely the way in which they are targeted by rogue traders for financial gain on

[1] 1.2.

account of characteristics which make them more susceptible to abuse, is a growing problem in modern society.[2] `Rogue trading' is a term which has gained popular usage in relation to the unscrupulous business practices seized upon by rogue traders, and can include situations where `consumers are cold-called and tricked or pressurised into paying large sums of money for shoddy goods or services.'[3] Rogue trading often involves high value transactions, and a high degree of deception or intimidation.

Because of the opportunistic and transient nature of many rogue traders, the UK government's focus to date on dealing with rogue trading is to ascribe responsibility for this exploitation firmly with those rogue traders who make unsolicited[4] calls at the homes of those consumers whom they regard as vulnerable[5] - hence references by consumer and government bodies to `doorstep traders'.[6] One major challenge is not to penalise legitimate HRI traders who also make unsolicited calls to consumers.[7] Those exploited by rogue HRI traders have little prospect of achieving a civil remedy as this type of rogue trader tends to travel from area to area so as to avoid detection,[8] and tends not to provide consumers with the kind of information that would identify them to the courts.[9]

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[2] Office of Fair Trading, *Doorstep Selling campaign: Your Doorstep, Your Decision, OFT Evaluation report*, (OFT 1300, January 2011) fig 6.5, paras 6.16 and 6.18 (OFT 1300); Office of Fair Trading (OFT), Doorstep *Selling Market Study* (OFT 716, May 2004) para 3.30 <http://webarchive.nationalarchives.gov.uk/20090508230208/ http://www.oft.gov.uk/advice_and_resources/resource_base/market-studies/completed/doorstep-selling> accessed 25 December 2017 (OFT 716); OFT, *Home Repairs and Improvements Toolkit*, (OFT 1411, March 2012) para 1.1 <http://www.wiltshire.gov.uk/home-repairs-and-improvements-toolkit.pdf> accessed on 25 December 2017 (OFT 1411); Citizens Advice Service Q1 2014/15 Statistics show a 9% increase over Q1 2012/13 (Consumer Protection Partnership, *Priorities Report 2015: Second Report on the Partnership's Work to Date and Future Priorities* (BIS/15/24, January 2015)) <https://www.cas.org.uk/system/ files/publications/CPP%20Priorities.pdf > accessed 25 December 2017 (CPP Report 2015).

[3] ibid, paras 1.6 and 6.8; Law Commission, *Consumer Redress for Misleading and Aggressive Practices: A Joint Consultation Paper* (Law Com CP No 199, 2011) xiv and 6; Department of Trade and Industry, *A Fair Deal for All. Extending Competitive Markets: Empowered Consumers, Successful Business* (June 2005) (DTI Fair Deal); OFT 1300 (n2).

[4] The Consumer Protection (Cancellation of Contracts Concluded away from Business Premises) Regulations 1987, reg3(3); OFT 716 (n2) para 1.10 (CCRs 2013).

[5] OFT 716 (n2) paras 1.1 and 2.3; Department of Trade and Industry, *Doorstep Selling and Cold-Calling: Consultation on Proposals to Improve Consumer Protection when Purchasing Goods or Services in their Home* (URN 04/1331, July 2004) para 8.1 (DTI DSCC Consultation 2004); Office of Fair Trading, *Doorstep Selling Campaign' Your Doorstep, Your Decision, Evaluation Report*, (June 2010, OFT 1238).

[6] DTI DSCC Consultation 2004 (n5).

[7] ibid.

[8] Coretta Phillips, *Doorstep Crime: Prisoner Interviews. Report for National Trading Standards Doorstep Crime Project* (2016) (Phillips 2016)

[9] Brian Steele and others, *The Formulation of a Strategy to Prevent and Detect Distraction Burglary Offences Against Older People,* (2002) 50 (Steele 2002).

It is fundamentally important in this thesis to recognise that rogue trading[10] is not confined to those unincorporated traders who call uninvited to consumers' homes with the aim of exploiting them, but may also include those rogue traders who incorporate their business with the primary aim of benefitting from limited liability and thereby putting their personal assets beyond the reach of those consumers who seek to recover any losses resulting from the, often sole, company owner-director who engages in rogue trading. To this extent, the incorporated rogue trader may be regarded as every bit as avoidant of legal redress as his unincorporated counterpart. However, whereas much has been done to warn consumers about exploitation by the latter, little has been done to forewarn consumers about the former.

This incorporated form of rogue trader will be referred to throughout this thesis as a `rogue director'.[11] Therefore, `rogue trading' is the term used to identify the bad faith or dishonest conduct of traders in the HRI market; and `rogue director' is the name given to a director of an incorporated business who practises rogue trading. Although both terms will be used throughout this thesis, they are to be understood in the light of the aforementioned distinction.

The main focus of this thesis will be on rogue directors of closely-held HRI companies, that is owner-managed companies,[12] who exploit consumers through the practice of rogue trading, and who are able to escape liability for such bad faith conduct because of mechanisms put in place by company law which serve to protect them: namely, separate personality and limited liability.[13]

Until the coming into force of the Consumer Protection (Amendment) Regulations 2014 (CPARs),[14] legislative provisions aimed at empowering enforcement bodies to tackle rogue trading have denied consumers any direct rights to seek redress. Historically, in

[10] The Consumer Protection from Unfair Trading Regulations 2008/1277, implementing Directive 2005/29/EC, reg2. Law Com CP No 199, 2011 (n3) xiv, 6; DTI Fair Deal (n3); OFT 1300 (n2).
[11] Andrew Hicks, `Director Disqualification: Can it Deliver?' (2001) JBL 433; Roman Tomasic, `Phoenix Companies and Rogue Directors: A Note on a Program of Law Reform' (1995) 5 Aust Int of Corp Law 474; Richard Posner, `The Rights of Creditors of Affiliated Corporations' (1976) 43 Univ Chic LR 499.
[12] Department for Business, Innovation and Skills, *Modern Company Law for a Competitive Economy: Developing the Framework* (2000, URN: 00/656) para 6.5 (Developing Framework 2000).
[13] 3.4.
[14] SI 2014/870. Implementing recommendations for targeted reform to serious breaches of the CPRs 2008 (Law Commission and Scottish Law Commission, *Consumer Redress for Misleading and Aggressive Practices* (Cm 8323, 2012) (Law Com Cm 8323).

cases where enforcement bodies have decided to prosecute, the courts have been unwilling to exercise their rights to award compensation or restorative justice to victims of rogue trading.[15] For example, in 2012-13, HRI sector cases represented the highest category of Local Authority Trading Standards Services (LATSS) prosecutions for contraventions under the Consumer Protection from Unfair Trading Regulations 2008 (CPRs 2008), with only 5 out of a total 325 defendants prosecuted being ordered to compensate their victims.[16] Any compensation orders made were low when compared to contraventions by other sectors.[17] Peysner and Nurse have found that this has left consumers with no choice but to pursue civil action themselves in order to achieve some form of redress: `This puts individual consumers … at the disadvantage of having to seek legal advice and to bear the costs of their own legal action.'[18] This, and the elusiveness of unincorporated rogue traders,[19] may offer some explanation why a significant number of those consumers that do report incidents of rogue trader exploitation do not in fact pursue legal action against rogue traders.[20] It therefore seems that the potential deterrent of rogue traders being held liable to account financially for exploiting consumers is virtually non-existent. What is vitally important to note in this thesis is that this lack of deterrent is all-the-more evident in closely-held companies. This is because a company has a separate legal personality from its owners and therefore consumers must sue the company itself rather than those responsible for their exploitation. Furthermore, the concept of limited liability means that the rogue directors of these companies, qua shareholders, need only contribute any outstanding amount owing on their shares in the event that the company lacks sufficient funds to settle a claim. As will be seen in Chapter 3, UK company law now imposes no minimum capital requirements for private companies, and only requires that at least one share is issued on incorporation. It was the Joint Stock Companies Act 1856 that removed these vital safeguards, such that today the sole director/shareholder in the closely-held company could lose as little as one penny,[21] compared to the position in the

[15] John Peysner and Angus Nurse, *Representative Actions and Restorative Justice: A Report for the Department for Business Enterprise and Regulatory Reform* (2008) (Peysner and Nurse 2008) 10.
[16] Office of Fair Trading, *Annual Report 2012-13*, *Annexe F* <http://webarchive.nationalarchives.gov.uk/20140402160246/http://www.oft.gov.uk/OFTwork/publications/publication-categories/corporate/annual-report/> accessed on 26 December 2017 (OFT Annual Report 2012-13).
[17] ibid.
[18] Peysner and Nurse 2008 (n15) 11.
[19] Law Com Cm 8323 (n14) para 10.2.
[20] Peysner and Nurse 2008 (n15) 11.
[21] CA 2006, ss123, 7(1) and 8(1)(b).

early 1800s when `shares of at least £50 and £100 remained the norm'.[22] The option of seeking legal redress in the civil courts can therefore seem futile to consumers, irrespective of the merits and likelihood of success of their individual cases.

Whilst there has been a great deal of research conducted into the detriment caused to consumers by rogue traders generally, with notable recent legislative development in the area of consumer protection,[23] the problems resulting from the two cornerstones of company law, which enable rogue directors of closely-held HRI companies to enrich themselves at the expense of consumers without fear of reprisals, remain largely unresolved. This thesis suggests that the scarcity of research relating to rogue directors in closely-held companies, and the lack of any adequate legal response, leaves consumers in a more vulnerable position since they will not necessarily associate rogue trading with limited liability companies. Instead, many consumers associate incorporated businesses with having goodwill to be protected and longevity, seeing limited liability at the end of the company's name as more of a `badge of respectability',[24] rather than the warning its words represent.[25] As Aubrey Diamond observed, few consumers will recognise that the word `Limited' at the end of a company's name was intended as `a warning signal, a red flag' but instead has come to be seen by consumers as `a banner of respectability, a mark of a body with substance.'[26] However, English courts have little sympathy for such ignorance other than where the corporate form is used solely to shield directors/shareholders from their wrongful acts.[27] In *Salomon v A Salomon & Co Ltd,*[28] Lord Macnaghten saw nothing wrong with corporations rendering unsecured creditors the company's residual risk-bearers: they `may be entitled to sympathy, but they have only themselves to blame for their misfortunes. … they had full notice that they were no longer

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[22] J B Jeffreys, `Trends in Business Organisations in Great Britain since 1856' (PhD thesis, University of London 1938) (as cited in Paddy Ireland, `Limited liability, shareholder rights and the problem of corporate irresponsibility` (2010) 34 Camb J Econ, 837-856, 844).

[23] For example, Consumer Protection from Unfair Trading Regulations 2008 (CPRs 2008); Consumer Protection from Unfair Trading (Amendment) Regulations 2014 (CPARs 2014); Consumer Rights Act 2015 (CRA 2015).

[24] Judith Freedman `Small Business and the Corporate Form: Burden or Privilege?' (1994) 57 MLR 555; Andrew Hicks, Robert Drury and Jeff Smallcombe, *Alternative Company Structures for the Small Business* (Research Report No 42, 1995) (as cited in Andrew Hicks, `Corporate Form: Questioning the Unsung Hero' (1997) JBL, 306, 317) 555.

[25] CA 2006, s3(2).

[26] Aubrey Diamond, 'Corporate Personality and Limited Liability', in Tony Orhnial (ed), *Limited Liability and the Corporation* (Croom Helm 1982) 34.

[27] *Jones and Another v Lipman and Another* [1962] 1 WLR 832 Ch D, 836; *Gilford Motor Co v Horne* [1933] Ch 935.

[28] [1897] AC 22.

dealing with an individual, and they must be taken to have been cognisant of the memorandum and of the articles of association'.[29]

Although limited liability was not introduced with small one-man companies in mind, there exists today in the UK a proliferation of closely-held companies.[30] The UK government has been so keen to promote economic growth by encouraging the start-up of small to medium-sized businesses that it has not seen fit to reinstate minimum capital requirements and has instead sought to remove red tape by relaxing reporting requirements for private limited companies. This has effectively created a legislative lacuna in relation to abuse of the corporate form by such owner-managed companies.[31] Paul Davies and Sarah Worthington note how

> The Company Law Review, anxious not to place barriers in the way of the organic growth of small companies, rejected the arguments for a separate form of incorporation, and in fact, under the banner `Think Small First' proposed some further deregulation of company law as it applies to small companies.[32]

Many scholars believe the cornerstones of company law, and the subsequent contentious yet unshakeable decision of the House of Lords (HL) in *Salomon*,[33] provide closely-held companies with the opportunity for abuse of the corporate form.[34] In this way, the

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[29] ibid, 53.
[30] 3.5; n722.
[31] Department for Business Innovation and Skills, *Reducing the Impact of Regulation on Small Business* (2012), <https://www.gov.uk/government/policies/reducing-the-impact-of-regulation-on-business/supporting-pages/reducing-regulation-for-small-businesses> accessed on 26 December 2017; Department for Business Innovation and Skills; *Cutting Accountancy and Reporting Fees for SME's* (2011), < https://www.gov.uk/government/news/cutting-accountancy-and-reporting-fees-for-smes--2 > accessed on 26 December 2017; Department for Business Enterprise and Regulatory Reform, *Companies House Annual Report and Accounts 2008/09: Giving Business a Helping Hand* Companies House (HC 708, July 2009) (CH Annual Report 2008-09) <https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/248247/0708.pdf> accessed on 26 December 2017.
[32] Paul Davies and Sarah Worthington, *Gower's Principles of Modern Company Law* (10th edn, Sweet & Maxwell 2016) 193.
[33] N28.
[34] Davies and Worthington (n32) 2.15, 191-196; Tan Cheng-Han `Veil Piercing – a Fresh Start' (2015) JBL, 20; Nicholas Grier `Piercing the Corporate Veil: Prest v Petrodel Resources Ltd' (2014) 18 Edin LR, 275; Brenda Hannigan `Wedded to Salomon: Evasion, Concealment and Confusion on Piercing the Veil of the One-man Company' (2014), 48 IJ 11; Philip Lipton, `The Mythology of Salomon's Case and the Law Dealing with the Tort Liabilities of Corporate Groups: An Historical Perspective' (2014) 40 Mon LR 452; Sneha Mohanty and Vrinda Bhandari, `The Evolution of the Separate Legal Personality Doctrine and its Exceptions: a Comparative Analysis' (2011) Co Law, 196; Marc Moore, `"A Temple Built on Faulty Foundations": Piercing the Corporate Veil and the Legacy of *Salomon v Salomon'* (2006) JBL, 181; Andrew Keay,`Wrongful Trading and the Liability of Company Directors: A Theoretical Perspective' (2005) 25(3) JLS, 431, 457.

government has cleared the path for opportunistic rogue directors to shirk their liability under the veneer of the corporate form. Some may support the view that Parliament, in its haste to encourage enterprise and economic growth, unwittingly permitted the means for such abuse of the corporate form by small companies;[35] others may believe that Parliament fully anticipated that the corporate form might be used by small businesses and even anticipated such abuse,[36] and this latter contention cannot be denied when one considers that those debating the advent of the Limited Liability Act in the mid-nineteenth century had predicted such abuse.[37] When one considers that the main motivation for rogue traders choosing to incorporate their business is because the corporate form protects them from being held personally liable for any losses resulting to consumers through their use of unfair business practices, the scale of the threat posed by the proliferation of closely-held companies to consumers becomes clearer. When rogue directors of closely-held HRI companies then unscrupulously and dishonestly exploit consumers in their own self-interest by trading with the consumer in the company's name, secure in the knowledge that their ill-gotten gains will go unchallenged as a result of the *Salomon*[38] decision, then such conduct constitutes abuse of the corporate form.

1.2 Key Terms Defined

This section seeks to make clear the meaning of certain key terms that are used throughout this thesis. It is important that these be understood at an early stage in order to pave a clear path for the reader.

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[35] Otto Kahn-Freund, 'Some Reflections on Company Law Reform' (1944) 7 MLR, 54; Andrew Hicks (n24) 306; Susan Watson, `The significance of the source of the powers of boards of directors in UK company law' (2011) JBL 607, 608.

[36] The potential for abuse of the corporate form was highlighted even before the enactment of the Limited Liability Act 1855 (LLA 1855) itself; the Bill had been described as `The Rogues' Charter' (Diamond (n26) 33). Abuse of the corporate form has also received detailed judicial scrutiny (for example Slade LJ in *Adams v Cape Industries* [1991] 1 All ER 929) and academic scrutiny (for example, Moore (n34) 181; Mohanty and Bhandari (n34) 196; Keay (n34) 457; Freedman (n24) 568; Len Sealy `Is the Companies Bill 2006 on target, or has it lost its way?' Company Law Newsletter (2006) 18, 3); Nigel Griffiths, Parliamentary Under Secretary for Small Business, `Think Small First' Department of Trade and Industry (2001) <http://www.publicservice.co.uk/pdf/ dtlr/winter2001/p160.pdf> accessed on 28 December 2017; `Companies Act 2006 FAQs' Companies House.

[37] Earl Grey, for the opposition, had predicted that the hasty enactment of the Bill would result in `great mischief' that would be `most difficult hereafter to repair' (Hansards *House of Lords' Debate about the Limited Liability Bill, 07 August 1855 vol 139, col.1905);* in the same debate, Lord St Leonards accurately predicted the absence of proper, stringent checks would result in inevitable abuse and a tremendous escalation of small companies start-ups.

[38] N28

The focus of this thesis is on consumers who have been exploited by rogue traders. `Rogue trader' is a term that has been used by both policy-makers[39] and academic writers[40] yet it lacks any clear definition. The many examples postulated as to what constitutes ***rogue*** behaviour have been broad[41] and, though helpful, a narrower interpretation has been used in this thesis to convey the bad faith nature of such conduct and to more easily distinguish legitimate traders from their rogue counterparts. In this thesis, therefore, the imposition of personal liability will be the preserve of those who act in `bad faith' – who either deliberately exploit consumers, whether motivated by self-interest or otherwise, or who show such blatant disregard for consumers' interests that intention to exploit consumers may be imputed. Some examples of rogue trading in the HRI market are given above.[42]

As stated at 1.1 above, `rogue trader' is an umbrella term to describe the bad faith conduct described in the preceding paragraph. The rogue traders under scrutiny in this research are those who have incorporated their businesses, and are trading as private limited companies; and, narrower still, the focus is on `one-man companies',[43] or `single-member companies',[44] referred to throughout this thesis as ***closely-held companies,*** where the sole director is also the controlling shareholder.[45] When those in day-to-day control of these companies,[46] who negotiate contracts between the company and its consumers, trade in a rogue manner, then they are referred to as ***rogue directors.***[47] This includes those rogue traders whose primary motivation for incorporating their business[48] is self-enrichment

[39] Law Commission Impact Assessment, Consumer redress for misleading and aggressive commercial practices, Final Report; Insolvency Service *Annual Report and Accounts* (House of Commons Papers, session 2002-2003, 963), 3 (Law Com Impact Ass). Richard Williams, `Disqualifying Directors: A Remedy Worse than the Disease?' (2007) 217).
[40] For example, Hicks (n11); Posner (n11) 499; Tomasic (n11) 474.
[41] Hicks (n11) describes rogue traders/directors as `fly-by night' (433), traders who `deliberately rip-off creditors' (440) or are `deliberately reckless' (at 448); `bad faith' (Carl Werner, `Phoenixing: avoiding the ashes' (2009) Insolvency Intelligence 106); `gross negligence' (Sir Nicholas Browne-Wilkinson V-C in *Re Lo-Line Electric Motors Ltd* [1988] 1 Ch 477, at 486); `total incompetence' (Insolvency Service 2002-3, n39, 963); and ` unfair, misleading or aggressive selling practices' (CPRs 2008, n23). Lawrence Mitchell, `The Death of Fiduciary Duty in Close Corporations', UPa LRev (1990) 138:1677, 1699 talks in terms of bad faith and intentional misconduct, or intentional unfairness on the part of badly behaving directors (as fiduciaries).
[42] 4.2.
[43] *Salomon* (n28) 53 per Lord Macnaghten.
[44] Grier (n34) 279.
[45] Some closely-held companies may have more than one
[46] For the purpose of this thesis, this would be the director-shareholder.
[47] Directors have the power to manage the company.
[48] Whereupon they become the controlling director/shareholder of their newly-formed company.

through unscrupulous, and often dishonest, commercial practices and the intentional or reckless exploitation of their consumers.[49]

Previous research into abuse of the corporate form by rogue directors of closely-held companies has been focussed largely on creditors in general,[50] and not so much on consumers[51] who are arguably one of the company's most vulnerable[52] forms of creditor.

One reason for the increased vulnerability of consumers is that, unlike a company's trade creditors, consumers will often lack business acumen and will often not recognise any element of risk involved in their trading relationship; they may naively believe that the law will provide adequate protection if things do go wrong;[53] and perhaps most significantly they represent the true residual risk-bearers of an undercapitalised company.[54] This is because they are unsecured creditors of the company and therefore their debts are settled only before shareholders in the order of payments on insolvency.[55] For this reason, the focus of this thesis is confined to ***consumers***.

Although there is no single, consistent definition of `consumer', the one applied in this thesis is taken from the Enterprise Act 2002 (EA 2002), s210: someone who buys goods or services, not in the course of a business,[56] but from a supplier who is acting in the course of a business.[57] Furthermore, the ***average consumer*** is defined in the Consumer Protection from Unfair Trading Regulations 2008 (CPRs 2008), s2(2) as someone who will be `reasonably well informed, reasonably observant and circumspect'. The purpose of the CPRs 2008[58] is to prevent traders, through criminal law sanctions, from `distorting

[49] `Bad faith'.
[50] 3.5.
[51] Particularly those engaging in HRI contracts with the company.
[52] 2.2.2.
[53] Although a TNS survey found that most of the 4,127 consumers interviewed for the study were `less positive about how well protected they feel by consumer law and supported by consumer advice and enforcement agencies.' Department for Business Innovation and Skills *Consumer Engagement and Detriment Survey 2014* (BIS/14/881 2014) (Detriment Survey 2014), 1.2. <https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/319043/bis-14-881-bis-consumer-detriment-survey.pdf> accessed on 27 December 2017.
[54] Judith Freedman, `Limited Liability: Large Company Theory and Small Firms' (2000) MLR 332.
[55] Insolvency Act 1986 (IA 1986), Schedule B1.
[56] EA 2002, s210(4). Department for Business Innovation and Skills, *Enhancing Consumer Confidence by Clarifying Consumer Law: Consultation on the supply of goods, services and digital content* (July 2012) 4.25, 25.
[57] EA 2002, s210(3). CRA 2015, s2(2) and (3).
[58] Implementing the Unfair Commercial Practices Directive (Directive 2005/29/EC).

the market through misleading actions, misleading omissions, aggressive practices and some other unfair behaviour.'[59] It is clear the purpose is not to excuse foolishness or wilful blindness on the part of consumers,[60] and this is why an objective test[61] of the average consumer is applied. The CPRs 2008 do, however, recognise that there are factors which render consumers more vulnerable to exploitation by rogue traders.[62]

Exploitation is the term used throughout this thesis to describe the way in which rogue HRI traders target consumers with the primary aim of parting them from their money.[63] Brian Steele uses the term, *inter alia*, to describe how rogue traders abuse psychological characteristics of consumers.[64] Doorstep trading has been linked to distraction burglary (for example, through bogus traders) and, when rogue HRI traders are involved, these two forms of `exploitation'[65] share many characteristics, particularly the targeting of vulnerable consumers, and the rogue traders in each case act in bad faith. When consumers are exploited by rogue HRI traders, they invariably suffer a detriment, most commonly financial but also emotional, psychological and sometimes even physical. A significant degree of harm from rogue trading arises because of the use of aggressive and unfair sales techniques and other bad faith conduct.

As already posited, ***consumer vulnerability*** is a factor which might make exploitation by rogue traders more likely,[66] and the resultant consumer detriment more severe.[67] The CPRs 2008 s2(5) identify certain factors which might render consumers more vulnerable to exploitation. For example, a consumer's physical or mental disability, age or credulity may all materially distort their economic behaviour.[68] Where one or more of these factors is present, a consumer's economic behaviour will not be judged through the lens of the

[59] Law Com Impact Ass (n39), Law Com Cm 8323 2012 (n14) 5, 1.4.
[60] DTI Fair Deal (n3) 1.5, 5.4. David Detmer, `Sartre Explained : From Bad Faith to Authenticity' (2009) 77.
[61] CPRs 2008, regs2(2)-(6).
[62] 2.2.2.
[63] Steele 2002 (n9) 5, 23; Phillips (n8); Department for Business Innovation and Skills, *Reform of Consumer Law: Draft Regulations - Government Response to Consultations on Misleading and Aggressive Practices and the European Consumer Rights Directive* (August 2013) <https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/226626/bis-13-1107-government-response-to-consultations-on-misleading-and-aggressive-practices.pdf> accessed on 27 December 2017 (Consumer Law Reform).
[64] Steele 2002 (n9) 63, 67, 84. Phillips (n8).
[65] Financial and psychological.
[66] Steele 2002 (n9) 19. Phillips (n8).
[67] Steele 2002 (n9). Phillips (n8).
[68] CPRs 2008, reg2(5)(a)(b).

average consumer, but as an average consumer within that group would behave.[69] *Prima facie*, this thesis posits that the exhaustive list of factors given in the CPRs 2008 s2(5) are too narrow and fail to take into account the susceptibility[70] of consumers to the unscrupulous conduct of rogue traders. Given the above-stated purpose of the CPRs 2008, the conduct of the trader will be a factor affecting the `credulity' of the consumer, as will other factors such as a consumer's learning difficulties. This will be discussed further when considering the extent to which consumers are in need of protection.[71]

1.3 Research Objective

There is a great deal of research into limited liability and the general reluctance of the courts to lift the veil of incorporation[72] in order to hold accountable those human constituencies of the company who dishonestly and unscrupulously exploit creditors in general whilst at the same time abusing the corporate form in order to shield themselves from personal liability.[73] The deliberate under-capitalisation of the closely-held company for the purpose of transferring risk from the director qua shareholder to the company's unsecured creditors, resulting in excessive risk-taking and other unscrupulous conduct on the part of the rogue director, is one way in which this might occur.[74] There is also a great deal of reporting about the growing problems of exploitation experienced by consumers when dealing with rogue traders in the HRI market.[75] However, there does not seem to be anything which ties the issues relating to consumer exploitation resulting from rogue directors abusing the corporate form together, and efforts by government departments to address problems appear to be skirting the issues. Without appropriate intervention to close the lacuna which exists under company law and a more concerted shift in impetus by the government towards a more stakeholder-centric approach to company law, this long-standing problem is one which is not likely to abate.

This thesis seeks to heighten awareness of the problem posed to consumers by those rogue directors who have incorporated their HRI businesses if not with the specific aim

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[69] ibid, regs2(4) and (5).
[70] Detmer (n60) 76.
[71] 2.3.
[72] 3.6; also nn33-34..
[73] Chapter 3.
[74] Freedman (n54) 342; Cheng-Han (n34) 25.
[75] OFT 716 (n2) paras 1.1, 1.33, 3.31; OFT 1300 (n2) 2.2, 4.1). Steele 2002 (n9). Phillips (n8).

of exploiting consumers then with the aim of escaping liability when such exploitation occurs. The research will show that, whereas much has been done by way of consumer protection to address the exploitation of consumers by rogue traders generally, this does not go far enough in addressing the additional problems consumers face when dealing with rogue directors of closely-held companies.

This thesis also seeks to demonstrate how this problem has been created by the two cornerstones of company law, and steadfastly perpetuated by case law,[76] and how the government's response to date has been insufficient and largely ineffective in addressing the issue of consumer exploitation. Consumer remedies for losses caused by unscrupulous, or bad faith, practices of rogue directors are founded on contract law principles,[77] including the doctrine of privity of contract.[78] Therefore, this thesis aims to explain how separate corporate personality and limited liability serve to place those human constituencies of the company responsible for consumer losses resulting from the company's breach of contract beyond the reach of consumers. The doctrine of separate corporate personality means that it is the company which must be sued rather than the director who runs the company, and the doctrine of limited liability means that all that director, qua shareholder, stands to lose personally is limited to the amount of his/her shareholding in the company; this may mean that the rogue director, as owner-manager, may lose as little as one penny due to the legislative removal of minimum capital requirements.

In this way, UK company law creates an unsatisfactory situation for consumers, particularly when considering that they are unsecured creditors of the company and unable to protect themselves against the risk of exploitation and detriment. The research will seek to show that the cornerstones of company law render consumers even more vulnerable when dealing with rogue directors as compared to rogue traders of unincorporated businesses since, in the latter case, consumers are not restrained by the doctrine of separate corporate personality and are therefore able to seek redress against the rogue traders personally. An examination of the very limited circumstances in which company law permits the lifting of the veil of incorporation, by which those responsible

[76] *Salomon* (n28*)*. Lipton (n34).
[77] CRA 2015, s1(1); CPARs 2014 (n23), reg27A(2)(a).
[78] *Dunlop Pneumatic Tyre Co Ltd v Selfridge & Co Ltd* [1915] AC 847

for bad faith conduct within the company are held personally liable, will demonstrate that more needs to be done to protect consumers.

The current state of the law would seem to suggest that both *ex-ante* preventative regulation and *ex-post* forms of redress are inadequate. There appears to be a distinct lack of policing of the corporate form and its relationship with vulnerable or unwitting consumers who associate limited liability with respectability. If the justification for a tightening of the laws is established, then more positive action in the form of law reform needs to follow; it is this which forms the ultimate objective of this research in the hope that the interests of both consumers and legitimate companies can be met. Any judicial power to lift the veil of incorporation has been rendered largely redundant by the House of Lords' literal interpretation of statutory law in the case of *Salomon*; subsequent courts are bound to observe the House of Lords' insistence that economic and moral considerations have no part to play in deciding whether the corporate veil should be lifted. It is therefore clear that the status quo will remain until such time as Parliament recognises the need to legislate for those holding the controlling interest of a company to be held personally accountable for their actions when the interests of justice require it, or until a stakeholder-centric approach to corporate governance such as Andrew Keay's[79] Entity Maximisation and Sustainability (EMS) approach supplants the current shareholder wealth maximisation approach. Knowing that their unscrupulous, or bad faith, conduct might result in them being held personally liable will restrain many directors from acting so recklessly or dishonestly.

This thesis aims to make a case for the veil of incorporation to be lifted in situations where directors use the corporate form in order to escape liability arising from their bad faith conduct towards consumers, and will do so by showing that the unscrupulous exploitation of consumers arising from closely-held HRI company directors' deliberate abuse of the corporate form falls into one of Lord Sumption's two grounds for piercing or lifting the veil of incorporation – evasion or concealment.[80]

[79] Andrew Keay, `Formulating a framework for directors' duties to creditors: an entity maximisation approach' (2005) 64 CLJ 614.
[80] *Prest v Petrodel Resources Ltd* [2013] UKSC 34; [2013] 3 WLR 1. Cheng-Han (n34); Hannigan (n34)..

Any proposals for law reform will recognise the importance of ensuring that the interests of legitimate traders are not interfered with and that any proposed reforms complement government strategies for economic growth and consumer empowerment.

The research question for this thesis is: *Should Parliament provide for directors of closely-held companies who engage in unfair trading practices to be held to account to consumers under civil law in circumstances where consumers are adversely affected by such practices?*

The hypothesis is that the research question will be answered in the affirmative. The reason for this is that, although legal remedies available to consumers under different legal regimes have shown significant improvements in recent years,[81] such remedies cannot overcome the problems arising when rogue directors abuse the corporate form in order to exploit consumers.

1.4 Methodology

This section will discuss the methodologies adopted and identify the strengths and limitations of any research carried out.

The methodology for this thesis outlines the areas being researched and the reasons for this research. Since the main objective of this thesis is to make recommendations for law reform, it will be necessary to assess the opposing theoretical approaches to company law, namely contractarianism and communitarianism. The arguments of proponents for each will be considered,[82] since this will facilitate an assessment of the adequacy or otherwise of consumer protection in the context of consumers who have suffered detriment arising from exploitation by rogue directors of closely-held HRI companies. An understanding of these two theories will also help explain the development of policy and law in the area of company law. Political debate lies at the core of this study due to the concept of parliamentary sovereignty, since it is Parliament which must ultimately lead the way in changing this area of company law.

[81] 2.4.2.

[82] 1.5.2.

There will follow an examination of the law and practice. In this section, legislation and codes of practice governing consumer protection will be considered. Consideration will be given to how effective these measures are, particularly in the light of leading cases.

Since the thesis requires an in-depth examination of the development, application and impact of UK company law (as well as consumer protection law), a doctrinal approach has been mainly adopted. According to McConville and Chiu, black-letter law `focuses heavily, if not exclusively, upon the law itself as an internal self-sustaining set of principles which can be accessed through reading court judgments and statutes with little or no reference to the world outside the law.'[83] Because of the nature of the problem, other legal approaches have been used in tandem with the doctrinal approach. These include the `law in context' approach since the starting point for this thesis is not the law *per se* but generalised or generalisable problems in society:

> Here, law itself becomes problematic both in the sense that it may be a contributor to or the cause of the social problem, and in the sense that whilst law may provide a solution or part of a solution, other non-law solutions, including political and social re-arrangement, are not precluded and may indeed be preferred.[84]

The starting point for this thesis has been the problem of consumers being exploited by rogue directors of closely-held HRI companies who, through their deliberate abuse of the corporate form, have been enabled by the cornerstones of UK company law to enrich themselves without any fear of reprisals. Various qualitative and quantitative empirical studies were examined to assess the extent and the impact of this problem. An examination of the black-letter law has permitted the development of modern company law to be traced, to enable a better understanding why such a problem was able to perpetuate in the UK.

The thesis also makes limited references to socio-legal research. A socio-legal approach recognises the influences that other disciplines have on legal research. Socio-legal

[83] Mike McConville and Wing Hong Chiu, *Research Methods for Law* (Edinburgh University Press 2007) 1.
[84] ibid.

scholars seek to learn how the law affects society and acts to protect the public. For instance, sociology studies human behaviour and may explain why certain factors render consumers more vulnerable to exploitation by rogue directors as well as explaining why, for example, consumers might be unwilling to report having been exploited. Similarly, social policy issues may explain the extent to which vulnerable consumers need more interventionist help. Psychology studies people's mental functions and behaviour; it could help explain why consumer frailty – gullibility, desire for a bargain, trust, politeness, feelings of intimidation – is something that needs protecting by the law. Political science studies political institutions, their behaviour and their impact on society. This is of relevance when considering policies underpinning legislation, and how the government determines which policies take precedence over others. Finally, an assessment of law and economics helps the author to understand how and why economic factors have influenced the development of government policy. As McConville and Chiu note, `socio-legal research broadens legal discourse in terms of its theoretical and conceptual framework which guide the direction of the studies …'.[85]

The research project cannot be said to be based on grounded theory since the research question does reveal certain presumptions. For example, it suggests that there is a general reluctance for the courts to lift the veil of incorporation in instances where to do so would satisfy the interests of justice. Despite these presumptions, the research findings have been shaped by the data/research gathered, and in particular from lived experiences.

The research will conclude with a normative analysis of how the law in this area can be improved, based on an objective analysis of all available data, to which will be contributed the author's own recommendations for law reform.

1.5 Literature Review

1.5.1 Policy Considerations

The research will show that part of the problem stems from the fine balancing act that the government has to perform between introducing policies and legislation geared towards empowering and

[85] ibid.

protecting consumers, and at the same time not being seen to interfere in and restrict the growth and management of small businesses which are seen as vital to economic growth. Other factors such as globilisation, resulting from fierce international competition, attractive tax breaks and cheap labour, meant that the government had to do more to make the UK an attractive place to do business:[86]

> Globalisation also marked the beginning of the end of the ability of any national government to significantly influence macro-economic outcomes. Nation states came under increasing pressure from free trade, and from the increasing concessions they were forced to make in order to induce global firms to invest domestically.[87]

It is commonly understood that neo-liberalism is the political project that is the main policy driver of much UK law.[88] Neo-liberalism was popularised in the 1970s,[89] resulting from the belief in `efficacy of unrestricted markets in maximising economic welfare'[90] and culminating in reduced government intervention:

> The underlying assumption of neo-liberalism, inherited from Adam Smith, is that self-regulating markets transform the inherent selfishness of individuals into general economic well-being. The market is seen as providing opportunities and incentives for individuals to fully exploit their property … whilst preventing them from exploiting any advantages that ownership might afford by throwing them into competition with others similarly endowed. … Consequently, neoliberals assert that man-made laws and institutions need to conform to the laws of the market if they are not to be in restraint of trade and therefore economically damaging.[91]

Neo-liberalism has resulted in the deregulation of markets and business, privatisation of public sector companies, tax cuts to encourage enterprise, and a shareholder wealth

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[86] Sue Konzelmann and others, `Governance, regulation and financial market instability: the implications for policy' (2010) 34 Camb J Econ 929.
[87] ibid, at 935.
[88] David Harvey, *A Brief History of Neoliberalism* (OUP 2005); Daniel Attenborough, `The Neoliberal (Il)Legitimacy of the Duty of Loyalty' (2014) 65 N Ir Legal Q 405.
[89] Lipton (n34).
[90] ibid.
[91] ibid.
[92] Konzelmann and others (n86).

maximisation approach to corporate governance.[92] The Corporate Reform Collective are amongst the critics of neo-liberalist principles. They assert that: `[a]lmost all of the propositions that underpin [the] neoliberal agenda are suspect – legally, pragmatically and morally'[93] and that [m]aximisation of one thing necessarily implies the impoverishment of everything else, with a resulting focus on the immediate and short term.'[94]

The shareholder-centric approach to corporate management at the expense of all other stakeholder interests has been described as lacking both legal and theoretical support since company directors are required to always act in the best interests of the company[95] and the company comprises wider interests than solely those of the shareholders. On this basis, and the fact that `[t]he remorseless advance of managerial self-interest is the cause of much anger among other stakeholders',[96] a more pluralistic approach to the economy and to company law is called for.[97] John Lowry noted that, in 1998, New Labour commenced the UK's most `far-reaching review of company law since Gladstone's Joint Stock Companies Act 1844 and the introduction of limited liability in 1855'.[98] Margaret Beckett, then Secretary of State for Trade and Industry, stated the principal objective of the review as being to create `a framework of company law, which is up-to-date, competitive and designed for the [new] century, a framework that facilitates enterprise and promotes transparency and fair dealing'.[99] The independent Company Law Review Steering Group (CLRSG) was set up to oversee the UK's company law review process. The CLRSG's approach was centred on the axiom "think small first"[100] on the basis that `the vast majority of UK companies are small, private and generally owner managed' and therefore tailoring the law specifically to the needs of such companies would encourage future UK economic growth.[101] The CLRSG reported that 90% of private companies had fewer than 5 shareholders, and a significant proportion of these were owner-managed.[102]

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[93] Corporate Reform Collective, *Fighting Corporate Abuse: Beyond Predatory Capitalism, (*PlutoPress 2014) 82.
[94] ibid, at 47.
[95] ibid, at 49. CA 2006, s170.
[96] ibid, at 42
[97] ibid, at 51.
[98] John Lowry, `The Duty of Loyalty of Company Directors: Bridging the Accountability Gap Through Efficient Disclosure', (2009) Camb LR 607, 608.
[99] Department of Trade and Industry, *Company Law for a Competitive Economy* (DTI/Pub3162/6.3k/3/98/NP, March 1998) Foreword, para 3.8.
[100] Developing Framework 2000 (n12) 6.5.
[101] Lowry (n98) 609-610.
[102] Developing Framework 2000 (n12) para 6.9.

1.5.2 The Theoretical Debate about the Need for Consumer Protection in Company Law

Government policies are very much influenced by theoretical perspectives of the company which dominate at any given time, and any laws which follow must strike a balance between both economic and social concerns. However, UK company law has so far been unable to strike any such balance, with evidence instead suggesting a predisposition thus far to the furtherance of economic over social concerns. An understanding of the legal theories of the corporate form will aid any understanding of the appropriateness of any legal response to the issue of consumer exploitation by rogue directors.

There is a lack of any theoretical consistency in determining the need for consumer protection in UK company law. The two theoretical perspectives of the company, and company law, under scrutiny in this thesis – namely contractarianism, a branch of law and economics and progressive[103]/communitarianism – are useful in describing the workings of the company theoretically and the role of state intervention,[104] but offer little support in settling disputes between companies and consumers. It is difficult to see how consumers' interests are to be adequately protected when these theories are in such diametric opposition.[105]

1.5.2.1 A Law and Economics Approach to Company Law

Since 1932,[106] and despite influential claims from academics such as Professor Dodd that directors should have a discretion to consider other corporate stakeholder interests,[107] the orthodox view of company law in the US has been that its primary objective has been

[103] Lawrence Mitchell (ed), *Progressive Corporate Law* (Westview Press 1995).
[104] Mohanty and Bhandari (n34) 15.
[105] David Millon, `New Directions in Corporate Law: Communitarians, Contractarians, and the crisis in Corporate Law' (1993) Wash & Lee L Rev 1381.
[106] Following the publication of Adolf Berle and Gardiner Means' work ` The Modern Corporation and Private Property' (New Brunswick 1997; first published 1932).
[107] Edwin Merrick Dodd Jr, `For Whom Are Corporate Managers Trustees?' (1932) 45 Harv L Rev 1145, 1147. Debate with Adolf Berle and Professor Dodd (`For Whom Corporate Managers are Trustees: A Note' (1932) 45 Harv L Rev 1365; Professor Jennifer Hill `Then and Now: Professor Berle and the Unpredictable Shareholder' (2010) 34 Seattle UL Rev, 1010.

> to develop legal structures that will maximize shareholder wealth. This shareholder primacy vision of company law therefore disregards claims of various nonshareholder constituencies … [such as consumers] whose interests may be adversely affected by managerial pursuit of shareholder welfare.'[108]

Instead, remedies accruing to consumers who have suffered as a result of rogue directors abusing the corporate form in order to exploit them have had to rely on legal regimes other than company law. Neo-liberalism, with its deregulation and laissez-faire approach, started influencing policy-making and company law from the late 1970s.[109]

Generally, law and economics scholars assert that individuals should be free to live how they choose and enter whatever agreements they see fit.[110] Their focus is on reduction of transaction costs and improved efficiency, driven by market forces.[111] Hawtrey and Dullard[112] describe Manne's theory[113] of the market for corporate control as `predicated upon the share market as an objective criterion for guiding managerial performance.'[114] Market forces are therefore seen as the most effective way of regulating the company and disciplining directorial misconduct which causes loss to consumers.[115] For example, directors' job prospects will be damaged if they get a bad reputation; consumers will cease dealing with a company which is run by unscrupulous directors; and shareholders will not wish to invest in a company which is not performing well. However, this thesis argues that these responses to directorial misconduct do little to help consumers *ex post;* what is appropriate in these situations are preventative, *ex ante* measures to provide for an equilibrium in power relations between the corporate structure and consumers.[116]

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[108] Millon (n105) 1374. Andrew Keay, `*The Corporate Objective'* (Edward Elgar 2011) 36. Richard Posner, *Economic Analysis of Law* (Little Brown 1992); Frank Easterbrook and Daniel Fischel, *The Economic Structure of Corporate Law* (Harv U 1991).
[109] Attenborough (n88); Harvey (n88); Anthony Ogus, *Regulation, Legal Reforms and Economic Theory* (OUP, 1994); Brian Cheffins, *Company Law: Theory Structure and Operation* (Clarendon Press 1997).
[110] Millon (n105) 1382; Keay (n108, 26). Lipton (n34).
[111] Ronald Coase 'The Nature of the Firm' (1937) 4 Economica 387 and his later work, 'The Problem of Social Cost' (1960) 3 J L& Econ 1; Armen Alchian, and Harold Demsetz, `Production, Information costs and Economic Organizations' (1972) 62 AER 777.
[112] Kim Hawtrey and Stuart Dullard `Corporate Virtue and the Joint Stock Company', (2009) 12 J Mkts and Morality 23.
[113] Henry Manne, `Mergers and Market for Corporate Control' (1965) 73 J Pol Econ 110.
[114] Hawtrey and Dullard (n112) 23.
[115] ibid.
[116] CPRs 2008 (n23).

According to Sol Picciotto,

> theories which assume the efficiency of markets, and seek to confine the role of the state or the public sphere to remedying 'market failure', greatly underestimate the importance of normative standards and regulation in establishing the trust and confidence necessary to ensure that production and exchange can operate smoothly and to the benefit of society as a whole.[117]

By creating a legal regime which has effectively removed all of the internal controls and safeguards in the closely-held and small private company,[118] Parliament's development of company law has predominantly reflected a law and economics approach. Shareholder primacy is secured by the very fact that they sit in a very strong position in relation to other corporate stakeholders; they enjoy the right to share the company's profits when declared; the right to say how the company is run and by whom; the right to be separated from the company's liabilities and any corporate irresponsibility and so on.

1.5.2.2 Contractarianism

Contractarianism is the dominant variant of the law and economics approach.[119] Like law and economics scholars, they shun state intervention and uphold the shareholder primacy vision, but they place less reliance on market forces. Contractarians see the company not as a `creation of the state' but as a `voluntary association between shareholders',[120] which should be regulated by a series of private contracts – a `nexus of contracts'.[121]

Being anti-regulatory, contractarians argue that companies should be at liberty to opt out of legal rules which interfere with shareholder wealth maximisation, and instead provide

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[117] Sol Picciotto and Ruth Mayne, `Regulating International Business: Beyond Liberalisation' (1999) Macmillan, 278.

[118] `Limited liability discourages shareholders from monitoring and controlling their company's commercial ventures.' (Puig GV `A Two-Edged Sword: Salomon and the Separate Legal Entity Doctrine', (2000) 7 E Law 19).

[119] Keay (n108) 26-27.

[120] Cheffins (n109) 41. Simon Goulding, *Principles of Company Law*, Cavendish Publishing Limited, London, 1996, 20.

[121] William Bratton, 'The ''Nexus of Contracts'' Corporation: A Critical Appraisal' (1989) 74 Cornell LR, 407; Alchian, and Demsetz, (n111); Michael Jensen and William Meckling `Theory of the Firm: Managerial Behaviour, Agency costs, and Ownership Structure', (1976) 3 J Fin Econ); Eugene Fama,, `Agency Problems and the Theory of the Firm' (1980) 88 J Pol Econ 288, 290; Frank Easterbrook and Daniel Fischel, `The Corporate Contract' (1989) 89 Colum L Rev 89 1426.

for these under privately-negotiated contracts.[122] They recognise that the state may have a role to play in establishing some default rules[123] to govern certain contractual relationships within the company, such as those relating to directors' duties, but otherwise believe that consumers should be free to negotiate their own rights and obligations through their individual contracts with the company.[124] In this way, consumers should negotiate to protect themselves against the harmful external effects of management activity.[125] Any breach of contract can be dealt with *ex post* by way of traditional contractual remedies, or alternatively consumers should seek protection from non-corporate law legal regimes such as consumer law.[126]

1.5.2.3 How Contractarianism Strengthens the Position of Rogue Directors at the Expense of Consumers

One of the greatest limitations of the contractarian theory of company law is its disregard for consumer vulnerability, inequality of bargaining power, and `the limits of the human mind in comprehending and solving complex problems'.[127] The contractarian view of consumers presupposes that consumers are able to assess the risk of default at the time of contracting, and are more fitting to the position of trade creditors and lenders who are able to negotiate security, prepayments or personal guarantees.[128] For instance, it makes no allowance for the fact that consumers do not become creditors of the company out of choice; often they only become creditors once the exploitation has taken place except where they are owed money due to depositing money with the company in advance of work being carried out, and the legal position is that they become creditors once the court makes a damages order in their favour.[129] To this extent, therefore, consumers often lack the foresight and capacity to bargain against such unanticipated risks of dealing with a

[122] Stephen Bainbridge, `Community and Statism: A Conservative Contractarian Critique of Progressive Corporate Law Scholarship' (1997) 82 Cornell L Rev 856,860; Keay (n866) 674; Millon (n105) 1383.
[123] Easterbrook and Fischel (n108).
[124] Keay (n34) 451; Easterbrook and Fischel (n121) 1426; John Armour and Michael Whincop, `The Proprietary Foundations of Corporate Law' (2007) OJLS 429, 431. Lipton (n34).
[125] Millon (n105) 1378.
[126] David Millon, `Communitarianism in Corporate Law: Foundations and Law Reform Strategies' in Mitchell (n103) 7-9.
[127] Dale Tauke 'Should Bondholders Have More Fun? A Reexamination of the Debate Over Corporate Bondholder's Rights' (1989) Colum Bus L Rev 1, 15, cited by Keay (n866) 694.
[128] ibid, 59.
[129] Stephanie Blankenburg, Dan Plesch and Frank Wilkinson, Limited Liability and the Modern Corporation in Theory and in Practice' (2010) 34 CambJEcon. 821, 831.

closely-held HRI company. In this regard, there is merit for classifying them as involuntary creditors, in much the same way as tort victims are.[130]

From the above, it can be seen that the contractarian view of company law is defective in the case of the closely-held company whose directors seek to maximise their own wealth, qua shareholders, at the expense of consumers. This is because UK company law has allowed access to a corporate structure – the limited liability company – which permits under-capitalisation and at the same time protects the company's intended risk-bearers[131] through limited liability and recognises the company as a separate legal entity which is responsible for any wrongful acts committed in its name. Easterbrook and Fischel note that `managers' incentive to undertake overly risky projects is greater in close corporations' due to the fact that limited liability allows the `investor-managers … [to] limit their risk to the amount of capital in the corporate treasury and transfer more of the risk to third parties.'[132] Easterbrook and Fischel suggest piercing, or disregarding, the corporate veil as one way of reducing third party losses but, as will be seen in Chapter 3, English courts have shown a dogged reluctance to make the human constituencies of the company liable for wrongs committed in the company name where to do so might undermine the doctrine of separate personality.[133] There are no barriers to socially excessive risk-taking in the case of the closely-held company under scrutiny in this thesis, due to the total absence of shareholder monitoring or managerial accountability that might otherwise provide a check on managerial risk-taking.

The orthodox contractarian response to this `moral hazard'[134] is simple: through the process of contracting, those to whom the risk is externalised as a result of under-capitalisation must negotiate higher prices, or sufficient *ex ante* compensation to cover the increased risk of default *ex post,*[135] or even insure themselves[136] against such risk.

However, as even Easterbrook and Fischel acknowledge, `Contractual powers are the least of creditors' tools,'[137] and the transaction costs of individuals purchasing insurance `are prohibitive'.[138]

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[130] Lipton (n34).
[131] Shareholders.
[132] Easterbrook and Fischel (n108) 56.
[133] *Salomon* (n28).
[134] Easterbrook (n108) 50.
[135] ibid, 58.
[136] ibid, 52.
[137] ibid, 46.
[138] ibid, 47.

An adherence to contractarian principles has led to a marked imbalance between the protection afforded to shareholders over that extended to non-shareholder constituencies of the company such as consumers; therefore, a strict application of the contractarian theory strengthens the argument justifying the need for consumer protection against rogue directors of closely-held companies.

1.5.2.4 Communitarianism – the Champion of Consumers

Communitarians contend that too much reliance on contracts or market forces to regulate the company is not adequate in protecting consumer interests; they argue that company directors should take into account other corporate stakeholder interests, such as those of consumers, rather than just those of shareholders when running the business.[139] The communitarian theory is diametrically opposed to the contractarian view that non-shareholder protections should be limited to the extent that they can be bargained for.[140] Communitarians focus on the social impact of corporate activity.[141] They see the company as a social institution which should act in the interests of all its stakeholders, namely those who can affect or be affected by the company's actions.[142] By regulating the company's actions to satisfy wider stakeholder interests, the company's reputation would improve which would ultimately improve the shareholders' long-term interests.[143] Contractarianism is seen by communitarians as far too simplistic and thereby insensitive to the social costs resulting from the pursuit of shareholder wealth maximisation.[144] Keay notes that `communitarians opine that whether the company is useful is measured by evaluating how it assists society in gaining a richer understanding of community by respecting human dignity and overall welfare.'[145]

Communitarians reject the contractarian notion that consumers can protect themselves through their individual contractual negotiations and instead highlight[146] the need for

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[139] David Millon, `Communitarianism in Corporate Law: Foundations and Law Reform Strategies' in Mitchell (n103) 7-9. Keay (n108) 34.
[140] Millon (n105) 1381.
[141] Millon (n105) 1379.
[142] ibid 1378; Mohanty and Bhandari (n34) 203.
[143] Mohanty and Bhandari (n34) 203.
[144] Millon (n105) 1380.
[145] Keay (n108) 35, referring to the article by Daniel Sullivan and Donald Conlon, `Crisis and Transition in Corporate Governance Paradigms: The Role of the Chancery Court of Delaware' (1997) Law and Society Review 713.
[146] Millon (n126) 4.

stakeholder representation on the board and mandatory rules to redress any imbalance resulting from such things as unequal bargaining power,[147] information asymmetry,[148] comparative lack of business acumen, and lack of funds, particularly where company law does not require directors to treat company stakeholders with `respect, trust and fairness'.[149] To the extent that consumers and other stakeholders are unable to protect themselves, then corporate regulation and intervention is needed `to overcome the transaction costs and market failures that impede self-protection through contract.'[150] It is clear that this communitarian perspective of the company reflects the needs of consumers when dealing with HRI companies generally.

1.5.2.5 Just How Workable is Communitarianism?

The effective implementation of communitarianism is not without its difficulties. Some regard the theory as too idealised,[151] or too vague,[152] particularly in its failure to clarify precisely the number and identity of corporate stakeholders,[153] and the weight to be attached to each of them.[154] When compared to the shareholder primacy approach advocated by contractarians, it has been said that trading accountability to shareholders for accountability to all corporate stakeholders is `to sacrifice clarity for blancmange'.[155] Such scepticism is understandable but settling for clarity is not sufficient reason to abandon the search for a fair and workable alternative to shareholder primacy.

Accountability of directors under the communitarian approach has been criticised as

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[147] Deryn Fisher, `The enlightened shareholder - leaving stakeholders in the dark: will section 172(1) of the Companies Act 2006 make directors consider the impact of their decisions on third parties?' (2009) ICCLR 10.
[148] Millon, (n126) 4;. Keay (n108).
[149] Keay (n108) 35, 106.
[150] Millon (n105) 1379.
[151] For example, Christopher Stoney and Diana Winstanley, `Stakeholder Confusion or Utopia? Mapping the Conceptual Terrain' (2001) 38 Journal of Management Studies 600 at 606.
[152] Mark Goyder, *Living Tomorrow's Company*, (Gower Publishing 1998) 3; Eric Orts and Alan Strudler, `The Ethical and Environmental Limits of Stakeholder Theory' (2002) 12 Business Ethics Quarterly, 215, 215.
[153] Ronald Mitchell, Bradley Agle and Donna Wood, `Toward a Theory of Stakeholder Identification and Salience: Defining the Principle of Who and What Really Counts' (1997) 22 Academy Management Review, 853, 858.
[154] Thomas Donaldson and Thomas Dunfee, `Toward a Unified Conception of Business Ethics: Integrative Social Contracts Theory' (1994) 19 Academy of Management Review, 252.
[155] Goyder (n152) 3.
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useless,[156] valueless,[157] and unworkable,[158] since making directors accountable to everyone effectively renders them accountable to no one. Effective accountability of directors is of fundamental importance to curb the exploitation of consumers. In Chapter 3, it will be seen that directorial accountability to shareholders, arising from the separation of power within a company, acts as a restraint on directors from abusing their power and acting in their own self-interest. However, the absence of any real separation of power within the closely-held company, owing to the fact that directors and shareholders are often the same persons in these companies, means that accountability of directors cannot be relied on in the closely-held company.[159] Therefore, far from this being a negative aspect of communitarianism, it in fact makes the case for regulation to protect consumers and other stakeholders of closely-held companies all the more urgent. Whilst such broad accountability would strengthen the position of consumers dealing with closely-held companies, this aspect of the communitarian approach may be problematic for more widely-held companies. Directors are expected, when managing the company, to take decisions which often involve an element of risk. To require them to achieve the kind of balancing act that the law has so far failed to achieve would inevitably result in a reluctance to hold the office of director.

Communitarian theories have been questioned on the grounds that they might lose sight of the commercial goal of the company, namely shareholder profit maximisation.[160] Notwithstanding this, Mohanty and Bhandari claim that social demands over the last 20-30 years have helped to create a gradual shift in the UK in favour of the stakeholder value approach.[161] This can be seen in the new statutory statement of directors' duties in the Companies Act 2006 (CA 2006); in particular s172 which requires directors to consider a range of other interests when promoting the success of the company for the benefit of its members as a whole. Some would say that this has caused a move towards a more enlightened shareholder value (ESV) approach[162] which, whilst still recognising the

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[156] Orts and Strudler (n152) 218.
[157] Goyder (n152) 3.
[158] Elaine Sternberg, `The Defects of Stakeholder Theory' (1997) 5 Corporate Governance: An International Review, 3, 6
[159] Although the CLRSG alludes to this point (Developing Framework 2000 (n12) paras 2.7, 6.10, 7.96, 7.97), the CA 2006 fails to address this issue.
[160] Sulette Lombard, `Directors' Duties to Creditors', University of Pretoria Thesis (2006) 15, 18.
[161] Mohanty and Bhandari (n34).
[162] Department of Trade and Industry, *Modern Company Law: For a Competitive Economy – The Strategic Framework*, (February 1999) 31, 7 (DTI Strategic Framework 1999); Fisher (n147) 10.

primacy of shareholder interests, also seeks to protect the interests of other corporate stakeholders. However, there is a significant amount of scholarly debate which questions whether the interests of other corporate stakeholders will be protected under s172 since directors are required to consider stakeholder interests only insofar as to do so would promote the interests of the company's shareholders.[163]

1.5.2.6 A Union of Two Opposing Theories? The Enlightened Shareholder Value Approach

That the UK government has been largely influenced by the contractarian theory of company law cannot be doubted in the light of its dogged preservation of separate corporate personality, *Salomon* and limited liability. However, there have been tentative murmurings towards a more progressive shift. For instance, in 1999 the Company Law Review Steering Group considered the practicality of extending directors' duties to corporate stakeholders[164] and extending board composition to reflect other stakeholder interests,[165] balanced against the ability to hold directors and shareholders to account for the external impact of the company's operations under the requirement for transparency and public accountability.[166] A pluralist or stakeholder approach was vetoed on the bases that most respondents to the CLRG's Strategic Framework Consultation Document favoured the retention of a shareholder primacy approach, albeit in a more inclusive form,[167] and most respondents felt it would make `little sense in requiring a duty to be owed to a group that is unable to enforce it.'[168] This is true, since company law only affords shareholders the right to take derivative action against those who commit wrongs against the company,[169] and in the closely-held company this is not a right that would be exercised so as to hold directors to account for wrongs done to the company's consumers or other stakeholders. Furthermore, this will remain the case until the government legislates to enhance the rights of consumers and other corporate stakeholders to take direct action against rogue directors.

[163] Lombard (n160); Keay (n180). Fisher (n147).
[164] Developing Framework 2000 (n12) 2.7.
[165] ibid, 2.8.
[166] ibid, 2.10
[167] ibid, 2.11.
[168] ibid, 2.12. Keay (n108); DTI Strategic Framework 1999 (n162) 31, 40.
[169] Part 11 CA 2006 ss261-263

The theory which has been embedded in the CA 2006[170] is known as the ESV approach. For example, s172 requires directors to promote the success of the company having regard to a number of factors, including the need to foster relationships with consumers[171] and maintain a good reputation.[172] This reflects the CLRSG's overall objective of directors as `… pluralist in the sense that companies should be run in a way which maximises overall competitiveness and wealth and welfare for all.'[173] The Companies Act therefore represents a distinct move[174] towards encouraging corporate social responsibility, and a shift from a short-termism focus to an elevation of trust, reputation, stakeholder value and long-term sustainability. Although the CLRSG did not expect directors to become moral, political or economic arbiters, they refer to the fact that reputation builds shareholder value.[175] Despite acknowledging that directors' duties lie at the heart of effective corporate governance,[176] the CLRSG has recommended very little conscious change to their substance.[177] Apart from placing a new emphasis on the importance of managing the company for the long-term, ESV is very similar to shareholder primacy in both direction and application. One must therefore question whether s172, and therefore ESV, is a genuine attempt at raising the profile of wider stakeholder interests, particularly as directors' decisions will not be questioned provided they *had regard* to factors (a) to (f). Their primary aim under s172 is to promote the success of the company `for the benefit of its members as a whole'. Directors therefore remain unaccountable to consumers and other corporate stakeholders, who still have no rights of action[178] against directors who fail to consider their interests when making management decisions and, as Keay fears that, despite being required to exercise reasonable care and skill in their consideration,[179] `directors will simply pay lip-service to the need to consider the interests of stakeholders and then make the decision that they want, possibly based on self-interest.'[180] This is likely when one considers that UK courts are only likely to question whether directors have acted

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[170] Following the recommendations of the House of Commons Trade and Industry Committee, *Sixth Report of Session 2002-03: The White Paper on Modernising Company Law*, 10, 13.
[171] CA 2006, s172(1)(c).
[172] ibid, s172(1)(e).
[173] Developing Framework 2000 (n12) 2.21.
[174] CA 2006, s172.
[175] Developing Framework 2000 (n12) 2.21.
[176] ibid 3.2.
[177] Sarah Worthington, `Reforming Directors' Duties' (2001) 64 MLR, 440.
[178] Modernising Company Law White Paper (n170) 16.
[179] CA 2006 Explanatory Notes, para 328.
[180] Keay (n108) 151; Andrew Keay, *The Enlightened Shareholder Value Principle and Corporate Governance* (Routledge, 2013).

in good faith in relation to s172 in cases of `really bad behaviour',[181] `manifest excess or abuse of power'.[182] As Keay notes, `It is very difficult … to impugn the actions of someone who is able to state clearly that he ... believed that what was done was for the company's best.'[183] Attenborough posits that, given Keay's scepticism of ESV actually reflecting a more stakeholder- oriented approach to corporate governance, s172 may amount to no more than `an educational tool, which sends signals to directors and others that wider interests than those of the shareholders matter'.[184]

Therefore, shareholder primacy – enlightened or otherwise - does not really work in the closely-held company and, as Fisher notes: `a stakeholder approach could be theoretically justified and would not have required a fundamental shift in UK company law doctrine.'[185]

1.5.2.7 How the Above Theories have Influenced Modern Company Law and Consumer Protection Policy in the UK

The Conservative and Liberal Democrat Coalition Government's consumer empowerment strategy sought to create an environment where

> confident, empowered consumers [are] able to make the right choices for themselves – to get the best deals, demand better products or services, and be able to resolve problems when things go wrong. This approach makes it easier for honest, high quality businesses to compete and will drive innovation, competition and growth.[186]

The strategy adopted a stance similar to that of its predecessor, New Labour, which refused to `impose heavy-handed regulation on the entire business world when it is only a very few traders who are causing real problems.'[187] However, this reference to `very

[181] Keay (n108) 155; Davies and Worthington (n32). 2.15.
[182] Daniel Attenborough's Review of Andrew Keay's book: *Andrew Keay*, *The Enlightened Shareholder Value Principle* (n180) (2013) 76 MLR, 935, 941.
[183] Keay (n108) 155.
[184] Attenborough (n182) 942.
[185] Fisher (n147) 12.
[186] Department for Business, Innovation and Skills, *Better Choices: Better Deals. Consumers Powering Growth* (April 2011), 5 <http://www.bis.gov.uk/assets/biscore/consumer-issues/docs/b/11-749-better-choices-better-deals-consumers-powering-growth.pdf> accessed on 27 December 2017 (BIS Consumer Empowerment 2011).
[187] Law Com CP No 199, 2011 (n3) 1.5.

few traders' demonstrates New Labour's reluctance to acknowledge the enormity of the problem and its impact on consumers.[188] This is surprising given the OFT was publishing reports at the same time showing the magnitude of the problem posed by rogue traders.[189]

The tenor of government strategy is, at times, one of impatience rather than empathy with consumers: `We know that there are rogue traders who will prey upon the foolish or vulnerable consumer',[190] and appears to be seeking to shift the onus onto consumers to better protect themselves. This is along similar lines to the contractarian approach taken by New Labour in 2005 which reported that the `Government … cannot and should not protect consumers who make foolishly rash decisions when they could have made an informed choice instead.', and when a consumer `willingly chooses to make a bad deal … [they] will need to accept the consequences of their own decisions.'[191] The Conservative government's 2015 Manifesto[192] only referred to consumers in the context of food labelling,[193] trading with energy suppliers[194] and financial markets.[195] This is not due to any sudden reduction or cessation of consumer exploitation by rogue directors of closely-held HRI companies. Conversely, the government was very clear about its plans to encourage and support the formation of more small companies.[196] In the Conservative and Unionist Party Manifesto 2017,[197] Teresa May spoke of broad pledges to create fair markets for consumers; strengthen the powers of consumer enforcement bodies; give consumers a voice in the regulation of businesses; and put the interests of vulnerable consumers first. In relation to small businesses, she pledged favourable changes to business rates and regulatory cost savings through The Red Tape Challenge. Any improvements in corporate governance appeared only to relate to public companies, and not closely-held companies.[198]

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[188] BIS Consumer Empowerment 2011 (n186) 48.
[189] OFT 1300, OFT 716 (n2).
[190] DTI Fair Deal (n3) 6, 1.5.
[191] DTI Fair Deal (n3) 13, 5.4.
[192] Conservative Party Manifesto, *Strong Leadership, A Clear Economic Plan, A Brighter, more Secure Future* (2015) <https://www.conservatives.com/manifesto2015> accessed on 27 December 2017.
[193] ibid, 9.
[194] ibid, 56-57.
[195] ibid, 21.
[196] ibid, 21.
[197] Conservative and Unionist Party Manifesto, *Forward Together: Our Plan for a Stronger Britain and a Prosperous Future* (2017) <https://www.conservatives.com/manifesto> accessed on 27 December 2017
[198] ibid, 20.

Prima facie it appears that governments throughout the last decade remain committed to the contractarian school of thought in relation to small companies, favouring minimal intervention and regulation.[199] The extent of any cautious recognition of the merits of the communitarian view of the company by the government is therefore somewhat ambiguous, particularly when creating a fairer trading environment for consumers threatens to impede its ultimate goal of stimulating economic growth, which relies heavily on creating a positive trading environment and removing cumbersome barriers for companies operating in the private sector. In its push for `localism', the Government has sought to decentralise the consumer protection work of Consumer Focus and the OFT, and place all this work with LATSS and the Citizens Advice Service (CAS).[200] This coincides with huge budgetary cuts in the public sector, where LATSS and the CAS are already having to rationalise their services to absorb these cuts, and lack the resources and the expertise to take on this additional work.[201] Therefore, despite clear evidence pointing to continued consumer detriment resulting from rogue traders, generally, operating in the HRI market, the above cuts and restructuring appear to leave today's consumers in an even more disadvantageous position.[202] This therefore heightens the need for positive action to be taken in reforming the law. Until such time as the government strikes the right balance between meeting both consumers' needs and those of legitimate businesses, it is hard to see how, with its inability to balance consumer interests, a contractarian approach can prevail.

1.6 **Structure of Thesis**

This Chapter has introduced the main areas under consideration in this research and outlined the main aims and objectives of the research. It includes a methodology review and a detailed literature review.

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[199] BIS Consumer Empowement 2011 (n186), 48.
[200] Department for Business, Innovation and Skills, *Public Bodies Bill – Changes to the UK Consumer and Competition Bodies* (14 October 2010).
[201] Steven Poulter,, `Shoppers will pay the price of scrapping the OFT, consumer group warns', *The Daily Mail* (9 March 2011) News <http://www.dailymail.co.uk/news/article-1364380/Shoppers-pay-price-scrapping-Office-Fair-Trading.html#ixzz1cMTipGKy> accessed 27 December 2017.
[202] 2.4.6.1, 3.9.2, 4.2.1.8,

The next chapter, Chapter 2, will examine further the ways in which rogue HRI traders exploit consumers. It will also consider factors which render consumers more vulnerable to such exploitation, and the impact of rogue trading on consumers. References are made throughout this chapter to government and consumer group reports as well as other relevant source data. Reported statistical data is used to demonstrate the nature of consumer exploitation; any measurable detrimental impact on consumers; volume of complaints to local authorities; evidence of under-reporting; volume of cases pursued against rogue traders by enforcement bodies or private consumer action and reasons for failure to take action. Current consumer protection measures will be discussed to ascertain their adequacy in resolving the problems identified. Specific reference will be made to the rogue director in the closely-held company and the impact of this corporate structure on remedial rights for consumers. Any inadequacies in consumer law that are identified will highlight the need for a company law response to a company law problem.

The way in which UK company law facilitates rogue directors of closely-held HRI companies to abuse the corporate form at consumers' expense forms the focus of Chapter 3. This will involve a study of the cornerstones of company law, namely limited liability and separate legal personality. Evidence relating to the impact of abuse of the corporate form on legitimate businesses will also be presented. An overview will then be given as to the current methods of substantive protection conferred upon consumers. From this, it will be possible to formulate arguments for why current levels of consumer protection are inadequate or ineffective in protecting consumers who are exploited by rogue directors of closely-held companies. Consideration of company law, practice and theoretical perspectives of the company will provide the basis for developing the rationale for the giving of limited liability and separate legal personality to companies on incorporation. The case of *Salomon* will be discussed, particularly in relation to its rigid and literal interpretation of the Companies Act 1862 and the far-reaching consequences of the House of Lords' decision. It will be seen how this crucial decision has helped create the possibility for abuse of the corporate form by closely-held companies, resulting in unfairness for consumers and other unsecured creditors. Discussion will then turn to Parliamentary and judicial attempts to redress this balance in very limited circumstances to disregard the separate legal personality of the company by lifting the veil of incorporation to make the shareholder-directors personally liable for losses resulting from their wrongful conduct.

Normative recommendations for law reform will be made in Chapter 4. The focus for potential reform will be on company law since it is the cornerstones of company law that enable rogue directors to escape liability for their bad faith conduct which results in consumer detriment. It has already been demonstrated that consumer protection law, most notably contract law, fails consumers who deal with incorporated HRI traders due to the rules of privity of contract. Therefore, any reforms need to focus on ways in which rogue directors might be held personally accountable for their bad faith conduct towards consumers. This might be through redrafting the statutory directors' duties to reflect a more progressive approach to company law. For example, adopting Keay's EMS model of the company would ensure that the duties of the directors are owed to the company as a whole, with shareholders and the factors listed in CA 2006, s172 being given equal ranking. This then may justify consumers and other corporate stakeholders having direct rights of redress against rogue directors who are in breach of their duties to act bona fide in the interests of the company as a whole. However, such reform of directors' duties could be problematic from a number of different perspectives. Arguably, the simplest and most effective potential for reform could lie in the courts' willingness to disregard the corporate form, by lifting the veil of incorporation to expose those who do not deserve its protection. Although, as will be seen in Chapter 3, the courts since *Salomon* have resisted even compelling justifications for the company's separate legal personality to be ignored.

Concluding remarks will be made in Chapter 5.

CHAPTER 2

NATURE AND EXTENT OF CONSUMER EXPLOITATION

BY ROGUE HRI TRADERS

2.1 Introduction and Overview

Consumer exploitation by rogue HRI traders, particularly those who cold-call at consumers' homes, has been a key concern for the Department for Business, Energy and Industrial Strategy (BEIS) and its predecessors since the beginning of the new millennium, and both the UK government and the EU recognise the need to protect consumers from exploitative and unfair trading practices.[203]

This Chapter will examine the nature and extent of consumer exploitation by rogue HRI traders generally with the aim of demonstrating there is a very real problem that needs addressing. It is intended in this Chapter to provide a comprehensive overview of rogue trading in the HRI market, with a view to narrowing the focus in Chapter 3 to rogue directors of closely-held HRI companies specifically; as will be seen in the next chapter, this will raise an additional set of problems that consumers do not face when dealing with unincorporated rogue traders.

The ways in which rogue traders exploit consumers was introduced at 1.1 and 1.2; this will be examined further in Chapter 2, together with a comprehensive explanation of the factors which might render consumers more vulnerable to such exploitation, and the impact of rogue trading on them. The nature and extent of any measurable consumer detriment will then be discussed since this will be one of the main factors illustrating the need for consumer protection against this type of exploitation. Some explanation will be offered for the reasons why the reporting of rogue trading incidents to public bodies is

[203] CPP Report 2015 (n2). National Trading Standards Board, *Strategic Assessment* (2013) 26-27 <https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/252730/bis-13-1267-consumer-protection-partnership-future-priorities.pdf> accessed on 27 December 2017.

under-reported, and why therefore it is difficult to gauge the true extent of the problem with rogue traders operating in the HRI market. Related to this will be a discussion as to why it is that consumers are often reluctant to take civil action to recover their losses from rogue HRI traders. This Chapter will then conclude with an examination of current consumer protection measures and their adequacy, or otherwise, in resolving the problems identified.

2.2 Nature and extent of consumer exploitation by rogue HRI traders generally

2.2.1 Consumer Exploitation by Rogue HRI Traders

While the stated focus of this thesis is on rogue directors of closely-held companies in the HRI market, consideration will first be given to the way in which consumers may be exploited by rogue traders generally before returning the focus in Chapter 3 to the ways that company law, in allowing small private closely-held companies to incorporate, exacerbates the problems that consumers face when dealing with rogue directors of such companies. The term `exploitation'[204] is used to describe a whole array of unscrupulous and unfair conduct by rogue traders since they will often prey on the vulnerability of certain demographics of consumers with the primary aim of parting them from their money. The CPP Report 2015[205] differentiates between the type of exploitation that arises with doorstep crime:

> it often involves charging extortionate prices for goods or services, including charging for unnecessary goods or services, deliberately damaging property in order to obtain work, leaving work unfinished, substandard and poor quality work, claiming to have done work which has not been done, claiming work is required urgently, or persuading consumers to allow work to start during the statutory cooling off period and false statements being made about a variety of things including goods and services being required for specific reasons and membership of trade associations.[206]

[204] Defined in 1.2.
[205] CPP Report 2015 (n2).
[206] ibid, 1.31. Citizens Advice Service, *Consumer Detriment: Counting the Cost of Consumer Problems*, September 2016

and the type that arises within the HRI market:

> `problems mainly related to delays, poor quality of work and use of sub-standard materials.'[207]

This thesis does not make any distinction between the two types of exploitation but more regards rogue trader exploitation as a combination of both. This is because of the deliberate and unscrupulous nature of rogue trading, and the fact that the problems described in relation to the HRI market could equally at times be attributed to those whom this thesis refers to as `legitimate HRI traders'; though acting irresponsibly at times in order to increase their profits, the conduct of legitimate traders is not done with the same bad faith as the rogue trader. Illustrations of the bad faith conduct associated with rogue HRI traders is given at 4.2.1.

2.2.2 Why Should Consumers be Seen as Vulnerable When Dealing with Rogue HRI Traders?

Much EU consumer protection law divides consumers into two categories – the `average consumer' who is deemed to be `reasonably well informed, observant and circumspect'[208] and the `particularly vulnerable consumer'.[209] This is an understandable distinction to make since it widely accepts that certain consumers are particularly vulnerable to rogue HRI traders, even to the extent of being actively targeted for exploitation by them.[210] Brian Steele[211] describes how frail and elderly people are least able to protect themselves from rogue traders and other bogus doorstep callers, often because they `have deep-rooted attitudes and beliefs making it difficult to change lifestyles and behavioural routines to better protect themselves … These factors are exacerbated by problems that sometimes accompany ageing, such as short-term memory loss, dementia, and perception

<https://www.citizensadvice.org.uk/Global/CitizensAdvice/Consumer%20publications/Final_Consumer Detriment_OE.pdf > accessed on 27 December 2017 (Consumer Detriment 2016) 11, 19, 34, 2.6..
[207] ibid, 1.45. CPP Report 2015 (n2) 26; OFT 1411 (n2) 6.4.
[208] Lorna Waddington, `Vulnerable and Confused: the Protection of "vulnerable" Consumers under EU Law' 2013, 757.
[209] ibid, 758.
[210] According to Morgan, FW, Schuler, DK and Stoltman, JJ, `A Framework for Examining the Legal Status of Vulnerable Consumers' (1995) J Pub Pol&Mktg, 272 (cited in Waddington (n208)).
[211] Steele 2002 (n9). Phillips (n8).

impairment.'[212] In addition to targeting older people, evidence[213] suggests that rogue HRI traders often target other vulnerable groups, including those who are recently bereaved; those with mental health problems or learning difficulties; those who are socially isolated, in poor health or with a physical disability – consumer groups that are arguably in greater need of protection on account of their vulnerabilities.[214]

Even `average consumers', contracting with HRI traders, are often not in a position to judge for themselves the extent of the work needed, the comparative costs of such work, nor the quality of the work undertaken.[215] Similarly, consumers will not recognise the need to protect themselves against unjustified additional charges or unilateral variations of the contract terms, particularly when they rely on assurances given by consumer law advisers that a trader is legally bound by the terms of any quotation given. The unexpected and often audacious nature of consumer exploitation by rogue HRI traders; the inequality of the `average consumer's' bargaining power as compared with that of other creditors such as suppliers; and their lack of private remedy under company law render even reasonably well-informed, observant and circumspect consumers more vulnerable to exploitation than unsecured trade creditors who at least have the opportunity to guard against the risk of losses.[216] The above characterisation of the `average consumer's' vulnerability will therefore serve as the working definition of `vulnerable consumer' in this thesis, although acknowledgement will be given throughout to the aggravating nature of the factors that make a consumer `particularly vulnerable'.[217]

Consumer fear of rogue traders can potentially hinder their proactive management of HRI work, making them less likely to challenge quality issues or compliance with contractual terms until the work is finished, for fear that the trader may abandon the work.[218]

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[212] ibid.
[213] LATSS reports.
[214] Steele 2002 (n9); Phillips (n8)
[215] Steele 2002 (n9) 60. Phillips (n8).
[216] Chapter 3.
[217] 2.2.2 to 2.2.5 re rogue HRI traders generally and 3.8 re rogue HRI directors.
[218] Office of Fair Trading, *Home Repairs and Improvements: A Research Report by TNS-BMRB*, June 2011, 6.35. (HRI Research Report 2011)
<http://webarchive.nationalarchives.gov.uk/20110117190348/http://www. oft. gov.uk/OFTwork/markets-work/othermarketswork/home-repairs/> accessed on 20 November 2017 1.14; CPP Report 2015 (n2) 1.36.

Finally, consumers will invariably be drawn towards smaller traders, including small closely-held companies, to carry out work on their homes as they will possess necessary levels of expertise and experience. Furthermore, the avoidance of 20% VAT payments incentivises many consumers. Research shows that most consumers opt to contract with small businesses having fewer than 10 employees, and 55% of consumers surveyed chose a business with only one employee to carry out their maintenance and repair work.[219] These statistics not only further demonstrate the vulnerability of consumers generally, but also present compelling arguments for the need for greater consumer protection, particularly when dealing with rogue directors of small closely-held companies intent on abusing the corporate form at the expense of consumers.[220] The current economic climate makes the position of consumers more tenuous, resulting in changing priorities for many in favour of cost over quality.[221] Although consumer protection mechanisms are strengthening the position for consumers dealing with sole traders, ordinary and limited partnerships and well-capitalised private limited companies,[222] the problems created by abuse of the corporate form by closely-held companies remain immune to any strengthening of consumer laws. For as long as rogue directors of closely-held companies, whether in their own right or qua shareholders, are permitted to escape any financial liability for their wrongful acts, they will continue to behave in this way. The proper and effective response, therefore, must come from company law.

2.2.3 Consumer Exploitation by Rogue HRI Traders

The exploitation of consumers by traders operating in the HRI market is a growing problem;[223] this therefore indicates that existing models of consumer protection are inadequate. The CAS quarter 1 statistics for 2014/15 show that HRI work is the second most commonly reported problem, representing a 9% increase on the same period in 2012/13.[224] A 2013 BIS report showed that, between 2007 and 2009, over 60% of the

[219] HRI Research Report 2011 (n218).
[220] 2.2 and 2.3.
[221] Citizens Advice Bureau (now CAS), *Desperate Times Desperate Consumers: CAB Evidence on the Consumer Problems Caused or Exacerbated by the Recession*, June 2011 <http://www.citizensadvice.org.uk/desperate_times_desperate_consumers> accessed 27 December 2017.
[222] 2.4.
[223] OFT 1411 (n2) 1.1.
[224] CPP Report 2015 (n2) 1.44.

adult population had experienced a misleading or aggressive commercial practice.[225] In 2012, the OFT reported that complaint levels about rogue traders had `more than tripled'[226] over the years and, between 2009 and September 2010, advice service Consumer Direct (CD)[227] had received over 146,000 complaints from consumers about problems involving HRI projects.[228] Although the CAS received approximately 58,200 complaints during 2014/15,[229] the CPP Report estimates that only 10% of HRI problems are actually reported by consumers; this would indicate over 580,000 HRI problems arose in 2014/15.[230] The main areas of HRI work complained of include building, double-glazing and plumbing and heating work,[231] as well as roofing, tarmacking, and insulation.[232]

During interviews with incarcerated bogus property repairers, Steele asked how they had managed to persuade consumers to use their services. Responses included: '"If you tell them their house is in need of immediate repair or it will immediately deteriorate beyond repair, they're so frightened they'll give you the job in panic'"; "A good way is to quote the price in yardage. That confuses them and you can bump up the charge easily."'[233] When Steele then asked how they got the consumer to hand over money before the work was done, responses included: '"We usually quote work that they cannot check up on"; "Sometimes I just ask for a deposit, or for money to buy materials and then never go back and do the job."'[234]

Misleading and aggressive practices are often used by HRI traders[235] who are often associated with cold-calling at consumers' homes and therefore fall under the head of

[225] Department for Business Innovation and Skills, *Consumer Redress for Misleading and Aggressive Commercial Practices: Final Impact Assessment* (BIS/13/1110, August 2013). <https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/298982/bis-13-1110-consumer-redress-for-misleading-and-aggressive-commercial-practices-impact-assessment-final-1.pdf > accessed on 27 December 2017.
[226] OFT 1411 (n2) 4.20.
[227] CPP Report 2015 (n2).
[228] OFT 1411 (n2) 1.1.
[229] CPP Report 2015 (n2) 1.44. A 9% increase from 2012/13.
[230] ibid, 1.34. 2.2.4 and 2.2.5.
[231] CPP Report 2015 (n2) 1.18. OFT 1300 (n2) 2.3.
[232] CPP Report 2015 (n2) 27.
[233] Steele 2002 (n9) 59-60.
[234] ibid, 60.
[235] CPP Report 2015 (n2) 25.

`cold callers',[236] `doorstep selling',[237] and `doorstep crime'.[238] However, misleading and aggressive commercial practices are not solely the domain of those who cold-call and may just as easily occur with HRI traders whose services are actually solicited by consumers themselves.[239]

2.2.4 Consumer Detriment

Much work has been done by government bodies[240] and consumer organisations[241] to chart the harmful effects caused to consumers by rogue HRI traders.[242] In its 2015 report, the CPP defined 'detriment' as: `A commercial practice or behaviour of a business or trader resulting in harm (loss of welfare) caused to individuals'.[243] Detriment may be felt immediately, such as financial loss, wasted time and effort remedying problems, psychological effects; or may have longer term impacts such as lost confidence in purchasing goods and services and a negative impact on health and wellbeing.[244] The CPP's work is targeted where detriment causes most harm to consumers, and doorstep crime and HRI traders remain a high CPP priority.[245]

Although much focus has been placed on itinerant, unsolicited doorstep traders, Chapter 3 will demonstrate that the impact on consumers exploited by rogue directors of closely-held HRI companies is just as great. This thesis suggests the consumer detriment suffered when rogue traders are involved is altogether more serious because of feelings of being

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[236] Trading Standards Institute, *Door to Door Cold Calling of Property Repairs, Maintenance & Improvements – Long overdue for statutory control*, April 2003 (TSI, Research and Reports) (Door to Door Cold Calling 2003).
[237] Office of Fair Trading, *Doorstep Selling Consumer Education 2012-13 Autumn 2012 activity*, OFT 1456
[238] CPP Report 2015 (n2) 25.
[239] Consumer Focus, *Waiting to be Heard: Giving Consumers the Right of Redress over Unfair Commercial Practices* (August 2009). Department for Business Innovation and Skills, *Misleading and Aggressive Commercial Practices – A New Private Right for Consumers* (BIS/13/1114, 2013) <https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/226642/bis-13-1114-misleading-and-aggressive-commercial-practices_a-new-private-right-for-consumers.pdf > accessed on 27 December 2017 (Waiting to be Heard).
[240] OFT 716 (n2).
[241] CPP Report 2015 (n2); TSI press release, `Operation Rogue Trader 2013, 24 April 2013; Consumer Detriment 2016 (n206).
[242] Trading Standards Institute, *Public Survey – Doorstep Traders/Callers*, February 2003 <http://thecrimepreventionwebsite.com/personal-security/697/no-cold-calling-zones-and-doorstep- selling/> accessed on 27 December 2017.
[243] CPP Report 2015 (n2) 41.
[244] ibid.
[245] ibid.

deceived, tricked and pressured in their own homes. Consumers are often made to feel intimidated by rogue traders if they question either their workmanship or overcharging.[246] As Mark Walker of Nottingham City Trading Standards Service notes: `The effect on the victims is devastating – the financial loss involved is often not the most serious consequence– they are often left so traumatised that they are incapable of continuing to live independent lives. In the worst cases, their lives are cut short as a direct result.'[247]

Negative experiences with rogue HRI traders have reportedly had an adverse long-term impact on consumers' health, wellbeing and relationships,[248] and feelings of vulnerability to repeat exploitation or other crimes[249] which interfere with their normal spending patterns.[250] Consumers reported feeling frustrated,[251] angry,[252] stressed,[253] and worried[254] after encountering problems with the sale and supply of goods and services.

Financially, consumer detriment can sometimes total huge sums.[255] Around £27 billion a year is spent on HRI work.[256] In 2011, the OFT reported the average amount paid to rogue traders was `well over £2,000',[257] and `most of the detriment and distress stems from higher value house and garden repairs where losses can run into thousands.'[258] A 2015 study into consumer detriment[259] estimated that year's gross financial cost to consumers of poor quality goods and services overall was £9.572 billion, of which £8.668 billion related to services alone. This compares to 2014 figures for goods and services of £4.15 billion.[260]

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[246] Oxfordshire County Council's Safer and Stronger Communities Scrutiny Committee, *Annual Report of the Trading Standards Doorstep Crime Team*, 7 November 2011.
[247] Adult Protection News. Issue 12, August 2005, 6-7, produced by the Nottinghamshire Committee for the Protection of Vulnerable Adults.
<https://www.nottinghamshire.gov.uk/EasySiteWeb/GatewayLink.aspx?alId=52361> accessed on 27 December 2017. Consumer Detriment 2016 (n206) 1.4; Steele 2002 (n9) 19; Association of Chief Police Officers Good Practice Guide 'Distraction Burglary and Doorstep Crime' (Home Office Standards Unit) 2004 1; OFT 1300 (n2) 2.5.
[248] Office of Fair Trading, *Home Repairs and Improvements: A Research Report by TNS-BMRB*, June 2011, 6.35. HRI Research Report 2011 (n218); CPP Report 2015 (n2).
[249] HRI Research Report 2011 (n218) 6.35.
[250] Consumer Detriment 2016 (n206) 36; CPP Report 2015 (n2).
[251] 80%. Consumer Detriment 2016 (n206) chart 6.4.
[252] 72%.(ibid).
[253] 56% (ibid).
[254] 47% (ibid).
[255] Adult Protection News (n247) 6-7.
[256] HRI Research Report 2011 (n218) 1.1.
[257] OFT 1300 (n2) 2.2.
[258] ibid.
[259] Consumer Detriment 2016 (n206).
[260] Detriment Survey 2014 (n53) 6.2.

2.2.5 Under-Reporting by Consumers of Problems with Rogue HRI Traders

As posited above, evidence suggests that consumers vulnerable[261] to exploitation are actively targeted by rogue traders.[262] The prevalence of consumers being targeted by rogue traders is all-the-more serious when taking into account the fact that such practices are significantly under-reported;[263] reasons include consumers' failure to recognise themselves as victims; shame at been deceived; fear of repercussions from offenders; fear of loss of independence; perceived futility of reporting; and wanting to forget about the incident.[264]

In both *Ackleton*[265] and *Jones*,[266] the wider detriment suffered by victims was highlighted, and particularly their loss of independence, one of the main reasons for under-reporting.[267] Research also shows that many consumers lack confidence and/or knowledge about how to raise a complaint effectively,[268] and legal action is rarely taken against rogue traders. Statistics reveal that only 3% of micro-businesses reported that unsatisfied customers had initiated legal proceedings,[269] mostly for faulty goods/services and misdescriptions of goods/services.[270] Only 50% of those micro-businesses responding declared having dissatisfied customers, averaging 10.6 a year.[271] 47% of micro-businesses reported 90% of complaints were resolved informally rather than through refunds, replacements or repairs.[272] *Prima facie*, these statistics appear very favourable. However, the limitations presented by largely uncorroborated, imprecise self-reporting must raise questions as to the reliability of these findings. Furthermore, the low proportion of legal proceedings being instituted is not necessarily indicative of complaints being resolved informally, but could instead be on account of consumer apathy, lack of faith/confidence in civil court proceedings and enforcement of orders, or

[261] For example, elderly consumers. Steele 2002 (n9) 49. Phillips (n8).
[262] Steele 2002 (n9) 25, 49, 62; Phillips (n8).
[263] CPP Report 2015 (n2). OFT 1300 (n2) 2.4.
[264] CPP Report 2015 (n2) 1.36.
[265] N1023.
[266] N1002.
[267] Steele (n9); Phillips (n8).
[268] Consumer Detriment 2016 (n206) 1.25.
[269] Department for Business Innovation and Skills, *Consumer Rights and Business Practices*, March 2013, 8.8, Table 6.2.
[270] ibid, 8.10.
[271] ibid, 8.3.
[272] ibid, 8.6.

recognition of the futility of incurring costs suing a financially strained and asset-poor business. In surveying consumers who had experienced an unfair commercial practice,[273] Consumer Focus found that 52% of complaints raised directly with traders remained unresolved, but only about one-quarter of these consumers took any further steps to resolve their problem.[274]

To improve levels of reporting, and disrupt the activities of rogue HRI traders, LATSS worked closely with providers of care and public services for elderly and vulnerable consumers to encourage prompt reporting of incidents. Through establishing meaningful partnerships,[275] and the creation of Rapid Response Units, the Police and LATSS organised joint operations to catch rogue traders `in action' and challenge them for non-provision to the consumer of written cancellation rights and other offences. It is not known how effective these interventions were, other than temporarily protecting some vulnerable consumers and raising awareness of the work of LATSS; given the transient, opportunistic nature of rogue traders, it is likely to have resulted in a mere redistribution of activity rather than a reduction.

2.3 Do Consumers Require Protection from Rogue Traders?

It is clear that rogue traders do exploit consumers with the primary aim of parting them from their money. The HRI market provides a rich environment for this exploitation to occur. In an extensive household survey conducted in 2002,[276] the CTSI gave reasons for why rogue traders specifically use the HRI market to exploit consumers. Reasons given were that HRI services are generally high value, leading to high consumer detriment and high reward for the rogue trader/director; rogue traders are unlikely to be challenged by consumers who often lack sufficient knowledge about HRI work to make judgements about value and price; rogue traders target vulnerable consumers, such as the elderly, who for a range of reasons tend to be more trusting, or gullible, and have difficulty judging current prices and lack easy access to independent guidance; rogue traders will often rely on the fact that consumers are often not able to check what work, if any, is needed and whether it has been carried out properly, or at all; and the complexity of HRI issues often

[273] 2.4.3.
[274] Consumer Focus, *The Extent of Unfair Commercial Practices*, March 2009, 16.
[275] For example, the Greater Nottingham Doorstep Crime Partnership.
[276] Door to Door Cold Calling 2003 (n236).

makes consumers easy to mislead. These reasons directly correlate to the factors affecting consumer vulnerability discussed at 2.2.2.

From Detmer's observations of Sartre's works, consumers would be seen as vulnerable to misleading statements made by rogue traders: `ambiguity and vagueness, when coupled with a skilful appeal to the intended audience's prejudices and interests, can facilitate the successful suggestion of a message that would not be received so uncritically if it were stated clearly.'[277] However, according to Detmer, Sartre would consider that consumers must take some responsibility themselves for behaving in an inauthentic way by *allowing* themselves to be fooled by, or wilfully blind to, such `misleading partial-truths'.[278] It is perhaps this realisation that influences the government's aim to support consumers through education, and the commonplace promotion through consumer advice services of colloquialisms such as `If it sounds too good to be true, it probably is', and their avoidance of paternalistic intervention in anything other than the most deserving circumstances.[279] Recent legislative advancements have been made in this regard through the CPRs 2008,[280] and the Consumer Protection from Unfair Trading (Amendment) Regulations 2014 (CPARs 2014) which will give consumers a private right of redress against rogue traders who use misleading and aggressive commercial practices.[281] Often, however, consumers are loathe to pursue legal action on the basis of the perceived risks, costs and complexity of civil law claims.[282] The Consumer Rights Act 2015 (CRA) may therefore offer a complementary layer of support to consumers, to the extent that enforcers of breaches of consumer law (whether under criminal or civil law action) will be able to move prosecutions to the civil process where appropriate and apply under an amended Part 8 of the EA 2002 for civil remedies to be attached to enforcement orders and undertakings.[283] A 2011/2012 BIS survey asked LATSS what proportion of prosecutions may have been suitable for civil action, and it was calculated that £12m worth of redress could have been recovered for consumers under the proposed new

[277] Detmer (n60) 77.
[278] ibid.
[279] For example, implied terms (CRA 2015).
[280] N23.
[281] CPARs 2014 (n23)
[282] Department for Business Innovation and Skills, *Consumer Rights Bill: Proposals on Enhanced Consumer Measures – Final Impact Assessment* (January 2014) 6, para 5 (CRB Final Impact Assessment).
[283] ibid, 7, para 11.

legislation.[284] Greater levels of compliance are also likely to be achieved,[285] but there is still uncertainty for consumers as much depends on enforcers' willingness to pursue the alternative civil approach where historically sanctions against offending businesses have proved comparatively ineffective.[286]

The statistics given in 2.2.4 do demonstrate that a very real problem does exist in the HRI market and those consumers who are exploited by rogue HRI traders do suffer significant detriment as a result of having been exploited. When one considers the vast majority of incidents remain unreported,[287] the problem is all the more serious. Evidence shows that certain consumers are more vulnerable than others,[288] and therefore more susceptible to repeat exploitation by rogue HRI traders.[289] Despite the assertions from proponents of the law and economics school,[290] it is clear that the market cannot regulate the exploitation of consumers by rogue HRI traders, and even less so their exploitation by rogue directors. Consumers therefore do require protection from rogue HRI traders, and more so when dealing with rogue directors of closely-held companies since their rights to satisfactory legal redress are greatly restricted by company law and the corporate form.[291]

Having established that consumers do need protecting from the exploitation of rogue HRI traders, this Chapter will conclude with a brief examination of current consumer protection measures in the UK, and their adequacy or otherwise in assisting consumers who have been exploited by rogue traders. Chapter 3 will then highlight the ways in which the corporate form creates additional problems when consumers are dealing with directors of closely-held HRI companies, which render these measures less effective in such circumstances.

2.4 Consumer Protection in the UK

Successive governments have sought to redress any imbalance caused to consumers by rogue trading and unfair trading practices through a host of consumer regulation and

[284] ibid, 8, para 16.
[285] ibid, 16, para 56.
[286] ibid, para 55. Strawson (n990).
[287] 2.2.5.
[288] OFT 1300 (n2) 2.2; Steele 2002 (n9) 25 and 35.
[289] Steele 2002 (n9) 5; CPP Report 2015 (n2) 12.
[290] At 1.51-1.5.2; Nn111 and 113.
[291] 3.3 and 3.5.

government initiatives, known as `consumer protection'. Consumer protection is not just a national issue, but is a matter of shared competence and therefore heavily influenced by European Union (EU) law.

Data gathered from governmental and consumer body statistics, reports and empirical studies will be examined in this section to help demonstrate the extent to which the current legal regime adequately and effectively supports legal redress and enforcement action against rogue traders, as well as highlighting any deficiencies. A review of current regulatory measures will be undertaken, as well as any justifications for deregulation. Consumer empowerment is not a new concept, and consideration will be given to the development and impact of consumer empowerment strategies over the last two decades since New Labour first formed a government.

2.4.1 EU Influence on the UK's Consumer Protection Regime

The EU has been a major player in positively influencing the transformation of the UK's consumer protection landscape. EU law is created after being proposed by the European Commission and approved by the EU Council. EU regulations take direct effect in domestic law,[292] whereas EU directives take indirect effect, allowing member states time to alter existing legislation or bring in new law to reflect the directive's requirements. The two main pieces of EU law under discussion are the Unfair Commercial Practices Directive[293] which led to the passing, through delegated legislation,[294] of the CPRs 2008[295] and, following a Law Commission review, the CPARs 2014; and the Consumer Rights Directive[296] which led to `the biggest overhaul of consumer law for many decades'.[297]

2.4.1.1 Unfair Commercial Practices Directive 2005/29/EC (UCPD)

The UCPD was designed to boost consumer confidence and choice, and protect the economic interests of consumers by prohibiting unfair commercial practices by traders

[292] For example, the Sale and Supply of Goods to Consumer Regulations 2002 (SSGCRs 2002).
[293] Directive 2005/29/EC.
[294] European Communities Act 1972.
[295] SI 2008/1277.
[296] 2011/83/EU.
[297] House of Commons Briefing Paper, *Consumer Rights Act 2015* (No CBP6588, 18 May 2017).

before, during and after a business-to-consumer transaction relating to a product.[298] `Product' includes the provision of a service, and any rights and obligations under a services contract.[299] The power to decide whether a commercial practice is unfair or not is left to the member state.[300] However, Annex I provides a black list of those kinds of commercial practices that will always be considered unfair, subject only to modification of the Directive.[301] This list was designed to enable enforcement bodies to take an immediate response to prevent such conduct without the need for consideration on a case-by-case basis. For example, Point No 2 of Annex 1 bans a trader from `displaying a trust mark, quality mark or equivalent without having obtained the necessary authorisation'.

UCPD's provisions cover a wide range of commercial practices and are sufficiently broad to encompass fast-evolving services and sales methods.[302] This therefore should make it difficult for rogue HRI traders to identify and then exploit any loopholes. In the event of any conflict with the provisions of any prior Directive, the provisions of the UCPD will prevail.[303] In recognition of consumer vulnerability and the high cost of consumer detriment, Article 11 specifically requires that enforcement agencies work collaboratively to enforce compliance in the interests of consumers.[304]

In accordance with the provisions of the UCPD, and under the power vested under the enabling European Communities Act 1972, the UK passed the CPRs in 2008, followed six years later by the CPARs in 2014.[305]

2.4.1.2 Consumer Rights Directive 2011/83/EC (CRD)

The CRD is part of an increasing EU trend towards strengthening consumer rights in Member States. It paved the way for a total overhaul of the UK's consumer protection

[298] European Commission Staff Working Document, *Guidance on the implementation/application of Directive 2005/29/EC on Unfair Commercial Practices* SWD(2016) 163 final, Art 3(1). <http://ec.europa.eu/justice/consumer-arketing/files/ucp_guidance_en.pdf> accessed on 9 November 2017 (UCP Guidance).
[299] ibid, Art 2(c).
[300] ibid, 5.
[301] UCPD, Art 5(5).
[302] ibid, 6.
[303] ibid, Art 3(4) and Recital 10.
[304] ibid, 17.
[305] 2.4.3.1 and 2.4.3.2 respectively.

regime, resulting, most significantly, in the passing of the CRA 2015 which replaced eight pieces of outdated legislation. For example, UK consumer legislation such as the Sale of Goods Act 1979 (SGA 1979) had become difficult to discern following various amendments and EU Regulations,[306] and nebulous standards such as `reasonable time'.

The CRD also standardised the many different cooling-off periods at 14 days.[307] It extended provision to include solicited visits.[308] The aim of cooling-off periods is to protect consumers from aggressive commercial practices by rogue traders and the psychological pressure of feeling obliged to contract with the trader before they have an opportunity to obtain certain information and advice on which to base their decision. Cooling-off periods were first introduced by the Molony Committee in 1962 `in response to the many atrocity stories that they heard in relation to doorstep sales',[309] something the Committee went so far as to describe as `a serious social evil'.[310] The Committee saw them as necessary to give the consumer `time for reflection and, if desired, retraction'.[311]

Chapter III, Article 6 CRD requires traders to provide consumers with minimum levels of written information, including a notice of the consumer's right to withdraw from the contract and details of how they can comply and in what time period.[312] The trader must then reimburse all payments received from the consumer, including any costs of delivery, within 14 days from the day on which he is informed of the consumer's decision to withdraw from the contract.[313] A consumer cannot withdraw if work has commenced early at the consumer's express consent provided he knows that starting early means he loses his right to withdraw.[314] or where `the consumer has specifically requested a visit from the trader for the purpose of carrying out urgent repairs or maintenance.'[315]

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[306] SSGCRs 2002 (n292).
[307] CRD, Article 9.
[308] ibid, Article 1. The Cancellation of Contracts made in a Consumer's Home or Place of Work, etc, Regulations 2008 extended cooling-off period to solicited visits
[309] Ian Ramsay, *Consumer Law and Policy, Text and Materials on Regulating Consumer Markets* (Hart, Oxford, 2012) 201.
[310] Final Report of the Committee on Consumer Protection, Cmnd 1781 (1962), 742.
[311] ibid, 520.
[312] CRD, Article 6(1)(h).
[313] ibid, Article 13(1).
[314] ibid, Article 16(a).
[315] ibid, n442, Article 16(h).

Article 22 relates to the imposition by the trader of additional payments over and above the remuneration agreed upon for the trader's main contractual obligation. This could relate to increases in the cost of materials between the date of the quotation and the date of performance. Alternatively, it could relate to the discovery of latent defects which render the work more expensive. This Article could also serve to protect consumers from rogue traders unilaterally varying the terms of the contract by doing (or claiming to have done) additional `necessary' works without giving the consumer the opportunity to verify that the additional work was in fact necessary or that it had in fact been carried out. If a trader fails to give a consumer a notice of their right to cancel the contract, then not only can the trader not enforce their contract against the consumer, but also they are committing a criminal offence.[316] To Ben-Shahar and Posner, cooling-off periods make good economic sense as a consumer is far more likely to buy something that he knows he can return if he does not like or want it.[317] However, others argue that `cooling-off periods should be limited to situations where the consumer's rationality is likely to be undermined, the seller is likely to have superior knowledge about relevant market prices, and the consumer has difficulty in checking out a purchase before buying.'[318] Some maintain cooling-off periods should be limited to high-pressure door-to-door sales, and that other than this consumers, should be entitled to opt out of their right to withdrawal by paying a lower price.[319] However, this right of opt-out would appeal to many consumers not because they will not need a right to withdraw but because they cannot afford to pay for such a right.

[316] ibid, Article 16(h).
[317] Omri Ben-Shahar and Eric Posner, `The Right to Withdraw in Contract Law' (2011) 40 JLS (2011) 115, 121
[318] Ramsay (n309) 209. Pamaria Rekaiti and Roger Van den Bergh, `Cooling-off Periods in the Consumer Laws of the EC Member States: A Comparative Law and Economics Approach' (2000) 23 JCP 371.
[319] Gerhard Wagner, `Mandatory Contract Law: Functions and Principles in Light of the Proposal for a Directive on Consumer Rights', (2011) 3 Erasmus LR 47, cited in Ramsay (n309) 210.

2.4.2 Consumer Protection under Private Law

2.4.2.1 Contract Law

Much consumer law in the UK, such as the CRA 2015, SGA 1979, Supply of Goods and Services Act 1982 (SGSA 1982) and SSGCRs 2002,[320] is or has been founded on contract law principles and therefore any examination of consumer protection must necessarily start with a brief discussion of contract law insofar as it relates to consumers. According to the doctrine of privity of contract, any remedies arising from a breach of a contract for services can only be enforced by one party to the contract against the other.[321] Although the Contracts (Rights of Third Parties) Act 1999 provides for some limited exceptions, a very real problem exists where a rogue trader who is in breach of contract has incorporated his business. In such a situation, it is the company itself consumers must sue for any breach and not the director(s) responsible for having caused the breach.[322]

Damages are available to the consumer as of right for any breach of contract by the trader, and they are designed to put consumers into the position they would have been in had the contract been completed in accordance with the contract terms. They are therefore designed to compensate consumers.[323] However, in line with the injured party's duty to mitigate their losses,[324] it would be usual in the case of unsatisfactory workmanship for the consumer to give the trader an opportunity to correct the deficiencies of the work within a reasonable time and at their own expense. A rogue HRI trader may have little interest in complying with this request, which then leaves the consumer having to sue them for the cost of putting the work right, plus damages to cover any other reasonably foreseeable losses which are directly attributable to the breach of contract. It is also very likely that, having been exploited by a rogue trader, the last thing the consumer wants is for them to come anywhere near their home again. Similarly, if a rogue trader gives an unrealistically and untenably low quotation in order to under-cut competitors and win the contract with the consumer, any eventual unauthorised variation from the price would amount to a breach of contract by the trader.

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[320] 2.4.2.1 and 2.4.2.2.
[321] *Tweddle v Atkinson [1861]* 1 B&S 393; *Dunlop* (n78).
[322] *Salomon* (n28). 3.4.2.
[323] *Addis v Gramaphone Co Ltd* [1909] AC 488.
[324] *Payzu v Saunders* [1919] 2 KB 581.

The common law's *laissez-faire* approach to contracting suggests that consumers must take care of themselves when negotiating contracts for goods and services. As Briggs J noted, `The starting point under English common law in relation to pre-contractual negotiations is *caveat emptor*'[325] which translates as `buyer beware';[326] this means that consumers cannot complain about, for instance, being charged too much under a contract if they have not obtained comparative quotes or otherwise carried out preliminary research to determine a fair price.[327]

2.4.2.2 Consumer Rights Act 2015

As part of the government's current Consumer Law Reform Programme, the CRA 2015 was enacted to clarify and simplify consumer protection legislation and consumer rights of redress. The CRA 2015 addresses four main areas: goods, services, digital content and unfair contract terms.

Prior to the CRA 2015, the SGSA 1982 covered service contracts and goods supplied under them. Part I required that goods must conform to their description,[328] be of satisfactory quality;[329] and fit for any purpose made known to the trader before the contract commences.[330] Remedies included repair and replacement,[331] a price reduction for goods, or rescission of the contract.[332] Part II implied three main terms into consumer contracts: services must be performed with reasonable care and skill;[333] within a reasonable time if time was not contracted for;[334] and at a reasonable price if price was not agreed.[335] The SGSA 1982 would therefore have applied to many rogue trading situations where overcharging, long delays and substandard workmanship were at issue.[336]

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[325] *OFT v Purely Creative Industries & Others* [2011] EWHC 106 (Ch), 73.
[326] *Ward v Hobbs* [1878] 4 App Cas 13.
[327] SGSA 1982 s15 (2.4.2.1).
[328] SGSA 1982, s3(2).
[329] ibid, s4(2).
[330] ibid, s4(4).
[331] ibid 1982 (as amended by the SSGCRs 2002), s11N.
[332] ibid, s11P.
[333] SGSA 1982, s13(1).
[334] ibid, s14(1).
[335] ibid, s15(1) and (2).
[336] 4.2.1.1.

Ordinary contract law remedies were available for breach of contract, namely damages[337] in respect of any minor breach, and the right to repudiate the contract and claim damages for any major breach. The normal duty to mitigate losses[338] would be excused in cases where the consumer had been exploited by the rogue HRI trader since it would be unrealistic for the court to expect a consumer to invite the rogue trader back to their home to put right, or complete, the contract according to the terms agreed.

One of the major difficulties with the SGSA 1982 was that the onus was on consumers to prove, on the balance of probabilities, that the trader had breached the implied terms. This would often mean having to call in specialists to give an expert opinion on the quality and value of the workmanship and goods supplied under the contract. The costs of doing this would be recoverable from the trader as consequential losses flowing from the breach, but many consumers would fear that they might lose even more money if the specialist does not decide in their favour, and the long-drawn-out procedures involved simply served as another barrier to an already fraught situation. The SSGCRs 2002[339] improved the situation for consumers considerably by reversing the proof burden during the first six months after taking delivery of the goods. However, these regulations related solely to goods and not to services and therefore did not go far enough in assisting consumers with rogue HRI traders.

The CRA 2015, Part I covers consumer contracts for both goods and services. Most of the provisions relating to the sale and supply of goods consolidate existing legislation and therefore the same statutory implied terms relating to satisfactory quality,[340] conformity to description,[341] and fitness for purpose made known to trader[342] are reflected in the CRA 2015.

Chapter 2 – Contracts Under Which Goods are Supplied

Section 12 of the CRA 2015 states that, in relation to the supply of goods only,[343] any pre-contract information to be supplied under the CCRs 2013,[344] regs9, 10 or 13 is to be

[337] 2.4.2.1.
[338] N324.
[339] N292, S11M(3).
[340] CRA 2015, s9.
[341] ibid, s11.
[342] ibid, x10.
[343] ibid, s12(1).
[344] 2.4.3.3.

regarded as a term of the contract.[345] Therefore, breach of the CCRs 2013 give rise to civil as well as criminal liability.

Section 15 covers HRI service contracts in which goods are to be installed, but are installed incorrectly – poor workmanship. The service will not conform to the contract, giving rise to a remedy under s19.[346] Consumer remedies available under s19 for non-conformity of goods to the contract,[347] or its terms,[348] include the short-term right to reject;[349] the right to a repair or replacement,[350] or the right to a price reduction or final right to reject.[351] Consumers are also entitled to claim damages under common law.[352] These remedies are in sequential order. The short-term right to reject must be exercised within 30 days of ownership/possession passing;[353] or delivery;[354] and the trader having notified the consumer that the goods have been installed and are ready for use.[355] The trader bears the return costs.[356] Under the SGA 1979 and SSGCRs 2002, the right to reject was lost once the goods had been legally `accepted', which could occur `after the lapse of a reasonable time'.[357] This nebulous wording was determined by the courts on a case by case basis. To this extent, a 30-day period in which to reject is much clearer and definitive for consumers whose rights are breached under ss9, 10 or 11, for example.

However, this remedy is of limited use when goods are installed as part of an HRI service contract, as it is not always possible for the consumer to return the goods in their original state, in which case the consumer is unable to claim the refund[358] that they would otherwise be entitled to under s20(7)(a). In such circumstances, or if the 30-day period has lapsed, they could claim a repair or replacement under s23, although it is unlikely an exploited consumer would want any further dealings with the rogue trader. Repair or replacement must be carried out by the trader `within a reasonable time and without

[345] CRA 2015, s12(2).
[346] Though not the short-term right to reject.
[347] For example, s15 (subject to n382).
[348] For example, ss9, 10 and 11.
[349] CRA 2015, ss19(3)(a) and 20.
[350] ibid, ss19(3)(b) and 23.
[351] ibid, ss19(3)(b) and 24.
[352] ibid, s19(11).
[353] ibid, s22(3)(a).
[354] ibid, s22(3)(b).
[355] ibid, s22(3)(c).
[356] ibid, s20(7)(b).
[357] SGA 1979 (as amended), s35(4).
[358] ibid, s22(18)(b).

significant inconvenience to the consumer',[359] and the trader must bear any necessary costs in doing so.[360] Even if the fault is not discovered within 30 days, then as long as it is discovered within the first six months after taking delivery/installation of the goods, then the law presumes the fault was there at the time of contracting and the onus is on the trader to prove otherwise.

Any failure in carrying out a satisfactory repair or replacement will mean the consumer can reject the goods for a full refund or, if they want to retain the goods, they may wish to claim a partial refund instead.[361] Where the consumer has had the goods longer than six months at the time of claiming a full refund, the trader will be entitled to make a reasonable reduction to take account of the use the consumer has had use of the goods.[362] As with the SGA 1979,[363] once the six-month period has elapsed, the onus of proof shifts to the consumer.

Chapter 4 – Service Contracts

CRA 2015 Chapter 4 provisions of ss49, 51 and 52, reflect the statutory implied terms of the SGSA 1982, and s50 is the service contract equivalent of CRA 2015, s12.

The remedies for breach are repeat performance for substandard workmanship under s55,[364] or the right to a price reduction under s56[365] for delays in performance or overcharging. This latter remedy would presumably be available where the rogue HRI trader has charged for work not performed. Any repeat performance must be carried out within a reasonable time, without inconvenience to the consumer, and at the trader's expense.[366] Any partial reduction may, where appropriate, amount to the full contract price.[367]

[359] ibid, s23(2)(a).
[360] ibid, s23(2)(b).
[361] ibid, s24(5).
[362] ibid, s24(8).
[363] Amended by the SSGCRs 2002.
[364] CRA 2015, s54(2)(a).
[365] ibid, s54(2)(b).
[366] ibid, s55(2)(a) and (b).
[367] ibid, s56(2).

The reverse proof burden only applies to Chapter 2.[368] It is surprising that Parliament did not see fit to introduce the same reverse proof burden in respect of service contracts. Therefore, in any contested claims, the consumer will have to pay up-front for an expert to give an opinion on the quality and value of workmanship – a further deterrent to consumers pursuing court action.

Whilst the provisions of the CRA 2015 do seem to provide adequate remedies for most cases where the performance of a HRI contract has fallen below reasonably expected standards, they do not appear to adequately reflect the situations which arise in contracts between consumers and rogue HRI traders. At 4.2.1, it can be seen that rogue HRI traders behave unscrupulously, exploitatively and are intent on parting consumers from their money. Such traders will not be interested in repeating their performance to a standard that conforms with the contract and its terms. They are also going to resist any requests for partial refunds, forcing the consumer to have to initiate proceedings in the civil courts which, as we have seen, many consumers are unwilling to do. Similarly, consumers who realise they have been exploited are unlikely to want to invite the very trader who has cheated them back into their home to repeat the performance of the contract, something a strict reading of s56(3) requires before the consumer can request a price reduction. Consumers do still retain their normal common law and equitable contract law remedies[369] and can therefore claim damages to compensate them to the full extent of any losses they have sustained, including the cost of getting another trader to perform the contract. However, it is difficult to see how consumers exploited by rogue HRI traders are assisted to any great extent by the CRA 2015. Those consumers who do pursue rogue HRI traders through the civil courts are able to claim against the rogue *trader* personally if they are able to locate them but, as has been demonstrated in the first two chapters of this thesis, rogue HRI traders are notoriously elusive and well-practised in evading identification.

Part 2 – Unfair Terms

The UK has had to legislate against abuses of the concept of freedom of contract to protect the weaker party in the contract. Therefore, in business-to-consumer contracts, consumers

[368] Reflecting the SSGCRs 2002.
[369] CRA 2015, s54(6) and (7).

have enjoyed the safeguards offered by the Unfair Contract Terms Act 1977 (UCTA) and the Unfair Terms in Consumer Contracts Regulations 1999 (UTCCRs).[370] Now the CRA 2015 has replaced these.

Section 62 states that any consumer contract unfair term will not be binding on the consumer, and an unfair term is one which `causes a significant imbalance in the parties' rights and obligations under the contract to the detriment of the consumer'.[371] The CRA 2015 fairness rules apply to both standard-term contracts and individually negotiated contracts. Part 1 of Schedule 2 lists those terms which are likely to be regarded as unfair. These include any term purporting to: exclude or limit a trader's liability for the death or personal injury of a consumer resulting from an act or omission of the trader;[372] exclude or limit the legal rights of consumers concerning the total, partial or inadequate performance by the trader of any of his contractual obligations; enable the trader to alter the contract terms unilaterally without a valid reason for doing so set out in the contract; enables the trader to alter unilaterally without a valid reason any characteristics of the goods or services to be provided; and gives the trader the discretion to decide the price payable under the contract after the consumer has become bound by it, where no price or method of determining the price is agreed when the consumer becomes bound.[373] Therefore many of the unscrupulous practices of rogue HRI traders involving overcharging, and unilaterally varying contracts by doing or claiming to have done unauthorised additional work are likely to be regarded as unfair and therefore not binding on consumers.

Whilst these provisions might assist a litigating consumer, more needs to be done to educate consumers about their rights so that they can avoid or minimise the effects of any exploitation by rogue HRI traders. For example, if consumers were confident that what the rogue HRI trader was doing was unlawful, they might avoid paying over the full amount requested by the trader. However, even if this were so, rogue HRI traders are skilled in deception and could easily convince many consumers of credible reasons why their conduct does not fall foul of CRA 2015 provisions.

[370] Implementing the Unfair Terms Directive (1993/13/EC).
[371] CRA 2015, s62(4).
[372] ibid, Note s65(1).
[373] Paras 1, 2, 5, 11, 13 and 14 respectively.

2.4.3 Consumer Protection under Public Law

2.4.3.1 **Consumer Protection from Unfair Trading Regulations 2008 (CPRs 2008)**[374]

Under pre-existing laws, misleading and aggressive commercial practices would fall to be dealt with under contract law for misrepresentation, duress and undue influence, and under the tort of harassment. Private rights of action for consumers in respect of these unfair trading practices, particularly action for misrepresentation, were `fragmented, complex and unclear'.[375] This was found to be deterring consumers from seekingredress for their losses resulting from misleading and aggressive practices.[376] In 2009, research commissioned by Consumer Focus reported that within the previous two years almost two-thirds of the population had been a victim of a misleading or aggressive practice, resulting in an estimated consumer detriment of £3.3 billion a year.[377]

The CPRs 2008, which implemented the UCPD, criminalised misleading and aggressive commercial practices by traders.[378] This reflects the increasing tendency to see rogue trading as more a form of criminal activity than an infringement of civil law.[379] The exploitation of consumers by rogue traders has increasingly over the years come to be seen as a form of criminal activity.[380]

The CPRs 2008 aim to prevent traders from `distorting the market through misleading actions, misleading omissions, aggressive practices and some other unfair behaviour.'[381] They prohibit traders from employing unfair commercial practices with their consumers.[382] They are not designed to penalise legitimate traders. However, any trader who misleads, behaves aggressively, or otherwise acts unfairly towards consumers will be in breach of the CPRs 2008 and may face civil or criminal enforcement action.[383] A

[374] SI 2008/1277.
[375] Law Com Cm 8323 2012 (n14) S12.
[376] Consumer Law Reform (n63) 10.
[377] ibid, 4. OFT, *Evaluating the Impact of the 2004 OFT Market Study into Doorstep Selling* (2012) 3.19, 6.2.
[378] Regs 2(1) and 13.
[379] OFT 1300 (n2) 2.2; CPRs 2008; CCRs 2013 (n4); Crimestoppers, *Beating Doorstep Crime* (20 March 2015). < https://crimestoppers-uk.org/in-your-area/scotland/beating-doorstep -crime/> accessed on 27 December 2017.
[380] OFT 1300 (n2) 2.2; Crimestoppers (n379).
[381] Law Com Impact Ass (n39) 5, 1.4.
[382] CPRs 2008 (n23) reg3(1).
[383] OFT's Guidance on the CPRs 2008, BERR, para 2.5; CPRs 2008, paras 3(3) & (4)).

commercial practice is misleading where it contains false information, is untruthful, deceives or is likely to deceive the average consumer,[384] and causes or is likely to cause the average consumer to take a transactional decision he would not have taken otherwise.[385] Transactional decisions include pre-purchase as well as post-purchase decisions.[386] This could therefore cover a situation where a rogue HRI trader gives an unrealistically low quotation as a means of defeating competition, with the aim of charging more once he is awarded the contract. Ramsay describes such conduct as `unfair competition' since it also harms competitors as well as consumers.[387] The CPRs 2008 do not apply if the unfair commercial practice only affects another legitimate trader's economic interest; the economic interest of a consumer must be affected if its provisions are to apply.[388] However, the UCPD does permit Member States to have the dual aim of protecting consumers' and competitors' economic interests.

References in the CPRs 2008, reg5(4)(i) to a consumer being misled by the trader as to `the need for a service, part, replacement or repair' could cover the kind of exploitation described under 2.2 above where the rogue HRI trader carries out unnecessary or bogus work. Further conduct that may amount to a misleading practice might include

> false claims made by traders, for example that they are members of well respected and trusted trade associations when they are not, misleading product descriptions or being deliberately vague about the actual price of a product and hiding additional costs and charges from the consumers.[389]

An aggressive practice covers `any behaviour that significantly impairs the average consumer's freedom of choice.'[390] A commercial practice would be deemed aggressive where the consumer is exposed to harassment, coercion or undue influence by the trader, or such conduct as is likely to impair the average consumer's ability to exercise their freedom of choice.[391] Undue influence is defined under the CPRs 2008 as a trader `exploiting a position of power in relation to the consumer so as to apply pressure … in

[384] CPRs 2008 (n23) reg5(2)(a)).
[385] ibid, reg5(2)(b). This appears to be a simplified restatement of the law relating to misrepresentation. Note reg77(1)(b) also makes the same provision relating to aggressive practices.
[386] ibid, reg2(1); UCPD art 3(1).
[387] Ramsay (n309) 152.
[388] UCP Guidance (n298) Recital 6 and 10.
[389] Waiting to be Heard (n239) 3.
[390] *R v Waters and Westminster Recliners Limited* [2016] EWCA Crim 1112.
[391] CPRs 2008, reg7(1)(a).

a way which significantly limits the consumer's ability to make an informed decision.'[392] This could be taken to cover those situations where a rogue HRI trader might create a sense of false urgency for the need for certain works to be carried out under the threat that the damage will be far more extensive if work is not carried out immediately.[393] This interference with the consumer's free will appears to support the view held in this thesis of the consumer as a form of involuntary creditor. An aggressive practice could also arise where consumers are harassed for payment of excessive charges, either by phone or by visits to their property. It could also cover situations where traders drive the consumers to their bank to withdraw cash, or enter them into unwanted credit arrangements.[394]

To be found guilty of an offence, the trader must knowingly or recklessly engage in such prohibited act(s),[395] and his conduct materially distorts of is likely to materially distort the economic behaviour of the average consumer.[396] The CPRs 2008 only allow enforcement bodies to take action against rogue traders who employ misleading and aggressive commercial practices against consumers, and any financial penalties imposed have been paid into the public purse rather than compensating consumers for their losses. The due diligence defence is designed to protect honest traders.[397]

Although the CPRs 2008 provided a much-needed means for tackling the kind of conduct that was typical of rogue HRI traders, they provided only for public enforcement rather than any private rights of redress. Any remedies were restricted to civil enforcement by LATSS under Part 8 of the EA, the OFT, or through criminal proceedings. Therefore, in order to start civil proceedings to obtain compensation or other remedies, consumers had no option but to rely on private law doctrines such as the law of misrepresentation and duress. As the Law Commission reported in 2012, `Under the existing laws that govern misleading and aggressive practices it is difficult, if not impossible, for consumers to get their money back.'[398] Despite having the power to enforce the law, and despite the

[392] ibid, reg7(3)(b).
[393] For examples, Steele 2002 (n9) 57-58, 59.
[394] 4.2.1.
[395] CPRs 2008, reg8(1)(a).
[396] ibid, reg8(1)(b).
[397] CPRs 2008, s17.
[398] Law Commission Online Summary, *Consumer Redress* <https://www.lawcom.gov.uk/project/consumer-redress-for-misleading-and-aggressive-practices/> accessed on 27 December 2017.

frequency of breaches of the CPRs 2008 and high levels of consumer detriment, very few prosecutions were brought against traders under the CPRs 2008 by LATSS.[399]

In research it commissioned in 2009, Consumer Focus called for a private right of redress for all consumers suffering loss resulting from breach of the CPRs 2008.[400] They believed enforcement would become more effective `if public authorities and consumers "worked in tandem", using both private and public enforcement sanctions'.[401] This research document was cited by the Law Commission in its recommendations for further reform of the law relating to misleading and aggressive practices. In its 2013 report,[402] the Government accepted all the key recommendations of the Law Commissions' Report:[403] private rights of redress for consumers who have been victims of a misleading and aggressive practice; standard remedies such as the right to unwind the contract and claim a full refund,[404] or the right to have the purchase price discounted; and the right to claim damages where the misleading or aggressive practice caused them further losses or distress or inconvenience. The Government's impact assessment report[405] estimates that these measures would deter these unfair practices and increase compensation to consumers of between £2 and £5 million each year. Or at least this would be the potential compensation if all computers suffering as a result of a misleading or aggressive practice exercised their right to a remedy and the traders against whom they claimed were traceable and solvent. As this thesis has demonstrated, all-too-often consumers are reluctant to exercise their rights.

2.4.3.2 Consumer Protection from Unfair Trading (Amendment) Regulations 2014 (CPARs 2014)

The provisions of the CPARs 2014[406] add an extra layer of consumer protection to the CPRs 2008. They not only give consumers wider rights of action against rogue HRI

[399] Law Com Cm 8323 2012 (n14) S4. 2.4.4.
[400] ibid. Waiting to be Heard (n239).
[401] ibid, S4.
[402] Consumer Law Reform (n63).
[403] Law Com Cm 8323 2012 (n14).
[404] CPARs 2014 (n23) reg27F(3).
[405] Department for Business Innovation and Skills, *Empowering and Protecting Consumers. Consumer Landscape Review: Impact assessments on Enforcement, Advocacy and Information, Advice and Education* (April 2012) (CPARs Impact Assessment).
[406] Department for Business Innovation and Skills, `The Consumer Protection from Unfair Trading (Amendment) Regulations 2013: Draft Regulations', August 2013

traders, and a longer period in which to cancel the contract and claim a full refund,[407] but they also permit non-financial consumer detriment such as distress and inconvenience to form part of a consumer's damages claim.[408] However, the Law Commissions' 2012 report[409] suggests the statutory statement of such a right is unlikely to add anything more to the position currently existing under common law since consumers will have to satisfy the court `that an important object of the contract was to give pleasure, relaxation or peace of mind, or that the practice caused them alarm, distress, physical inconvenience or discomfort.[410]

By providing consumers with limited private rights of redress for misleading or aggressive commercial practices, the government will ensure that only non-compliant traders are targeted by consumers, without encouraging unmeritorious claims for minor issues.[411] The most significant right of redress available to consumers is the right to `unwind' the contract,[412] whereby the consumer would be reinstated to their pre-contractual position, and the right to claim a refund,[413] and damages for any consequential losses the consumer has suffered as well as a right to claim for any distress or inconvenience suffered.[414] If the consumer does not choose to unwind the contract, they have a right to claim a discount instead.[415] The courts apply the `average consumer' test[416] whereby the consumer would have to satisfy the court that `i. The trader carried out a misleading or aggressive practice; ii. This practice would be likely to cause the average consumer to enter the contract or make the payment; and iii. It was a significant factor in this consumer's decision to enter the contract or make the payment.'[417] It is unclear

<https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/226640/bis-13-1112-the-consumer-protection-from-unfair-trading-amendment-regulations-2013-draft-regulations.pdf> accessed on 16 November 2017; Department for Business, Innovation and Skills, *Misleading and Aggressive Commercial Practices – A New Private Right for Consumers* (BIS/13/1114 2014); CPARs 2014 (n23).

[407] 90 days as compared to 30 days in the CRA.

[408] Generally under contract law the courts have not been willing to award damages for distress and inconvenience unless the contract was, say, for the avoidance of distress, as in *Heywood v Wellers (A Firm)* [1976] QB 446. Most damages have been recovered where there has been a loss of enjoyment in package holiday cases, as in *Jarvis v Swan Tours Ltd* [1973] QB 233.

[409] Consumer Detriment 2016 (n206) 8.149 to 8.163.

[410] ibid, 8.163, recommendation 43.

[411] Consumers retained the right to sue under contract law for any breach of contract, subject to the rules on privity.

[412] CPARs 2014, (n23) reg27F.

[413] ibid, reg27F(3).

[414] ibid, reg27J.

[415] ibid, reg27I.

[416] Waiting to be Heard (n239) 18. CPRs 2008 (n23) reg2(2). 2.1.

[417] Law Com Impact Ass (n39) para 52.

whether `mere puffs', in the form of exaggerated claims made to excite interest which the courts regard as mere expressions of opinion and therefore not intended to form the basis of a contract,[418] will survive the government's latest consumer protection reforms `mainly because consumer protection laws recognise the need to cleanse the market ofunreliable information which not only causes detriment to consumers but distorts the market.',[419]and any award of damages would be `restrained and modest'.[420]

The CPRs 2008, and CPARs 2014, go a long way towards tackling unscrupulous conduct of directors of the type described at 2.4 above, and even impose a positive duty on enforcement authorities to enforce the Regulations.[421]

The CPARs 2014 aim to simplify the range of consumer protection remedies available, but still rely on consumers having entered a contract with the trader, and having paid for `products'.[422] It is to be understood from this that the doctrine of privity of contract will therefore prevail which, although not creating a problem for consumers suing unincorporated rogue traders, presents a significant problem for consumers wishing to sue a misfeasant director whose actions have caused them to sustain losses.[423]

2.4.3.3 The Consumer Contracts (Information, Cancellation and Additional Charges) Regulations 2013 SI 2013/3134 (CCRs 2013)

These Regulations apply, *inter alia*, to on-premises, off-premises,[424] and distance[425] selling HRI contracts.[426] Generally, any HRI contracts concluded at consumers' homes would be off-premises contracts. The Regulations focus on the type of information that

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[418] *Weeks v Tybald* [1605] Noy 11.
[419] Waiting to be Heard (n239) 18.
[420] ibid, 8.162.
[421] ibid, reg19(1); UCPD, art 11, 17 (n327). Enforcement of the Regulations had been found to be lacking (UCPD, 50).
[422] Including a service (CPARs 2014 (n23) reg2(6)(b)).
[423] Chapter 3.
[424] Away from trader's premises but with simultaneous physical presence of consumer and trader (CCRs 2013, reg5).
[425] ibid but no simultaneous physical presence.
[426] CCRs 2013, reg7.

must be provided to consumers prior to the conclusion of a contract in order*, inter alia*, to help consumers to resolve an issue when things go wrong; and also on giving consumers a cooling-off period to ensure they do not feel pressurised to enter a contract and to enable them to ensure they have entered a good bargain. The cooling-off period is 14 calendar days.[427] Regulation 36 states that the trader must not commence with the supply of a service until any cancellation period has ended, unless he does so at the express request of the consumer,[428] such request being made `on a durable medium' in off-premises contracts.[429] If the consumer then wishes to exercise their right to cancel, then they would be required to pay a reasonable amount for the work done so far by the trader.[430]

Schedule 1 sets out the information that must be given or made available by a trader to a consumer before the consumer is bound by a contract that is made at the trader's premises.[431] This includes the main characteristics of the services and any goods supplied thereunder;[432] the name, address and telephone number of the trader;[433] the total price inclusive of taxes;[434] any additional delivery charges;[435] and arrangements for payment, delivery, and performance.[436] Schedule 2 sets out the information required for distance and off-premises contracts.[437] This information broadly mirrors that required under Schedule 1 but requires a lot more information to be provided, including an email address for the trader, and the geographical address of the trader; and if the trader is acting on behalf of another trader, then the geographical address and identity of that trader so that the consumer can address complaints to the correct person. The trader must also provide the consumer with the cost of using distance communication to make the contract if it is more than the basic rate.[438] Where the consumer has cancellation rights, then the trader must provide information as to the conditions, time limit and procedures for exercising

[427] Department for Business Innovation and Skills, *Consumer Contracts (Information, Cancellation and Additional Charges) Regulations: Implementing Guidance* (BIS/13/1368, December 2013).
[428] CCRs 2013, reg36(1)(a).
[429] ibid, reg36(1)(b).
[430] ibid, Schedule 2, reg10(1)(n).
[431] ibid, reg9(1).
[432] ibid, reg9(1)(a).
[433] ibid, reg9(1)(b).
[434] ibid, reg9(1)(c).
[435] ibid, reg9(1)(d).
[436] ibid, reg9(1)(e).
[437] ibid, regs10(1) and 13(1).
[438] ibid, para (i).

that right;[439] and whether the consumer must bear the cost of returning goods already supplied on cancellation.[440] The consumer must also be made aware of when there is no right to cancel, or of the circumstances in which he may lose any right to cancel.[441]

Other than during any proceedings for breach of the CCRs provisions, the burden of proof is on the trader to show that he has complied with the Regulations where this is disputed.[442] Failure to provide the consumer with information required in Schedule 2 paragraph (l),(m) or (n) during an off-premises contract amounts to a criminal offence.[443]

Many LATSS[444] operate Rapid Response Teams which have been set up to tackle rogue HRI traders whilst they are still at consumers' homes to detect infringements of consumer law and disrupt their activities.[445]

2.4.4 Enforcement

There are three national consumer protection organisations, the CTSI, the CAS[446] and the Competition and Markets Authority (CMA). The CTSI develops intelligence-led working and supports LATSS.[447] Its specialist teams tackle national and regional issues and in April 2014 these collectively prevented around £345 million worth of consumer detriment, at a cost-benefit ratio of 12:6.[448] The biggest barrier to the success of CTSI projects is the short-term nature of funding, which makes longer-term planning and complex prosecutions difficult, and the inadequacy of funding:

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[439] ibid, para (l). Schedule 3.
[440] ibid, para (m).
[441] ibid, para (o)
[442] ibid, regs17(1) and (2).
[443] ibid, reg19.
[444] For example, Coventry City Council and Cardiff City Council <http://www.coventry.gov.uk/info/30/trading_standards/325/rogue_traders_and_doorstep_crime/4> <http://www.walesonline.co.uk/news/local-news/cardiff-launches-rapid-response-unit-2028329> accessed on 27 December 2017.
[445] For example, under CCRs 2013 (n4).
[446] Discussed at 2.4.6.3.
[447] Report of the National Audit Office requested by the House of Commons, *Protecting consumers – the system for enforcing consumer law*, HC 1087, 15 June 2011 (Enforcing Consumer Law). <https://www.nao.org.uk/wp-content/uploads/2011/06/10121087es.pdf> accessed on 29 December 2017.
[448] Report of the National Audit Office requested by the House of Commons, *Protecting consumers from scams, unfair trading and unsafe goods*, HC 851, 11 December 2016. <https://www.nao.org.uk/wp-content/uploads/2016/12/Protecting-consumers-from-scams-unfair-trading-and-unsafe-goods.pdf> (Protecting Consumers from Scams).

> National Trading Standards does not have sufficient money to address all the detriment it has identified. The organisation ran out of money about two-thirds of the way through the 2015-16 financial year, and could not undertake any enforcement cases after this period.[449]

The CMA has a statutory duty to `promote competition for the benefit of consumers …It seeks to maximise efficiency by intervening early … by changing trader behaviour where it identifies emerging unfair commercial practices.'[450] The civil fining powers it enjoys in relation to anti-competitive practices do not extend to breaches of consumer law.[451] The CMA estimates that, between April 2013 and March 2016, `its consumer enforcement work generated direct financial benefits to consumers of at least £222.3 million, or £74.1 million annually at a cost of £6 million.'[452]

2.4.4.1 Under Private Law

Despite having direct rights of redress, private civil litigation rates by consumers against rogue HRI traders remain low.[453] This is because consumers face many problems with enforcing their rights under private law. Civil court proceedings can be costly, complex, protracted and stressful, and consumers may also have difficulty in gathering sufficient evidence to substantiate their claims. Not only may the costs of litigation be prohibitively expensive, particularly in high value contested claims which may fall to be heard in the High Court rather than the less expensive County Court, but consumers need to weigh up the likelihood of any judgment in their favour ever being settled by the rogue trader. Even though the rogue trader's personal assets can be seized in settlement of their business debts, they may not be solvent or they may not actually own any assets.

Government statistics support the contention here that damages orders in favour of consumers are often not settled by traders. For example, an HMCTS analysis of financial impositions (fines and penalties) and amounts paid during 2011 and 2012 showed that an

[449] ibid, 3.19.
[450] ibid, 3.20.
[451] BEIS currently reviewing.
[452] Competition and Markets Authority, *CMA impact assessment 2015/16* (CMA15, 14 July 2016) 3.8. <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/537539/cma-impact-assessment-2015-16.pdf> accessed 17 December 2017 (CMA Impact Assessment).
[453] Nn273 and 274.

average of 50% of financial impositions remained unpaid 12 months after the imposition month; this is despite the HMCTS itself seeking to enforce these debts.[454]

Against this backdrop, it is to be expected that consumers acting on their own behalf are going to be more easily deterred from pursuing any form of enforcement order, particularly as the costs of enforcement will add to the already mounting debt. If a consumer wins a case and is awarded damages, there is no-one who will enforce the judgment on their behalf; it is for them to apply to the court for further order.[455] Therefore, whilst the enforcement of their debts against rogue traders might have some deterrent value, the potential gains from exploiting consumers means that many rogue HRI traders may be prepared to risk being sued by consumers since evidence suggests that very few cases make it to court,[456] and even fewer consumers pursue enforcement orders. The CAS reports that consumers aged 75 and over are twice as likely to fail to seek redress on the basis that they felt they would not succeed.[457]

2.4.4.2 Under Public Law

Since 2014, Trading Standards has been the main enforcement body for breaches of the CPRs 2008, CPARs 2014 and CCRs. Prior to this, the OFT also had wide powers to enforce consumer law, although in practice they dealt mainly with large national and `ground-breaking cases'.[458] There are a range of instruments at Trading Standards' disposal for enforcement purposes, `from administrative action (informal and formal warnings) to civil proceedings (injunctions and enforcement orders) and … criminal prosecutions.'[459] In 1998, the government issued some guidelines in the form of an Enforcement Concordat[460] which, though having no legal force, was followed by all enforcement authorities. This code of practice[461] established principles of good enforcement and recognised that, although regulation is necessary, it should not become

[454] HMCTS Management Information: *Number of enforcement accounts opened and closed, quarterly 2011 Q2 - 2012 Q4* tables 1.6 and 1.8.
[455] ibid.
[456] Consumer Detriment 2016 (n206) 6.1.
[457] ibid.
[458] CPARs Impact Assessment (n405).
[459] Directorate for Science, Technology, and Industry Committee on Consumer Policy, *Best Practices for Consumer Policy: Report on the Effectiveness of Enforcement Regimes* (2006) para 137, 39.
[460] Department of Trade and Industry, *Enforcement Concordat: Good Practice Guide for England and Wales,* 1998. DSTIC, n88, para 136, 65.
[461] Legislative and Regulatory Reform Act 2006.

unduly burdensome on businesses.[462] Today LATSS publish their own Enforcement Policies on their websites.[463]

Prosecutions are regarded as a last resort however,[464] as are sanctions to correct a breach of consumer protection legislation; the favoured approach is to first exhaust compliance measures through persuasion and warning letters, undertakings, etc.[465] This makes sense given the immense budgetary pressure placed on public services and the fact that investigation, detection and prosecution of rogue HRI traders takes up such a large part of LATSS' annual budget.

The government acknowledged in 2012 the importance of sustaining minimum levels of enforcement action throughout the entire UK to maintain a credible impact overall and to avoid rogue traders targeting consumers in areas where enforcement is weaker.[466] However, resources for enforcement action are very limited, and the government is concerned that small LATSS struggle to meet their statutory obligations, `let alone other useful services such as second-tier advice, support for compliance, consumer education or enforcement work in bigger, resource-intensive cases. This creates the potential for an 'enforcement gap'. Resources for each LATSS varies greatly `from £240,000 to over £6 million annually.'[467] Since 2011, budgets have reduced by 46%, and the number of Trading Standards Officers (TSOs) have reduced by 56% since 2009.[468] There is one Trading Standards officer for every 36,000 people in the West Midlands, but only one for every 70,000 people in London.'[469] One of the problems with rogue HRI traders is that they will exploit consumers across different geographical areas and this means that one LATSS could have to expend local funds investigating an offence that has occurred within a different local authority's boundaries. With such limits placed on public

[462] Ramsay, (n309) 239. See also HM Government's Better Regulation Executive, *Reducing Regulation Made Simple: Less regulation, better regulation, and regulation as a last resort* (December 2010) (Reducing Regulation).
[463] For example, Nottinghamshire County Council. <http://www.nottinghamshire.gov.uk/media/106070/enforcementpolicy.pdf> accessed on 18 November 2017.
[464] Nottinghamshire County Council's online Prosecution Policy <http://www.nottinghamshire.gov.uk/media/106071/prosecutionpolicy.pdf> accessed on 28 December 2017.
[465] Ramsay (n309) 219 citing Ian Ayres and John Braithwaite, *Responsive Regulation: Transcending the Deregulation Debate* (OUP 1992); CPARs Impact Assessment (n405).
[466] CPARs Impact Assessment (n405).
[467] ibid, paras 25, 27.
[468] ibid. Enforcing Consumer Law (n447).
[469] CPARs Impact Assessment (n405) para 27.

spending, it is understandable that LATSS prioritise local issues.[470] One problem with this is the obvious disincentive to LATSS to take on large, complex cases,[471] meaning the more prolific the `offender' and the more geographically widespread his exploitation of consumers, the more likely he is to avoid enforcement action, especially as it normally falls on the LATSS with which he is registered to investigate and take enforcement action under the Home Authority Principle.[472] According to the National Audit Office (NAO), the cost of a typical enforcement case `typically ranges from £30,000 to over £200,000 for larger and more complex cases. The average total cost of a case involving legal proceedings is about £100,000…'[473] and the investigation and prosecution of cases involving itinerant traders and recurring instances of doorstep crime can cost over £200,000.[474] In one recent cross-border case, the prosecuting authority was ordered to pay £4m in legal costs.[475] `Under current funding arrangements, this means that around half of LATSS would need to commit over 40% of their annual staff budget to resourcing such a case.'[476] The only statutory requirement for each LATSS is that each must employ one weights and measures officer.[477] Other than this, LATSS have a wide discretion on how they allocate their resources, and a recent CTSI survey found that six LATSS were stopping their work on doorstep crime.[478] It is clear therefore that the under-resourcing of this vital service is compromising their ability to adequately protect consumers against exploitation by rogue HRI traders,[479] notwithstanding the fact that taking action against large-scale rogue traders is one of the government's priorities.[480]

It should be noted that, despite an arsenal of diverse enforcement instruments, `[t]he direct powers of public enforcement agencies in the United Kingdom to seek compensation for private individuals have traditionally been limited. … A compensation order may be

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[470] ibid, para 29.
[471] CPARs Impact Assessment (n405).
[472] For example, Lancashire County Council, `The Home Authority Principle', <http://www.lancashire.gov.uk/media/119746/Home-authority-principle.pdf> accessed on 27 December 2017. Protecting Consumers from Scams (n468).
[473] ibid, 3.13. CPARs Impact Assessment (n405). Enforcing Consumer Law (n447) 29.
[474] ibid.
[475] CPARs Impact Assessment (n405).
[476] ibid, para 29.
[477] ibid.
[478] Protecting Consumers from Scams (n468) 3.13.
[479] ibid.
[480] CPARs Impact Assessment (n405) para 36.

sought in criminal proceedings … However, in 2010-11, of 308 convictions under the … [CPRs 2008], only 13 defendants were asked to pay compensation.[481] Research indicates that `trading standards officers regard compensation claims as an additional burden'.'[482] This demonstrates that enforcement bodies are more concerned with seeking compliance of the law by rogue traders than seeking compensation on behalf of consumers. This may be due to the fact that consumer law takes its origins from English contract law, which traditionally espouses a market-individualism approach rather than the modern day shift towards consumer welfarism. This, together with the economic arguments in favour of deregulation of small private companies, would suggest the state's reluctance towards intervention in what are often seen as private law issues. One might question why the state would award bodies the power to seek compensation orders on behalf of consumers if they then do not exercise these powers. It demonstrates all the more keenly the need for consumers to have their own private rights of redress against rogue directors.[483]

2.4.5 Self-Regulation and Co-Regulation

Two administrative processes widely employed in the UK as alternatives to `command and control' regulation, which can be unnecessarily burdensome on legitimate businesses,[484] are self-regulation and co-regulation.

2.4.5.1 Self-Regulation

Self-regulation occurs where individual industries establish their own codes of practice, customer charters, ombudsman schemes, etc, to promote ethical conduct within their sector. However, codes of conduct are not always ethically motivated and can sometimes be initiated for self-serving reasons. For example, in 2009, the UK Contractors Group and National Federation of Builders encouraged their 1,500 members – mainly small and medium-sized businesses engaged in the construction industry – to sign up to an anti-competition code of practice. However, as reported in one construction industry publication,[485] the code, which is `designed to reassure regulators that contractors are

[481] Rogue HRI trader cases in Chapter 4 follow this trend.
[482] Ramsay (n309) 255.
[483] N1047. Strawson (n990).
[484] Reducing Regulation (n462) 9.
[485] Building.co.uk, *Industry bodies launch competition code of conduct*, Joey Gardiner, 20 August 2009 <http://www.building.co.uk/news/industry-bodies-launch-competition-code-of-conduct/3147142.article> accessed 28 December 2017.

abiding by competition rules … has been launched in advance of the final verdict in the Office of Fair Trading's enquiry into over pricing and is designed to head off severe fines from the regulator.'

2.4.5.2 Co-Regulation

Co-regulation, on the other hand, involves some degree of government involvement in, say, developing a code of practice which will be enforced by the industry itself. In relation to the HRI market, the British Standards Institute publishes a number of guides encouraging good practice in the building and construction industry. For example, PD 6079-4 `applies to projects that involve maintenance, repair, refurbishment, decommissioning or demolition.'[486] Another example of co-regulation is the CTSI's self-funding Consumer Codes Approval Scheme (CCAS) which aims to `bolster consumer protection and improve customer service standards'.[487] It does this by approving and promoting voluntary codes of practice, establishing principles of effective customer service, and recognising and promoting trusted traders to consumers.

The codes seek to achieve some minimum standards including a trader giving consumers clear pre-contractual information; protecting any prepayments made; and independent dispute resolution schemes. Approval of new codes will only be given `if they can robustly demonstrate a potential reduction in consumer detriment. Codes approval is intended to be a rigorous and intensive process for code sponsors.'[488] CCAS therefore seeks to reassure consumers with the consistency and integrity of its approved codes. Similarly, the CTSI works closely with the Local Authority Assured Trader Scheme Network (LAATSN) for LATSS approved trader schemes and with TrustMark, a government-backed initiative which helps consumers find reliable and trustworthy traders in the HRI market. Early attempts at centrally-administered government initiatives

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[486] British Standards Institute Shop, Building and Construction, `Construction and project management' <http://shop.bsigroup.com/en/Browse-by-Sector/Building--Construction/Construction-project-management/> accessed on 28 December 2017.
[487] Chartered Trading Standards Institute, *Consumer Codes Approval Scheme, Core criteria and guidance* (February 2013 as amended January 2016)
< https://www.tradingstandards.uk/media/documents/consumers/ctsi_ccas_core_criteria_rev_2016-1.pdf> accessed on 28 December 2017 (CCAS Core Criteria).
[488] ibid.

designed to achieve these outcomes did not succeed,[489] although the TrustMark scheme established in 2006 has had more success.[490]

Locally-administered schemes have historically achieved greater success. For example, Nottingham City Council's Quality Builder Scheme outlasted the government's Quality Mark scheme and merged with a similar scheme operated locally by registered charity Age Concern[491] `to help protect people across the county from unscrupulous traders.'[492]

Since 2008, self-funding Approved Trader Schemes have become increasingly popular within local government and today most local authorities in the UK operate such a scheme. These operate mainly under the banner `Trusted Trader Scheme',[493] although they may also operate under other names.[494] What the schemes have in common is that they are backed by LATSS which carry out rigorous checks into the workmanship, solvency, and trading history of its members, who in return for membership pay a substantial fee.[495] In return, their business name is promoted on the scheme register according to the trades practised by the business, and they are able to advertise the scheme's logo on their stationery and vehicles.[496] The LATSS `police' these schemes to ensure that consumers are treated fairly and members can, if they do not adhere to the scheme's rules, be forced to leave the scheme.[497] For example, in 2012 Derbyshire County Council forced 12 members to leave its Trusted Trader Scheme following complaints about their service and `consumers are being supported by trading standards in bringing claims for compensation against three other firms which are still members.'[498] These

[489] DTI Quality Mark Scheme 2003-4
<http://webarchive.nationalarchives.gov.uk/20040105033258/http://www.qualitymark.org.uk/>
<http://webarchive.nationalarchives.gov.uk/20040117050403/http://www.qualitymark.org.uk/> accessed on 28 December 2017.
[490]<http://webarchive.nationalarchives.gov.uk/+/http://www.dti.gov.uk/sectors/construction/trustmark/page11266.html> accessed on 28 December 2017.
[491] Age UK.
[492] Nottingham City Council Press Release Archive: `Consumer Scheme Trades Up', 20 November 2006
[493] For example, Derbyshire County Council, Norfolk County Council, Dundee City Council.
[494] For example, `Buy with Confidence' in Nottinghamshire County Council and `Checkatrade' in Suffolk County Council.
[495] Chartered Trading Standards Institute, *Consumer Codes Approval Scheme Annual Report 2015*, (CCAS Annual Report)
<https://www.tradingstandards.uk/media/documents/consumers/ccas_annual_report_2015.pdf> accessed on 28 December 2017.
[496] For example, see Derbyshire County Council's Trusted Trader Scheme, Information for Traders and Business
[497] Enforcement criteria of CCAS can be found in its *Annual Report 2015, F1*, 43 (n495).
[498] Derby Telegraph ` *12 booted out of Trusted Trader as county's scheme is hailed a success'* 5 January 2012

schemes do represent a good bank from which a consumer can select an HRI business, particularly as the closely-held HRI companies under scrutiny in this thesis are unlikely to gain membership due to not having established a sufficiently good reputation with previous customers. One wonders how rigorous the checks by LATSS are as rogue traders generally are adept at deception, and so any loophole would most certainly be exploited to the full.

In the CCAS Annual Report 2015,[499] the CTSI reported that over £85 billion was being spent by consumers with the 33,392 CCAS members across the full range of consumer codes/economic sectors. Problems with traders operating as a CCAS member still arise, but one significant feature of the CCAS is that it can recover compensation for consumers who suffer losses resulting from members' breaches of the Code. In 2015, £2.3m compensation was recovered for consumers under the complaints and dispute resolution mechanism which Code members subscribe to.[500]

One of the barriers to CCAS, for both consumers and traders alike, is the high cost of membership. Those traders who can afford the initial outlay often pass the costs on to consumers and therefore, even when consumers do phone Code members for quotes, these are not necessarily competitive and, unless consumers restrict their pricing research to Code members, rogue HRI traders exploit consumers' desire for a bargain.[501]

Significantly, it is unlikely that many rogue HRI traders will make their way onto these Approved Trader Scheme registers as it is dubious that they will have established a sufficiently good reputation with previous consumers, and they are unlikely to want Trading Standards probing into their business.[502] Furthermore, unless there is a sufficient time lag between being entered onto the register and being forced to leave the register, it may be that the substantial membership fee and probity checks act as an effective deterrent to any rogue traders considering Approved Trader Schemes as a ready market of trusting consumers waiting to be exploited. These schemes therefore represent an effective protective device for consumers, provided, that is, that consumers are made aware of them locally.

[499] N495, 6.
[500] ibid.
[501] ibid.
[502] CCAS Core Criteria (n487).

Where rogue HRI traders falsely claim to be a member of such a scheme, this is a criminal offence.

2.4.6 Provision of Consumer Information, Advice, Education, Advocacy

For more than two decades, successive governments have sought to create a marketplace in which strong, confident consumers, armed with clear, intelligible information, feel able to protect themselves from exploitation by rogue HRI traders. The aim has been not only to ensure that appropriate information is readily accessible, but also to educate consumers so that they may feel more empowered to assert their rights.

At the turn of the new millennium, information, advice, education and advocacy was principally provided by the LATSS and CAS. Other information and advice providers represented specific consumer demographics, such as Age Concern[503] and the Alzheimer's Society for instance. Care had to be taken to ensure that consistently good advice and information was being conveyed to consumers from the different information and advice providers.

2.4.6.1 Local Area Trading Standards Service

Up until 2004, individual LATSS dealt with consumer complaints and queries directly, as well as dealing with local business compliance and enforcement issues. All data was held locally which meant that it could not be readily aggregated when needed which made it of limited benefit for intelligence purposes.[504] Local provision of advice, information, education and advocacy was inconsistent. Some LATSS allocated very few resources to dealing with consumer complaints, whereas other authorities stood out as comparative exemplars. Nottingham City Council's Trading Standards Service was an example of the latter, and employed a full-time Education and Information Officer. Their consumer advice centre was open at regular hours each working day for consumers to obtain information or advice from a trained advisor. Consumers were provided with the information, advice and letter-templates needed to effect self-help, and with further

[503] Now Age UK.
[504] Enforcing Consumer Law (n447).

assistance and advocacy if this proved necessary. Business and consumer information leaflets were drafted in non-legal jargon, and these were given out at community events, in the advice centre, and during outreach educational talks to mainly vulnerable consumer groups. In the case of business information leaflets, these were given out during routine inspections, online and at awareness-raising events as Trading Standards also sought to support legitimate local businesses. Important information was periodically publicised online and in paper form using inhouse newsletters, as well as issuing press releases and reaching the public through Cabinet Members. Consumers were frequently consulted in many different ways in order to ensure that access to these key services was maximised, and to measure levels of consumer satisfaction with the service, and identify ways in which the service could be improved further. Consumers were always at the very heart of service delivery.

LATSS also worked closely with other partners in order to spread important information. For example, in addition to Trading Standards' staff from Nottingham City and Nottinghamshire County Councils, members of the Greater Nottingham Doorstep Crime Partnership included Police, Victim Support, Crimestoppers, Heads of Service for Housing and Social Services, Age Concern, and others. Partners were educated about the exploitative practices of rogue HRI traders, so that key, consistent messages could reach a wider segment of the local population and so that more channels were open to address the under-reporting issue.

Other advice and information providers were educated through training organised by Trading Standards whose staff administered local Consumer Support Networks in order to ensure that wherever the consumer chose to seek advice and information, the quality of that advice and information would be consistently high. Education of school children also took place online;[505] through talks in schools; educational interactive events such as Safety Zone; and competitions such as Young Consumer of the Year competitions. Every year the CTSI co-ordinated National Consumer Week[506] when themed awareness-raising campaigns were run throughout the country.

[505] AskCedric <http://northumberland.tradingstandards.uk/index.htm> accessed on 18 November 2017 and The Virtual High Street.
[506] CPP Report 2015 (n2) 13.

The aim of the consumer service was to provide a comprehensive information, advice, education and advocacy service, using partnership work wherever possible to reach as many different consumer groups in ways that they found easy to access and engage with. Trading Standards also worked collaboratively with other consumer bodies such as the statutory consumer advocacy organisation, National Consumer Council.[507]

By 2005, most consumer advice centres across the country had closed, the provision of consumer information was given mainly online, face-to-face advice provision diminished, and consumer advice was provided through a central government-funded call centre, CD.

In authorities such as Nottingham, which offered a comprehensive consumer protection service, consumers benefited from a more personalised service which was well-placed to break down barriers to information, advice and guidance. However, LATSS tended to be more insular and out-of-touch with the national picture. A NAO report in 2016 noted that such extreme budget cuts to LATSS were likely to have a negative impact on consumer protection at a local level and would lead to enforcement gaps.[508]

> Local Trading Standards has lost 56% of full-time equivalent staff since 2009. Twenty services in England have reduced funding by over 60% since 2011 and some now have only one qualified officer. The funding of smaller services is no longer sufficient for them to undertake significant enforcement cases.[509]

Today, LATSS resources are more narrowly focussed on providing businesses with advice and information on consumer issues, and ensuring local businesses comply with a vast array of statutory provisions,[510] conducting investigations, gathering evidence, and taking enforcement action, including prosecutions, wherever necessary. The CTSI also manages the CCAS which aims to improve standards of customer service without placing unnecessary regulatory burdens on businesses.[511]

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[507] Predecessor to Consumer Focus.
[508] Enforcing Consumer Law (n447).
[509] ibid, para 15, 9.
[510] 263 as at 2016 (Enforcing Consumer Law (n447) para 3.8.
[511] BIS Policy Paper on Deregulation based largely on the recommendations of the Hampton Report: HM Treasury *Reducing administrative burdens: effective inspection and enforcement* (March 2005).

2.4.6.2 Office of Fair Trading

Up until April 2014, the OFT was the national consumer protection body responsible for enforcement at a national level.[512] The OFT was also responsible for launching consumer protection campaigns and initiatives.[513] It administered CCAS, and acted in an advisory capacity to consumers and businesses alike.

2.4.6.3 Citizens Advice Service

The role of the CAS in consumer protection and empowerment has grown hugely in recent years. It now serves as the single point of contact for consumers who have had a problem with a trader.[514] The service has taken over the running of the consumer service helpline,[515] and also has responsibility for educating consumers about their rights. It is also recognised as the national `consumer advocate' highlighting issues to, *inter alia*, the government on behalf of consumers. Its Adviceguide website provides consumers with online information and advice about their rights.

2.4.6.4 Education

According to Carol Brennan and Katrina Ritters,[516] educating consumers is a key element of consumer empowerment. It is when consumers acquire knowledge of threats involving, say, rogue traders, that they become more adept at recognising the tactics used and rejecting such approaches. This then makes them better able to act in their own best economic interest and better protect themselves from exploitation. The sharing of rogue trader stories or tactics, teamed with slogans such as `If it sounds too good to be true, it probably is' are effective ways of making consumers question the offers they receive and the choices they make.[517]

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[512] Enforcing Consumer Law (n447).
[513] For example, the Doorstep Selling Campaign.
[514] Protecting Consumers from Scams (n468).
[515] Enforcing Consumer Law (n447).
[516] Carol Brennan and Katrina Ritters, `Consumer Education in the UK: New Developments in Policy, Strategy and Implementation', (2003) 27 IntlJCS 223.
[517] Hillingdon Borough Council's `How to beat the rogue doorstep caller' is a good example of online information that is educational. <http://www.hillingdon.gov.uk/index.jsp?articleid=17775> accessed on 17 November 2017.

2.4.6.5 Information

A common theme in the government's development of consumer protection policy is the concept that consumers who are well-informed about their rights are more confident. This then leads to them making better economic decisions about what to buy and from whom, and rewards legitimate businesses who want to give consumers what they want, and thereby stimulates economic growth.[518] To be understood properly, information, especially legislation, needs to be clear and simple.

The most recent consumer law reforms and restructuring of those organisations which provide information, advice, education and advocacy to consumers came about following a report in 2011 by the National Audit Office,[519] in which it was identified that having no clear lines of responsibility between enforcement agencies was leaving rogue traders free to continue exploiting consumers. Following this, the main responsibility for consumer advice was transferred to the CAS to ensure that all consumers had access to the same high quality of information and advice irrespective of where they lived. LATSS was given the lead on consumer enforcement.

In 2014, UK consumers were found to be significantly more confident and knowledgeable when choosing goods and services than their European counterparts.[520] However, their knowledge of their rights to redress was found to be poor,[521] with Black and ethnic minority consumers knowing least about their rights and being less likely to approach a consumer organisation for advice or information.

In its drive to save money and deliver greater efficiencies, it is understandable why the government has restructured consumer advice services since its focus is on simplifying structures and making service provision more consistent and less fragmented, making it clearer to consumers how they can assert their rights. By one service only being responsible now for collating data relating to consumer complaints, consumer detriment,

[518] Department for Business, Innovation and Skills, *2010 to 2015 government policy: consumer protection*, (updated May 2015) <https://www.gov.uk/government/publications/2010-to-2015-government-policy-consumer-protection/2010-to-2015-government-policy-consumer-protection> accessed on 18 November 2017.
[519] Enforcing Consumer Law (n447).
[520] Detriment Survey 2014 (n53).
[521] ibid.

and consumer consultations, there will inevitably be less duplication, more consistency, easier policy development and more rapid intelligence-sharing.[522] This will all hopefully lead to improved enforcement of consumer laws, and more empowered consumers who are able to assert their rights.

2.5 Conclusion

It is very clear that consumers suffer huge detriment as a result of being exploited by rogue HRI traders. What makes it worse is that it is not even due necessarily to their own poor economic choices, because the targeted nature of the exploitation leaves them, in reality, with very little choice due to the unfair and dishonest practices used by the rogues.

The government recognises this inequality in negotiating power and, without resorting to tighter regulation for fear of its negative effect on enterprise and economic growth, the government has sought to reform consumer law in order to provide a comprehensive set of rights of private redress for consumers to assert once they have fallen victim to such exploitation. In tandem with this, the government has sought to continue its programme of information, advice, education and advocacy for consumers in order that they are able to access whatever help they may need to challenge rogue HRI traders and initiate court proceedings against the trader whenever possible.

Much focus has been placed on making consumer services and legislation easier to understand and simpler to follow. Whilst the CRA 2015 does consolidate many different pieces of legislation, it is an overwhelming piece of legislation and this is why consumers should be able to access this information in a much simpler format. This has been successfully achieved by making CAS a `one-stop shop' for consumer services. Although this service will lack the personalised, local provision that consumers enjoyed through many LATSS, the priority focus on ensuring that consumers know where to go to in order to find out about their rights will become more widely known. The effective

[522] CPARs Impact Assessment (n405) para 56.

signposting provided by LATSS[523] and CAS[524] will assist with this, and evidences the collaborative approach being taken to consumer services.

Efforts are being made to change the economic behaviour of consumers by promoting CCAS in the hope that they will only obtain quotations from traders who have been checked out by, for example, Trading Standards. The fact that Trading Standards have the ability to secure compensation from traders on their schemes for any breaches of the law is something that could give consumers much-needed peace of mind, and perhaps more awareness-raising of this aspect of the scheme would be beneficial to consumers and legitimate businesses alike. However, this does not overcome the problem presented by the opportunistic nature of rogue HRI traders who cold-call at consumers' homes and highlight urgent work on their homes that consumers did not even realise needed doing.

Under-reporting of incidents is still at unacceptably high levels, and it appears that the initiatives and strategies designed to boost reporting levels, directly or indirectly, through carers for example, have had to give way to the core work of public services due to the year-on-year extreme budgetary cuts over the last decade.[525]

Despite all its effort to increase consumers' knowledge and skills about their rights in the hope of empowering them to avoid being exploited and to assert their private rights of redress, the volume of rogue HRI trader incidents and the levels of consumer detriment show no signs of abatement, and consumers remain reluctant to pursue their own rights of redress. To this extent, consumer protection laws in the UK are inadequate and more focus needs to be given to finding ways of helping consumers recover their losses where they are unable or unwilling to help themselves. It is clear that the government needs to be more paternalistic in this respect, and one answer may be to allow Trading Standards to recover compensation on behalf of consumers as part of their enforcement work.[526] Whilst more funding would need to be given to LATSS

[523] For example, Nottingham City Council's website on consumer advice, <https://www.nottinghamcity.gov.uk/business-information-and-support/trading-standards/consumer-advice/> accessed on 18 November 2017.
[524] <https://www.citizensadvice.org.uk/consumer/get-more-help/report-to-trading-standards/> accessed on 18 November 2017.
[525] For example, the Greater Nottingham Doorstep Crime Partnership.
[526] For example, CPRs 2008.

to facilitate this, it would result in a boost to the HRI market for legitimate traders,[527]and would be more likely to deter rogue HRI trading than any of the measures discussed so far. This, and other potential for law reform, will be considered under Chapter 4.

[527] Law Com Cm 8323 2012 (n14) S51(3).

CHAPTER 3

HOW COMPANY LAW FACILITATES CONSUMER EXPLOITATION BY ROGUE DIRECTORS OF CLOSELY-HELD COMPANIES

3.1 Introduction

In Chapter 2, it was established that consumers are, generally, vulnerable to exploitation by rogue HRI traders and, as a result, suffer high levels of consumer detriment. It was further established that they do need protection against such unfair and unscrupulous practices, particularly in relation to obtaining compensation to cover any losses resulting from the exploitation.

A review of consumer protection law in the UK found that certain statutory provisions, in particular the CPRs 2008, CPARs 2014 and CRA 2015, were specifically aimed at tackling the kind of conduct that distinguished rogue HRI traders from their legitimate counterparts and, theoretically at least, making it easier for consumers to cancel their contracts with rogue HRI traders.[528] The government, keen to empower consumers to make good economic decisions, has simplified the structure of consumer protection organisations so that consumers can more easily find out about their rights, and report any problems. Facilitated self-regulation through CCAS have gone above and beyond consumer law in connecting consumers with approved traders and, in some cases, obtaining compensation for consumers when they have had a problem with a scheme member.

[528] This is often not practically possible due to the opportunistic nature of rogue HRI trader exploitation.

However, in cutting budgets so aggressively over the last decade's transformation of public services, and in placing LATSS under so much pressure, the government has created an enforcement gap where resources are so stretched that there is not the capacity within LATSS to deal with every local rogue HRI trader, let alone cross-border or large national cases. As a consequence, many rogue HRI traders continue to go unchallenged and unpunished, despite sufficiently stringent legislative provisions being in place to curb misleading and aggressive practices, and the exploitation of consumers.

Consumers do have private rights of redress under the above provisions but these avenues of redress are practically limited, which speaks more to the difficulty consumers have in protecting themselves against exploitation. Exploitative practices by rogue HRI traders still show no signs of abatement, and consumer detriment remains at unacceptably high levels. LATSS are unable to enforce the law due to such high volumes of cases, and such great demands being placed on their limited resources. It is not possible, therefore, to say that the law is adequate in protecting consumers from rogue HRI traders as it has not proved effective in deterring them from exploiting consumers. Neither has it been effective in enforcing breaches of consumer law, seeking fines or gaining compensation orders against rogue traders.

Chapter 3 will demonstrate how much worse the situation for consumers is when rogue HRI traders incorporate their businesses. As stated in Chapter 1, the focus of this thesis is on closely-held HRI companies, particularly those in which the director(s) and shareholder(s) are one and the same. This Chapter will demonstrate how, through incorporation, rogue HRI director-shareholders are protected by limited liability and separate corporate personality, widely recognised as the cornerstones of modern company law.[529] Consequently, directors are incentivised to take greater risks[530] than they would do if they were to be made personally liable when things go wrong.

Prima facie, transferring risk from shareholders to creditors may seem unfair, particularly when they are unable to survive being saddled with such additional financial burden. However, trade creditors themselves are `persons of business' and therefore should be imputed with knowledge of the dangers of dealing with closely-held companies. They are

[529] *Salomon* (n28); The Companies Act 1965, s214(1)(d); IA 1986, s74(2)(d).
[530] Lipton (n34).

often able to protect themselves against losses.[531] However, the position of consumers is more tenuous. Their vulnerability to excessive risk-taking arises from their lack of awareness that having "Limited" at the end of a company name serves as a warning rather than a badge of respectability;[532] their weaker bargaining position;[533] and the unavailability of suitable remedies under company law.[534] It is because of their vulnerability, and their inability to protect themselves adequately against exploitation by rogue HRI directors that more needs to be done to safeguard consumer interests without causing any detriment to legitimate HRI traders.

It will be in Chapter 4 that this normative analysis for law reform will be considered. To the extent that the various company law tools designed to deter abuse of the corporate form and exploitation of consumers are failing, the focus will shift to the way in which rogue HRI directors might be held personally liable and punished for their unscrupulous conduct, and how any monies unlawfully obtained or proceeds of crime might be recovered.

Not only are consumers victims of abuse of the corporate form by rogue HRI directors, but reputable HRI traders also suffer from consumers losing confidence in the integrity of HRI traders generally. As Theresa May notes, `when individual businesses lose the confidence of the public, faith in the business community as a whole diminishes – to the detriment of all.'[535] Since the 1970s, the government has struggled to balance the interests of legitimate businesses and the economic necessity for deregulation against the comparatively few closely-held HRI companies who hide behind the corporate veil to avoid personal liability for their exploitative practices against consumers.[536]

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[531] At 3.4.3 and 3.8.
[532] Nn26, 27.
[533] Fisher (n147).
[534] Though consumer interests should be considered in directors' decision-making under CA, s172 (at 3.6.4.1), there is no available enforcement mechanism to ensure their interests are given due regard.
[535] Department for Business Energy and Industrial Strategy, `Corporate Governance Reform: Green Paper', November 2016 <https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/584013/corporate-governance-reform-green-paper.pdf> accessed on 21 December 2017 (Corporate Governance Green Paper 2016).
[536] Freedman (n54) 333 found 66% of company directors surveyed gave limited liability as a reason for incorporating their business. In his study, Hicks (n24) 317 reported just 61% of 90 small companies interviewed admitted to being motivated to incorporate by limited liability. Note any rogue directors interviewed may have falsely responded, seeing such an admission as inculpatory.

Formulating policies from a contractarian perspective of company law, the government has placed more responsibility for consumers to secure their own remedies than they can manage, and this is why there remain such high levels of exploitation and consumer detriment. However, Parliament readily accepts that rogue directors should not escape liability simply because the company is a legal entity responsible for the offensive conduct; by granting statutory enforcement powers to public bodies under the CPRs 2008 and through various statutory bypass provisions,[537] Parliament has ensured that the company's controller(s) may also be prosecuted for criminal offences where they have consented[538] to or connived or been negligent in regard to the commission of the offence. Despite its focus apparently being limited to unincorporated rogue HRI traders, Parliament has therefore recognised that laws to tackle their wrongs should apply equally to rogue directors of closely-held HRI companies.

Research undertaken for this thesis indicates there is a gap in the literature relating to exploitation of consumers as a result of abuse of the corporate form by small closely-held HRI companies and this thesis seeks to fill this gap. The focus of this Chapter will therefore be limited to rogue directors of closely-held HRI companies.

The Chapter will commence by distinguishing rogue directors of closely-held HRI companies from their legitimate counterparts. After considering why small businesses choose to incorporate their businesses, this Chapter will then examine the nature and effect of incorporation; the origins and historical development of company law's two cornerstones; and how these are abused by rogue HRI directors.

To suggest there is no company law response to abuse of the corporate form and consumer exploitation would be inaccurate. There are sanctions that can be imposed against unscrupulous directors; for instance, `Owner-managers form the vast bulk of disqualified directors [and] are the clear target of the sanction.'[539] Chapter 3 will therefore examine the ways in which company law curbs abuse of its cornerstones. However, the flyby-night nature of many closely-held HRI companies controlled by rogue directors,

[537] 4.2.1.6.
[538] Knowing the material facts that constitute the offence and agreeing expressly or impliedly to the company conducting its business on the basis of those facts (*Attorney General's Reference (No 1 of 1995)* [1996] 4 All ER 21; *Chargot Ltd (trading as Contract Services) & ors* [2008] UKHL 73.
[539] Williams, (n39) 219.

and the asset-stripping nature of `phoenixing',[540] means that any remedial action that does fall to consumers is all-the-more unattainable. This Chapter will conclude with an exposition of how consumers' private rights of redress under consumer protection law are effectively frustrated by the cornerstones and the doctrine of privity; and how, despite extensive recent reforms of both company law and consumer protection law, Parliament has still not overcome the problem of consumer exploitation by rogue HRI directors. Since consumer vulnerability is exacerbated by the cornerstones and contractarian policies, it follows that those dealing with rogue HRI directors are in greater need of protection under company law.

3.2 Distinguishing Rogue Directors from their Legitimate Counterparts – the Requirement for `Bad Faith'

Given that small and medium-sized enterprises (SMEs) are seen as vital to economic growth, the government is under pressure to ensure that legitimate HRI traders are not penalised by any measures taken to tackle rogue trading or rogue directors. To distance themselves from the bad faith conduct associated with rogue traders, legitimate HRI traders may feel under pressure to sign up to LATSS approved trader schemes,[541] or other CCAS-registered scheme. They rely on government bodies to promote these to consumers as safer alternatives to contracting with non-recommended traders.[542] However, unless consumers know how to access approved trader lists online, then they are still vulnerable to exploitation as one frequently occurring unfair commercial practice is of rogue traders falsely purporting to belong to a trade association or CCAS-registered scheme.[543]

Research commissioned by the OFT in 2011 asked traders what they considered to be the main barriers to providing a good quality service to consumers. The most frequently cited

[540] Werner (n41); Ian Fletcher, `The genesis of modern insolvency law – an odyssey of law reform' (1989) JBL 366, 367.
[541] For example, the government-endorsed `TrustMark' scheme or LATSS schemes such as `Buy with Confidence' or `Trusted Trader'.
[542] However, very few consumers surveyed by TNS-BMRB (n218) 1.35 were aware of approved trader schemes.
[543] Consumer Detriment 2016 (n206) 8; The Extent of Unfair Commercial Practices: A Draft Report Prepared by Kate Roberts, Cairn Enterprises Ltd, March 2009 <http://www.consumerfocus.org.uk/assets/1/files/2009/11/UCPDresearch.pdf> accessed on 15 February 2014.

response[544] was `undercutting by poor quality or rogue traders'.[545] Such unfair commercial practices create an unfair trading environment for reputable traders, stifle legitimate competition, and are further examples of bad faith.

A clear line therefore needs to be drawn in this thesis between those traders who incorporate their business to access greater borrowing instruments or even to minimise their personal losses in the event of business failure,[546] and those whose primary motivation for incorporation is self-enrichment through unscrupulous commercial practices and the intentional or reckless exploitation of consumers.[547] The law does not seek to penalise legitimate HRI traders, but instead seeks to create a level playing field where competition is fair. This thesis is therefore not suggesting that all losses consumers suffer from dealing with HRI traders should be actionable. For instance, it would not advocate the punishment of traders who, as economic victims themselves, inadvertently cause losses to consumers since they did not set out to exploit.

The law of contract distinguishes `mere puffs'[548] from terms, with the former regarded as expressions of opinion and therefore not intended to form the basis of a contract.[549] However, where a misrepresentation,[550] fraudulently or negligently made, induces a consumer to contract, then it will be actionable if the consumer relies on its truth and suffers a loss. Therefore, an unrealistically low quotation which the rogue HRI trader intends to inflate once the contract is awarded, should be an actionable misrepresentation.[551]

Some degree of risk-taking is vital for wealth creation and judicial attempts to establish acceptable levels of risk-taking has resulted in directors becoming risk-averse[552] which

[544] 67% of the 506 businesses surveyed (HRI Research Report 2011 (n218) chart 8.1, 92.
[545] ibid, 1.30. Discussed at 2.2.3 and 2.2.4.
[546] Though perhaps unethical, this is not illegal.
[547] `Bad faith'.
[548] Exaggerated claims to excite interest.
[549] *Weeks v Tybald* [1605] Noy 11.
[550] False statement of fact.
[551] An innocent misrepresentation which results in inflated costs due to an unexpected rise in the cost of materials will, however, not be.
[552] *Fatupaito* v *Bates* [2001] 3 NZLR 386; *Re South Pacific Shipping Limited (in liq); Traveller* v *Lower* [2004] 9 NZCLC 263,570; *Mason* v *Lewis* [2006] 3 NZLR 225. Robert Thompson, `Unpacking Limited Liability' (1994) 47 *Vanderbilt Law Review* 1, 19-20; Ross Grantham, `Limited Liability of Company Directors' (2007) 362 LMCLQ 375.

adversely affects profitability.[553] The modern approach is for courts to therefore distinguish between legitimate and illegitimate business risks,[554] the latter exposing directors to personal liability. Excessive and opportunistic risk-taking of the type[555] associated with abuse of the corporate form is regarded as bad faith conduct, particularly when it is seen that the real risk-bearers are consumers and other unsecured creditors. It is these *rogue* directors who pose the greatest threat to consumers.

The term `rogue director', used throughout this thesis, denotes a rogue trader[556] who has incorporated his business to take advantage of the cornerstones of company law. Andrew Hicks[557] describes them as `flyby night … rogue directors'[558] to reflect their transient nature and the speed with which they can close one company and start another;[559] `deliberately reckless'[560] in their dealings; and people who `deliberately rip-off creditors'[561]. A rogue director is therefore someone who behaves unscrupulously, or in bad faith, who either deliberately exploits consumers or who shows such blatant disregard for their interests that intention to exploit may be presumed.

This characterisation of rogue behaviour is a logical one since, as fiduciaries, directors are obliged to exercise their powers in good faith; this is, not to act in bad faith.[562] This corresponds to Sartre's emphasis on the need for contracting parties to behave `authentically' towards each other.[563] Deliberately misleading statements[564] are, according to Sartre,[565] as damaging as an outright lie since a consumer can more easily verify or refute explicit claims, whereas

[553] *Fatupaito* (n552); *South Pacific* (n552)*; Traveller* (n552) 570; Anthony Mason, `Contract, good faith and equitable standards in fair dealing' (2000) 66 LQR 225.
[554] *South Pacific* (n552)*; Traveller (*n552) 570; *Mason* (n552) 225.
[555] 1.5.2.3 and 3.3.
[556] 1.2.
[557] Hicks (n11).
[558] ibid, 433. Tomasic (n11).
[559] 3.4 and 3.5.
[560] Hicks (n11) 451.
[561] ibid, 440.
[562] For example, *Gisborne* v. *Gisborne* (1877) 2 App Cas 300 305 per Lord Cairns
[563] Detmer (n60) 76; Simon Feldman and Allan Hazlett, `What's bad about bad faith?' (2010) 69.
[564] For example, misleading marketing materials (*Secretary of State for Business Innovation and Skills v Aaron* [2009] EWHC 3263 (ch)).
[565] Detmer (n60).

> it requires much more … critical thinking skills to consider what important information may have been simply omitted from a message, and how that message may have been distorted by means of a onesided emphasis.[566]

Rather than the emphasis being on the director's conduct[567] or the undesirable consequence,[568] bad faith can be `ascertained by reference to actual, subjective, states of mind'[569] and has been `taken to include acts taken for reasons of caprice or spite'.[570] Whilst this is true, Mason asserts that bad faith can also be manifested as conduct where, without reasonable justification, a director `acts in relation to the contract in a manner which substantially nullifies the bargained for benefits or defeats the legitimate expectations of the other party.'[571]

To fairly distinguish a rogue director from his legitimate counterpart, then bad faith as a subjective state of mind, which involves conscious deliberation, wilful blindness or dishonesty as to the exploitation of consumers, is a vital requirement.[572] Failing to complete work to a satisfactory standard is a breach of contract, but does not of itself make a director *rogue*; however, if he deliberately intended to, or recklessly, carry out substandard work in order to maximise profits at the expense of the consumer, he would possess the bad faith required of a rogue director.

3.3 How Company Law Facilitates Exploitation of Consumers by Rogue Directors

Whilst a fundamental issue of this thesis is on the ways in which rogue HRI directors exploit consumers, the focus of the thesis is on the way that company law enables them to do so by making available to one-man businesses the opportunity to register as private limited companies. It is difficult to understand what purpose this serves anyone other than allowing director-shareholders to safeguard their own personal wealth at the expense of

[566] Detmer (n60) 76,
[567] Except insofar as it falls outside the scope of his/her power, in which case it is regarded as bad faith (Nolan RC, `Controlling fiduciary power' (2009) CLJ 68(2)).
[568] Since good faith conduct may also lead to an illegal action, for example directors exercising powers for an improper purpose (*Howard Smith* v. *Ampol Petroleum* [1974] AC 821).
[569] Nolan, (n567).
[570] ibid.
[571] Mason (n553).
[572] HRI case examples at 4.2.1.

the company's creditors. Secure in the knowledge that company law protects them from being held personally responsible for their unscrupulous conduct, they are given a free rein to exploit consumers; for rogue HRI directors, this will inevitably be their main purpose for incorporating their business. So, whilst it cannot be said that the corporate form *causes* rogue directors to exploit consumers, it certainly encourages greater risk-taking[573] by directors generally and creates a rich environment for consumer exploitation by rogue directors to flourish. And because the corporate veil protects the director-shareholder from being sued for wrongs he commits in the company's name, the consumer is deprived of suing the person responsible for their losses – a barrier they do not face when dealing with rogue HRI traders. This is primarily due to the two cornerstones of company law.[574]

Unlike other, larger companies with more widely-dispersed membership, in closely-held companies all shareholders are typically also directors, and all directors are also shareholders.[575] This means that the normally separate roles of shareholder *ownership* and directorial *management* are merged. The separation of these roles[576] is of great importance in corporate governance where directors are held accountable to the company's shareholders for their actions, and particularly their misfeasance.[577] The merging of these roles in closely-held companies creates an accountability vacuum resulting in those rogue directors who act in bad faith towards the company's consumers being able to do so without fear of being challenged or removed from office[578] by the company's shareholders since it is implausible to suppose that the closely-held company shareholder would ever challenge his own wrongful conduct, qua director.

In this situation, it is difficult to see how the company is distinguishable from its director(s) and shareholder(s), and yet, under UK law, they are each separate legal persons. Consequently, the role of shareholder-centric corporate governance – a system designed to improve company performance and accountability for the maximisation of

[573] 3.3 to 3.5.
[574] 3.4.
[575] Developing Framework 2000 (n12) 6.23.
[576] Also 3.4.1.
[577] CA, ss170-177. It should be remembered that, except in exceptional circumstances discussed in Chapter 3, directors are ultimately only accountable shareholders – in the closely-held company, they are only accountable therefore to themselves.
[578] ibid s168.

shareholder wealth – has no place in the small closely-held company, something made possible by the limited disclosure requirements of modern company law[579] and the relaxation of other legal and regulatory requirements.[580] This lack of directorial accountability in the closely-held company poses a problem for consumers insofar as it provides no safeguards against the deliberate and dishonest exploitation of consumers by those directors who are so-minded to profit themselves from their bad faith conduct, and may even encourage it. Furthermore, there are no real regulatory safeguards imposed upon these companies which might otherwise make incorporation an unattractive proposition. For example, increased minimum issued share capital levels might cause directors to temper excessive risk-taking since their liability, as shareholders, will increase. The inadequacy of accountability in closely-held companies is further compounded by the fact that consumers have no way under English company law of enforcing any breach of directors' duties.[581]

One might therefore question the wisdom of successive governments continuing to allow owner-managed businesses to incorporate without some measures to prevent abuse of the corporate form. The ideal opportunity to address issues of accountability in closely-held companies fell to the CLRSG during its very lengthy review of company law, which started in 1998 and culminated in the passing of the CA. Although small private companies formed the focus of this review, the proposals sought to encourage more owner-managed businesses to incorporate through further deregulation rather than to tighten their governance mechanisms.[582] The consistency with which company law has relaxed formalities and reporting requirements for such companies has increased the potential for abuse of the corporate form by such companies.[583] Furthermore, the ease, speed and affordability of liquidating one company and forming a new company[584] means rogue HRI directors can exploit consumers without any fear of interrupted trading or being held personally accountable for their wrongdoing.[585]

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[579] CA 2006, s444(5C).
[580] CA 2006, s154(1)); (Stephen Griffin, `Limited Liability – a necessary revolution?' Company Lawyer (2004), 99); and Cutting Accountancy and Reporting Fees 2011 (n31).
[581] CA 2006, ss170-181. 3.6.4 and 4.3.2.
[582] Developing Framework 2000 (n12).
[583] 1.1, 3.6, and n693 re minimum requirements.
[584] By this, the CLRSG sought to improve accessibility to incorporation for SMEs (Developing Framework 2000 (n12).
[585] CA 2006, s260(3).

In addition to problems caused by the accountability vacuum, company law is also responsible for creating another problem for consumers. This is because, on incorporation, each company acquires separate legal personality. The company is seen as a separate legal entity, quite distinct from its shareholders, with its own legally registered name.[586] Most significantly its human constituencies are shielded from the public by a veil of incorporation and it is the company itself which must be sued for any misfeasance committed by its director(s) in the company's name.[587] Since the HLs' judgment in *Salomon,*[588] there are only very limited circumstances[589] in which the courts have been willing to lift the veil to expose director-shareholders to personal liability. By protecting their personal wealth this, together with limited liability, encourages reckless risk-taking and dishonesty within closely-held companies, and further facilitates consumer exploitation[590] by rogue directors.

Limited liability creates problems for consumers because it limits the amount of money shareholders must contribute towards the company's assets in the event of corporate failure to any amount which remains unpaid on their shareholding; this can be as little as £1.[591] This, compounded by company law's abrogation of minimum capital requirements,[592] effectively places all personal assets of director-shareholders beyond the reach of consumers. Essentially, limited liability allows the closely-held company director, qua shareholder, `to reap all the rewards of entrepreneurial risk-taking but protects them from the financial consequences of failure, which will instead be borne by creditors.'[593] This is because company law allows risk and costs to be externalised onto consumers.[594] In 2013, 2.35 million small companies (77% of all companies on the UK register) had an issued share capital of less than £100,[595] representing a high proportion of under-capitalised companies. If one couples the under-capitalised closely-held company with one which owns no assets itself, but holds its property on credit or rental

[586] CA, s59.
[587] *Salomon* (n28). Discussed at Chapter 3.
[588] ibid.
[589] 3.6.1.
[590] 2.2.1.
[591] Davies and Worthington (n32) 2.15.
[592] CA, s542. Developing Framework 2000 (n12) 7.21.
[593] Williams (n39) 219; Ireland (n22) 844-848.
[594] Freedman (n54).
[595] Companies House, `Statistical tables on companies registration activities 2012/13' Table A6. According to the CLRSG, 90% of companies had under five shareholders in 2000, and 70% had only one or two (Developing Framework 2000 (n12) 6.9).

terms, then exploited consumer have little chance of recouping their losses when they sue the company.

Because of the strong incentive for directors to negotiate business in order to maximise their wealth as shareholder, `[i]t is … unsurprising that the combination of owner-management and limited liability is widely recognised as posing a particular danger for creditors.'.[596]

Taken together, or individually, the accountability vaccuum, separate personality, and limited liability coupled with the total relaxation of minimum capital requirements, serve as a lure to excessive risk-taking that might otherwise be avoided were director-shareholders themselves to bear any resulting losses.

3.4 Incorporation and the Cornerstones of Company Law

3.4.1 Nature and Effect of Incorporation of a Company

Often motivated by the desire to limit their liability in the event of business failure, entrepreneurs may, and are positively encouraged to,[597] elect to incorporate their business in order to access the cornerstones of company law.

Incorporation is the process by which a new or existing business complies with certain legal formalities to acquire separate legal existence from its members;[598] the incorporated company acquires `an autonomous legal personality in its own right'.[599] As Marc Moore notes, it exists `independently and distinct both from its original incorporators and the controlling mind(s) who may at any time be operating the company's business.'[600] As the company is a separate legal entity, it can continue in perpetuity and does not cease simply because its membership or directors change unlike ordinary partnerships.[601] It can

[596] Williams (n39) 219.
[597] Tax Research UK, *500,000 missing people: £16 billion of lost tax. How the UK mismanages its companies*' By Richard Murphy, March 2011 <http://www.taxresearch.org.uk/Documents/500000Final.pdf > accessed on 29 December 2017.
[598] Ireland (n22) 838.
[599] Moore (n34), 180. JSCA 1862, s18.
[600] ibid. CA 2006 Explanatory Note 61 relating to s16.
[601] *Regal (Hastings) Ltd v Gulliver* [1942] 1 All ER 378. Companies Act 1862, s18.

contract,[602] and own property in its own name,[603] and sue for breach of its legal rights or be sued for breach of its legal obligations[604] Today, private companies may be formed quickly, cheaply, and simply, and without the onerous registration/regulatory requirements placed on public limited companies.[605]

Crucially, the process of incorporation creates a `veil' (or a shield) which protects shareholders from being held accountable for their wrongful acts by attributing these in certain circumstances to the company itself.[606] This is of huge benefit to shareholders and directors when they are one and the same person, but of grave concern to consumers because of the increased risks this creates.

Incorporation presupposes a demarcation between ownership and management, with the roles of shareholders and directors being very separate within the company.[607] This separation of roles is most evident in public limited companies[608] or widely-dispersed companies in which the directors manage the company by promoting its success for the benefit of its members as a whole,[609] and the shareholders have ultimate power to make decisions on how the company is run and by whom.[610] In this regard, there has been a significant divergence between UK company law's `deliberate policy choices in favour of allowing shareholders to exercise residual and ultimate control in companies' flowing from its recognition of companies as voluntary associations of shareholders,[611] and the US's traditional approach of restricting shareholder participatory rights and power.[612] Whereas shareholders in the UK have the power to bring about corporate change through constitutional amendment, this parallel power in the US is curbed insofar as shareholders

[602] CA 2006 ss40(1)&(3) and 43(1)(b)).
[603] *Macaura v Northern Assurance Co Ltd* [1925] AC 619, 633.
[604] *Foss v Harbottle* (1843) 67 ER 189.
[605] Davies and Worthington (n32) 51.
[606] Ottolenghi S `From Peeping Behind the Corporate Veil, to Ignoring it Completely' (1990) 53 MLR 344, 342); *Parker & Cooper Ltd v Reading* [1926] Ch 975. Rules of Attribution discussed at 4.2.2.1.
[607] 3.3.
[608] Keay A, `Company Directors Behaving Poorly: Disciplinary Options for Shareholders' (2007) JBL 656, 656.
[609] CA 2006, s172; The Companies (Model Articles) Regulations 2008 SI No 3229, articles 3(1) and 5(1)(a)); Andrew Hicks and Say Goo, *Cases and Materials on Company Law* (6th edn, OUP, 2008) 1.
[610] Ross Grantham `The Doctrinal Basis of the Rights of Company Shareholders', (1998) Camb LJ 566; Ireland (n22); Simon Bowmer `To Pierce or not to Pierce the Corporate Veil - Why Substantive Consolidation is not an Issue under English law', (2000) Journal of International Banking Law 193; and the CA in *Short v Treasury Commissioners* [1948] 1 KB 122).
[611] Richard Nolan, `The continuing evolution of shareholder governance' (2006) 65 CLJ 92, 120.
[612] Jennifer Hill, `The Rising Tension between Shareholder and Director Power in the Common Law World', (2010) 18 Corporate Governance: An International Review 344, 344.

are able to alter corporate bylaws only to the extent that they do not contravene State law; not unsurprisingly, State law precludes shareholders from `initiating changes to the corporate charter'.[613] Gower attributes the divergence between the balance of power of directors and shareholders in these two jurisdictions to the different ways in which the historical roots of the company have evolved in each;[614] in the UK, the focus of company law has been on attracting capital,[615] whereas in the US the focus has been on `attracting managers'.[616] It is interesting to note that this divergence is lessening as `[a]n unprecedented array of reforms and proposals to increase shareholder powers are on the table in the United States'.[617] However, this shift is not without an impressive raft of opponents who posit a number of credible arguments against shareholder empowerment, not least the argument that `it would revive an outmoded and inappropriate image of the shareholder as owner of the corporation or principal in a principal-agent relationship with directors'.[618] However, shareholder empowerment in the UK has not prevented developments in law such that shareholders are today seen only as owners of shares and not of the company itself.[619] Previously shareholders held the equitable interest in the company's assets, with the company as trustee.[620]

In theory, this separation of roles under UK company law seeks to regulate the conduct of director internally, through the company's articles of association,[621] and render them accountable to shareholders for their actions.[622] Grantham suggests a credible rationale for this internal regulation: `As residual claimants, shareholders have the greatest incentive to monitor the conduct of management.'[623] This may be true of widely-held companies but is of little benefit in closely-held companies where, in fact, rogue directors ensure instead that creditors are the residual claimants.

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[613] ibid, 347.
[614] Laurence Gower, `Some Contrasts between British and American Corporate Law' (1956) 69 Harv L Rev (1956) 1369.
[615] See 3.4.3.
[616] Hill (n612) 348, citing Jonathan Rickford, `Do Good Governance Recommendations Change the Rules for the Board of Directors? in Klaus Hopt and Eddy Wymeersch (Eds), *Capital markets* (2003) 474; Stephen Bainbridge, `In Defense of Shareholder Wealth Maximisation Norm: A Reply to Professor Green' (1993) 50 Wash & Lee L Rev 1423; Lucian Bebchuk, `Letting Shareholders Set the Rules' (2006) 119 Harv L Rev 1784.
[617] Hill (n612) 345.
[618] ibid, 350.
[619] Grantham (n610).
[620] Lipton (n34).
[621] Davies and Worthington (n32) 62.
[622] ibid. Note, however, CA 2006, ss255(2), s255(2)(a)(i), (s255(2)(b)(i)) and (s255(2)(b)(ii)).
[623] Grantham (n610) 577.

The right of shareholders to control the company's constitution by voting to alter the articles makes shareholders `the ultimate source of management authority within the company' and any delegation making directors the `central decision-making body on behalf of the company' is that which is given and which can therefore be taken away by the shareholders.[624]

Problems arise where there is a merging of these roles, something which is increasingly the case in SMEs. This problem is compounded by the fact that, just as companies can be formed quickly and easily, they can equally be dissolved with relative speed and ease. The precise nature of such problems, particularly within closely-held companies, will be examined further below.

3.4.2 Origins of Separate Legal Personality

The very existence of a company law regime of free incorporation by registration resulting in its two cornerstones demonstrates the political sway in shaping the development of modern company law.

The doctrine of separate personality was initially laid down in statute by the JSCA 1844; it was later combined with the concept of limited liability[625] in the CA 1862.[626] Prior to the CAs 1844-62, the legal regime was based solely on the Law of Partnership `where corporate privileges were meagrely rationed by the state',[627] and where `membership' was seen as synonymous with ownership of the business.[628] As the nature of JSC membership changed to a more detached, passive rentier investor whose only real interest lay in maximising their returns rather than monitoring the company's management, the case for separate corporate personality became all the more compelling in order to protect such vital corporate investment. This growing need to separate companies from their shareholders, and thereby distinguish them from partnerships, was reflected in the CA 1862, s6 which impliedly declared that the company was formed *by them*, not *of them.*[629]

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[624] ibid, 63, 577; Davies and Worthington (n32) 62.
[625] LLA 1855. 3.4.3.
[626] John Armour, *Codification and UK Company Law*, A Report prepared for the Conference Celebrating the 200th Anniversary of the *Code Commerciale,* (2008) 19; Moore (n34) 180.
[627] Ireland (n22) 838.
[628] Lipton (n34). The JSCA 1856 `permitted seven or more persons `*to form themselves'* into an incorporated company' (Ireland (n22) 846).
[629] N682. Ireland (n22) 846. Note ambiguity of CA 1862, s18.

It is widely thought that the HLs' ruling in *Salomon*[630] represents a landmark decision in establishing the fundamental principle of modern company law – that the separate personality of an incorporated company exists completely separate from its members.[631] As Lord Halsbury LC noted, `Either the limited company was a legal entity or it was not. If it was, the business belonged to it and not to Mr. Salomon.'[632] Since *Salomon*, the complete separation between the company and its members upon incorporation has not been in doubt.[633]

However, as Lipton illustrates,[634] `By the time of *Salomon*, the company form had largely evolved away from its partnership origins, and the separate legal entity concept, in relation to joint stock companies, had become almost fully developed.'[635] A year before the HL's decision in *Salomon*, the CA in *Re George Newman & Co*[636] had stated that a small private company's `corporate capacity cannot be ignored' and `An incorporated company's assets are its property and not the property of the shareholders for the time being.'[637] Interestingly, Lindley LJ stated that if Newman, as controlling director, expected to treat the company's assets as his own, then it would be just and proper for him and his co-shareholders to be `liable without limit for the debts which were contracted in the name of the company.'[638]

What *Salomon* did establish was that a one-man business has as much right to enjoy the privileges that incorporation brings as any larger business incorporating, provided the correct statutory formalities were followed. This decision has been very controversial in many ways, but remains good authority for the legitimacy of closely-held companies being able to benefit from the cornerstones of company law. Their Lordships did not consider the intention behind the wording of the 1862 Companies Act despite this being reasonably discoverable from the Parliamentary debates, instead adopting a literal approach. Neither did they consider Salomon's morality in using nominees or `mere dummies' to make up the seven subscribers needed. Lipton notes, `the marked difference in the approaches taken by … the lower courts … strongly supports the view that the

[630] N28.
[631] *Salomon* (n28) 51 per Lord Macnaghten.
[632] *Salomon* (n28) 31.
[633] Davies and Worthington (n32) 36.
[634] N34, citing CA 1862, and *Bligh v Brent* [1837] 2 Y & C Ex 268.
[635] Paddy Ireland 'The Rise of the Limited Liability Company' (1984) 12 Int'l J Soc L 239.
[636] [1895] 1 Ch 684.
[637] ibid, 685 per Lindley LJ.
[638] ibid.

outcome of the HL decision was not inevitable.',[639] especially as leave to appeal to the HL was only granted to Salomon in the unusual circumstance of a pauper litigant.[640]

As one of the consequences of separate personality is that the company is liable for its own debts and can sue and be sued,[641] it follows that limited liability of members automatically flows from separate legal personality. This has laid the corporate form open to much abuse in the closely-held company where any actual separation between company and members, or even between company and the controlling shareholder, is not evident.[642]

The HLs' decision in *Salomon* and its strict adherence to the literal rule has attracted much criticism.[643] One reason for this is that the doctrine of separate personality applies equally to the closely-held company as it does to the large publicly-held company. Many commentators have questioned the validity of this doctrine,[644] and, despite, or perhaps because of, the HLs' judgment in *Salomon*, have suggested it should `in certain contexts at least, be taken less seriously and corporations more closely identified with their shareholders.'[645] Paddy Ireland argues that `those responsible for the Companies Acts of 1844-62 thought and intended them to be applicable to JSCs and JSCs alone'[646] in order to attract large numbers of passive rentier investors who, due to the risk, might otherwise invest in overseas companies. That is how things progressed initially; however, from around 1880, a proliferation of closely-held companies became incorporated to access the benefits of separate personality and limited liability.

The far-reaching and unambiguous effects of *Salomon* has not, according to Lord Cooke `had an enthusiastic academic press. Modern writers will quote Sir Otto Kahn-Freund's

[639] Lipton (n34). Ireland (n22) 847.
[640] ibid.
[641] 3.4.1 to 3.4.3.
[642] 3.5.
[643] Kahn-Freund (n35) 54. Puig (n118) 26, who thought it a good decision felt it had created opportunities for fraud and evasion of legal duty for closely-held companies (ibid, 15).
[644] Henry Hansmann and Reinier Craakman `Toward Unlimited Shareholder Liability for Corporate Torts', 100 Yale LJ 1879; David Campbell and Stephen Griffin, `Enron and the End of Corporate Governance?' (2006) in MacLeod S (ed) *Global Governance and the Quest for Justice: Volume II Corporate Governance,* (Hart Publishing 1991).
[645] Ireland (n22) 839. 3.6.1.
[646] Ireland (n22) 847.

description of it as "calamitous".'[647] Others have questioned the effects of the *Salomon principle* on the basis that it has given `priority to the separate identity of the legal form and essentially ignored the economic reality of a one-person company.'[648] This concern lies at the very heart of this thesis. Furthermore, *Salomon* gives rogue HRI traders the opportunity to `abuse the advantages that the Corporations Act gives them by achieving a "wafer-thin" incorporation of an undercapitalised company.'[649] Today, shareholders:

> enjoy the best of all possible legal worlds. … [T]he law treats separate personality very seriously in some contexts (shareholder liabilities), while ignoring it in others (shareholder primacy, shareholder control rights). The result is a shareholder's paradise: a body of law able to combine the ruthless pursuit of `shareholder value' without any corresponding responsibility on … shareholders for the losses arising out of corporate failure or the damage caused by corporate activities or malfeasance.[650]

Although Lord Cooke recognised the merit in using the purposive approach to interpretation where the application of the literal approach would result in an absurdity, he believed there could have been no different decision than the one reached by the HL:

> In terms of the *Salomon* context, once an inquiry is admitted into where lies the beneficial ownership or control of company shares, the difficulty of inferring workable limits to the statutory right of incorporation with limited liability becomes practically insuperable.[651]

This then relies on *ex post* action to deal with any difficulties arising from the incorporation `net' having been cast too wide – for example, rogue directors of closely-held HRI companies escaping liability for losses resulting from their bad faith conduct towards consumers. Despite widespread recognition of the ways in which closely-held companies exploit the corporate form at the expense of consumers, the courts, since

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[647] Lord Cooke `A Real Thing: Salomon v A Solomon & Co Ltd' in *Turning Points of the Common Law*, The Hamlyn Lecture Series, Forty Seventh Series, Sweet & Maxwell Ltd, London, 1997, pp.1-27 at p8.
[648] Puig (n118).
[649] ibid, citing the work of Goulding (n118) 49.
[650] Ireland (n22) 848.
[651] Cooke (n647) 10.

Salomon, have continued to uphold the `separate personality' principle.[652] Moreover, they have demonstrated their willingness to disregard separate personality by lifting the veil of incorporation in only a very limited number of circumstances. These, and the SC's decision in *Prest,*[653] will be discussed further at 3.6.1.

The reluctance of the courts to challenge the *Salomon* decision by affirming a set of clear and absolute exceptions to the principle expounded above, or of Parliament to legislate to curb abuses of the principle that have emerged particularly within closely-held companies, has only served to justify the fears of those who fought so vehemently against the Limited Liability Act 1855 (LLA 1855).[654]

3.4.3 Historical Development of Limited Liability

Prior to the nineteenth century, most UK business was conducted through sole traderships and small partnerships, and the concept of limited liability was largely unknown.[655] Partnership law was traditionally founded on agency principles whereby all partners were presumed to be actively involved in the business and could bind each other to contracts made in the name of the firm. Most significantly, partners were unable to limit their liability for partnership debts, for which they were jointly and severally liable `to their last shilling and acre'.[656] As Ireland noted,[657]

> It was widely believed that by ensuring … success was properly rewarded and failure properly punished, the law of partnership not only accorded with … principles of eternal justice and providence … but operated in the public interest by ensuring that firms were run conscientiously and efficiently.

[652] *Williams v Natural Life Health Foods Ltd* [1998] 1 WLR 830; *Lonrho Ltd v Shell Petroleum Co Ltd* [1980] 1 WLR 627; *Tunstall v Steigman* [1962] 2 All ER 417; *Lee v Lee's Air Farming* [1961] AC 12; [1960] 3 WLR 758; [1960] 3 All ER 420; *Macaura v Northern Assurance Co Ltd* [1925] AC 619; *Gas Lightning Improvement Co Ltd v IRC* [1923] AC 723. In *Northern Counties Securities Ltd v Jackson & Steeple Ltd* [1974] 1 WLR. 1133; [1974] 2 All ER 625, the court ruled shareholders owe the company no fiduciary duties, and can use their vote as selfishly as they please.
[653] *Prest* (n80).
[654] N36.
[655] Colin Mackie, `From Privilege to Right - Themes in the Emergence of Limited Liability' (2011) 4 Jur Rev 293, 294. Hansards *House of Lords' Debate about Limited Liability,* 14 March 1856 (LLB 1856 Debate), vol 141, col 137 per Lord Monteagle.
[656] Ireland (n22) 840, citing Gow N, *A Practical Treatise on the Law of Partnership* (Charles Hunter 1823).
[657] ibid.

Distinguishing limited liability from partnership principles, Edward Cox[658] wrote in 1856 how limited liability

> is founded on the opposite principle and permits a man to avail himself of acts if advantageous to him, and not to be responsible for them if they should be disadvantageous; … the law depriving the … the injured of a remedy against the property or person of the wrongdoer, beyond the limit, however small, at which it may please him to determine his own liability.

However, as early as 1776 it was felt that the legal privileges afforded by corporate status and limited liability through JSC formation could be justified, albeit in very limited circumstances only.[659] A system was therefore developed of private Parliamentary Acts[660] and Royal Charters[661] granted by the Crown,[662] by which JSCs were permitted to circumvent the restrictive partnership principle of unlimited liability by acquiring the corporate privileges of separate personality and limited liability.[663] However, these were criticised as unsuitable, inconsistent,[664] and `objectionable'.[665]

As Ireland noted,

> industrialists in the first half of the nineteenth century saw no great economic imperative for general limited liability as they had funded their own expansion by the plough-back of partnership profits; in fact, many were opposed to it.[666]

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[658] Editor of *The Law Times*, `The Law and Practice of Joint Stock Companies' (1856) London, Law Times Office, ppi-ii).

[659] Geoffrey Todd, `Some Aspects of Joint Stock Companies, 1844-1900' (1932) 4 The Economic History Review 46; and Grantham (n610) 557. Ireland (n22) 837. Adam Smith, *The Wealth of Nations* (Liberty Fund 1776) cited in Ireland (n22).

[660] As more and more companies sought incorporation, a great strain was placed on parliamentary time. (Roger Mason, *Company Articles and Company Constitution*, A Thoroughgood Special Briefing, Thoroughgood Publishing Company, 2).

[661] In operation since the sixteenth century, albeit rarely granted (Mason (n660) 4); Katharina Pistor, Yoram Keinan, Jan Kleinheisterkamp, and Mark West, `The evolution of Corporate Law: A cross-country comparison', The University of Pennsylvania Journal of International Economic Law, 23:4, 791-871, 806; Todd (n659) 46.

[662] On the advice of the Privy Council.

[663] Grantham (n610). Earl Grey (Hansards *House of Lords' Debate about the Limited Liability Bill, 07 August 1855 (LLB 1855 Debate) vol 139, col.1896*). Louis De Koker ` The Limited Liability Act of 1855' (2005) 26 Co Law (2005) 130.

[664] President of the Board of Trade was a political government member and changed with every new administration.

[665] Per Lord Stanley of Alderley, LLB 1855 Debate (n663).

[666] Robert Bryer, `The Mercantile Laws Commission of 1854 and the Political Economy of Limited Liability', Economic History L Rev (1997) 37–56 cited in Ireland (n22).

Due to the predominance of the partnership form in the UK, investment opportunities were few, and those that did exist were risky and offered poor returns. Consequently, `British capital began to flood abroad in search of secure outlets offering better returns.'[667] Although there remained grave concerns that making limited liability more freely available to businesses would create a situation whereby under-capitalised businesses might exploit the corporate form to the detriment of creditors and the investing public,[668] by the mid-nineteenth century these concerns were all but ignored in favour of the view that attracting greater investment in British firms was essential to sustaining economic growth with increased competition and fewer monopolies.[669]

The gradual increase of JSC formation did not appease rentiers' need for security and good returns since many JSCs were still unincorporated and therefore were not able to limit shareholders' liability. English company law essentially started with the passing of the Joint Stock Company Act 1844 (JSCA 1844), which simplified the system of incorporating companies by allowing incorporation through registration.[670] The JSCA 1844 required all new businesses with 25 or more participants to become incorporated rather than to form as partnerships; the new company would become an autonomous legal entity in its own right and would be required to file certain documents with a Registrar of Companies to allow greater transparency of the company's affairs for those wishing to deal with or invest in the company.[671] The JSCA 1844 sought to stem the outward flow of capital from Britain by creating attractive investment opportunities for rentiers.[672] Although the JSCA 1844 did not itself provide for limited liability, the company's internal rules could provide for this.[673]

[667] Ireland (n22) 841 citing Jenks LH, *The Migration of British Capital to 1875,* (1927) New York and London: Alfred Knopf.
[668] The Limited Liability Bill was drafted in contemplation of `undertakings of great magnitude' (Hansards *House of Commons' Debate about the Limited Liability Bill, 27 July 1855, (HC LLB 1855 Debate) vol 139, col 1454)*. Lord Monteagle, citing Mr McCulloch, argued `you may prevent the formation of such companies, but you cannot prevent them, when formed, from degenerating into mere swindling engines.' (LLB 1856 Debate (n663) vol 141, col 137).
[669] Ireland (n22) 839.
[670] Joint Stock Companies Act 1844, sXXV. Ireland (n22) 843.
[671] Hicks and Goo (n609) 7-8.
[672] Ireland (n22) 841.
[673] *Hallett v Dowdall* (1852) 18 LJ QB 2, 118 ER 1. See also Armour (n626) 13.

By the 1850s, the volume of attractive investment opportunities offering good returns had increased substantially.[674] All that remained to `make the morsel wholesome as well as tempting' for rentiers was limited liability.[675]

Limited liability was therefore a political construct designed to raise finance by furthering the interests of politically and legally powerful, yet idle, wealthy rentier investors who wanted to earn healthy returns on their investment in companies without getting involved in monitoring the company's affairs. As ordinary partners, they would have been jointly and severally liable.[676]

The original demands for limited liability had envisaged something resembling the later Limited Partnership Act of 1907 where sleeping partners (rentiers) were protected by limited liability, whilst active partners remained liable to an unlimited extent for the debts of the company. Shareholders' rights and powers in the firm and their ability to intervene in management were to have been strictly limited. The rationale behind this was that the risk of bad faith conduct by rogue directors would be minimised if they had unlimited liability; `It was, in other words, a legal form which decoupled limited liability from rights of control.'[677] What they got instead was the LLA 1855 which coupled free incorporation with general limited liability and very few regulatory measures.

It is ironic that a statute which represents such a `significant building block in the formation of the legal framework of the modern company'[678] should have remained in force for only a few months. The principle of limited liability survived the repeal of the LLA. The 1856 Act relaxed the limited liability eligibility criteria,[679] and a continuation of this trend[680] has paved the way for the conglomeration of under-capitalised limited

[674] Ireland (n22) 843 citing Jeffreys (n22).
[675] Ireland (n22) 842 citing *The Times*, 9 October 1940.
[676] Ireland (n22).
[677] Ireland (n22) 853.
[678] De Koker (n663) 130.
[679] For example, reducing the minimum number of members from 25 to 7, and removing the minimum paid-up capital requirements (Hicks (n24) 311.
[680] Griffin (n580), 99; Companies (Single Member Private Limited Companies) Regulations 1992, SI 1992/1699; Hicks and Goo (n609) 2.15.

liability companies that saturate the market today.[681] Partnership principles prevailed under the Joint Stock Companies Act 1856, which

> permitted seven or more persons to `*form themselves'* into an incorporated company, implying that 'the company' and the corporate entity was composed of its shareholders … At this time, then, there was nothing like the modern conception of separate corporate personality, with its 'complete separation' of company and shareholders.[682]

Although the Act permitted smaller businesses to take advantage of limited liability, it is clear the `one-man' limited company that forms the focus of this thesis was not envisaged.[683] Little would the government in 1855 have realised the lacuna that would later come to be exploited by those very businesses which fell outside of their contemplation whilst they rushed through their hasty and ill-considered piece of legislation which would permanently change the course of trading practices. Had Parliament been open to this possibility, it is submitted that it would not have seen fit to set such a minimum limit on a company's membership. However, by failing to have regard for what surely cannot have been Parliament's intention when passing the Companies Acts of 1844-1862[684], the HL in *Salomon* in effect paved the way for abuse of the corporate form by the closely-held company.[685]

Today, a private limited liability company may be formed with just one member[686] and with no minimum capital requirement, thereby `endangering small trade creditors, consumers and tort victims.'[687] One wonders how those who described the LLA 1855 as the `Rogues' Charter' would regard the current company law regime,[688] which has all-but abandoned the vital safeguards needed to foster responsible behaviour; in so doing Parliament has effectively rendered limited liability `available as of right'.[689]

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[681] Represented by sole traders and private partnerships seeking the protection afforded by separate personality and limited liability.
[682] Ireland (n22) 846.
[683] Hicks and Goo (n609) 7-8; Freedman (n54) 319, 331; Ireland (n22) 847; Watson (n35) 608 citing Ron Harris, `The Private Origins of the Private Company: Britain 1862—1907' (November 4, 2009).
[684] Ireland (n22) 847.
[685] Salomon (n28).
[686] CA 1985, s1(1).
[687] Griffin (n580) 99-101.
[688] *The Law Times*, 25 March 1858, 14. Earl Grey (*LLB 1855 Debate (n663) col 1905).* (Diamond (n26) 33.
[689] Mackie (n655) 293.

There can be little doubt that limited liability makes sound economic sense insofar as it creates an efficient market for shares,[690] and `facilitates optimal investment decisions since a positive attitude to risk taking will ensue.'[691] The greatest single advantage afforded by limited liability is that, in the event of business failure, shareholders are only liable to pay any amount on their shares which remains unpaid and no more.[692]

The removal of minimum capital requirements for private companies means the closely-held company shareholder could lose as little as one penny, and this was seen as helping prevent monopolies forming.[693] This is notwithstanding the fact that they, as controlling shareholder, may have caused the company to accrue substantial debts, and its consumers to suffer substantial losses. As Ireland notes, this transformed `the *de jure* regime of limited liability into a *de facto* regime of no liability', resulting in shareholders lacking any real financial incentive to `ensure that the managers involved behave legally, ethically, or decently' and thereby promoting corporate irresponsibility.[694] Stephen Griffin concurs:

> limited liability encourages the taking of business risks. Although risk is an ingredient in the generation of economic growth, the downside … is that it encourages continued trade in circumstances where the health of an enterprise is critical, to the point of its imminent fatality.[695]

It is clear that company law, and more precisely limited liability, affords great protection for investors, who know precisely how much they stand to lose in the event of business failure, and allays any fears they may have had about threats against their personal wealth. As Davies and Worthington state,

> there is an apparent disparity in the risks and rewards which are allocated to shareholders: they benefit, through limited liability, from a cap of their down-side risk, whereas the chance of up-side gain is unlimited.[696]

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[690] Puig (n118).
[691] John Farrar, Nigel Furey, and Brenda Hannigan, *Farrar's Company Law* (2nd ed, Butterworths, 1988), 66, citing Easterbrook and Fischel (n108) 94.
[692] IA 1986, s74(2)(d).
[693] HC LLB 1855 Debate (n668) vol 139 cc1454-55.
[694] Ireland (n22) 845 citing Harry Glassbeek, `Wealth by Stealth', Between the Lines, Toronto (2002).
[695] Griffin (n580) 99-101.
[696] Davies and Worthington (n32) 194.

The encouragement of competition, enterprise and investment are clearly important in stimulating economic growth, and these represent the very things facilitated by limited liability.[697] However, limited liability places consumers in a very precarious position, as when combined with separate corporate personality there is no reserve fund comprising residual shareholder liabilities. Whilst the threat to trade creditors may be mitigated by, for example, the negotiation of personal guarantees from the directors, consumers do not enjoy any such freedoms.

3.5 How the Cornerstones of Company Law are Abused by Closely-Held Companies

The type of private limited company under scrutiny in this thesis is the small closely-held company.[698] The law relating to separate personality and limited liability was never developed with this kind of company in mind.[699] As Moore eloquently observes, the HL in *Salomon*

> sanctioned the use by a sole trader of a shrewd and opportunist arrangement that enabled him not only to immunise himself from personal liability towards his creditors, but also to "trump" them on the winding up of his company by contracting in advance for a sizeable charge over its assets in part-exchange for the assets and goodwill of his pre-existing business.[700]

It is this kind of company which has prompted many appeals for a return to the partnership principle of unlimited liability,[701] or for the courts to take separate corporate personality `less seriously'[702] in certain circumstances. Ireland talks of separate personality having created `a shareholder's paradise: a body of law able to combine the ruthless pursuit of 'shareholder value' without any corresponding responsibility on the part of shareholders

[697] Freedman (n54) 317, 320. See also Department of Trade and Industry White Paper, *Our Competitive Future: Building the Knowledge Driven Economy,* Cm 4176 (1998) 2.7.
[698] Sometimes referred to by other company law scholars as the `one-man company' (for example, Ireland (n22) or `owner-managed company' (Williams (n39) 6.23) to convey the fact that the director(s) are also the controlling shareholder(s).
[699] 3.4.
[700] Moore (n34) 182.
[701] For instance, Hicks (n24) 321, 330.
[702] Ireland (n22) 847; Peter Ziegler and Lynn Gallagher `Lifting the Corporate Veil in the Pursuit of Justice' (1990) JBL 292.

for the losses arising out of corporate failure or the damage caused by corporate activities or malfeasance.'[703] Whilst this is true, some justification may be attributable to the government's desire to attract investment capital from a group of rentier investors who lacked the desire, and probably skill, to monitor the activities of the company's management. Limited liability and separate corporate personality facilitated such passivity. On the basis of the arguments put forward in this thesis, it may be more fitting to describe the cornerstones of company law as having created `a rogue directors' paradise', `a closely-held company's paradise' or a combination of each.

Of all company types, the closely-held company has the greatest potential to abuse the corporate form. This assertion may not be readily acknowledged by those who associate abuse of the corporate form with high profile corporate failures or scandals[704] which have typically involved large public limited companies with widely dispersed ownership. However, it is important to note that abuse by small private companies occurs on a much more frequent basis,[705] involves unsuspecting victims such as consumers who lack the means of effecting self-help in the same way as a shareholder who might be able to sell their shares at the first sign of trouble, and often involves significant financial sums.[706] Such widespread abuse by closely-held companies occurs because the directors and those who exercise control over them – the shareholders – are invariably one and the same person. A rogue director who acts in bad faith towards a consumer is unlikely to suddenly acquire a conscience in their capacity as company shareholder. Coupling this kind of company with separate corporate personality and limited liability is a recipe for disaster, and a breeding ground for corporate irresponsibility of the type described by Ireland.[707]

The protective devices available to shareholders to curb managerial misconduct have no role in the closely-held company. There is no directorial accountability since no danger exists of them, qua shareholder, voting for their own removal from office; and directors will be at liberty to conduct company business in their own interest, since that too will satisfy the requirement for them to act in the shareholders' best interests[708] of wealth

[703] Ireland (n22) 848.
[704] For example, US companies Lehman Brothers in 2008 and Enron in 2001 respectively.
[705] Tax Research UK (n597).
[706] Chapter 2.
[707] Ireland (n22); 3.4.3.
[708] Synonymous with *company's best interests* (see Ireland (n22) 48).

maximisation. If they are employees of the company, it is the company which will be primarily liable for their torts rather than the directors themselves, although in certain circumstances directors may be held jointly liable with the company for their own torts.[709] As agents, they will face no responsibility for having acted outside of their authority since they will also effectively be their own principal.[710] As principal, the shareholders could ratify their own ultra vires acts as agents. Similarly, they will have no fear of statutory derivative action[711] even if it can be established that their actions have resulted in a wrong being done to the company, nor will they be held accountable for any breach of their statutory[712] or fiduciary duties.[713] The protective devices to protect the public[714] are equally ineffective in deterring bad faith conduct by rogue directors.[715] If directors wish to walk away from company debts, a bad reputation, a civil action or disqualification investigation, they can dissolve the company and simply buy another ready-made company `off the shelf' for £19.99 plus VAT from an incorporation agent.

Accessibility to the corporate `privileges' requires no possession of consummate skill or resourcefulness on the part of the company's incorporator(s). They are automatically available on the simple incorporation of the business, at which time the company exists as a separate legal entity, liable for its own debts, and shareholder liability is limited to the sum total of their capital investment.[716] It is commonplace today for shares to be issued at a nominal value of only £1 and, if the company has only one or two shareholders, then not only does this mean that shareholder(s) only stand to lose only £1 or £2 but it also means that the company's assets may be limited to a similar amount, particularly if it has already been subject to asset-stripping in readiness for its dissolution.[717] It follows that any consumer who has borne losses as a result of dealing with a rogue director is left having to sue a company which lacks the means to settle their claims. Meanwhile the

[709] *Rose v Plenty* [1976] 1 WLR 141. Discussion on joint liability at 4.2.2.1.
[710] As Kahn-Freund (n35) 56 notes, even if one were to regard the director as the agent of the controlling shareholder, `the Courts were prevented by the strait-jacket of the *Salomon* decision from holding the latter liable for debts contracted by the company as his agent.'
[711] Under Part 11 of the CA, s260.
[712] For example, CA 2006, s172 (3.6.4.1).
[713] Any failure to protect stakeholder interests can only be enforced by shareholders, for example CA 1985, s309.
[714] CDDA 1986.
[715] See 3.3 and 3.6.3.
[716] Or unpaid portion thereof.
[717] `Phoenixing'.

directors and shareholders escape liability, free to enjoy the fruits of their `enterprise'. It can therefore be seen that the very cornerstones of company law that were designed to stimulate economic growth and attract investment capital into incorporated companies have come to be abused by a growing number of closely-held companies in order to exploit consumers and other unsecured creditors, each of whom have effectively replaced shareholders as the real risk-bearers of corporate activity. Easterbrook and Fischel note that `managers' incentive to undertake overly risky projects is greater in close corporations' due to the fact that limited liability allows the `investor-managers … [to] limit their risk to the amount of capital in the corporate treasury and transfer more of the risk to third parties.'[718] Easterbrook and Fischel suggest piercing the corporate veil as one way of reducing third party losses but English courts have shown a dogged reluctance to make the human constituencies of the company liable for wrongs committed in the company name.[719] There are no barriers to socially excessive risk-taking in the case of the closely-held company under scrutiny in this thesis, due to the total absence of shareholder monitoring or managerial accountability that might otherwise provide a check on managerial risk-taking.

There has been much written by respected academics about the fact that limited liability has paved the way for small closely-held companies to abuse the corporate form. Mohanty and Bhandari, for instance, describe how `unfair advantage accrues to shareholders who limit their losses at the creditors' expense, but simultaneously derive unlimited profit during boom times.'[720] In a similar vein, Hicks explains how the proliferation of `small limited companies is … undesirable as it transfers the risk of business failure to unsecured creditors'.[721] The *proliferation* to which he refers was discussed in the Jenkins report which found:

> The Board of Trade have referred in their evidence to the irresponsible multiplication of companies, particularly of 'one-man' companies; to the dangers of abuse through the incorporation with limited liability of very small, undercapitalised businesses. We are satisfied that this proliferation of small companies can and does lead to abuse and should if possible be checked.[722]

[718] Easterbrook and Fischel (n108) 56.
[719] *Salomon* (n28).
[720] Mohanty and Bhandari (n34) 194.
[721] Hicks (n24) 330.
[722] *Report of the Company Law Committee* (Chair: Lord Jenkins), Cmnd 1749 (1962) para 20.

Only 20 years later, a government consultation paper[723] reported that the number of small companies had virtually doubled since the Jenkins report.[724] Just a year later, the Cork Committee report on the reform of the law of insolvency[725] identified a pattern of abuse of limited liability that has come to be known as `phoenixing'.[726] `Phoenixing' invariably involves directors deliberately exploiting consumers and incurring debts to the point that the company becomes insolvent, and then voluntarily winding-up the company using a `planted' or `cowboy' liquidator who sells off the company's assets `at a knock-down price to a newly-formed company'[727] controlled by the existing company's controlling shareholder. This new company will then `take over the old business, using the old premises and even reemploying the old workforce. The new company would … have a slightly different name … and would to all intents and purposes be the old business under the old management and ownership.'[728] The new company would not be saddled with the debts of its predecessor as the creditors would have no legal claims against this company.

Companies House records show that 2.35 million small companies (77.1% of all companies), having an issued share capital of less than £100, were on the UK Register as at the year ending March 2013.[729] During the same period, 482,800 new companies were incorporated (of which it is estimated that 372,000 were closely-held). Interestingly, more companies were dissolved (302,600), in liquidation (80,400), and in the process of being removed (185,900), bringing the `net effective' total of UK companies on the Register at the end of the period under the total number of UK companies on the Register at the beginning of the period.[730]

Rather than regulate small private companies more closely, there has been an extensive programme of deregulation instead, thereby encouraging their continued proliferation.[731]

[723] A New Form of Incorporation for Small Firms (1981) Cmnd 8171 at para 1.6.
[724] Hicks (n24) 313.
[725] Insolvency Law and Practice (Chair: Sir K Cork), Cmnd 8558 (1982).
[726] Hicks (n24) 314.
[727] Fletcher (n540) 368.
[728] ibid.
[729] Companies House statistics (n595) Table A6.
[730] ibid, Tables A2 and B6.
[731] For example, CA 1985, ss379A; ss246-249); ss.249A-249E); and simplified accounting requirements. Hicks (n24) 318.

As Hicks observes, `Even though limited liability shifts the risk of failure to unsecured creditors, the legislature continues its love affair with the limited liability company.'[732] This is surprising given that `the economic benefits brought about by limited liability are absent with respect to closely held or private companies.[733]

Puig describes how the reduction in monitoring costs is of no consequence as the `owners and managers are one and the same'.[734] Moreover, the benefits of developing an efficient market for shares has no basis in the closely-held company where the only shares in the company are owned exclusively by the director(s), or by the director and his nominees.`[735] Significantly, Puig describes how

> limited liability encourages such companies to take excessive risks …, the corporate form has been responsible for the development of many different forms of fraudulent or anti-social activity.[736]

The main benefit to closely-held companies of incorporation is limited liability as the incorporators recognise that incorporation allows them to create a risk-free environment for themselves, qua shareholders. It has already been established that this was never Parliament's intention, so why therefore this steadfast determination to create an attractive, and arguably irresistible, trading environment for such small entrepreneurs? The answer must lie in the government's belief that small private companies are the backbone to a strong economy. Coupling this with the problems explored in Chapter 2, where consumers suffer financially and psychologically at the hands of rogue traders in the HRI market who masquerade as respectable limited companies, and it becomes very difficult to defend the availability of the corporate form for the closely-held company.

[732] Hicks (n24) 315.
[733] Puig (n118).
[734] ibid.
[735] ibid. As in *Salomon* (n28).
[736] Puig (n118).

3.6 Ways in which Company Law may be seen as Curbing Abuse of the Corporate Form

Since the problem relating to consumers being exploited by rogue directors of closely-held companies is one created by company law, then arguably so too should the remedy lie in company law. Yet, this is not the case. This is not because the government does not recognise the seriousness of the problem and its impact on consumers. As Hicks observes, `Many of the most complex and controversial areas of United Kingdom company law are aimed at protecting consumers and creditors generally from the risks imposed by limited liability.'[737] Yet many of the legal provisions Hicks cites by way of example - strict accounting, audit and disclosure regimes; and capital maintenance provisions – have now been relaxed for SMEs to such an extent that they are virtually ineffective in providing consumer protection.

There are various corporate governance mechanisms designed to curb abuse of the corporate form. However, these typically only work in the context of large companies with widely-dispersed ownership. For example, public limited companies require non-executive directors to monitor executive directors by bringing `an independent judgement to bear on issues of strategy, performance and resources including …standards of conduct.'[738] The UK Corporate Governance Code[739] applies to companies with a premium listing of equity shares in London. In the case of large private companies, shareholder activism arising from the separation of powers should, in theory at least, prevent `the dangers of untrammelled management power'.[740] However, these corporate governance mechanisms play no part in supporting the position of consumers dealing with closely-held companies because of the absence of separation of powers, and the dominance of the contractarian theory ensuring that any protection is aimed predominantly at shareholders rather than at other corporate stakeholders.[741]

[737] Hicks (n24) 320.
[738] Institute of Directors' Factsheet: `The role of the non-executive director', 2010, citing from The Cadbury Report 1992.
[739] Financial Reporting Council, `The UK Corporate Governance Code' April 2016.
[740] Hill (n612) 344.
[741] 1.5.

There are occasions when the veil of incorporation may be lifted (or pierced), but these are few. Even those exceptions to separate personality as do exist have no application in making the human constituents of the company liable for exploitation of consumers since consumers have never been permitted to deploy these exceptions to circumvent separate legal personality and limited liability. The common law and statutory exceptions to the veil of incorporation will be described below. These will then be revisited in Chapter 4 for the purpose of examining their applicability to rogue HRI directors' abuse of the corporate form at the expense of consumers in order to examine whether there is the potential for a case to be made for law reform in this area.

3.6.1 Development of Common Law Exceptions to Separate Corporate Personality

This area of the law is complex in nature and unclear in scope.[742] Since the HLs' ruling in *Salomon*[743] when Lord Halsbury enunciated that pragmatism had no part to play in any court decision to look behind the veil of incorporation to make those who control a limited liability company liable in any way, the courts have been very reluctant to invoke or extend the very restricted circumstances in which the veil can be effectively lifted. Not surprisingly, this situation has been the source of much academic and judicial debate. Ziegler and Gallagher[744] note that there is support for[745] and against[746] the view that the courts have become increasingly willing to lift the veil of incorporation.

Whether or not this is true, and despite the apparent unshakabability of the *Salomon* principle, it appears since *Salomon* itself there has never been any question that there will be some exceptions to the doctrine of separate personality.[747] In delivering his judgment in the *Salomon* case, Lord Halsbury stated that the courts would recognise the company's separate legal identity provided there was `no fraud and no agency, and if the company was a real one and not a fiction or a myth'.[748] Lord Denning, in *Littlewoods Mail Order*

[742] Particularly following decisions such as Creasey *v Breachwood Motors Limited* [1992] BCC 638.
[743] N28. 3.6.
[744] N702, 293.
[745] Clive Schmitthoff `Salomon in the Shadow', (1976) JBL (1976) 305; Ziegler and Gallagher (n702): *Harris* (1980) FLC 75, 117, *Smith* v *Saywell* (1980) 47 FLR 267, and *Buckeridge (No 2) (*1981) FLC 76, 853.
[746] Phillip Lipton and Abe Herzberg, *Understanding Company Law* (2nd ed, Butterworths, 1985) 24.
[747] Ziegler and Gallagher (n702) 295.
[748] *Salomon* (n28) 33.

Stores Ltd v IRC[749] warned that shareholders should not feel untouchable on account of being hidden from view by the veil of incorporation; `The courts can, and often do, pull off the mask' to see the reality of what is happening behind the veil.[750]

At common law, the courts have shown a general willingness to lift the veil of incorporation[751] in cases of fraud,[752] agency, avoidance of existing obligation,[753] façade/sham cases,[754] prevention of injustice,[755] and imputation of members' characteristics to the company.[756] In 1990, Ziegler and Gallagher regarded these as essentially subsets of *prevention of injustice* since they all indicated the judicial desire to prevent injustice.[757] This appears incongruent with the injustices of exploited consumers since, as the body of case law shows, there have been no recorded cases of the veil being lifted to hold rogue HRI directors accountable. Unfortunately, in 1998, the *interests of justice* test, which had offered such a positive counter-measure to the effects of the *Salomon* principle, became `defunct'[758] following the Court of Appeal (CA) in *Ord v Belhaven Pubs Ltd*[759]overruling the court's decision in *Creasey.*[760] The general reasoning behind this decision has, according to Moore, `been confusing and, at times,

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[749] [1969] 1 WLR 1241, 1254 (1985) 3 ACLC 565.
[750] Ziegler and Gallagher (n702) 295.
[751] Thereby making the company's controllers personally liable rather than the company itself.
[752] 4.3.4.3.
[753] For example, the CA in *Gilford* (n27*)* granted an injunction against director and company where the company was incorporated to conceal the director's breach of a non-solicitation clause. Also in *Jones* (n27), Russell J found `the defendant company was the creature of the first defendant, a mask to avoid recognition by the eye of equity'.
[754] In *Gencor ACP Ltd v Dalby* [2000] 2 BCLC 734 (Ch), the veil was lifted to hold the controlling shareholder responsible for breaching his fiduciary duties by taking diverting corporate opportunities or secret commissions to his newly incorporated company.
[755] *Re Bugle Press Ltd* [1897] AC 22[1961] Ch 270.
[756] Ziegler and Gallagher (n702) 293.
[757] A view shared by Murray Pickering `The Company as a Separate Legal Entity', (1968) 31 MLR 481, 483.
[758] Moore (n34) 182.
[759] [1998] 2 BCLC 447.
[760] *Creasey* (n742).

contradictory'[761] and a source of much contention.[762] In *Adams,*[763] Slade LJ comprehensively identified just two circumstances in which the courts would be justified in disregarding the separate corporate personality - using the company as a sham or façade, and in group company situations where the subsidiary is a *de facto* agent of the parent company.[764]

More recently, the SC refused to lift the veil in *VTB Capital Plc v Nutritek Corp*[765] where the controller of the company was being sued for damages as though he had been a party to the contract personally; his misrepresentations had induced *VTB* to contract with his company. Lord Neuberger, representing the majority, said there were overwhelming reasons for refusing to lift the veil in these circumstances,[766] not least the fact that *VTB* were seeking to make the company a quasi-agent whereas it was in fact the principal under the contract. Lord Neuberger denied this would result in unfairness since *VTB* could sue the director directly for negligent or fraudulent misrepresentation. Furthermore, in this case, the company was not being used as a façade to conceal the true facts. As in *Salomon,* morality did not feature in the SC's decision as Lord Neuberger found that the director's alleged abuse of the corporate form brought nothing further to the debate on whether the veil should be lifted. Although Lord Neuberger did allude to the fact that the veil could be lifted in certain circumstances `in order to defeat injustice', clearly the façade requirement is still the test to be applied.

The most recent case to come before the SC is *Prest*,[767] a case in which the veil was not lifted in order to reach a matrimonial settlement concerning companies controlled by the husband. In the first hearing, Moylan J held that the veil cannot be lifted merely because

[761] Moore (n34) 183. Creasey claimed for wrongful dismissal. In anticipation of his claim succeeding, his employers transferred all of their assets to Breachwood, another company they controlled, thereby depriving him of the ability to enforce his claim for damages. He therefore sought an order for Breachwood to ascertain the reality of the situation by looking behind the veil. Although Creasey's claim succeeded, the CA in *Ord v Belhaven Pubs Limited* [1998] 2 BCLC 447 overruled saying fraud and sham were the only exceptions to Salomon.
[762] Moore (n34) 201. Jennifer Payne, `Lifting the Veil: A Reassessment of the Fraud Exception' (1997) 56 CLJ 290; Daniel Bromilow `Creasey v Breachwood Motors: Mistaken Identity Leads to Untimely Death', Company Lawyer (1998) 19, 198; Png C A, `Lifting the Veil of Incorporation: Creasey v Breachwood Motors: A Right Decision with the Wrong Reasons' (1999) 20 Co Law 122.
[763] *Adams* (n36).
[764] Slade LJ's statement has come to be viewed as good authority on the subject of lifting (or piercing) the veil of incorporation (see Moore (n34) 183 for example).
[765] [2013] UKSC 5.
[766] ibid, 137.
[767] *Prest* (n80).

it is in the interests of justice to do so, but can be lifted if there is impropriety linked to the company structure being used to conceal that impropriety. He ordered the lifting of the veil in compliance with the Matrimonial Causes Act 1973 (MCA). The CA overturned the decision saying that the MCA could only be used in this case if the corporate form was being abused, that is being used for an improper purpose or the company's properties were being held on trust for the husband. The SC unanimously overturned the CA's decision, holding the companies in fact held the properties under a resulting trust for the husband who owned them beneficially, and therefore there was a power under the MCA to transfer half the value of the property to the wife. There was therefore no need for the veil to be lifted. The SC confirmed the veil can be lifted when someone incorporates a company to evade an existing legal duty/perpetrate a fraud. As Mr Prest had not set the companies up to evade any liabilities in the divorce proceedings, there were no grounds for lifting the veil. Lord Neuberger stressed that the veil should only be lifted as a last resort.[768] He agreed with Lord Sumption that `fraud unravels everything'.[769] Lord Sumption confirmed the starting point in any modern analysis of the general principle of ignoring separate personality comes from Lord Keith of Kinkel's dictum in *Woolfson v Strathclyde Regional Council*:[770] `it is appropriate to pierce the corporate veil only where special circumstances exist indicating that it is a mere facade concealing the true facts.'[771] or being used for a `deliberately dishonest purpose'.[772] In *Adams*,[773] Slade LJ said `the court is not free to disregard the principle of *Salomon* ... merely because it considers that justice so requires.' However, Lady Hale's judgment in *Prest v Petrodel* seemed to blur the boundaries somewhat when she said of those cases in which the courts have disregarded separate legal personality: `They may simply be examples of the principle that the individuals who operate limited companies should not be allowed to take unconscionable advantage of the people with whom they do business.'[774] After going through all relevant precedent, Lord Sumption tried to clarify the law:

[768] Para 83.
[769] Para 18.
[770] 1978 SC (HL) 90.
[771] ibid, p96.
[772] Per Slade LJ in *Adams* (n36) 539, 540.
[773] *Adams* (n36).
[774] [2013] UKSC 34, 92.

> I conclude that there is a limited principle of English law which applies when a person is under an existing legal obligation or liability or subject to an existing legal restriction which he deliberately evades or whose enforcement he deliberately frustrates by interposing a company under his control. The court may then pierce the corporate veil for the purpose, and only for the purpose, of depriving the company or its controller of the advantage that they would otherwise have obtained by the company's separate legal personality.[775]

A recent application of the *Prest* principles arose in *Clegg v Pache.*[776] In that case, Pache, the co-director and shareholder of a steel trading business, incorporated FPL to divert funds and business opportunities of the steel company to his own company, in breach of his fiduciary duties. The CA lifted the veil in a one-man companywhich had been set up to conceal its controlling shareholder's breaches of fiduciary duties. The CA held that the new company was Pache's *alter ego* because he had `complete dominion over the conduct of its business and affairs'.[777] It was merely `a corporate cloak for the exploitation byMr Pache of a steel trading business for his own benefit.'[778] As Greg Allan notes, `Only five years previously, in the same court, Thorpe LJ branded similar reasoning "heretical". … The catalyst for this apparent U-turn … was the Supreme Court decision … which has introduced a new level of uncertainty into an area of law which has long been plagued by inconsistency.'[779]

A similar case to *Clegg* had arisen in *Gencor*[780]17 years earlier. In that case, Rimer J had ruled that the corporate veil be lifted to hold a director liable for diverting secret profits and corporate opportunities to a new company under his sole control as these had belonged to his principal company. However, in *Prest* Lord Sumption and Lord Neuberger agreed that such `façade/sham' cases are no longer to be treated as exceptions to *Salomon* as they can be determined by ordinary principles of agency law where the

[775] *Prest* (n80) 35. These principles have been accepted as good law since *Prest* (*Airbus Operations Ltd v Withey* [2014] EWHC 1126 (QB); *R v Sale* [2013] EWCA Crim 1306; [2014] 1 WLR 663; *Pennyfeathers Ltd v Pennyfeathers Property Co Ltd* [2013] EWHC 2520 (Ch).
[776] [2017] EWCA Civ 256.
[777] Briggs LJ, 17.
[778] ibid, 53.
[779] Greg Allan, `The Corporate Veil and the Rise of Alter Ego Companies', (2017) 398 CLN 1, 1.
[780] N754.

one-man company is legally identified as its controller's alter ego.[781] By regarding the newly-formed company as its controller's agent, the controlling shareholder[782] would be liable to account for profits made in breach of his duty as a director of the claimant company, and therefore the same outcome could be reached without disturbing the veil of incorporation. This formed the basis of the CA's decision not to lift the veil in *Clegg*.

It is difficult to understand how the SC makes the distinction between a breach of contractual duty[783] and a breach of fiduciary duty[784] when both breaches by a director could be against the company,[785] and when both involve a director trying to enrich himself as a result of his breaches. One difference between these duties is that contractual duties are legal, whereas fiduciary duties are equitable. But, when equitable interests prevail over legal interests, where any conflict exists, it is difficult to understand any differentiation on this basis.

Furthermore, if evasion of an existing legal duty (normally contractual) operates as the only circumstance in which the veil can be lifted at common law,[786] then it is hard to see why a rogue HRI director who uses money made from exploiting consumers as a result of breaching contractual terms,[787] and converts this into assets which he then diverts into a newly-formed `phoenix' company in order to put them beyond the reach of litigating consumers, should not be caught under the evasion principle. He is in breach of an existing contractual duty to the consumer, and will have set up a new one-man company of which he has sole control specifically to defeat any claim that might have been made against his former asset-rich company. Because of the doctrine of privity, it has already been shown that consumers have very little chance of succeeding in a claim for damages against the company and therefore it may be that the evasion principle would represent their only hope of an effective remedy. It has been stated that many rogue HRI directors incorporate their company with the intention of exploiting consumers, and thereby

[781] Applying *Prest's* concealment principle.
[782] Together with the company.
[783] *Gilford* (n27*)*.
[784] *Gencor* (n754); *Clegg* (n776).
[785] Director as employee/agent.
[786] *Prest's* evasion principle.
[787] Either expressly made or impliedly under the CRA 2015.

breaching their contractual obligations. Stefan Lo,[788] in his article examining veil-piercing in the context of tort, notes that the evasion principle in *Prest* does not just cover existing legal *liabilities* but also covers existing legal *obligations*: `Obligations or duties can arise, whether in tort or in contract, before there is legal liability for breach. In the present context, proper identification of the time at which the legal obligation can be said to arise is critical in determining whether there is an evasion of an existing legal obligation.' Arguably, there would be greater scope for success of this argument for breach of a tortious obligation than there would be for a contractual obligation because whereas tortious duties[789] can arise as soon as a trader starts trading, a contract must be established between trader and identified consumer in order for the parties to be bound by any contract terms. One way of getting around this might be to say that the CRA 2015 creates statutory implied contractual duties, and therefore obligations on traders to operate fairly with consumers as a class, and this becomes a duty as soon as the contract is made with an identifiable consumer.

In light of case law concerning the limited circumstances in which the courts are willing to lift the veil of incorporation, one wonders why phoenixing has not come under the judicial radar before since the very motivation for rogue directors incorporating a new company is to evade tax liabilities or court judgments.[790] This matter will be given greater consideration in Chapter 4.

One of the greatest difficulties facing the courts, and the legal profession generally, is the uncertainty and therefore unpredictability of the law in this area. For example, if the courts are prepared to protect the beneficiaries of restrictive covenants,[791] it is difficult to understand why they are not prepared to extend this concept of prevention of injustice to consumers.

Moore suggests a more consistent and reliable way of deciding whether or not a case qualifies as a common law exception would be to apply a *genuine ultimate purpose* rule, which could run in parallel to the *Salomon* principle.[792] This rule would consider whether

[788] Stefan Lo, `Piercing of the Corporate Veil for Evasion of Tort Obligations', (2017) 46 CLWR 42.
[789] For example, the duty of care in *Donoghue v Stevenson* [1932].
[790] Tax Research UK (n597); Tomasic (n11).
[791] As in *Gilford* (n27).
[792] Moore (n34) 200).

`the company … whose autonomous existence is questioned is either active or passive in relation to its controlling trader'.[793] The court's decision would then rest on whether the company was *carrying on* its incorporator's business, or whether business was *being carried on* by the incorporator.[794] Evidence of whether a company is active in relation to the company's affairs can be determined by whether or not it `exists to promote a genuine purpose of that business.'[795] A genuine purpose is one which `*precedes* and also *exists independently* of the specific activity that gave rise to the dispute at hand'.[796] Moore therefore asserts that the court in *Creasey* reached the right decision,[797] but based on a different set of reasons.[798]

It is clear that the circumstances in which the courts are prepared to disregard the separate corporate personality of the company remain in an unsatisfactory state due to the divergence of opinion, particularly in relation to whether or not there should be an exception to *Salomon* where the interests of justice demand it. According to the logic and language of communitarianism, a rogue HRI director of a closely-held company should not be permitted to escape personal liability when he has enriched himself by exploiting his company's consumers. However, *Salomon* demonstrated that, provided the correct formalities are followed and provided there is no fraud involved, the court will not concern itself with what type of business has been incorporated nor for what purpose, however immoral. Therefore, as the law currently stands, it is unlikely that a consumer would succeed in asking the court to lift the veil to expose the rogue director responsible for their exploitation and, just as it is very likely that no consumer has ever tried, it is quite likely that none ever will until a new precedent is established. To this extent, the decision in *Prest* is to be welcomed insofar as it highlights the need to consider other remedies first before looking to lift the veil of incorporation.

[793] Moore (n34) 198.
[794] Moore (n34) suggests that *Gilford* is a case in example of a company having a passive existence, `making it an object *being deployed in,* rather than itself deploying, the affairs of Mr Horne's business.'
[795] Moore (n34) 199.
[796] ibid.
[797] Since Breachwood's independent legal existence was attributable to its founders' foresight of an impending claim rather than any identifiable strategy of the motor industry (Moore (n34) 202-203)).
[798] ibid.

3.6.2 Statutory Exceptions to Separate Corporate Personality

The UK legislature clearly recognises the potential for abuse of the corporate form resulting from rogue directors' bad faith conduct.[799] Most of the statutory exceptions to the doctrine of separate legal personality are to be found in the Insolvency Act 1986 (IA 1986), Part IV.[800] From the perspective of the exploited consumer, these provisions are protective rather than remedial since it is generally only open to the liquidator to take action[801] against rogue directors and, even where any proceeds are recovered for consumers these are paid towards the company's assets and therefore shared amongst other unsecured creditors rather than direct to exploited consumers.

According to Hicks,

> The provisions of the Insolvency Act 1986 for "adjustment of prior transactions" and the much heralded but largely ineffective wrongful trading action, are to give liquidators a last minute opportunity to salvage assets for the ordinary creditors. … [D]isqualifying unfit directors under Company Directors Disqualification Act 1986 s6 may be … little more than a cosmetic attempt to withdraw the privilege of limited liability as a protective measure.[802]

Under s212, a director may have to account for any losses resulting from any breach of fiduciary or statutory duty committed during the winding up of the company.[803] This includes misapplying or retaining company funds.[804] An exploited consumer, or one with a judgment order in their favour, would therefore have a right to apply to the court under s212(3) for an order against the rogue HRI director to `repay, restore or account for the money or property or any part of it, with interest …'[805] or `contribute such sum to the company's assets by way of compensation in respect of the misfeasance or breach of fiduciary or other duty as the court thinks just'.[806] However, s212 only applies in the case

[799] As seen in various legislative provisions designed to protect creditors who have a legitimate interest in the company's operations.
[800] Part IV.
[801] On behalf of creditors. Though note s212.
[802] Hicks (n24) 320.
[803] IA 1986, s212(3).
[804] ibid, s212(1).
[805] ibid, s212(3)(a).
[806] ibid, s212(3)(b).

of formal insolvency proceedings. It therefore would not apply where a rogue HRI director incorporates a new company and then transfers to that company the assets from his existing company in order to put them beyond the reach of exploited consumers. Even though such an act will render his existing company insolvent, unless he commences a formal winding-up procedure, s212 will not apply. It has already been shown that enforcement levels amongst consumers are low, and therefore it is unlikely that any consumer would pursue an application under s212 even if they knew such a right existed.

Under s213 (fraudulent trading), a director may be ordered to personally contribute to the company's assets where, during the winding up of the company, the company has been carried on with the intent to defraud its creditors. It must be proved that the director actually knew that there was `no reasonable prospect of the creditors ever receiving payment of those debts'.[807]

Under s214 (wrongful trading), only those directors who knew or ought to have known there was no reasonable prospect of the company avoiding insolvent liquidation will be liable to account.[808] Just as the courts may fix the amount of compensation payable by a director to reflect their degree of culpability,[809] they will not penalise directors who have acted honestly and reasonably in trying to trade the company through its troubled times.

When a company is in financial difficulty, to the point that it is either insolvent or facing insolvency, the directors owe a general duty to the company's creditors as well as to the company;[810] this is designed to ensure that the company's property is not `dissipated or exploited for the benefit of the directors themselves to the prejudice of the creditors.'[811]

By continuing to trade when the company is in such financial difficulty would not only be in breach of s214, but could also trigger an application under s212.

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[807] *Re William C Leitch Brothers Limited* [1932] 2 Ch 71, per Maugham J at p77. In *Re Patrick and Lyon Ltd* [1933] 1 Ch 786, the court believed the words `defraud' and `fraudulent purpose' conveyed actual dishonesty on the part of the director (at p790).

[808] IA 1986, s214(2)(b)&(c).

[809] Vanessa Finch, *Corporate Insolvency Law: Perspectives and Principles*, Cambridge University Press (Cambridge, 2002) 514.

[810] *Winkworth v Edward Baron Development Co Ltd* [1987] 1 All ER 114.

[811] Per Lord Templeman (at 1516). Andrew Keay, *Company Directors' Responsibilities to Creditors*, Routledge-Cavendish, Abingdon, 2007, 159. See also *Brady & Anor v Brady & Anor* [1987] 3 BCC 535. Consumers who have advanced money to a company in anticipation of receiving goods/services are a form of unsecured creditor (Finch, n809). So too should be consumers who have paid for sub-standard work or for work not carried out.

According to Keay,[812] only the most irresponsible directors are sued under s214 and even then judges are not best-placed to judge or impute a director's state of knowledge, particularly where these directors can afford to hire expert company lawyers. Interestingly, in the limited number of cases proceeded against for wrongful trading, most involve closely-held companies and all successful claims have involved directors of closely-held companies.[813]

Sections 216 and 217 seek to curb attempts by directors to exploit the goodwill of their failed business by incorporating another company prior to the liquidation of the first company, and using a trading name so similar to that insolvent company that it gives consumers the impression they are one and the same company.[814] These are known as `phoenix companies'.[815] S216(3) prohibits the director of the insolvent company becoming a director or being involved in the management of the new company bearing the same or similar name as the insolvent company, and breach of s216 constitutes a criminal offence.[816] Moreover, the director will be personally liable for the relevant debts.[817]

Despite the fact that the statutory provisions relating to the lifting of the veil do not provide a response to all situations coveringconsumer exploitation, and do not provide a direct cause of action to consumers themselves,[818] it should be noted that there are many other provisions which can curb mismanagement of a company in more conventional ways than to disregard the separate legal personality of the company. For example, when a transfer of assets is made with the intention of giving someone a preference, the court 'shall make such an order as it thinks fit for restoring the position to what it would have been if that individual had not entered into that transaction.'[819] A preference is given when a creditor is placed `into a position which, in the event of the company going into

[812] Keay (n34) 446.
[813] Keay (n811) citing P James, I M Ramsay and P Siva, `Insolvent Trading – An Empirical Study' Research Report, Centre for Corporate Law and Securities Regulation, University of Melbourne (2004)
[814] IA 1986, s216(2). In *First Independent Factors and Finance Ltd v Mountford* [2008] EWHC 835 (Ch), both companies used similar names, similar logos, and the controlling director-shareholder of the first was also director of the second. The director was made personally liable on the debts of the first company.
[815] 3.5.
[816] IA 1986, s216(4).
[817] IA 1986, s217.
[818] Except potentially under s212.
[819] IA 1986, s239.

insolvent liquidation, will be better than the position he would have been in if that thing had not been done;'[820] and the company must have been influenced by a desire to achieve this outcome.[821] Where the creditor is connected with the company, this `motive' is presumed.[822]

Similarly, if a transaction has been entered into with a person at an undervalue[823] in order to put assets beyond the reach of the company's creditors,[824] or in order to prejudice the interests of creditors, [825] the defrauded creditor may apply (with leave) for the court to set aside the transaction at undervalue.[826] Unlike s239, no intention or motive needs proving, but there is a defence if the company was acting in good faith and for the purpose of carrying on its business.[827] As Vanessa Finch and David Millman note, `A precondition for bringing an action … is that the company must have been unable to pay its debts at the time or have become unable to do so because of the transaction.'[828] The court will `make such order as it thinks fit for restoring the position to what it would have been if the company had not entered into that transaction.'[829] However, as it is the liquidator who makes an application under s238, a `director's friend' is not going to challenge that which he facilitated.[830]

The best chance for consumers where assets have been transferred to a phoenix company at an undervalue comes under s423. The court can make any order as it thinks fit to restore the position prior to the transaction[831] and to protect the victim's interests,[832] provided it is satisfied that the undervalue transaction was entered into for the purpose of placing the assets out of the consumer's reach[833] or prejudicing the consumer's interests in relation to the claim he is making or may make.[834]

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[820] ibid, s239(4).
[821] ibid, s239(5).
[822] ibid, s239(6).
[823] An undervalue transaction is a gift, or for a consideration, in money or money's worth, which was `significantly less than the value, in money or money's worth, of the consideration provided by the company'. ibid, s238(4).
[824] ibid, s423(3)(a).
[825] ibid, s423(3)b).
[826] ibid, s423(2)(a).
[827] ibid, s238(5).
[828] Vanessa Finch and David Millman, *Corporate Insolvency Law: Perspectives and Principles*, (3rd edn, Cambridge University Press, 2017) 492.
[829] ibid, s238(3).
[830] 3.5.
[831] IA 1986, s423(2)(a).
[832] ibid, s423(2)(b).
[833] ibid, s423(3)(a).
[834] ibid, s423(3)(b).

The proceeds recovered through successful claims under ss213, 214, 238 and 239[835] belong to the unsecured creditors and cannot therefore be claimed by the company's floating charge holders.[836]

Finally, s245 renders void or unenforceable, in full or in part, any floating charge which was created by a director in favour of an unconnected third party within 12 months of the company going into liquidation. Any floating charge grant in favour of a connected third person within two 2 years of the company going into liquidation remains vulnerable for a period of 2 years prior to the company going into liquidation.

The problem of consumer exploitation by rogue directors of closely-held companies is compounded by the fact that, just as companies can be formed quickly and easily, they can equally be dissolved with relative speed and ease. There is nothing to stop an owner-director from being the owner-director of one or more different companies. The sad reality is that all-too-often when a company faces substantial debts or has a judgment order against it following proceedings by a creditor, it `may be put into liquidation with assets already sold on to another enterprise (the phoenix company) which will then trade as a purportedly new enterprise often with the same human constituents as the failed company.' [837]

3.6.3 Disqualification under the Company Directors Disqualification Act 1986 (CDDA 1986)

One might be excused for thinking that the CDDA 1986, passed with rogue directors of closely-held companies in mind[838] and referred to by Hicks[839] as the `Culling of Delinquent Directors Act', might have more of an impact than it does on curbing rogue HRI directors' exploitation of consumers. However, it has proved ineffective in deterring

[835] ibid, s176ZB(3) (inserted by s119 of the Small Business, Enterprise and Employment Act 2015 (SBEEA 2015))
[836] ibid, s176ZB(2). Unless disapplied by a voluntary arrangement, or compensation undertaking (s176AB(4)).
[837] Griffin (n580) 99-101.
[838] Williams (n39).
[839] Andrew Hicks, `Millenial Law, Philosophy, Politics and Economics' (2000) 21 Co Law 92, 93

rogue directors from acting in bad faith,[840] and was described in *The Times* as a `limp lettuce leaf'.[841] As Hicks notes, `the real rogues are unlikely to take any notice of the threat of disqualification',[842] particularly as a finding of unfitness does not `divest them of any ill-gotten gains'.[843] It is also not an *ex ante* mechanism of redress as it offers no protection to consumers against exploitation by rogue directors.

The main problem is that disqualification investigations are undertaken by liquidation practitioners during formal insolvency proceedings.[844] However, rogue directors can avoid a formal investigation by applying for their company to be struck off the register before compulsory winding-up is initiated by any creditor who is owed more than £750,[845] or under just and equitable grounds.[846] By employing their own insolvency practitioner (IP), they may choose someone who is prepared to engage in improprieties which fall short of flagrant breaches of the law, and therefore are unlikely to be detected – the `low profile "directors' friend"'.[847] It is unlikely that such an IP will make enquiries as to the director's unfitness, leaving the controlling director-shareholder free to strip the company of all significant assets. Following the implementation of the Cork Report[848] recommendations on the licensing and control of IPs, the most overt abuses of power by IPs have been eradicated through debarment.[849] However, the fact that phoenixing remains such a problem in the UK points to the fact that professional standards of conduct by IPs are not being met. Many may calculate it to be a lucrative risk worth taking, particularly as their improprieties may never be detected.

Although a consumer who alleges an offence or default has been committed against them may apply for a disqualification order,[850] he is unlikely to initiate any formal investigation if it means the few remaining company assets will be spent on liquidators' expenses.[851]

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[840] Williams (n39).
[841] 17 January 1998 (as cited in Hicks (n11) 438.
[842] Hicks (n11) 437.
[843] ibid, 440. Williams (n39) 219.
[844] ibid, 443.
[845] ibid. Although creditors do have a right to object to the striking-off, in 1996-97
[846] IA 1986, s122(1)(g).
[847] Fletcher (n540) 367.
[848] Cork Mk II Committee, *Insolvency Law and Practice: Final Report* (Cmn 8558, June 1982).
[849] Fletcher (n540).
[850] CDDA 1986, s16(2).
[851] Hicks (n11) 443.

This all shows that, even if directors are obliged to seek creditor wealth maximisation when their company becomes financially-distressed, there is very little prospect in consumers enforcing this duty.

The court *must* disqualify any director of an insolvent company who is found unfit to be involved in the management of a company,[852] and *may* disqualify on grounds of wrongful trading or fraudulent trading.[853] Disqualification orders vary in duration from 2-15 years, depending on the seriousness of the misconduct.[854]

Under s15A,[855] when a disqualification order has been granted[856] against a rogue HRI director, whose conduct has caused one or more of the consumers of the insolvent company of which he was director to sustain loss,[857] the Secretary of State (SS) has two years from the date of the order to apply for a compensation order.[858] Any compensation recovered will be paid to the SS for the benefit of a specific consumer(s)[859] or class(es) of creditors[860] as a contribution to the assets of the insolvent company.[861] However, this indirect and limited remedy for exploited consumers relies on the CDDA 1986 being sufficiently robust to identify and disqualify rogue HRI directors.

Whilst under a disqualification order, the disqualified director must not be a director of any company, or involved in its management without leave of the court.[862] Breach of order constitutes a criminal offence.[863]

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[852] ibid, s6(1)(a) and (b). On receipt of an application for a disqualification order.
[853] S10.
[854] Re Sevenoaks Stationers Ltd [1991] Ch 164.
[855] Inserted by SBEEA 2015, s110.
[856] CDDA 1986, s15A(3)(a).
[857] ibid, s15A(3)(b).
[858] ibid, s15A(5).
[859] ibid, s15B(1)(a)(i).
[860] ibid, s15B(1)(a)(ii).
[861] ibid, s15B(1)(b).
[862] ibid, s1(1).
[863] IA 1986, s13. 3.6.3.

3.6.4 Breach of Directors' Statutory Duties

Given the type of company under scrutiny in this thesis, the only two general directors' duties under consideration are CA 2006, ss172 and 174.

The greatest problem in relation to directors' duties is that, despite the fact that directors can be held personally liable on any breach, this power is only of any practical utility in more widely-dispersed companies in which `ownership'[864] and management are both clearly separate; in such companies, structures and measures are in place to ensure that the company's management are monitored closely.[865] It is perhaps for this reason that greater justification exists for the application of the general statutory duties in relation to closely-held companies, but the contrary remains the case to all practical intents and purposes. This is due to the reasons advanced above – that those who `own' and those who manage the company are one and the same.

Contractarians see company directors as agents of the shareholders.[866] As such, they must focus their efforts solely on maximising shareholder wealth, and minimising agency costs, justifiable since shareholders are regarded as `primary, or sole, corporate constituents'.[867] This view appears to disregard the fact that directors' duties are owed to the `company as a whole'[868] and therefore regard should be had to the interests of future as well as present shareholders.[869] Whilst this may hold sway in larger private or public companies, it holds little meaning for small closely-held companies.

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[864] Of shares/residual value.
[865] For example, UK Corporate Governance Code.
[866] Andrew Keay ` Directors' Duties to Creditors: Contractarian Concerns Relating to Efficiency and Over-Protection of Creditors' (2003) 66 MLR 665, 673; Jensen and Meckling (n121) 305; Fama (n121) 288; Eugene Fama and Michael Jensen `Separation of Ownership and Control' (1983) 26 JLEcon 301. Alternative views are of directors are agents of the company (Chris Noonan and Susan Watson `Examining company directors through the lens of de facto directorship', (2008) JBL 587; CA 2006, s40(1)); or even of the board of directors in circumstances where the board delegates its power to one of its directors (Noonan and Watson (n866) 624.
[867] Lombard (n160) 14.
[868] CA, s170(1).
[869] Daniel Attenborough, `The Company Law Reform Bill: an analysis of directors' duties and the objective of the company' (2006) Comp Law 162; *Re Walt Disney Co. Derivative Litig. (Disney IV)*, 907 A.2d 693, 755 (Del. Ch. 2005) (emphasis in original), aff'd, 906 A.2d 27 (Del. 2006).

3.6.4.1 Companies Act 2006, s172

In many ways, the government has demonstrated a strong contractarian bias in its anti-regulation approach to small companies. However, CA 2006, s172 reflects an apparent shift towards an enlightened shareholder approach.[870] The rationale behind this is that `companies whose directors have regard to these various interests will provide better value for their shareholders and everyone else in the long run'.[871] As Lombard notes, this duty to promote the success of the company `*permits* directors to have regard, where appropriate, to the interests of other stakeholders of the company, but with shareholders' interests retaining primacy.'[872] This can be seen as a shift towards the communitarian `stakeholder theory'[873] which asserts that `co-operative and productive relationships will only be optimised where directors are permitted (or required) to balance shareholders' interests with those of others committed to the company.'[874] The wording of s172 suggests the duty is a mandatory one:

> A director of a company *must* act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to … [a number of criteria including]
> … (a) the likely consequences of any decision in the long term; … (c) the need to foster the company's business relationships with suppliers, customers and others; … (d) the impact of the company's operations on the community and the environment; … [and] (e) the desirability of the company maintaining a reputation for high standards of business conduct.[875]

However, the test is largely a subjective one, although the requirement to act in good faith suggests that a court finding that a rogue director has acted in bad faith[876] towards his company's consumers would hopefully demonstrate the unlikelihood that the director has acted in good faith, despite any assertions on his part to the contrary. One reason why

[870] At 1.5.2.6.
[871] Nicholas Grier, `The Irresponsible Director' (2017) ICCLR 355, 355.
[872] Lombard (n160) 18, emphasis added. CA 2006, s172.
[873] A term many see as synonymous with the `pluralist theory' (see for example, Kelly and Parkinson `The Conceptual Foundations of the Company: A Pluralist Approach', cited in Lombard (n160) 18.
[874] Lombard (n160), 18 referring to *South African Guidelines for Corporate Law Reform,* 2004, 25 with reference to DTI Strategic Framework 1999 (n162).
[875] CA 2006, s172(1) – emphasis added.
[876] At 1.2, 2.2.1, 3.2 and 4.2.1.

s172(1) may not be seen as genuinely promoting stakeholder interests is because the courts apply a subjective test for determining whether or not the director acted in good faith, and where a director insists he/she acted in good faith and can adduce evidence in support, it will be very difficult for a claimant to prove otherwise.[877] According to Keay, the courts `are likely to dismiss a director's claim to have acted in good faith where he or she has benefited personally from the impugned action …'.[878]

If s172 is interpreted so as to *allow*[879] directors to decide whether or not to consider other stakeholders' interests and wider social factors, then in the case of the rogue trader company[880] their sole focus will be to maximise their own profits qua shareholders. In any event, as the interests of other stakeholders are only required to be considered insofar as to do so would promote the interests of the company's shareholders, Lombard suggests that the ESV approach is another `confirmation of the fact that the only corporate constituency whose interests should be protected in terms of directors' duties is shareholders.'[881]

Although the emphasis in this thesis is on the contractarian and communitarian approaches to company law, it is relevant at this point to mention one further theory of the company, namely the `associative theory' since this reflects both the legal and economic reality of the company.[882] As Lombard notes, `[t]he crux of the associative theory is that members form an association, the focus of which is to pool money.'[883] Significantly, Lombard goes on to stress that `it should not be assumed that members as contributors of the capital comprise only shareholders.'[884] Therefore, `[t]he way in which an extension of directors' duties to creditors is approached could … be influenced to a large extent by the [theoretical] model favoured by a particular person.'[885] As Keay[886] notes, any legislative protection to creditors is given on the basis of them having extended

[877] *Charterbridge Corp Ltd v Lloyds Bank Ltd* [1970] Ch. 62; *Extrasure Travel Insurance Ltd v Scattergood* [2003] 1 BCLC 598; Andrew Keay, `Good Faith and Directors' Duty to Promote the Success of their Company' (2011) 32 Co Law 138.
[878] Keay (n108) 102.
[879] Lombard (n160) 19.
[880] Described in Chapter 1.
[881] Lombard (n160) 19. Keay (n108) 284.
[882] 3.4.1 and 3.4.2.
[883] Lombard (n160) 22. 3.4.1.
[884] ibid.
[885] ibid, 15.
[886] Indeed, Keay (n866) 667.

credit to companies. In this way, they might be regarded as contributors of the company's capital - in effect, if not by design. A similar argument might be advanced therefore in the case of consumers by virtue of the fact that the company owes them money as a result of consumers having paid the company for sub-standard work or work not carried out; or having been charged more than the contracted price.

As discussed in 3.6.2, directors do owe creditors certain duties once the company becomes financially distressed. As Grantham[887] explains, creditors receive `the greatest protection at the time of the greatest risk'. However, if Lombard's interpretation of `member' is to hold any sway, then this would create a continuing obligation on the part of directors in favour of the company's creditors also.[888] The position on this remains unclear, particularly as most debate focuses on the need for creditor protection being at its greatest when the company `is insolvent, in the vicinity of solvency or embarking on a venture which it cannot sustain without relying totally on creditor funds.'[889] At such time, `the interests of the company are in reality the interests of existing creditors alone.',[890] and the creditors replace the shareholders as the owners of the residual value of the firm.[891] As Keay notes,

> The unsecured creditors are protected only by contractual rights, but when companies are financially stressed there are, arguably, cogent arguments that their position warrants some form of fiduciary protection, whereby the directors become accountable principally to the creditors.[892]

What little protection is given to consumers' interests is still shrouded in uncertainty since `the predominance of case law supports the view that while directors must consider

[887] Ross Grantham, 'The Judicial Extension of Directors' Duties to Creditors' [1991] JBL 1 at 15.
[888] The judiciary in England have been in support of a directorial duty to creditors since 1980 (see *Lonrho* (n652); *Re Horsley and Weight Ltd* [1982] 3 All ER 1045; *Winkworth* (n810); *Brady* (n811); *Liquidator of West Mercia Safetywear v Dodd*
(1988) 4 BCC 30; *Facia Footwear Ltd (in administration) v Hinchliffe* [1998] 1 BCLC 218; Re Pantone 485 Ltd). See also Keay (n866) 665 and Lombard (n160) 97.
[889] Keay (n866) 668.
[890] *Brady* (n811) 552.
[891] Keay (n866) 668.
[892] Keay (n866) 669, citing the work of Mark E.Van der Weide, 'Against Fiduciary Duties to Corporate Stakeholders' (1996) 21 Delaware Journal of Corporate Law 27, 43; Ramesh Rao, David Sokolow & Derek White, 'Fiduciary Duty a la Lyonnais : An Economic Perspective on Corporate Governance in a Financially-Distressed Firm' (1996) 22 The Journal of Corporation Law 53, 64; and the judgment of the court in *Re Pantone 485 Ltd* [2002] 1 BCLC 266 at 285-286.

creditor interests, they are not obliged to focus solely on those interests.'[893] Any duty to consumers as unsecured creditors is indirect, and the duty is instead owed to the company to consider creditor interests.[894] This means that consumers would be unable to enforce any breach of duty in their own name, and any monies recovered from rogue directors would go towards the company's assets.[895]

One of the main difficulties faced by consumers with any private right of action is actually enforcing that right.[896] Finch cites many problems relating to enforcement; not least the fact that any right of action under s212 arises only when the company is being formally wound up, since the duty towards them only arises when the company becomes financially distressed.[897] Effective enforcement `demands an ability to acquire and use information; expertise or understanding of the relevant activity; a commitment to act; and an ability to bring pressure or sanctions to bear on the party to be controlled.'[898] However, these attributes are more befitting trade creditors than consumers.[899] Therefore, the inapplicability of some or all of these attributes to consumers, coupled with the fact that as unsecured creditors consumers rank after floating chargeholders for the repayment of debts, serve only to counteract any incentive consumers might otherwise have to pursue a claim against a rogue director.

As stated, the difficulty faced by the government is striking the balance between competing interests:[900]

> We shall pursue policies to facilitate productive and creative activity in the economy in the most competitive and efficient way possible for the benefit of everyone, with appropriate freedom for managers and others controlling

[893] Keay (n79) 621.
[894] Keay A, `Another Way of Skinning a Cat: Enforcing Directors' Duties for the Benefit of Creditors' (2004) 17 Insolvency Intelligence, 3.
[895] Dan Prentice, 'Creditor's Interests and Director's Duties' (1990) 10 OJLS 265, 275; Sarah Worthington, 'Directors' Duties, Creditors' Rights and Shareholder Intervention' (1991) 18 MLR 121, 151; Len Sealy, 'Personal Liability of Directors and Officers for Debts of Insolvent Corporations: A Jurisdictional Perspective (England)' in Jacob S Ziegel, Current Developments in International and Comparative Corporate Insolvency Law, (Clarendon Press, 1994), 486.
[896] 2.4.4.
[897] Finch (n809) 516; 2.4.4.
[898] ibid.
[899] 1.5.2.3.
[900] 1.5.2 and 2.4.

> companies.[901] … This does not mean that the law should merely facilitate and secure freedom for management and controllers of companies. There is a trade-off between freedom and abuse, and between freedom and efficiency. Indeed abuse damages efficiency and the credibility of business and of the productive system.[902]

The law and economics school opposes directors' duties being owed to consumers, directly or indirectly, because `any greater impositions on directors will make them less efficient in their role as agents of the shareholders of the company, because amongst other things, they will start to think of their own positions, rather than maximising profits.'[903] That many arguments in favour of such a duty can be advanced is not in doubt. However, as Keay notes,

> the company's development might be stifled as directors … will adopt a defensive posture, becoming extremely cautious and risk-averse … The result is that the company ultimately ends up with a lower positive net value, and so efficiency is not fostered.[904]

3.6.4.2 Companies Act 2006, s174

Under CA 2006, s174, directors are required to exercise reasonable care, skill and diligence.[905] Whether or not they reach the required standard will be judged against the

> reasonably diligent person with (a) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions carried out by the director in relation to the company, and (b) the general knowledge, skill and experience that the director has.[906]

[901] DTI Strategic Framework 1999 (n162) para 2.4.
[902] ibid, para 2.6; also para 2.7 of the same document where the government expresses its concern for company law to be fashioned in such a way as to enable `both internal and external interests to be satisfied.'
[903] Keay (n866) 677.
[904] Keay (n866) 683.
[905] CA 2006, s174(1).
[906] ibid, s174(2).

This dual subjective/objective standard reflects the recommendations of the Law Commission[907] and the views of Hoffmann J in *Norman v Theodore Goddard*[908] and *Re D'Jan of London Ltd*[909].[910] In the former case, Hoffmann J found that the duty of care was accurately set out in IA 1986, s214(4),[911] something he affirmed in the latter case.[912] However, whereas s214 only applied when a company was insolvent or in danger of becoming insolvent, Hoffmann J established that the common law duty of care (and therefore the statutory duty of care[913]) applied throughout the whole of the company's life.[914]

There has been much debate over the definitions of *skill* and *care*, terms which have been used interchangeably by the judiciary on many occasions.[915] Hicks offered some elucidation on the matter when he stated: `Whereas one cannot expect all directors to possess a comprehensive portfolio of skills, one can expect them all to be reasonably careful.'[916]

Any breach of s174 would result in the director(s) being rendered personally liable to account for any profit made from the act complained of or any loss sustained by the company. The company may also obtain an injunction to restrain the director from breaching his duty in circumstances where the director purports to act in a manner that would otherwise constitute a breach of duty.[917] The fact that the company may ratify any such breach by passing an ordinary resolution[918] places the rogue closely-held company director in a very powerful position. Not only would he, as controlling shareholder, never sue himself for any breach of his director's duties, but also, if ever a cause of action were

[907] Law Commission, *Company Directors: Regulating Conflicts of Interests and Formulating a Statement of Duties* (The Stationery Office 1999), Law Com No 261, Scot Law Com No 173.
[908] [1991] BCLC 1028 Ch D. Hoffmann J held that a director must possess the skill `that may reasonably be expected from a person undertaking those duties.' (at 1030) (Tamo Zwinge, `An Analysis of the Duty of Care in the United Kingdom in Comparison with the German Duty of Care', (2011) ICCLR, 31, 32.)
[909] [1993] BCC 646 Ch D.
[910] Zwinge, (n908) 31.
[911] 3.6.2.
[912] Zwinge (n908) 32.
[913] S170(4).
[914] Zwinge, (n908) 33.
[915] For example, by Hoffmann J in *Norman v Theodore* and *Re D'Jan* (as noted by Zwinge (n908) 33).
[916] Andrew Hicks `Directors' Liability for Management Errors', (1994) 110 LQR 390, 393 (cited by Zwinge (n908) 33.
[917] Stephen Griffin, `The Regulation of Directors under the Companies Act 2006', (2008) CLN,224, 1-4, 3.
[918] CA 2006, s239.

to accrue to the company's consumers, as controlling shareholder he could simply pass a resolution waiving his own liability qua director. However, CA 2006, s239(3)prohibits a director or connected person (who is a member of the company) from voting on such an issue. This effectively blocks any ratification of directorial breach in closely-held companies where the shareholder and `incompetent' director are one and the same person. The final sting in the tail comes when one considers that only the company may sue[919] for breach of s174, thereby effectively putting closely-held companies beyond the reach of this statutory duty.

Law and economics theorists favour such issues as directorial care, skill and diligence being controlled by market forces. For example, if a director is considered incompetent by the company's shareholders, they can sell their shares or vote collectively to remove the director from office.[920] Communitarians, on the other hand, favour consumers and other stakeholders being both recipients and enforcers of such duties; this would clearly advance the position of consumers in relation to any breach of s174 by any closely-held company director. However, for the reasons advanced above, the law and economics approach continues to dominate the modern company law landscape, and the position of consumers in the UK remains fraught with difficulty and uncertainty.

3.7 Private Rights of Redress against Rogue HRI Directors under Consumer Protection Legislation

A detailed study of the private rights of redress available to consumers was considered in Chapter 2.

3.7.1 Contract Law

The relationship between a consumer and closely-held HRI company is based on contract law.

The two main barriers to consumers recovering their losses resulting from exploitation by a rogue HRI director are the doctrines of separate corporate personality and privity of

[919] Multinational Gas [1983] Ch 258.
[920] Zwinge,(n908) 37.

contract, and under-capitalisation of the company itself. The former means consumers must sue the company for wrongs committed in its name rather than the rogue director responsible since, being separate from its shareholders, the company is the proper litigant in any claim for breach of contract. The latter may result from the asset-stripping nature of `phoenixing', or from the doctrine of limited liability due to shareholders only being liable for any amount which remains unpaid on their shares when the company assets are insufficient to meet its debts. The minimum capital requirements are set so low that today's shareholders stand to lose only a negligible amount. This means consumers will either be advised not to pursue an action for breach of contract at all, or those that do will not be able to enforce their judgment order against an under-capitalised or insolvent company. Whereas a sole trader or partner[921] could be sued personally to the full extent of their private wealth, the rogue director's personal wealth is safe under the law of contract. Under-capitalisation is justified by law and economics theorists on the basis of shareholder wealth maximisation.

3.7.2 Consumer Protection from Unfair Trading (Amendment) Regulations 2014 (CPARs 2014)

As discussed at 2.4.3.2, the CPARs 2014 give consumers private rights of redress against rogue traders who breach the CPR provisions in relation to the misleading and aggressive commercial practices that are often used by rogue HRI traders. However, crucially, they relate only to consumer contracts[922] and therefore the same problems arise for consumers, who must sue the company rather than the rogue HRI director if their rights exercised under the CPARs 2014 are not met. From the bad faith conduct that has come to be associated with rogue HRI traders, it is almost certain they are not going to issue refunds or discounts when requested by a consumer they have deliberately exploited. Consumers are therefore going to have to enforce[923] their rights of redress against the company itself, something that this thesis has demonstrated happens infrequently.

[921] Under the Partnership Act 1907.
[922] CPARs 2014, regs1, 3 and explanatory notes.
[923] ibid, reg27K.

3.7.3 Consumer Rights Act 2015 (CRA 2015)

Again, any private rights of redress that consumers have under the CRA 2015 are founded on contract law, and therefore consumers are in a more disadvantageous position when they deal with a closely-held HRI company than when they deal with a sole trader or partner.

3.7.4 Enforcement

Because of these additional barriers to claiming damages, consumers will be even less likely to pursue a civil claim against a closely-held HRI company for losses caused by its rogue director's unscrupulous conduct than they would against an unincorporated rogue HRI trader.

For the relative few that do take action, any judgment order will be against the company itself, not against the rogue director personally. Often rogue directors place their company into voluntary liquidation, transferring its assets to their newly-incorporated company, leaving an under-capitalised company;[924] this exacerbates the problem for consumers.

As the law currently stands, the only real hope exploited consumers have of being repaid any money owed[925] is to institute the compulsory winding-up of the company where they are owed more than £750.[926] However, this process in itself will only serve to further deplete company funds as liquidation costs are the first in order of payment[927] and can run into £000s.[928]

Consumer protection law is not able to overcome those difficulties the corporate form presents for contract-based remedies, and therefore consumers are even more vulnerable when dealing with rogue HRI directors than when they deal with their unincorporated counterparts. Any strengths consumer law offers in the context of trading between consumers and rogue HRI traders are lost when consumers trade with private limited HRI

[924] `Phoenixing' (3.5).
[925] For example, from having paid up front for work not done, or through being awarded a judgment debt in their favour against the company.
[926] IA 1986, s122(1)(f), 123.
[927] As unsecured creditors, consumers receive nothing until all secured creditor debts are settled.
[928] The Civil Proceedings Fees (Amendment) Order 2014 and The Insolvency Proceedings (Fees) (Amendment) Order 2014.

companies, and there appears to be very little done to address this problem. This is why the focus of this thesis is on the need for Parliament to address the problems it has created through the cornerstones of modern company law. Coupled with this enduring resistance to adequately protect the interests of consumers, separate legal personality and limited liability represent the root cause of consumer exploitation and abuse of the corporate form by closely-held companies today.

When one considers that in general it is EU law[929] that has added a much-needed extra layer of consumer protection, the imperative to deal properly with the serious problems of abuse of the corporate form and consumer exploitation by rogue directors of closely-held HRI companies becomes all-the-more pressing with the fast-approaching BREXIT deadline.

3.8 Consumer Vulnerability in the Context of Closely-Held HRI Companies

It has already been established[930] that consumers are vulnerable, to varying degrees, to exploitation by rogue traders. Reasons include consumers' personal characteristics, including their credulity;[931] inequality of bargaining power resulting from consumers' lack of business acumen or knowledge of HRI contracts, and information asymmetry; and the effect of the current economic climate pushing consumers towards contracting with small, non-VAT-registered companies, increasing the likelihood of them dealing with a rogue director of a closely-held HRI company; and, finally, UK company law maximising accessibility[932] for small businesses to the corporate form, since the cornerstones of company law facilitate abuse of the corporate form at the expense of unsuspecting consumers who are unable to, and unaware of the need to, protect themselves against such unforeseen losses.[933] Therefore, the consequences of incorporation,[934] though favourable to shareholders, are prejudicial to the interests of consumers.[935]

[929] For example, CCRs 2013 (n4), CPRs 2008 and CPARs 2014, SSGCRs 2002 (n292).
[930] 2.2.2; 2.3.
[931] 1.2.
[932] Developing Framework 2000 (n12).
[933] Freedman (n54).
[934] 3.4.
[935] At common law, directors were commonly viewed to owe duties primarily to shareholders (*Hutton v West Cork Railway Co* (1883) 23 Ch D 654; *Greenhalgh v Arderne Cinemas Ltd (No 2)* [1946] 1 All ER 512), and this concept of shareholder primacy has made it to the statute books by virtue of CA, s172.

This thesis regards consumers as involuntary creditors when exploited by rogue directors, and far more vulnerable to suffering detriment than the company's ordinary trade creditors. Trade creditors are more likely to recognise the economic risks of extending credit to closely-held companies and are better placed than consumers to take precautions against default of payment terms – for instance by requiring security in the form of fixed and floating charges,[936] negotiating retention of title clauses against goods supplied,[937] or taking out credit insurance. They are also more likely to understand the implications of incorporation and limited liability. Conversely, many consumers lack the same level of business acumen, and the same means of self-protection that trade creditors have.[938]

Any private rights of redress available to consumers for breach of contract, or for misleading or aggressive commercial practices are largely hampered by the doctrines of separate corporate personality, limited liability and privity of contract. It has to be questioned why, when rogue HRI traders and rogue HRI directors can be regarded metaphorically as two sides of the same coin,[939] Parliament has not done more to protect consumers when dealing with the latter, particularly when their *modus operandi* is so similar.

3.9 The Case for Greater Consumer Protection against Rogue HRI Directors

When one acknowledges the economic imperative for Parliament to retain corporate laws which are sufficiently appealing to businesses, it becomes clear that the elevation of consumer interests beyond their present level is no easy task. A clear dichotomy exists between protecting the interests of consumers who find themselves involuntary creditors of under-capitalised closely-held HRI companies, and encouraging investment in business without investors fearing the loss of their personal wealth if the company fails.

3.9.1 Policy Considerations

It was concluded at 1.5 that the contractarian school of thought continues to dominate in the UK, with the government's focus on encouraging enterprise, cutting red tape and adopting a *laissez-faire* approach.

[936] CA 2016, s860; The Companies Act 2006 (Amendment of Part 25) Regulations 2013 Schedule 1.
[937] SGA 1979, s19.
[938] Tauke (n127).
[939] 1.2 and 4.2.1.6 re bypass provisions.

Laissez-faire principles have dominated the world of commerce in the latter part of the twentieth and beginning of the twenty first centuries.[940] According to Sol Picciotto, `The Liberalism which emerged from the eighteenth-century enlightenment viewed society as consisting of autonomous and equal individuals interacting on the basis of their free choices.'[941] He describes how `The state is seen as existing outside and above the realm of `civil society' … and its power, exercised through law, must be limited to defining and enforcing the terms of those [private] transactions.'[942] *Laissez-faire* principles therefore complement to an extent the contractarian perspective of the company's relationship with its consumers; rather than paternalistically protecting consumers, the government has, instead, favoured empowering them to help themselves by raising awareness of the practices of rogue traders.[943] That said, there has been some willingness on the part of the state to regulate contractual freedom,[944] particularly where there is inequality of bargaining positions,[945] and to introduce robust legislation to curb misleading and commercial practices[946] in the hope of creating a more level playing field for consumers. Another example of asymmetric paternalism towards consumer policy measures can be seen in the imposition of mandatory cooling-off periods for certain consumer contracts.[947] Here, the state recognises that `consumers at times make purchases in emotionally "hot" states that, in a cooler and more rational state, they would not make.'[948]

Being vital to economic growth, successive UK governments have ardently removed barriers which may impede the start-up and survival of small limited companies, hence the continued strategy of deregulation.[949] Notwithstanding the difficulties consumers face when dealing with closely-held companies, there is little motivation for policy makers to

[940] Paddy Ireland, `Back to the future? Adolf Berle, the Law Commission and directors' duties' (1999) 20 Co Law 203.
[941] Sol Picciotto, *Regulating Global Corporate Capitalism* (2011) Camb UP, 26-27.
[942] ibid, 27.
[943] Campaigning has largely focussed on opportunistic itinerant rogue traders who cold-call.
[944] Through the various provisions of the CRA 2015.
[945] Fisher (n147). For example, implied terms under the CRA 2015 (2.4.2.2).
[946] CPRs 2008 (nn 10, 23) and CPARs 2014 (n23).
[947] CCRs 2013 (n4).
[948] Rischkowsky, F and Döring, T `Consumer Policy in a Market Economy: Considerations from the Perspective of the Economics of information, the New Institutional Economics as well as Behavioural Economics' (2008) 31 J Consum Policy 285, 307.
[949] Cutting Accountancy and Reporting Fees (n31); CH Annual Report 2008-09 (n31) 5; Davies and Worthington (n32, 195); Watson (n35) 606-607.

radically reform company law whilst small businesses continue to be extolled as `vital for wealth creation', and whilst `serial entrepreneurship' continues to be encouraged.[950] Indeed, in their review of company law, the CLRSG specifically stated: `the needs of smaller companies will become very much the mainstream of company law.'[951] It is because of this steadfast economic dependency on and political commitment to[952] the closely-held company that the UK government continues to facilitate and positively encourage incorporation by those who own and control their own business. For as long as there is no commensurate modification of company law in relation to closely-held companies, consumers will remain collateral damage of government policies/economic drivers in a neoliberal era.

The ancient maxim *`ignorantia juris non excusat'*[953] applies as much today as it did in Roman times, and the law is still prepared to impute knowledge of the law on a layperson with the result that they are bound by laws they do not even know about on the basis that they *should* know about them. Although this doctrine encourages those engaging in certain activities to make themselves aware of relevant law affecting those activities, its main purpose is to prevent exculpation on the basis of a person's wilful blindness to their legal obligations.[954] An application of *laissez-faire* principles to consumers dealing with rogue directors of closely-held HRI companies imputes a level of legal knowledge, experience and expertise on consumers that is both unrealistic and unfair. It is unreasonable to expect consumers to familiarise themselves with the intricacies of contract law, company law, and various regulations relating to building works before entering into a commercial contract with an HRI trader. And yet, in dealing with a closely-held HRI company, this is typically what a contractarian theorist would expect of any given consumer in fixing them with the foresight and skill to negotiate terms favourable to themselves in commercial contracts. Consumers fare no better with law and economics theorists since relying on market forces to secure fair trading invites use of the idiom `closing the stable door after the horse has bolted' for too many unsuspecting consumers

[950] 1998 speech by Rt Hon Peter Mandleson cited by Williams (n39) 219.
[951] Developing Framework 2000 (n12) 7.2.
[952] Conservatives: `Our Long Term Economic Plan' 2015 accessed on < http://longtermplan.org.uk/ > accessed on 19 February 2015; Labour: Changing Britain Together 2015 accessed on <http://www.labour.org.uk/issues> accessed on 2 December 2017.
[953] This terms can be defined as: `ignorance of the law is no excuse'.
[954] Detmer (n60).

who have already fallen prey to unfair trading practices. However, an alternative view is that consumers should arm themselves with knowledge of the law, especially when dealing with what is often their most valuable asset.

The desire to empower consumers has consistently been a driving force in government consumer protection policy-making, and is going some way towards creating a more level playing field.[955] However, as already posited, market forces are unlikely to have any bearing on those closely-held companies which are intent on exploiting consumers. They are more of a rhetorical device used primarily by law and economics theorists and have been criticised as being unreliable or illusory.[956] Furthermore, government campaigning to date has focused not on incorporated HRI traders who form the focus of this thesis, but on unsolicited opportunistic itinerant traders; therefore, rather than empowering consumers, this campaigning has instead lulled many consumers into a false sense of security in relation to contracting with closely-held companies since, quite reasonably, they would expect the government to warn them of any known risks. Parliament is well aware that consumers are at risk of being coerced or deceived[957] by rogue directors into entering contracts with closely-held companies, and that they often lack the necessary knowledge and understanding to enable them to contract `freely' in the ethical sense of the word.[958] As Lord Sumption notes in *Prest,*[959] in the context of a contract or other consensual arrangement, `the effect of fraud is to vitiate consent so that the transaction becomes voidable ab initio'.[960] This thesis therefore argues that consumers are at a distinct disadvantage when entering into such contracts and, in line with the communitarian theory, Parliament needs to provide a company law response to abuse of the corporate form. As part of the government's most recent Consumer Law Reform Programme, the

[955] CRB Final Impact Assessment (n282); Department for Business, Innovation and Skills, *Empowering and Protecting Consumers: Consultation on Institutional Changes for Provision of Consumer Information, Advice, Education, Advocacy and Enforcement* (June 2011); Department of Trade and Industry, *Extending Competitive Markets: Empowered Consumers, Successful Business*, (2004); Department of Trade and Industry, *Modern Markets, Confident Consumers* (Cmnd 4410 1999); Geraint Howells, `The Potential and Limits of Consumer Empowerment by Information' (2005) 32 J Law Soc 349.

[956] Marc Moore and Antoine Reberioux, 'Revitalizing the Institutional Roots of Anglo-America Corporate Governance' (2011) 40 Economy and Society 84

[957] 2.2.4; OFT 1300 (n2) 2.1.

[958] Consumers themselves perceive a power imbalance with traders, and lack the confidence needed to question or challenge traders (HRI Research Report 2011 (n218) 6.30, 6.32).

[959] N80.

[960] ibid, 18.

CRA 2015[961] was passed to clarify and simplify consumer protection legislation and consumer rights of redress. This, together with the CPARs 2014[962] and CCRs 2013,[963] will go some way towards creating a level playing field for consumers insofar as they are dealing with businesses other than under-capitalised closely-held companies. However, because of the cornerstones of UK company law, Parliament continues to fail those consumers who have been exploited by rogue HRI directors.

By allowing closely-held companies access to the corporate form, without implementing necessary safeguards, the government creates a legislative lacuna in UK company law which provides the opportunity for abuse of the corporate form;[964] though this may not be intended, it is certainly no accident.[965] It is this lacuna which creates the imperative for adequate consumer protection against exploitation by rogue directors' abuse of the corporate form.

3.9.2 Law Reform: the only Meaningful Response

Continued public service restructuring and austerity measures mean that those bodies tasked with consumer protection are more stretched than ever resource-wise and, of necessity, they have become more reactive than proactive. For instance, there has been no repeat of the extensive research and campaigning undertaken in the early part of the new millennium,[966] and much consumer education today is most easily accessed online via LATSS websites[967] or CAS website.[968] When one considers that one of the largest categories of vulnerable consumer is the elderly, it must be acknowledged that online information is not always the most appropriate medium for them to access. On the foregoing basis alone, there can be little doubt that consumers are more disadvantaged

[961] 2.4.2.2.
[962] 2.4.3.2.
[963] 2.4.3.3.
[964] Davies and Worthington (n32) 196-198); Keay (n34) 457; Moore (n34) 181; Mohanty and Bhandari (n34) 196; Slade LJ in *Adams* (n36).
[965] Diamond (n26) 34; Kahn-Freund (n35) 54; Hicks (n24) 311; Watson (n35) 608.
[966] OFT 1300, OFT 1411, OFT 716 (n2).
[967] For example, <https://www.nottinghamcity.gov.uk/business-information-and-support/trading-standards/doorstep-crime-and-rogue-traders/> accessed 28 December 2017.
[968] For example, <https://www.citizensadvice.org.uk/consumer/getting-home-improvements-done/before-you-get-building-work-done/> accessed 28 December 2017.

today than they were over a decade ago, and the fact that rogue traders generally target vulnerable consumers points towards a very clear need for protection from their unscrupulous conduct.

With consumers the weaker bargaining party, and rogue HRI directors so accomplished in their unscrupulous pursuits, many consumers would neither think nor dare to challenge them. As involuntary creditors of the closely-held HRI company, they do not knowingly advance credit on freely negotiated terms. Their exploitation by rogue HRI directors shows no signs of abatement as more and more small businesses register as private limited companies, paving the way for even more rogue HRI directors to abuse the corporate form.

Although the shareholder primacy principle continues to prevail in UK company law, there have been some, albeit limited and piecemeal, steps taken towards placing consumers and other corporate stakeholders on a more even standing with shareholders.[969] However, whilst the law readily facilitates shareholder actions against directors for breach of their statutory duties,[970] there appear to be no corresponding provisions for creditors of solvent companies. It is difficult to understand why the law permits directors to secrete company assets beyond the reach of creditors through the legitimate process of pre-pack administration,[971] or `phoenixing`.

The courts have been willing to lift the veil of incorporation to hold the officers of the company personally liable where a company has been set up to perpetrate a fraud or to evade a legal obligation[972] but consumers are for many reasons, not least cost,[973] reluctant to seek legal redress in the courts and this may be why `phoenixing' remains such an attractive option for rogue directors.

[969] For example, CA 2006, s172 and IA 1986, s214 (which places directors under a duty to minimise creditors' loss when a company is either in or approaching insolvency; *Winkworth* (n810)).
[970] CA 2006, Part 11, `Derivative claims and proceedings by members'.
[971] Where the administrator of an insolvent company sells the business as a going concern to a purchaser (usually the director-shareholder) located before his appointment before creditors are told about the failure of the business (`Graham Review into Pre-pack Administration Report to The Rt Hon Vince Cable MP, June 2014).
[972] *Gilford* (n27); *Jones* (n27).

One reason for consumers choosing to contract with a closely-held company is their mistaken belief in the company's desire to maintain longevity and goodwill.[974] This is understandable given that credibility and prestige are two of the main factors traders claim motivated them to incorporate their business.[975] Legitimate companies will be more inclined towards resolving disputes amicably rather than looking to dissolve their business in order to escape liability to consumers. Rogue HRI directors, on the other hand, will rely on consumers' misconceptions as a conduit for their egregious corporate conduct, and will have little interest in preserving goodwill except insofar as it might serve to mask the true nature of their unscrupulous commercial practices. Empirical studies by Ison,[976] and the OFT[977] recognised that any disinterest of traders `in repeat sales or in fostering goodwill'[978] would provide significant incentives for aggressive and fraudulent sales practices.

3.10 Conclusion

In concluding, it must be reiterated that most closely-held HRI companies operate fairly in their dealings with consumers, and similarly not all consumers are vulnerable to exploitation by the comparatively small percentage of rogue HRI directors.

Consumers are, however, particularly vulnerable to exploitation by rogue HRI directors for several reasons.[979] These include their own misconceptions about the meaning of *limited* at the end of the company name conveying respectability, longevity and goodwill to be protected, when in fact rogue HRI directors' behaviour is unscrupulous, and invariably they will close one company to escape their debts whilst another new company is waiting in the wings. More significantly, they are unaware of the protective devices that result from incorporation which encourage rogue HRI directors to exploit consumers without any risk to their personal wealth. Without any understanding of the nature and

[973] Consumer Detriment 2016 (n206); Department for Business, Innovation and Skills, *Consumer Rights Bill: Proposals on Services – Revised Impact Assessment - Final*, June 2013, 28, para 10).
[974] At 1.1.
[975] Freedman (n54) 333. Manne and Posner question the veracity of these as principal inducements for incorporating small businesses (334).
[976] Terence Ison, *Credit Marketing and Consumer Protection* (Croom Helm 1979).
[977] OFT 716 (n2).
[978] Ramsay (n309) 206.
[979] 2.2.2.

effect of incorporation, consumers are unable to guard against any abuse of the corporate form at their expense, and to this extent are to be regarded as involuntary creditors.

The cornerstones of company law, together with privity of contract, prevent consumers from exercising their private rights of redress under consumer protection law against rogue HRI directors themselves, and the opportunities for consumer redress against rogue HRI directors personally at common law and under the IA 1986 either do not extend to cover this type of exploitation, or are unlikely to allow consumers to recoup any losses on their own behalf.

The government consistently fails to provide adequate remedies to cover consumer exploitation by rogue HRI directors of closely-held companies, and instead relies on empowering consumers in order to create a more level playing field.

Coupled with this enduring resistance to adequately protect the interests of consumers, separate legal personality and limited liability represent the root cause of consumer exploitation and abuse of the corporate form by closely-held companies today.

Chapter 4 will therefore consider what law reforms might address the consumer problems that have been identified in this thesis, without prejudicing the interests of legitimate businesses or discouraging enterprise.

CHAPTER 4

NORMATIVE RECOMMENDATIONS FOR LAW REFORM

4.1 Introduction

The two main objectives of UK company law are, firstly, the restructuring of economic power of businesses that incorporate to secure such advantages as convenience, financial flexibility and limited liability; this is achieved through establishing the structure of the corporate form, and in particular property rules that partition corporate assets from the assets of those associated with the company. Crucially, for this thesis, the second objective is one that flows from the use of the corporate form; corporate law seeks to prevent value-reducing forms of opportunism among the voluntary relationships between corporate participants. This is typically referred to as addressing `agency' cost problems, most obviously between management and shareholders but also between non-shareholders and stakeholders with more tangible claims against the company.[980]

As already discussed at 2.3, the problem with rogue directors of closely-held HRI companies exploiting consumers relates to their abuse of the corporate form, something facilitated by UK company law. One would think, therefore, that any commensurate remedy for consumers should lie in UK company law. However, as Chapter 3 demonstrates, UK company law does little to remedy the problems it creates for exploited consumers of closely-held HRI companies.

Rogue trading in the HRI market is a significant problem and one that shows no real signs of abatement, particularly in relation to those rogue traders who incorporate their business. The CTSI called for greater statutory control[981] governing the practices of

[980] John Armour, 'Who Should Make Corporate Law? EC Legislation Versus Regulatory Competition' (2006) 58 CLP, 369, 371. For a fundamentally similar account of US corporate law: Melvin Eisenberg, 'The Architecture of American Corporate Law: Facilitation and Regulation' (2005) 2 Berkley BLJ 167, 169.
[981] Door to Door Cold Calling (n236). Phillips (n8).

rogue trading following publication of their extensive household survey in 2002 which revealed why rogue traders specifically, though not exclusively, target the HRI market.[982] Most of these incentives will appeal to the cold-calling rogue traders described in Chapter 1 who often repeatedly exploit consumers without being held to account because of their itinerant nature;[983] difficulties in enforcement agencies mounting prosecutions against them; and a general unwillingness or inability on the part of consumers to take civil action. What is important to recognise is that the incentives can, and do, equally apply when the rogue trader has incorporated their business.

As already explained, most instances of consumer exploitation by registered HRI companies occur in closely-held (invariably one-man) companies, principally because there is no-one to hold the rogue director accountable to when he behaves in an unscrupulous, self-serving way with the company's consumers.

This Chapter will firstly examine some alternative, non-company law remedies which *Prest* referred to as achieving the same result as veil-piercing. In so doing, references will be made to recent prosecutions which will show the practical application of provisions to HRI traders/directors who abuse the corporate form to exploit consumers. Such regulations are not generally considered as falling within the body of company law, and they do not become so just because they often happen to apply to companies. They focus on the activity that is being regulated, the bad faith conduct - and apply in the same way to whatever actor happens to be pursuing that activity, whether a company or not. By contrast, there are a number of regulatory mechanisms that are unique to companies, because they affect the particular institutional form that is a company. Mechanisms that affect the internal structure of the company, or the personal liability of participants within the company, the duties of directors, including the balance between shareholder primacy and stakeholder interests, which govern board structures or board decision-making processes, or which make shareholders personally liable for harm caused to others, are all examples. Such mechanisms tend, rightly, to be seen as part of company law, because they depend upon the actor being a company. As this thesis demonstrates, the corporate form generates a number of practical advantages and disadvantages, and company law responds to the various problems through

[982] Door to Door Cold Calling (n236). 2.3.
[983] Phillips (n8).

regulation. This thesis is arguing no differently to that regulatory path. Since, strictly speaking, alternative forms of redress lie outside the scope of this thesis insofar as they do not fall within the realms of readily identifiable corporate law, the primary focus of this chapter will be on one of the core objectives of company law, namely minimising agency cost problems between directors and consumers.

Existing company law responses will involve an examination into the development of the law as it relates to piercing of the corporate veil, behind which unscrupulous director-shareholders hide, in order to assess the scope for holding rogue HRI directors personally liable for the losses they cause to exploited consumers. A range of other company law responses designed to prevent or deter abuse of the corporate form will also be examined, including making the CDDA 1986 more robust; preventing directors from putting company assets beyond the reach of litigating consumers through pre-pack administrations by the process known as `phoenixing'; proposing a more joined-up approach to the relationship of these to various provisions under the IA 1986; and removing the automatic access upon incorporation to limited liability for closely-held companies.

Recommendations for a shift from Shareholder Value or Enhanced Shareholder Value to Andrew Keay's Entity Maximisation and Sustainability model,[984] which rightly makes the best interests of the company the central focus of directorial decision-making, will also be considered in order to examine the feasibility of making directors personally liable to consumers, as one of many corporate stakeholders, for any breach of duty as a means of finding a workable solution to the theoretical debate discussed at 1.5.2.

Throughout this Chapter, the focus will be on identifying whether there is any scope for attaching personal liability to directors rather than fixing the company with liability since, in order to effectively address the problem of rogue director exploitation within closely-held HRI companies, it is crucial that the malfeasant director is made

[984] 4.3.3.

accountable, and therefore the liability should follow the director and not the under-capitalised or `phoenixed' company.

4.2 Other Criminal/Civil Law Remedies as Alternatives to Veil-Lifting

Since the SC in *Prest* has `limited to a point of near extinction'[985] the cases in which the corporate veil can be pierced at common law, and since any such instances of veil-piercing can now only be invoked `as a last resort',[986] other civil and criminal law remedies by which the rogue director may be sued personally by exploited consumers, or prosecuted personally by state bodies, will be considered particularly in relation to the type of activity that is considered `rogue'. However, as the stated focus of this thesis is on company law, it will not be possible to consider an exhaustive list of alternative remedies. Focus will therefore be given to those consumer protection provisions discussed in Chapter 2, and on the liability of directors as joint tortfeasors.

As demonstrated in Chapter 2, consumer protection legislation has taken some positive strides in recent years towards holding rogue traders to account, and to giving consumers improved rights of private redress against traders who exploit them. For example, the CPARs 2014 and the CRA 2015. However, as these civil rights of action are founded in contract law, they are unable to offer consumers the much-needed response to the problems of dealing with the rogue director of a closely-held HRI company. That said, there are bypass provisions;[987] and repeated infringements of the CRA 2015, s49,[988] and denying consumers their CRA 2015 rights,[989] can lead to enforcement action being taken under the EA 2002, Part 8 - normally in the form of injunctive relief such as Stop Now Orders (SNOs). Furthermore, the fact that LATSS have found the CPRs 2008 and CCRs 2013 very useful demonstrates that they warrant further discussion below.[990]

[985] Stephen Griffin, `Disturbing corporate personality to remedy a fraudulent incorporation: an analysis of the piercing principle' (2015) 66 NILQ 321, 341.
[986] ibid.
[987] 4.2.1.6.
[988] 2.4.2.2.
[989] ibid.
[990] Conversation with Richard Strawson, Chartered Trading Standards Institute, 23 September 2016.

4.2.1 Consumer Protection Legislation

4.2.1.1 Consumer Rights Act 2015

In relation to service contracts, the CRA 2015, s50 provides that anything a rogue trader says or does which influences the consumer's decision to enter the contract, or to make a decision about the service after having entered the contract, will be regarded as a contract term; this `allows a consumer to bring a claim for breach of contract where previously they would have had to bring a claim for misrepresentation'.[991] This could, for instance, relate to *Thobani* where he recklessly[992] or fraudulently falsely represented that less costly work was involved in remedying a defect; rogue traders may do this to secure a job over their competitors, intending to vary the terms of the contract and even charge/overcharge for the full extent of the work required once awarded the contract. However, quotations are themselves legally-binding documents, although no case law has been identified where consumers have tried to enforce the terms against a rogue trader through a claim for breach of contract.

The two new remedies introduced by s54(3) in relation to service contracts - repeat performance,[993] and price reduction,[994] - arguably add little value to consumers who find themselves exploited by the rogue director of a closely-held HRI company. It is surprising that Parliament should provide the courts with a statutory power to order repeat performance of HRI contracts where previously their inability to supervise performance of such contracts has caused them to generally refuse to exercise their existing discretionary power to grant an equitable order of specific performance. *Prima facie*, this new remedy of repeat performance strengthens the consumer's arsenal of remedies. However, where a consumer has been exploited by a rogue trader, arguably the last thing they will want is repeat performance from a trader whose work has already been identified as substandard.[995] In reality, consumers are often not in a

[991] Julie Patient, `The Consumer Rights Act 2015: a new regime for fairness?' (2015) 30(12) JIBLR 643, 647.
[992] Even negligently.
[993] CRA 2015, s55.
[994] ibid, s56.
[995] *Jones* (n27).

position to check the quality of the workmanship themselves or indeed whether the work promised has been carried out at all.

Rogue directors are adept at misleading consumers and employing pressure tactics to ensure prompt and often inflated payments are made. This therefore causes one to wonder to what extent a price reduction[996] would prove a useful remedy when dealing with a closely-held company. Section 56(1) does allow the consumer to claim a refund for anything already paid above the reduced amount. However, as has been demonstrated throughout this thesis, one of the practices rogue directors often engage in when there is a judgment order against their company is to voluntarily wind-up their company leaving the liabilities of the old company behind, or to use a pre-pack administration when they wish to start a phoenix company. Where price reduction and repeat performance are not pursued, this then leaves consumers with their normal contractual remedies which, due to the doctrine of separate corporate personality, can leave consumers in a precarious position when dealing with an undercapitalised private limited company.[997]

4.2.1.2 Consumer Protection from Unfair Trading Regulations 2008

Most of the prosecutions instituted by LATSS involve breaches of the CPRs 2008. In 2012-13, there were 325 such prosecutions, fairly evenly spread across the various provisions with the highest number being for breaches of regs3(3) and 8.[998] More recently, in *Dudley Metropolitan Borough Council v Summit Roofguard Limited AND Beadle, Evans and Ors,*[999] this HRI company, its two directors and staff were found guilty of 66 counts of unfair trading, misleading or aggressive commercial practices under the CPRs 2008, regs3-7. Directors Beadle and Evans each received a two-and- half year sentence for giving staff a 14-step guide on how to deliberately `dupe victims into believing they were receiving substantial [`today-only'] discounts when they were in fact pressuring them into vastly overpriced sales.',[1000] and to create the inference that

[996] 2.4.2.2, CRA 2015, s56.
[997] Chapter 3.
[998] OFT Annual Report 2012-13 (n16).
[999] Wolverhampton Crown Court, Case T20140934, February 2016 reported in TS Today, `Multi-million pound firm guilty of unfair commercial practices', February 2016.
[1000] ibid, per Judge Amjad Nawaz.

they were `not going to leave until they got the signature on the dotted line.'[1001] In that case, one elderly couple, initially quoted £17,000, eventually contracted at £9,585 for work that was worth only £2,820; another consumer paid over £20,000 for guttering that could have been repaired for £40; and an 86-year old dementia-sufferer was harassed and pressured into having windows and guttering replaced that were still under guarantee.

Another case concerning breaches of the CPRs 2008 involved a closely-held HRI company, *West Yorkshire County Council v Adjust 4 Life Limited AND Jones and Jones.*[1002] This company was the subject of an investigation by the National Trading Standards' (NTS) Scambuster Team - `Operation Krypton'.[1003] Director Marc Jones was sentenced to three years' imprisonment after admitting, *inter alia*, doing `shoddy and overpriced building works'[1004] and using aggressive commercial practices. In one incident, Jones repeatedly contacted a 74-year old man by telephone until he agreed for Jones to visit his home.[1005] Once there, Jones charged the pensioner £36,000 for shoddy and unnecessary work. Jones drove him to the bank several times to withdraw cash and persuaded him to borrow £36,500 under an Equity Release Scheme to fund the work; the man now owes £47,000 and suffers anxiety due to his escalating debts. An independent expert valued the work at just £20,000. In another incident, an 81 year old lady had to give up her home of fifty years to live in a care home due to the trauma.

In *Cambridgeshire County Council v Twinley,*[1006] a rogue HRI trader was given a six-month sentence for using aggressive commercial practices after he offered to resurface an elderly couple's driveway for £2,000.[1007] They declined repeatedly but Twinley pretended he had already started the work.

[1001] ibid.
[1002] Leeds Crown Court, Case T20121392, 31 July 2015 reported in TS Today, `Wakefield criminals guilty of VAT fraud and scamming elderly victims', 31 July 2015.
[1003] National Trading Standards, *Annual Report 2015-16: Protecting Consumers, Safeguarding Business* <http://www.nationaltradingstandards.uk/uploads/2015-16%20annual%20report%20FINAL%2024.5.pdf>accessed on 28 December 2017 (NTS Annual Report 2015-16). Also "Operation Genesis" reported in National Trading Standards, *Consumer Harm Report 2016-17* (November 2017).
[1004] <www.theLawPages.com/court-cases> accessed on 29 December 2017.
[1005] Also an offence of harassment under the Harassment Act 1997, s2.
[1006] [2016] reported in Trading Standards Today, `Businessman jailed after targeting vulnerable people', April 2016.
[1007] CPRs 2008 reg7(1).

What "Operation Krypton", "Operation Genesis" and *Yates*[1008] demonstrate is that aggressive commercial practices such as driving victims to the bank are still forming part of a rogue trader's *modus operandi* (MO). In "Operation Krypton", police were alerted after the victim withdrew £100,000 from his bank.[1009]

According to Strawson,[1010] the CPRs are very effective in equipping Trading Standards Officers (TSOs) with a greater number of offence variants.[1011] However, the problems lie in the fact that they are principles-based which makes terms such as `average consumer' and `transactional choices' more difficult for lay magistrates and juries to comprehend.[1012] This is something the government can consider addressing when redrafting legislation in readiness for BREXIT.

4.2.1.3 The Consumer Contracts (Information, Cancellation and Additional Charges) Regulations 2013

As many HRI contracts are concluded at consumers' homes, the CCRs 2013 complement the CPRs 2008 by giving consumers the opportunity to reflect on their decision to contract with the trader once they no longer feel under pressure to succumb to his aggressive and persistent selling techniques. Some even find it difficult to resist offers purely because the trader is in their home, irrespective of whether any high- pressured tactics have been used to secure their agreement. TSOs have found that the CCRs are very effective in giving them an opportunity to `get a foot in the door' because it constitutes a criminal offence when rogue HRI traders make unsolicited visits and fail to provide consumers with written notice of their cancellation rights.[1013]

One of the main problems with rogue HRI traders/directors is their opportunism, which often results in them pressing to get underway with work straight away or very soon after. Whilst a consumer can freely waive their rights to a cooling-off period,[1014] they cannot be compelled or pressurised to do so. One of the main benefits of the CCRs is

[1008] N1022.
[1009] N1003.
[1010] N990.
[1011] ibid.
[1012] ibid.
[1013] Strawson (n990).
[1014] 2.4.3.3.

that the HRI trader must provide their full contact details, which overcomes the problem of not being able to identify the rogue trader once a consumer has been exploited. However, recognising the unscrupulous nature of rogue HRI trader conduct, and the fact that many such traders are convicted of failing to provide consumers with written notice of their cancellation rights,[1015] one must question whether there is any real deterrent to rogue HRI traders inserting false information about their identity, geographical location and contact details; to do so would make any infringements of the CCRs harder to detect than if they simply did not provide any of the written information required. If rogue HRI traders are prepared to provide false quotations, excessively overcharge, and charge for work not done, then it would seem that they would have little hesitation in falsifying Schedule 2 information. This is what occurred in *Twinley,*[1016] when the rogue HRI trader was sentenced to three months' imprisonment for each of the following: failing to provide a notice of cancellation rights, using a false address, and using the same name as a competitor. Instead, the time spent on complying with this bureaucratic paper-based procedure can have a negative impact on legitimate HRI traders, particularly as they will in all likelihood comply more often with the CCRs than will rogue HRI traders/directors.[1017]

4.2.1.4 Fraud Act 2006 (FA 2006)

Due to the difficulties encountered in securing a conviction under the CPRs 2008, many LATSS cases are prosecuted under the FA 2006.[1018] An offence of fraud by false representation occurs where the rogue director dishonestly makes a false representation, intending thereby to make a gain for himself or to cause a loss to the consumer.[1019] This could arise where the rogue director has charged for work not done, or deliberately excessively overcharged for the work done, as in *Jones*. Fraud by failing to disclose information is where the rogue director fails to disclose to the consumer information which he is under a legal duty to disclose, intending thereby to make a gain for himself or a loss to the consumer.[1020] This could potentially arise where, as in *Twinley,* the

[1015] 4.2.1.3.
[1016] N1006.
[1017] Strawson (n990).
[1018] N1039.
[1019] FA 2006, s2.
[1020] ibid, s3.

rogue director deliberately failed to provide written cancellation rights as required by the CCRs 2013 so that the consumer has no opportunity to obtain alternative quotations or change their mind before work commences. The third offence under the FA 2006 is fraud by abuse of position; this occurs where the rogue director occupies a position in which he is expected to safeguard, or not act against, the financial interests of the consumer, and he dishonestly abuses that position, intending to make a gain for himself or cause a loss to the consumer.[1021]

The FA 2006 applies equally to rogue directors, and rogue traders. The following cases illustrate in more detail some examples of the kind of conduct that constitutes fraud.
The typical MO of a fraudulent itinerant rogue trader was seen in the case of *Yates.* In 2013, Yates was sentenced to 43 months' imprisonment for four counts of fraud contrary to the FA 2006. During an unsolicited visit to an elderly lady, Yates told her she had some dangerous branches in her garden and offered to do some landscaping work for her. He later charged her £10,000 for some building work which took him 6-7 weeks and which he completed to a poor standard. He escorted her to her bank and to cash machines, and then used her card and bank details fraudulently to pay off some of his own debts totalling £7,295 without her knowledge.

Lord Justice Lloyd Jones described Yates' protracted exploitation as `mean and despicable'[1022] and the victim impact statement demonstrated that his actions had ruined her life as not only had she lost her life savings, but the incident had negatively impacted on her psychological and physical health, and her self-confidence.

In *Kent County Council v Ackleton*[1023] rogue HRI trader Ackleton received a six-year sentence for fraud after admitting bullying and cheating vulnerable and elderly consumers into paying £323,000 for work later valued at under £36,000. He also admitted to having carried out unnecessary work, or having failed to carry out work for which he had received payment; having quoted excessive amounts or providing quotes for unnecessary work; and refusing to remedy work that had been completed in an

[1021] ibid, s4.
[1022] R v Yates [2014] 2 Cr App R (S) 16, 15.
[1023] Maidstone Crown Court, December 2015.

unsatisfactory manner. He also pleaded guilty to eight counts of fraud contrary to the Fraud Act 2006. Fraud may also give rise to a civil action under the tort of deceit.

Ackleton's MO was to gain his victims' trust by undertaking a cheap job satisfactorily, and then cajoling, pursuing and bullying them into paying for unnecessary work at excessively inflated prices under the pretext of it being urgently needed. He performed this work to a poor standard, or not at all, and then refused to remedy the defective work. In one case, Ackleton left most of the jobs incomplete and the desperate elderly customer paid him £288,000 to finish the work. The court heard how the true value of Ackleton's work was under £30,000.

Judge Smith described Ackleton as `manipulative, callous, devious and dishonest to your core' and pointed to the impact of his actions on his victims: `… you robbed them of their security and their financial independence …'.[1024]

4.2.1.5 Enterprise Act 2002

As stated under 2.3, the CMA and other enforcement agencies have the power to use injunctions for the protection of consumer interests. Repeated infringements of the EA 2002's civil injunctive orders may result in criminal action being taken. For example, in *Bedford Borough Council v Express Plumbing Limited AND Shamrez,*[1025] sole rogue HRI director habitually exploited consumers by deliberately overcharging them by £000s for his company's plumbing services. He was given a six-month suspended sentence for deliberately breaching the terms of a civil s215 enforcement order under the EA 2002 due to repeatedly infringing consumer legislation, harming collective consumer interests, and failing to stop his bad faith dealings with consumers. Since the enforcement order, he had caused a further £340,000 of consumer detriment by deliberately overcharging; prolonging jobs to increase chargeable hours; inflating time taken on jobs; and failing to advise consumers his company was VAT-registered.

[1024] ibid, per Smith J.
[1025] Luton County Court, Case B20LU085, February 2016 reported in TS Today, `Rogue trader given suspended prison sentence', March 2016.

Ackleton also involved repeated infringements of the CRA 2015, s49 and denying consumers their rights.

The EA 2002 makes references to the collective interests of consumers being harmed, but offers no remedy to individual consumers exploited by rogue traders. This seems inefficient as research has shown that `consumers generally benefit from public enforcement through prevention of the spread of malpractice, but … seldom obtain compensation.'[1026] Instead, they are left to pursue their own separate civil action `but they often do not do so, due to the perceived complexity, risk or cost of the process.'[1027] Often investigations are very protracted – four years in *Jones*– and by the time a prosecution occurs the proceeds of crime will often have been disbursed.[1028]

In both *Ackleton* and *Shamrez*, the courts had no doubt about the individuals' criminal liability arising from their deliberate bad faith conduct, This differentiates them from legitimate HRI traders who may demonstrate negligence or naivety but who would be more likely to adhere to the terms of a s215 enforcement order.

4.2.1.6 Bypass Provisions

The bypass provisions provide one way in which a rogue director might be joined in with his company as a defendant, or even as a substitute where the company is insolvent, under criminal law. Personal liability can attach to the rogue director through the bypass provisions where his consent, connivance or neglect in respect of an offence creates an extended form of secondary liability against him for an offence committed by a body corporate.[1029] The bypass provisions are particularly useful in the CPRs 2008,[1030] EA 2002,[1031] and the CPA 1987.[1032] They are likely to be an increasingly valuable tool since the SC in *Prest* made it clear that the corporate veil could only be disregarded where no other suitable remedy or action was available. The bypass

[1026] CRB Final Impact Assesment (n282) 6.
[1027] ibid.
[1028] Strawson (n990).
[1029] David Ormerod and Karl Laird, *Smith Hogan's Criminal Law* (OUP 2015) 302.
[1030] Regulation 15.
[1031] Section 125.
[1032] Section 40(1) re s20 misleading price indications.

provisions are a vital tool under consumer protection legislation in punishing rogue HRI directors for their bad faith conduct towards consumers.

A number of recent prosecutions instituted by LATSS against rogue HRI traders demonstrates the effectiveness of bypass provisions against the rogue director personally and his company. In *Cambridgeshire County Council v Twinley,*[1033] rogue HRI trader Twinley was sentenced to six months' imprisonment for giving one customer a misleading price by charging £490 for work that had been agreed at £90, contrary to the Consumer Protection Act 1987 (CPA 1987), s20(1). Had Twinley incorporated his business, then he would have still been found guilty for this offence under CPA 1987, s40(2) since, according to the Recorder, he acted with `nous and cunning' and therefore the offence will have been committed with his consent, connivance or neglect.

In the case of the closely-held company, the consent, connivance or neglect of the rogue director should be fairly simple to establish in most cases. One wonders whether the motivation for including bypass provisions in legislation is Parliament's way of circumventing the restrictive nature of the doctrine of separate personality, in much the same way as they did with the doctrine of privity of contract through the passing of legislation such as the Contracts (Rights of Third Parties) Act 1999. If so, then the omission of comparable provisions in relation to civil law, where privity of contract serves as a barrier, is arguably due to *laissez-faire* liberalism and it is to be hoped that a more progressive approach will pave the way for such issues to be addressed in the not-too-distant future.

4.2.1.7 Proceeds of Crime Act 2002 (POCA 2002)

POCA represents an extremely valuable tool in criminal and civil actions against rogue HRI directors for the recovery of proceeds of crime and monies obtained through breach of trust, fiduciary and statutory duty. In cases where the proceeds of crime are paid into a company controlled by the rogue director, for example a phoenix company, these will be confiscated under POCA 2002, s6 from the rogue director provided the court

[1033] (2016) reported in Trading Standards Today, `Businessman jailed after targeting vulnerable people', April 2016.

believes the director has a criminal lifestyle,[1034] and has benefited from his general criminal conduct.[1035] For example, in *R v Sale,*[1036] it was held that proceeds of crime committed by an individual but paid directly to a company under his control could be recovered.

In 2015/16, the NTS Regional Investigations Teams, though not dedicated solely to rogue HRI trader cases, convicted 46 defendants, imposed £215,000 of fines, and awarded £928,000 in confiscation orders.[1037] In 2016/17, 67 defendants were convicted, and £1.6 million awarded in confiscation orders.[1038] LATSS use the POCA 2002 in cases of fraud and multiple infringements of the CPRs 2008.[1039] During investigations, LATSS can go back six years into the rogue trader's accounts and make assumptions about the criminality of their income; the onus is on the rogue director to prove his income was legitimate.[1040] In "Operation Genesis",[1041] father and son rogue HRI traders, Jeffrey and James Tawse, targeted vulnerable consumers, and used aggressive sales tactics to intimidate their victims. The former admitted money laundering, and in addition to custodial sentences, they were ordered to pay £201,500 in a POCA confiscation award. In one incident, a 71-year-old man with short-term memory loss was charged £64,500 for a three-course brick wall around his front lawn. An expert valued such work at £600, but ordered the wall to be demolished as the quality of the workmanship was so poor.

Although the term `defendant' contained in the statute has been substituted with `director' in order to relate it to the research question of this thesis and the rogue directors in the cases of *Shamrez, Beadle* and *Evans, Jones* and *Thobani,* the POCA applies equally to unincorporated rogue traders – for instance, *Twinley, Ackleton* and *Yates*. In these cases, the rogue traders and rogue directors committed offences under the following legislation: CPRs 2008, regs3-7 and 15(1), breach of EA 2002 s215

[1034] POCA, s6(4)(a).
[1035] ibid, s6(4)(c).
[1036] [2013] EWCA Crim 1306.
[1037] NTS Annual Report 2015-16 (n1003) 56.
[1038] NTS Annual Report 2015-16 (n1003).
[1039] Strawson (n990).
[1040] ibid.
[1041] NTS Annual Report 2015-16 (n1003) 4-5.

enforcement orders; CDDA 1986, s13,[1042] CPA 1987, ss20 and 40, CCRs 2013,[1043] and the FA 2006.

Interestingly, in none of these rogue HRI trader/director cases was a confiscation order awarded, although the staff in *Jones* were ordered to compensate victims, and Jones was ordered to pay £10,000 compensation. On a close reading of s7, if the recoverable amount does not equate to the benefit received, then the recoverable amount is however much is available, and if the available amount is nil then the recoverable amount will be nominal. Therefore, one would expect to see at least some money being confiscated bearing in mind these cases are all criminal prosecutions and consumer losses are as high as £340,000.[1044]

It is possible under POCA s240 for enforcement bodies during civil proceedings to recover `property which is, or represents, property obtained [from consumers] through unlawful conduct'.[1045] Unlike the mandatory nature of s6, s240 provides a discretionary power. Provided the court can identify traceable proceeds, be they in the form of property or cash,[1046] these can be recovered from rogue directors.

In practice, enforcement bodies seldom exercise this s240 power on behalf of exploited consumers.[1047] It is suggested that this is due to the impact of current austerity measures on public services since any monies recovered for consumers means there is less available for the public coffers.[1048] Whilst this is understandable from an LATSS perspective since it allows them access to funds they would not otherwise have, which then leads to wider-scale savings for consumers and legitimate businesses,[1049] it effectively blocks a meaningful route for consumers to recover their losses from rogue HRI directors, particularly as in 2016-17 LATSS reported the highest number of prosecutions since the NTS Regional Investigation Teams started in 2005.[1050]

[1042] Breach of disqualification order.
[1043] 2.4.3.3.
[1044] Shamrez (n1025).
[1045] POCA 2002, s240(1).
[1046] ibid, s240(2).
[1047] Strawson (n990).
[1048] ibid.
[1049] NTS Annual Report 2015-16 (n1003).
[1050] ibid, 4.

Greg Allan notes, `the most attractive avenue for relief for claimants in alter ego cases should be to pursue an equitable proprietary claim against the [traceable] profits arising out of the breaches of fiduciary duty, or the traceable proceeds of such profits.'[1051] This is because an equitable proprietary claim arises in the form of a constructive trust when a rogue director receives monies in breach of his fiduciary or general duty to the claimant. The claimant, as beneficiary, would then `take precedence over the claims of unsecured creditors, and would not be defeated by the bankruptcy of a controller or the insolvency of his/her one-man company.'[1052] Therefore, if directors were to owe a fiduciary duty to consumers,[1053] then this would mean greater certainty for consumers other than relying on the discretionary use of s240 by LATSS.

4.2.1.8 Conclusion

At first blush, consumer protection legislation appeared largely inadequate in overcoming the problems presented by the cornerstones of company law and the doctrine of privity of contract.[1054] Whilst this may still be true for consumers' private rights of redress, there are in fact provisions which not only address directors' bad faith conduct towards consumers,[1055] but also provisions which provide for compensation to be claimed from rogue directors on behalf of consumers.[1056]

There can be no denial that over the last decade consumer protection legislation has made great progress in protecting the interests of consumers. One might be excused for believing there to be a deliberate shift on the part of the government's consumer protection strategy from a *laissez-faire* liberalist approach to a more interventionist, paternalistic, and stakeholder-oriented approach, or even a deliberate attempt to pierce the corporate veil.[1057] However, one should bear in mind the origins of the CPRs 2008 and CPARs 2014, and the fact that the UK was compelled to adopt these statutory instruments into domestic law as part of its EU membership obligations. It is to be hoped that such effective and protective provisions are incorporated into a new consolidating

[1051] Allan (n779) 4.
[1052] ibid.
[1053] Keay (n79); *FHR European Ventures LLP v Cedar Capital Partners LLC* [2014] UKSC 45; [2015] AC 250.
[1054] 2.5.
[1055] 4.2.1.
[1056] 4.2.1.6, 4.2.1.7.
[1057] Bypass provisions.

Act of Parliament once the UK leaves the EU in March 2019, and that the care is taken to consult NTS and other agencies to ensure the language and terminology is more consistent with existing domestic legislation.

The government's austerity measures are impacting heavily on the effectiveness of enforcement action, and in particular the missed opportunities for LATSS to recover compensation for consumers under the bypass provisions and POCA 2002. It is unfortunate with such compelling cost-benefit analysis findings that more funding cannot be provided to LATSS in order that they may deliver their service to the full extent that the law provides for. The NTS Consumer Harm Report 2016-17 illustrates that Trading Standards' consumer protection work prevented £23 million of consumer detriment equating to an average of £50.39 saved for every £1 spent, whilst their criminal activity work saved £5.47 for every £1 spent.[1058] It is almost certain that these savings would increase significantly if more compensation was recovered for consumers, without a commensurate increase in expenditure.

Finally, the bypass provisions provide a valuable tool for overcoming the problems preventing rogue HRI directors being held personally liable for their bad faith conduct. It is unlikely that the government will explore the possibilities of introducing something resembling them into the CRA 2015 and CPRs 2008 to prevent consumers being constrained by the cornerstones of company law and the doctrine of privity of contract since this would undermine the doctrine of separate corporate personality. However, as *Prest* encourages the use of non-company law principles to allow consumers to sue directors personally, this issue is worthy of further Parliamentary attention.

4.2.2 Liability of Rogue Directors as Joint Tortfeasors

According to Ross Grantham and Charles Rickett, `careless or negligent conduct by company directors sits uncomfortably at the intersection of company law and the law of torts.'[1059] While company law places the liability exclusively on the artificial corporate

[1058] N2003, 7.
[1059] Ross Grantham and Charles Rickett, `Directors' `Tortious' Liability: Contract, Tort, or Company Law?' (1999) 62 MLR 133, 137.

entity, the law of torts imposes liability on the director as the actual tortfeasor. Tortious actions relevant to the subject matter of this thesis include negligent misstatement, negligent provision of services, and the tort of deceit. These therefore can provide a much-needed alternative remedy against rogue HRI directors that would not otherwise be available under company law or consumer protection.

The bypass provisions provide one way in which a rogue director might be joined in with his company as a defendant, or even as a substitute where the company is insolvent, under criminal law. Another way in which a rogue director may be held accountable for his unscrupulous conduct is as a joint tortfeasor with the company when the consumer exploitation complained of is regarded in law as a tort. Some tortious conduct is covered under the CPRs 2008. Whereas consumers cannot take direct action against the company/rogue director under the CPRs 2008, under tort law they can. As in contract law, action for tortious conduct must normally be taken against the company rather than the director. This section will therefore focus on the circumstances in which a rogue HRI director may be made liable as a joint tortfeasor. The law will then be applied to determine the liability of rogue directors of closely-held company for their tortious conduct.

4.2.2.1 Rules of Attribution

Being a separate legal entity, a private limited company is regarded as a legal abstraction, which relies on human agents in order to transact business with third parties.[1060] Neil Campbell and John Armour state `[a] necessary consequence of a company's legal abstraction is the development of rules of attribution, such as those that govern the company's liability for the wrongful acts of its agents.'[1061] Those who manage the company's affairs on a day-to-day basis are its directors, and the board of directors have all the powers of the company to enter into contracts with third parties.

Having a legal personality in its own right, the company's directors and shareholders are shielded from liability by the corporate veil, and therefore liability must attach to the company through the application of the rules of attribution. Attribution most

[1060] Neil Campbell and John Armour, `Demystifying the Civil Liability of Corporate Agents', (2003) 62 CLJ 290. Also Viscount Haldane LC in *Lennard's Carrying Co* [1915] AC 705 HL at 713.
[1061] Campbell and Armour (n1060), 290.

commonly occurs in the case of agency and vicarious liability. This separation of roles under the law of agency between agent (director) and principal (company) arguably lacks the same logic it has in larger companies in the case of the closely-held company where the director has been described as the `embodiment'[1062] of the company. This confusion arises from judgments such as that given by Hardie Boys J in *Trevor Ivory Ltd v Anderson*[1063] who said:

> [I]n appropriate circumstances [directors] are to be identified with the company itself, so that their acts are in truth the company's acts. Indeed I consider that … this identification normally be the basic premise and that clear evidence be needed to displace it with a finding that a director is acting not as the company but as the company's agent …[1064]

One must question, if the sole controlling director were not regarded at law as an agent, whether this would mean that he were instead the principal. Stephen Griffin, citing *Salomon,* argues that in a closely-controlled company, the company itself cannot be regarded as an agent: `the finding of an agency relationship in a one-man type company is unsustainable.' and would challenge the `very heart and soul of corporate law.'[1065]

If one accepts that the attribution rule has no part to play in the closely-held company, then one must examine the liability of sole directors through a different lens. Campbell and Armour examine three attempts that have been made to establish a universally applicable principle to the liability of corporate agents. These are the disattribution heresy; assumption of responsibility; and direction or procurement approaches. Each of these places primacy on company law.

The Disattribution Heresy as an Approach to Liability of Sole Directors

The disattribution heresy uses the identification doctrine, rather than rules of attribution, to disattribute acts and knowledge from the director to the company; as the company is

[1062] Grantham and Rickett (n1059) 133.
[1063] [1992] 2 NZLR 517.
[1064] ibid, 527.
[1065] Stephen Griffin `The one-man type company and the removal of corporate personality in the context of the attribution rules' (2011) 22 ICCLR 158, 162.

identified with the controlling director `as the company' or `as the directing mind and will of the company',[1066] these acts and knowledge cannot be simultaneously legally attributed to both the company and the director. Therefore the director escapes liability altogether under the disattribution heresy.

However, implying that a sole director could '"identify with" a corporate persona more completely than simply acting as an agent … gave rise to a metaphysical notion in which an agent identified with the company was seen as *embodying* the company …'.[1067] This occurred in *Trevor Ivory* when the New Zealand CA refused to hold the company's sole director liable for negligent misstatement arising from careless advice he had given; Hardie Boys J stated clear evidence was needed before the director would be found to be acting `not as the company but as the company's agent …'.[1068]

Campbell and Armour insist the `heresy is based on a misunderstanding of the identification principle, and cannot otherwise be supported.'[1069] They explain that in none of the cases in which the identification principle precedent was developed was the agent's liability in issue',[1070] and therefore a broad brush approach to the doctrine should not be taken where agents are involved.

Grantham and Rickett[1071]agree with Hardie Boys J, that further evidence is required before a sole director can be held personally liable for his own tortious conduct. Commenting on *Williams,*[1072] they regard directors as a special category of agent:

> although, necessarily, a director may be the actual tortfeasor or the individual responsible for a contract, the company law regime modifies the normal consequences of the director's actions, precisely to ensure that responsibility for, and the legal consequences of, the tortious conduct or contractual undertaking are

[1066] Campbell and Armour (n1060) 292.
[1067] ibid.
[1068] *Trevor Ivory* (n1063) 527, per Hardie Boys J.
[1069] Campbell and Armour (n1060) 295.
[1070] ibid.
[1071] Grantham and Rickett (n1059).
[1072] *Williams* (n652).

not sheeted home to the individual.[1073]

Grantham and Rickett argue that the company law regime and the doctrine of separate corporate personality must have primacy over general tort principles and other liability rules: `Where the company law regime applies, its essential function is to identify a different entity as the actual tortfeasor or contractor.[1074] This therefore demonstrates how important it is for company law to offer an effective response to consumer exploitation by rogue directors of closely-held HRI companies.

Applying *Trevor Ivory*, the CA, in *Standard Chartered Bank v Pakistan National Shipping Corp (No 2)*,[1075] refused to hold personally liable a sole director who, knowing his statements to be false and intending them to be relied upon, made various fraudulent misrepresentations when obtaining, for his company, payment under a letter of credit. However, the HL reversed that decision, stating:

> The fact that by virtue of the law of agency his representation and the knowledge with which he made it would also be attributed to Oakprime would be of interest in an action against Oakprime. But that cannot detract from the fact that they were his representation and his knowledge. He was the only human being involved in making the representation to SCB … It is true that SCB relied upon Mr Mehra's representation being attributable to Oakprime because it was the beneficiary under the credit. But they also relied upon it being Mr Mehra's representation, because otherwise there could have been no representation and no attribution.[1076]

Therefore, just because a sole director's company is attributed with his acts and knowledge, it does not follow that sole directors can enjoy blanket immunity from liability for their wrongful acts or statements as corporate agents. Lord Hoffman distinguished between the different causes of action in *Williams* (negligent misrepresentation) and *Standard Chartered* (fraudulent misrepresentation),

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[1073] Grantham and Rickett (n1059) 139. John Farrar, `The Personal Liability of Directors for Corporate Torts' (1997) 9 Bond LR, 102.
[1074] Grantham and Rickett (n1059).
[1075] [2000] CLC 133.
[1076] *Standard Chartered Bank v Pakistan National Shipping Corp (No.2)* [2003] 1 AC 959, 20 per Lord Hoffman.

emphasising: `[n]o one can escape liability for his fraud by saying "I am committing this fraud on behalf of someone else and I am not to be personally liable."'[1077] The fact that Mr Mehra was being sued for his own tort (deceit) rather than for the company's tort (as in *Williams*) distinguishes the two cases further and supports the assertion that a sole tortious director against whom all the elements of the tort could be proved will not escape liability in tort just because his wrongful conduct is also attributed to his company.

As Campbell and Armour state, `there is no convincing reason why the company being liable should exclude or immunise the agent from being liable.'[1078] To them, and others,[1079] the liability of corporate agents is `simple': `a corporate agent should incur liability for civil wrongs committed in the course of the company's business only where the requisite elements of the civil wrong are proved by the claimant against the agent.'[1080] It should make no difference whether the agent acts on behalf of an individual or a company.[1081] Relying on general principles of joint tortfeasance, Stefan Lo concurs, maintaining that if an individual could be liable in tort for his own actions/omissions, he would also be liable as an agent even though acting under the authority of a principal: `Where the principal is liable, then the agent would be a joint tortfeasor with the principal; however, the agent's liability can be seen to be primary as the elements of the tort are established as against the agent.'[1082]

Assumption of Responsibility as an Approach to Liability of Sole Directors

As can be seen from the above, supporters of the disattribution heresy approach place the primacy of company law over general tort principles.[1083] They believe tort principles disturb the cornerstones of company law. According to Grantham and Rickett, company law doctrines indicate that directors are either exempted from, or should be treated differently to general principles of joint tortfeasance under common law: `Unless the director has positively abandoned the shield of the company's separate personality,

[1077] ibid, 22.
[1078] Campbell and Armour (n1060) 295-296.
[1079] Stefan Lo, `Liability of directors as joint tortfeasors' (2009) 2 JBL 109-140
[1080] Campbell and Armour (n1060) 291.
[1081] ibid, 291-292.
[1082] Stefan Lo (n1079) 114.
[1083] Grantham and Rickett (n1059); John Farrar (n1073).

personal liability does not arise even where the director has physically committed the tortious act.'[1084] They maintain the basic premise that `[a]s the embodiment of the company the director incurs no liability unless and until he assumes personal responsibility.'[1085] This then constitutes the `clear evidence' referred to in *Trevor Ivory* that could displace the presumption that the sole director is acting `as the company' and instead is to be regarded as the company's agent. This approach has been described as an extended form of *Hedley Byrne*-type liability for economic loss.[1086] Lord Reid in *Hedley Byrne & Co Ltd v Heller & Partners Ltd*[1087] was the first to raise the concept of voluntary assumption of responsibility when he said: `There must be something more than the mere misstatement. … The most natural requirement would be that expressly or by implication from the circumstances the speaker or writer has undertaken some responsibility …[1088] He set out an example of how a voluntary assumption of responsibility might arise:

> A reasonable man, knowing that he was being trusted or that his skill and judgment were being relied on, would, I think, have three courses open to him. He could keep silent or decline to give the information or advice sought: or he could give an answer with a clear qualification that he accepted no responsibility for it or that it was given without that reflection or inquiry which a careful answer would require: or he could simply answer without any such qualification. If he chooses to adopt the last course he must, I think, be held to have accepted some responsibility for his answer being given carefully, or to have accepted a relationship with the inquirer which requires him to exercise such care as the circumstances require.[1089]

The HL has since confirmed the presence of a contractual relationship between the parties does not preclude an action in tort.[1090]

[1084] Grantham and Rickett (n1059) 138.
[1085] ibid 133.
[1086] Lord Goff in *Spring v Guardian Assurance plc* [1994] 3 All ER 129; Lord Steyn in *Williams* (n652).
[1087] [1964] AC 465.
[1088] ibid, 483.
[1089] ibid, 486.
[1090] *Henderson v Merrett Syndicates Ltd* [1994] 3 All ER 506.

In *Williams,* the HL found that the sole director of a closely-held company had not assumed personal responsibility towards his company's franchisee. This is despite the company, on the basis of the director's personal previous experience, having negligently overstated the likely income and profits for the claimant's new franchise shop. Finding no imposed duty of care on the director, the HL agreed unanimously that the recovery of damages in respect of economic loss relied on an extension to the *Hedley Byrne* principle whereby there must be a special relationship between the plaintiff and the defendant which could be evidenced by the defendant having assumed personal responsibility for any advice given or services provided. In stressing that `it is not sufficient that there should have been a special relationship with the principal … a director of a contracting company may only be held liable where it is established by evidence that he assumed personal liability …'.[1091] Lord Steyn's judgment lends weight to Grantham and Rickett's assertion that any negligent misstatement or negligent provision of services must `recognise and give effect to the separate legal personality of the company'.[1092] In this way, the assumption of personal responsibility by a sole director would be seen as the positive abandonment of the corporate shield referred to above.[1093] The mere fact that a director owns and controls a company would not be sufficient to infer that he assumes personal responsibility, and neither would it be reasonable for a claimant to presume that he does so on that basis alone.[1094]

The HL in *Standard Chartered Bank*[1095] has since ruled that an enquiry into assumption of responsibility is only relevant where it relates to the cause of action against the director personally, rather than against the company. Tort by a rogue director against a consumer does not require personal assumption of responsibility and therefore this principle should have no application in cases where it is the sole director's torts that are under scrutiny as opposed to the company's.

In *Customs and Excise Commissioners v Barclays Bank plc,*[1096] Lord Bingham stated that whilst assumption of responsibility is a `sufficient' condition of a director's liability

[1091] *Williams* (n652) 835-837.
[1092] Grantham and Rickett (n1059) 134.
[1093] ibid.
[1094] ibid 135.
[1095] N1076, 43.
[1096] [2006] 4 All ER 256.

in negligence for pure economic loss, it is not a `necessary' one.[1097] Therefore, if the objective test[1098] for assumption of responsibility on the part of a director is satisfied, there will be no need for the court to enquire further: `there are cases in which one party can accurately be said to have assumed responsibility for what is said or done to another, the paradigm situation being a relationship having all the indicia of contract save consideration.'.[1099] In *Caparo Industries plc v Dickman*[1100] Lord Oliver described it as: `a convenient phrase but … not intended to be a test for the existence of the duty for, on analysis, it means no more than that the act of the defendant in making the statement or tendering the advice was voluntary and that the law attributes to it an assumption of responsibility if the statement or advice is inaccurate and is acted upon. It tells us nothing about the circumstances from which such attribution arises.'[1101] Failure to establish a voluntary assumption of responsibility does not defeat the claimant's case as the courts can instead rely on the objective foreseeability-proximity-just and reasonable three-stage test enunciated in *Caparo.*[1102]

Caparo's three-stage test has also been applied in relation to group companies to identify whether a parent company should be liable for subsidiary company torts on the basis of assuming a duty of care. In *Chandler v Cape plc* [2012] EWCA Civ 525, the parent company was deemed to have a duty of care towards the subsidiary company's employees on the basis of having superior knowledge of the risks of working with asbestos and having actual or imputed knowledge that their superior knowledge would have been relied upon. In the similar case of *Thompson v The Renwick Group plc* [2014] EWCA Civ 635, *Chandler* was distinguished on the basis that The Renwick Group was no better placed than its subsidiary to protect employees and therefore there was no reliance on the parent company having any superior knowledge. Applying *Chandler*, the CA in *Lungowe and others v Vedanta Resources Plc and another* [2017] EWCA Civ 528 confirmed that a parent company's could extend to non- employees affected by the subsidiary's operation, paving the way for a wider class of claimants against parent

[1097] ibid, 190.
[1098] Henderson (n1090) 181.
[1099] ibid.
[1100] [1990] 2 AC 605,
[1101] ibid, 637.
[1102] *Barclays* (n1096) 195-197; also *Caparo* (n1100) 640 per Lord Oliver.

subsidiaries. This could have particular relevance in closely-held subsidiary companies for the wrongs committed by their companies which place the company's assets beyond the reach of consumers and other creditors, particularly where the parent company has knowledge that the subsidiary company's liquidity is relied on by its creditors.

`Direction or Procurement' as an Approach to Liability of Sole Directors

In *Rainhan Chemical Works Ltd (in liq) v Belvedere Fish Guano Co Ltd,*[1103] Lord Buckmaster stated that company directors would not be held liable for the company's tort simply by having control of the day-to-day management of the company. However, `[i]f a company is formed for the express purpose of doing a wrongful act or if, when formed, those in control expressly direct that a wrongful thing be done, the individuals as well as the company are responsible for the consequences …'.[1104]

Lord Atkin, in *Performing Right Society Ltd v Ciryl Theatrical Syndicate Ltd,*[1105] extended this approach: `If the directors themselves directed or procured the commission of the act they would be liable in whatever sense they did so, whether expressly or impliedly.'[1106]

Crucially, the `direct or procure' test is implied in circumstances where the director has not personally committed the tortious act: `the test is a test of a defendant's secondary liability … [and is of] no relevance where the defendant has personally engaged in the wrongful acts.'[1107] Since, in the closely-held HRI company, it is the rogue director who behaves unscrupulously towards the company's consumers, this test would not determine the liability of the type of director under scrutiny in this thesis.

[1103] [1921] 2 AC 465.
[1104] ibid, 476.
[1105] [1924] 1 KB 1 (CA).
[1106] ibid, 15.
[1107] Campbell and Armour (n1060) 298-299; *Standard Chartered Bank* (n1076) per Lord Rodger.

4.2.2.2 Attribution for Wrongs Committed by the Rogue Director in the Closely-Held Company

Civil Wrongs

In *Stone & Rolls Ltd (In Liquidation) v Moore Stephens (A Firm),*[1108] Lords Walker and Brown suggest that the closely-held company cannot sue the rogue director who has caused losses for the company itself. This is because the *ex turpi causa non oritur actio* principle barrs any claim on behalf of the company on the basis that the sole director's wrongful acts are attributed to the company which then cannot claim on account of having acted illegally itself. However, Lord Scott notes that the attribution rules should differ according to whether the claimant is an innocent third party, `with no notice of any illegality or impropriety by the company in the conduct of its affairs' in which case the *mens rea* of the '"sole actor" could and should be attributed to the company if it were relevant to the cause of action asserted against the company to do so. But it does not follow that attribution should take place where the action is being brought by the company against an officer or manager who has been in breach of duty to the company.'[1109] Griffin suggests that, had *Stone* concerned the company pursuing an action against a director for misfeasance or a derivative action on behalf of the company by independent shareholders against the company's auditors, `it is probable that the attribution rules would not have been applied to defeat the company's cause of action.'[1110] This view is consistent with that expressed by David Lord QC.[1111]

Since the *Stone* decision, claims by companies against dishonest directors have been thwarted by *ex turpi causa* defences. However, more recently in *Jetivia SA and another v Bilta (UK) Ltd and others* [2015] UKSC 23, [2015] All ER (D) 149 the SC

[1108] [2009] UKHL 39.
[1109] *Stone* (n1108) 1476.
[1110] ibid. Also David Lord QC, `3 Stone Buildings Presentation: Guilty Knowledge - The rule in Hampshire Land' (8th October 2009) 51, citing *Hampshire Land* and *Arab Bank v Zurich Insurance* [1999] 1 Lloyd's Rep 262.
[1111] David Lord QC (n1110) 51.

distinguished *Stone* on the basis that *Stone's* fraud was against a third party but *Bilta's* fraud was only against the company itself. In such circumstances, the SC found that the fraudulent company directors could not therefore escape liability by relying on their wrongdoing being attributed to the company. Therefore, by refusing to allow the fraudulent state of mind of the sole director and shareholder of a one-man company to be attributed to the company in cases where the company is the sole victim of the fraud, the SC has permitted the company to sue its director(s) for breach of fiduciary duty. Clearly in the closely-held company, the problem remains that the sole shareholder will not institute a statutory derivative claim against himself as director. However, it would be open for the liquidator to commence IA 1986, s213 proceedings against the fraudulent director.

This would seem to indicate that if, as discussed in relation to communitarianism, consumers were recognised as corporate stakeholders, with enforceable rights against directors who breach their duties towards them, then they would be able to sue the rogue director personally and not the company. How this would work in practice is unclear as it is the shareholders who exercise ultimate control on the company by voting on resolutions; for example, to sue a director who breaches his statutory duties or to remove a director from office. Consumers and other corporate stakeholders have no such rights at present. The benefits of them being given derivative rights of action against a misfeasant director have already been discussed, as have the disadvantages of derivative action for consumers, namely that any action would need to be commenced by a consumer, at his own expense, on behalf of the company rather than on its own behalf; as such, any losses recovered would be payable to the company rather than to the consumer. If one considers Keay's EMS model,[1112] then, again, any action must be taken by or on behalf of the company and any losses recovered would be payable to the company. The main problem in both instances is the nature of the closely-held company – that where the controlling owner is also the company's sole director, he will not hold himself to account for any harm or loss caused to the company.

[1112] 4.3.3.

Criminal Conduct

The HL in *Stone* made clear that the closely-held company would have been attributed with the *actus reus* and *mens rea* of the rogue director in the event the latter was charged with a criminal offence. This is because the sole director was the embodiment of the company, controlling every relevant act of the company.[1113] As Lord Scott stated:

> where the company has no human embodiment other than the fraudster and where, therefore, there is no one in the company for the fraudster to deceive, no one in the company to whom "a clean breast of … delinquency" could be made. In these "one actor" cases, it is said, the Hampshire Land Co rule can have no sensible application.[1114]

Accordingly, under the rules of attribution, the dishonest intention of the sole director on a fraud charge would, as the directing mind and will of the company and its owner, be attributed as the dishonest intention of the company itself,[1115] and `the fraudulent business activities of D were treated as the business of C carried on for the implied benefit of C.'[1116] David Lord QC justifies this judgment on the basis that the company in these circumstances is seen as the vehicle of the fraud rather than the victim of the fraud.[1117] He suggests that, where the company goes into liquidation, the rogue director would not be able to defeat any misfeasance summons commenced against him by the liquidator `by attributing his knowledge of the fraud to the company. In such a circumstance the rule in Hampshire would surely be invoked.' [1118]

[1113] Griffin (n1065) 161.
[1114] *Stone* (n1108) 1475.
[1115] An exception to the *Hampshire Land* principle due to the controlling director being complicit in the fraud. It was found in *Hampshire Land* (n1110) that the *mens rea* of the agent on a fraud charge will not be attributed to the principal when that *mens rea* relates to the agent's own breach of duty to the principal: `The rationale for Hampshire Land has been said to be that it is contrary to common sense and justice to attribute to a principal knowledge of something that his agent would be anxious to conceal from him.' (David Lord QC (n1110) 51.
[1116] Griffin (n1065) 161.
[1117] N1110, 53.
[1118] ibid, 54. Lord Scott, *Stone* (n1108) 1476.

Lords Walker and Brown in *Stone* concluded emphatically in respect of closely-held companies that the *Hampshire Land* principle did not apply where a company

> was suing to recover on behalf of all those that it, itself, had defrauded. … In such a case the company would comprise no human entity other than the individual representing its directing mind and will and therefore absent of an independent shareholder, the company … could never, as a matter of logic, be deceived so as to be considered a victim of the criminal conduct. In effect, the directing mind and will of the company could not be said to have deceived itself.[1119]

Therefore, even when the sole director has defrauded the company itself or its consumers, the company cannot sue the director on its own or their behalf. Both Lords Scott and Mance, on the other hand, believed that the company would be a victim where the director acted fraudulently *and* in breach of duty to the company, especially where, as a result, the company is `propelled into a state of insolvency'.[1120] The Court of Appeal in *Attorney General's Reference (No 2 of 1982)* [1121] `roundly rejected [the operation of the attribution rule] to circumstances where the sole shareholders, directors and directing minds were acting illegally or dishonestly in relation to the company.'[1122] According to Lord Mance, `it is not open even to a directing mind owning all a company's shares to run riot with the company's assets and affairs in a way which renders or would render a company insolvent to the detriment of its creditors.' [1123] Therefore a rogue director would have no authority, as agent of his closely-held company, to treat `his' company as a vehicle for defrauding either the company or its consumers. This latter reasoning appears consistent with that of the SC in *Bilta*.[1124]

[1119] Griffin (n1065) 161.
[1120] ibid.
[1121] [1984] QB 624.
[1122] ibid, per Lord Mance, *Stone* (n1108) 1515.
[1123] *Stone* (n1108) 1516.
[1124] *Jetivia SA and another v Bilta (UK) Ltd and others* [2015] UKSC 23, [2015] All ER (D) 149.

It is understandable why the courts would be willing to treat the sole director and the company as being one and the same in order to attribute the director's liability to the company, and thereby prevent any opportunity for unjust enrichment by a rogue director when he is also liable with the company. On the one hand, this may appear to dilute the compelling nature of the company as a separate corporate personality, but on the other hand it can be seen as reinforcing it since the company is being made jointly liable, as a separate legal entity, with the rogue director. One must question whether the rules of attribution would be any different if Keay's EMS model[1125] of the company came to the fore, since the corporate objective would be to maximise the wealth of the company and sustain its survival for the long-term. It is submitted that each of these objectives would be hampered if the company were attributed the criminal acts and knowledge of the rogue director.

4.2.2.3 Conclusion

Although some judges and commentators believe that, by applying the rules of attribution so as to establish the company's wrongdoing, this precludes the rogue director from being made personally liable for the wrongs he has committed. However, this thesis supports the view that it should still be possible for the director to be made liable when attribution has taken place, according to ordinary principles of law (and, where necessary, rules relating to assumption of responsibility by agents), on the basis of his bad faith conduct. It seems right therefore that the courts should resist any assertion that the cornerstones of company law should have primacy over tort law when it comes to fixing directors with liability for their tortious acts, preferring instead to determine the liability of directors according to general principles of joint tortfeasance.[1126] This is all the more important in the context of rogue directors of closely-held HRI companies since, as Lo notes `If the company is generally the only party liable to the tort victim, then there is the possibility of corporate controllers engaging in excessively risky activities through under-capitalised companies, leaving the tort victims uncompensated for their losses.'[1127] It is right that such a disregard for the position of consumers as involuntary tort victims should not be

[1125] 4.3.3.
[1126] A view with which many agree. For example, Campbell and Armour (n1060) and Lo (n788); *Standard Chartered Bank* (n1076); *MCA Records Inc v Charly Records* [2003] 1 BCLC 93 CA (Civ Div).
[1127] Lo (n1079) 110.

permitted since it is the way in which rogue directors of closely-held HRI companies rely on and in fact abuse these cornerstones of company law that has led to the reckless, or even intentional, exploitation of consumers that forms the focus of this thesis. It is asserted that it is because of company law's preoccupation with protecting those shielded by the veil of incorporation at the expense of a company's consumers and other corporate stakeholders that has created this need for a remedy to be found elsewhere. For these company law doctrines to then trump other potential common law remedies would be to strengthen the already seemingly unassailable position of those rogue HRI directors who seem determined to exploit consumers for their own enrichment. Remedies under the law of tort are all-the-more important when one considers that, `there are cases in which one party can accurately be said to have assumed responsibility for what is said or done to another, the paradigm situation being a relationship having all the indicia of contract save consideration'[1128]

As Keay notes, non-CA legislation gives `partial and imperfect cover to stakeholders and only allow[s] for some sort of remedy or relief *ex post*, while protection *ex ante* is often needed in order for it to be truly effective.'[1129] Only the company law regime can provide *ex ante* protection, which is another reason why the responses to the problems enunciated in this thesis should lie in company law.

[1128] *Barclays* (n1096) per Lord Bingham, 4.
[1129] Andrew Keay, `Tackling the Issue of the Corporate Objective: An Analysis of the United Kingdom's `Enlightened Shareholder Value Approach' (2007) 29 SydLawRw 577, Part 4, G - Enforcement.

4.3 Potential for Law Reform under Company Law

As discussed,[1130] there are alternative remedies for consumers under consumer protection and other areas of law, and these are likely to gain in standing since the SC ruling in *Prest.* However, they are not without their problems for consumers, and most notably the difficulties consumers have in making the rogue HRI director personally responsible for the wrongs he has committed against them and the detriment he has caused. Having to compete with constant cuts in public service funding means that consumer interests are never given the prominence they deserve.

Throughout this thesis, it has been stressed that the problems with rogue HRI directors exploiting consumers is made possible by the cornerstones of company law. The starting point of these problems is the accessibility to the corporate form for one-man businesses. `But-for' the automatic availability of limited liability and separate corporate personality, the corporate form would serve no useful purpose for sole traders and small partnerships, other than provide access to greater borrowing opportunities.

For this reason, the first thing considered in this section is the removal of automatically available limited liability. If robust mechanisms were then in place and a more stakeholder-oriented approach taken to directors' duties, with clear guidance as to whom they are owed and by whom they can be enforced, the accountability vacuum within closely-held companies would be addressed and more directors would think twice before displaying such reckless and dishonest conduct towards consumers. If directors' duties were owed to the company itself, with all other constituencies' interests being given equal standing, the best interests of the company will be better

[1130] 2.4 and 4.2.

served, along with those of consumers. And for those rogue HRI directors who still manage to exploit any loopholes in the law, there need to be adequate *ex post* provisions under the company law regime. This will involve an examination of the different veil-piercing grounds under common law and statute with the emphasis being on the suitability of each for exploited consumers seeking to hold rogue HRI directors accountable. The final section will group together the provisions under the IA 1986, CDDA 1986 in order to examine what *ex post* sanctions can be placed on rogue HRI directors to prevent them from repeating the cycle of abuse towards consumers through phoenixing.

Recommendations for law reform will be considered within this section, with particular focus on addressing the specific issues presented throughout this thesis.

4.3.1 Restricting the Availability of Limited Liability for Closely-Held Companies

As demonstrated in Chapter 3, the government's `[erroneous assumption] that limited liability is invariably essential to encourage enterprise', together with their enduring and `extensive programme of deregulation'[1131] in order to specifically attract small businesses creates an irresistible opportunity for rogue directors to exploit consumers, and places consumers in an extremely precarious position. As Hicks realistically observes, `In a political milieu that regards high numbers of company start-ups as essential, it is easy to overlook the impact on interests other than the business founders.' He goes on to describe the potential harm of such an oversight:

> it may encourage ill-considered or irresponsible risk-taking; it transfers much of the risk of failure to third parties; the domino effect caused by the failure of poorly run companies falls primarily on the small business sector[1131]; for third parties it increases the cost of investigating creditworthiness and dealing with what may be a paper company; … and the abuse of limited liability cannot be effectively

[1131] Andrew Hicks (n24) 314.

> compensated or redressed *ex post facto* by elaborate legal devices such as wrongful trading and disqualification.[1132]

Not only was limited liability not intended for small companies, Hicks maintains it is not needed by them,[1133] particularly as they do not have external investors; his research demonstrates that the vast majority of businesses continue to operate, successfully, without limited liability as sole traders and partnerships,[1134] and most of the proprietors of these businesses interviewed rarely regarded their unlimited liability as a significant disadvantage, especially as many had signed personal guarantees anyway: `Limited liability is therefore not always regarded as the essential protection to enable a business start-up that it is assumed to be'.[1135]

Hicks,[1136] Freedman,[1137] and Ireland[1138] are amongst those advocating reduced access to limited liability for small companies. Freedman suggests that this could be achieved by raising the minimum capital requirements for `micro companies' to £50,000,[1139] something John Armour suggests would need coupling with restrictions on distribution.[1140] This would certainly encourage more responsible risk-taking by directors and would be likely to deter unscrupulous conduct. Furthermore, it would remove what is arguably the main incentive for rogue traders to seek incorporation in the first place.[1141]

Many scholars have agreed that limited liability, rather than being the natural consequence of incorporation that it is today, should not be made available for closely-held companies.[1142] It has been suggested that it could be provided for instead under contractual principles, such as personal guarantees[1143] or via the company's Articles of

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[1132] Hicks (n24) 326.
[1133] Hicks (n24); Ireland (n22); Freedman (n24).
[1134] In 2016, 68% and 8% respectively (Department for Business Enterprise Innovation and Skills, *Business Population Estimates for the UK and Regions 2016* (BEIS/16/34, 13 October 2016) (BEIS Statistical Release 2016)
[1135] Hicks (n24) 325.
[1136] ibid.
[1137] Freedman (n24) 558.
[1138] Ireland (n22) 849.
[1139] Freedman (n54) 344.
[1140] John Armour, `Legal Capital: an Outdated Concept' (2006) 7 EBOR 5, 15.
[1141] Freedman (n54).
[1142] Hicks (n24) 330. Freedman (n24); Ireland (n22).
[1143] Freedman (n54) 338-9.

Association.[1144] In the former case, it is unlikely that rogue HRI directors would offer these and even less likely that consumers would think to ask for them; and in the latter case express provision would need to be negotiated in consumer contracts.[1145] Ireland's suggestion of decoupling limited liability from control rights, as evidenced in the very successful ordinary partnership structure, would certainly provide an effective means of fostering more responsible directorial conduct.[1146]

However, through the passing of the Limited Partnership Act in 1907 and the Limited Liability Partnership Act in 2000, Parliament has progressively sought to introduce limited liability into partnerships, with the result that the general partnership form which was thought by so many to be both efficient and morally fair is no longer the partnership form of choice for many businesses today.[1147] Any return to pure partnership principles, and unlimited liability, therefore seems unlikely, especially whilst the government refuses to question the wisdom of extending this universal use of limited liability to small companies even in the face of strong evidence of abuse of the corporate form and widespread detriment to consumers and other small trade creditors.

As for raising the minimum capital requirements, Armour suggests there is a direct correlation between minimum capital requirements and levels of entrepreneurial activity.[1148] Since the government places so much value on the increasing number of small company start-ups, seeing them as synonymous with economic growth, it is unlikely that Freedman's proposal concerning micro-businesses will gain favour for as long as the government maintains this mindset. Although greatly-inflated minimum capital requirements may be a good thing in relation to rogue HRI traders, there is a significant risk, or perceived risk, that these would unnecessarily penalise legitimate HRI traders who have other reasons besides limited liability for choosing to incorporate. This would almost certainly lead to a radical reduction in the number of small company start-ups that the government is so keen to encourage. The government's dogged dependence on SMEs is based on their belief that such companies are vital to the economy in terms of productivity, employment, and tax revenue.

[1144] Armour (n626) 12-13.
[1145] *Hallett v Dowdall* [1852] 18 LJ QB 2, 118 ER 1.
[1146] Ireland (n22) 839-840.
[1147] BEIS Statistical Release 2016 (n1134).
[1148] Armour (n626) 17.

However, the type of companies covered in this thesis in all likelihood do not have employees,[1149] are bad for competition, evade taxes, and actually harm the economy in terms of consumer detriment and the time and expense in trying to curb their exploitation of the corporate form. An important distinction therefore needs to be drawn between legislating for rogue closely-held companies and legislating for other legitimate closely-held companies or SMEs. Any parliamentary response must be strictly limited to rogue HRI directors, including rogue HRI shadow directors, in such a way that legitimate closely-held HRI companies are not adversely affected. One way of achieving this, as an interim measure at least, may be to target those closely-held companies which have already availed themselves of the pre-pack administration mechanism in order that their newly incorporated phoenix company may acquire the assets of their existing company leaving exploited consumers with no assets against which to claim.

Without the benefit of limited liability in their new company, the corporate form would arguably lose all of its appeal since rogue directors' focus on opportunism presents the company's perpetual existence as more of a problem for them than an attraction due to formal winding-up procedures, and they would have little interest in fixing the company's assets with fixed or floating charges especially if they hoped to engage in phoenixing at a time when what company assets there were came under threat of litigation.

Ireland[1150] goes further, claiming small companies do not really need limited liability, and suggests that a decoupling of limited liability from control rights, as evidenced in the very successful ordinary partnership structure, provides an effective means of fostering more responsible directorial conduct.[1151]

4.3.2 Making Directors Accountable to Consumers for Breach of Directors' Duties

Under CA 2006, s172, company directors are required to promote the success of the company, and this was seen at 3.6.4 as representing a shift from a narrow shareholder

[1149] BEIS Statistical Release 2016 (n1134).
[1150] Like Hicks (n24).
[1151] Ireland (n22) 839-840.

value paradigm to a more ESV focus. However, a closer examination cast doubt on whether a purportedly wider cast net would in fact result in directors acting more responsibly towards consumers and other corporate stakeholders.

Whilst the shareholder value paradigm may have been justifiable in widely-dispersed companies where shareholders, as residual risk-bearers, had the greatest stake in the company, the same cannot be said today. And certainly not in the case of closely-held companies. More recognition therefore needs to be given to the stake that consumers have in such companies as they, and other unsecured creditors, are the true residual risk-bearers given the absence of minimum capital requirements.

It was concluded at 3.6.4 that the contractarian approach to company law, with its sole focus on shareholder wealth maximisation, took too simplistic a view of the company[1152] as, *inter alia,* it failed to recognise consumers' inequality of bargaining power,[1153] information asymmetry,[1154] and their comparative lack of business acumen.

Similarly, the communitarian view that all corporate constituencies should rank equally was criticised as being: unmanageable from the director's perspective,[1155] since he would not know in whose interests to act and to what degree at any given point; too risk-inhibiting due to the director having to be accountable to all corporate stakeholders; and too problematic from an enforcement point of view.

In closely-held companies, arguably the enforcement of directors' duties is non-existent which means that any move towards a stakeholder approach remains merely conceptual in relation to s172,[1156] unless consumers and other stakeholders are given the right to take derivative action against rogue directors on behalf of the company. Clearly rogue directors of such companies will have no interest in protecting the reputation,[1157] or long-term sustainability,[1158] of their company, and in their capacity of controlling shareholder, it is inconceivable that they would ever take action against themselves for any breach of

[1152] Millon (n105), 1380.
[1153] Fisher (n147).
[1154] Millon (n126).
[1155] Millon (n126) 45.
[1156] 1.5.2.6.
[1157] CA, s172(1)(e).
[1158] ibid, s172(1)(a).

duty. According to Hugh Jones and Christopher Benson, `Stop Now Orders' (SNOs) are available for use by enforcement agencies `against traders who fail to run their businesses (in relation to consumers) with reasonable care and skill.'[1159]

Conceptually, communitarianism would be fairer and more fitting for the modern corporate landscape. Making directors accountable to the very people they exploit should ordinarily deter them from acting in their own self-interest. However, David Millon predicted that `the process of balancing might enable directors to indulge in either self-dealing and other opportunism, or shirking, because at the end of the day they are not accountable to anyone but an amorphous group of stakeholders.'[1160]

If communitarianism were to have any sway in modern company law, then it must overcome the fundamental problem with enforcement if it is not going to become yet another situation in which rogue directors may escape liability due to the inapplicability of company law measures to the closely-held company accountability vacuum. This again represents the difficulties presented by allowing closely-held businesses access to the corporate form. The combination of company law's protective cornerstones and the lack of directorial accountability in closely-held companies creates what have essentially been insurmountable problems from a company law perspective for consumers when dealing with a closely-held company's rogue director.

It is difficult to understand, therefore, why Parliament has not done more to curb abuse of the corporate form by rogue directors of closely-held HRI companies when harm results to both consumers and to legitimate HRI companies. This is all the more questionable when one considers that it is small trade creditors, consumers and other stakeholders who are the real residual risk-bearers of closely-held companies today,[1161] and particularly when consumers have not freely contracted with the company knowing

[1159] Hugh Jones and Christopher Benson, *Publishing Law (*5th edition, Routledge 2016) 328.
[1160] Millon (n126) 46. Fama and Jensen (n866) 301 and 305.
[1161] Margaret Blair, `Whose Interests Should Be Served' in M Clarkson (ed), *Ownership and Control: Rethinking Corporate Governance for the Twenty-first Century* (Brookings Institute, Washington DC 1995) 202-234; Gavin Kelly and John Parkinson, `The Conceptual Foundations of the Corporation: a Pluralist Approach' in J Parkinson, A Gamble and G Kelly (eds), *The Political Economy of the Corporation* (Hart Publishing 2000) 122; Margaret Blair and Lynn Stout, `Director Accountability and the Mediating Role of the Corporate Board' (2001) 79 Washington ULQ 403, 404; Keay (n180) 22; DTI Strategic Framework 1999 (n162) 5.1.10.

that they made face such a risk. For as long as the controlling shareholder in a closely-held company has sole control over enforcement of directors' duties, then rogue directors will continue to enjoy a free rein to act as unscrupulously as they wish, without any regard to their statutory duties.

It is also difficult to understand the government's reluctance to differentiate closely- held companies from larger companies, particularly since abuse of the corporate form by the former is known to occur. The government's dogged adherence to a one-size- fits-all approach for SMEs seems out of keeping with other government initiatives.[1162] It seems an unsatisfactory state of affairs for the CLRSG to look to non-Companies Act legislation to safeguard the interests of small trade creditors and consumers from, *inter alia*, exploitation by rogue directors.[1163] Not only has it already been demonstrated that alternative legal regimes are not without their difficulties,[1164] but any such legal responses would deal with the problem of consumer exploitation by rogue directors *ex post* whereas *ex ante* measures could serve as an effective deterrent.

The main difficulties the courts have encountered with s172, when determining whether a director has promoted the success of the company, relates to the requirement for it to be done `for the benefit of its members as a whole. With such drafting, it is understandable how the courts have treated the former as synonymous with the latter,[1165] particularly when the CLRSG itself has regarded them as such.[1166] However, the case law on the matter predates the CA 2006 and has therefore been decided based on the director's fiduciary duty to act in good faith in the best interests of the company. It is therefore to be hoped that the more recent willingness of the courts to see the company's best interests as being more synonymous with the wider interests of all corporate stakeholders will represent a more progressive move towards embracing communitarianism.[1167] In the Commonwealth case of *BCE Inc v 1976 Debentureholders,*[1168] the Canadian SC confirmed that, in determining the company's best interests, no set of interests should

[1162] For instance personalisation.
[1163] Developing the Framework 2000 (n12) 2.12.
[1164] CPARs 2014 (n23).
[1165] *Re Wincham Shipbuilding Boiler and Salt Co* [1878] LR 9 Ch D 322; *Greenhalgh* (n935); *Brady* (n811).
[1166] DTI Strategic Framework 1999 (n162) 5.1.5.
[1167] *Lonrho* (s652); *Fulham Football Club Ltd v Cabra Estates plc* [1994] 1 BCLC 363, 379.
[1168] [2008] SCC 69 (SC of Canada).

prevail over any other.[1169] Keay points to the fact that this does not mean the SC was advocating communitarianism, but rather to the fact that directors' duties are owed only to the company itself.[1170] Such a statement is congruent with the whole doctrine of separate corporate personality whereby the company, having its own artificial legal personality, has interests capable of being protected and promoted. It is not clear, if one accepts that the doctrine of separate personality does in fact bestow on the company its own legal personality, why there should have been so much debate on who or what is the company, and more importantly in this context what is the purpose of company law. Arguably, the preoccupation with contractarianism and the shareholder wealth maximisation paradigm is what has confused the issue concerning for whose interests the directors must act.

One wonders why it is that the courts have put so much time and effort into trying to interpret the phrase `in the best interest of the company' when any decisions taken so as to maximise the wealth and sustainability of the *company* would arguably achieve some workable balance between the interests of the company's shareholders and other stakeholders. Keay suggests that `[t]he influential agency theory provides that the directors are the agents of the shareholders and are engaged to run the company's business for the shareholders …'.[1171] However, Keay goes on to question the logic of this theory on the basis that directors have no express nor, arguably, implied contract with the shareholders as principal. Also, the directors are employed by the company, not by the shareholders, and enter into contracts in the company's name. Furthermore, the directors have no power to bind the shareholders personally into contracts with consumers and other third parties, and it is the board of directors that has the exclusive right to manage the company.[1172] In performing their duties and exercising their powers, they are acting as agents of the company, not the shareholders. It therefore follows that their duties are owed to their principal. If one accepts the company as a real entity, separate from its shareholders and directors,[1173] then as Lord Halsbury said in *Salomon v Salomon,*[1174] ` it must be treated like any other independent person with its rights and liabilities appropriate to itself …'.[1175]

[1169] Keay (n108) 48.
[1170] ibid, 57. *Brunninghausen v Glavanics [*1999] NSWCA 199; [1999] 17 ACLC 1247, 43 (CA New South Wales); *People's Department Stores v Wise* [2004] SCC 68; [2004] 244 DLR (4rh) 564 (SC Canada).
[1171] Keay (n108) 20-21.
[1172] Keay (n108) 21
[1173] Keay (n108) 183; Lord Denning MR in *Wallersteiner v Moir (No 2)* [1975] QB 373.

If it is accepted that directors' duties are owed to the company itself, then arguably the company's shareholders should rank equally with the interests of consumers and other corporate stakeholders. This is the reasoning behind the development of the Entity Maximisation and Sustainability (EMS) model of the company,[1176] which will be considered below.

As the law currently stands, Keay supports the view that ESV will need to be revisited in the future, `but given the fact that it took so long from the time when the CLRSG's Final Report was delivered in 2001 to the emergence of ESV in 2007, we should not `hold our breath'.'[1177] One can understand Keay's scepticism … In the government's green paper consultation on corporate governance reform, Theresa May highlighted that `for Britain to thrive in a global economy, we need to support strong businesses that focus on long-term value creation and command public confidence and respect.'[1178] The government highlighted the government's vision for consumers and employees to participate in board decision-making, something favoured by communitarians also. In respect of CA 2006, s172, `The challenge is to ensure that all companies are taking the steps needed to understand and take account of wider interests and different social perspectives.'[1179] The government explained that, in cases of particularly poor corporate conduct where the views and needs of consumers and other stakeholders had not been given appropriate consideration, `we need to consider how to respond appropriately and proportionately to the concerns they have raised.'[1180] Despite these insightful comments, the current s172 approach was endorsed to continue unchanged. One way Keay suggests for making directors `accountable' to stakeholders, such as consumers, is for stakeholders to become `very minor shareholders in companies with which they have dealings so that they have the option, as a last resort, of taking derivative action against the directors if the directors fail to have regard for the factors set out in s172(1)(a)-(f)'.1181 However,

[1174] Keay (n108) 22.
[1175] Keay (n108).
[1176] Keay (n79) 621; Keay (n1175).
[1177] Keay (n180) 292.
[1178] Corporate Governance Green Paper 2016 (n535).
[1179] ibid, 34.
[1180] ibid.

this would not be a viable option in the closely-held company whose shares would not be available for purchase.

In Canada,[1182] a creditor can take derivative action against a director on behalf of the company provided the court is satisfied the creditor is the proper person to make an application. However, Keay believes it `highly unlikely that the UK would introduce derivative actions for non-shareholders.'[1183] Whilst the deterrent value of this is acknowledged, consumers would be unable to enforce any breach of duty in their own name, and any monies recovered from rogue directors would go towards the company's assets.[1184]

UK law does recognise that there are limited occasions under the IA 1986 where the interests of creditors (including consumers) must trump those of shareholders,[1185] but such actions are not available to those who have been exploited and must instead by instituted by the insolvent company's liquidator.[1186] The relevance of CA 2006, s172(3) to the exploitation of consumers by closely-held HRI company rogue directors is unclear since the exploitation is precipitated by greed and self-interest and does not necessarily occur when the company is financially distressed.

Despite the problems with enforcement under CA 2006 in respect of breach of directors' duties, *Prest* has established that it is right that in cases where a closely-held company has been used to conceal its controlling shareholder's breaches of fiduciary duty owed in their previous company the controller should be liable to account for any losses caused to those to whom the duty was owed. This remedy has the same outcome as would arise under common law veil-piercing, but would be achieved on the basis of the company being its controller's alter ego on account of the level of control exerted over the company by the controller. If consumers are to be owed a fiduciary duty when the company is financially distressed,[1187] then they would be able to claim against the

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[1181] Keay (n180) 139.
[1182] Business Corporations Act 1985, s238.
[1183] Keay (n180) 138.
[1184] Prentice (n895) 275; Worthington (n895) 151; Sealy (n895).
[1185] CA 2006, s172(3).
[1186] *West Mercia* (n888) 33.
[1187] Keay (n79).

rogue director and his new company in the event that he sets up a phoenix company to escape the liabilities of his former company.[1188]

4.3.3 Keay's Entity Maximisation and Sustainability Model

Prima facie, like shareholder primacy, communitarianism does not adequately protect consumer interests, and neither does it adequately resolve issues of the accountability vacuum in the closely-held company. Andrew Keay has suggested an alternative approach which appears to deal with many of the issues raised in this thesis surrounding directorial accountability and protection of consumer interests; it would also offer consumers a direct right of redress against directors, albeit they would not derive any direct benefit personally from such redress.

EMS[1189] represents a workable alternative to both shareholder value maximisation – which directors cannot legitimately pursue absolutely following the implementation of CA 2006, s172 – and a wholly stakeholder approach since this undermines the whole purpose of the Limited Liability Act 1855 which was to encourage shareholder investment.[1190] At this juncture, it should be remembered however that closely-held private companies would be exempted from this rationalisation on the basis that shareholder motivation for investment in these companies is more a case of legal compliance than a desire to derive wealth from the company's legitimate profits. This means that stakeholderism would not be a factor which would deter shareholder investment in closely-held companies, as the purchase of a share or shares is the only way in which the company can become incorporated; the fact that there are so many closely-held companies today lends support to this proposition.

An EMS model would focus on increasing the wealth of the entity by increasing the `overall long-run market value of the company'.[1191] By fostering the common interest of all those who have `invested' in the company, including consumers, directors will be able to maximise the wealth-creating potential of the company.[1192] In this way,

[1188] *Airbus* (n775); *R. v Sale* [2013] EWCA Crim 1306; [2014] 1 WLR 663; *Pennyfeathers Ltd v Pennyfeathers Property Co Ltd* [2013] EWHC 2520 (Ch)
[1189] Keay (n79) 621.
[1190] Jonathan Macey cited in Andrew Keay, (n79) 625. But see Hicks (n24) 326.
[1191] Keay (n108) 198.
[1192] ibid.

shareholders' interests would still be protected, but they would not at any time `supersede the interest of the entity as a whole.'[1193]

The focus of EMS is for the long-term sustainability of the company, which preserves the general ethos of the factors in s172(1)(a)-(f), and therefore as much focus is given to engendering trust and confidence in consumers and other stakeholders,[1194] as it is to profit maximisation. For the maximisation of the entity value, `Growth and survival are two sides of the same coin'[1195] and, as Keay states, `the focus on only one of these aims does not necessarily mean either or both can be achieved.'[1196] According to Min Yan, EMS goes much further than simply giving effect to the company having its own independent legal personality and directors' duties being owed to the company rather than either the shareholders or the stakeholders collectively: `the company could also have its own objective – namely, maximising the values of the entity per se on one hand and ensuring its sustainability on the other. That is to say that neither shareholders nor other stakeholders are the end.'[1197]

Keay explains that, under this theory, the difficulties directors would have under stakeholderism of balancing all the different corporate stakeholders' interests would not be an issue since, instead, directors would focus solely on maximising the entity's wealth.[1198] EMS, therefore blends the two diametrically opposed aims of shareholder wealth maximisation and stakeholderism as it achieves fairness and efficiency;[1199] this is because it is not based purely on economic principles.[1200] Wealth would still accrue to shareholders as a result of maximisation of the wealth of the company itself, although it would take the form `as a by-product of corporate welfare, whereas under shareholder primacy the maximisation of the wealth of the shareholders is sought directly.'[1201] Keay describes how `A significant advantage of EMS is that the directors, while

[1193] ibid.
[1194] ibid, 200
[1195] ibid, 219.
[1196] ibid.
[1197] Min Yan, `The failure of the entity maximisation and sustainability model' (2013) 34 Comp Law 272, 272.
[1198] Keay (n108) 205.
[1199] ibid.
[1200] Keay (n108) 105.
[1201] ibid, 229.

respecting investors and recognising their importance to the company, are not especially accountable to any specific group.'[1202]

Yan contends that the advantages of EMS appear to be overstated and that `many inherent vaguenesses and defects in this new model' prevent it from being either efficient or fair, and the merits of EMS could instead be used to improve the shareholder primacy approach.[1203] It is difficult to see how any `tweaking' of the shareholder primacy approach would be any more successful or unambiguous in protecting consumer interests than the current ESV approach, particularly as one of the key problems in the context of rogue directors of closely-held companies is the inability of consumers and other stakeholders to take action against any director who acts in breach of the corporate objective. If the corporate objective remains shareholder wealth maximisation, which has survived despite the duty to act in the best interests of the company, then, in the absence of any means of redress, consumers' and other stakeholders' hands are tied when the rogue director's focus is only on self-interest and short-termism. As Keay states, long-termism is good for the company's sustainability in that it can engender within consumers trust and confidence in the company, which in turn generates goodwill and good reputation.[1204]

It is vital that EMS should offer some effective enforcement mechanism which motivates directors' adherence to the corporate objective; ensures more responsible and honest directorial behaviour; and acts as a deterrent from failure to comply. Yan argues that `[t]he maximisation and enhancement of the entity … have no direct relationship with the welfare of the shareholders or stakeholders ..'[1205] However, it is difficult to see how a company that engenders trust, confidence and goodwill in its consumers, as well as allowing derivative actions to deter the bad faith conduct of rogue directors, is not protecting their interests.

Keay states: `Implicit in the EMS model is a recognition that all investors should be entitled to take action to safeguard the wealth of the company entity, in which they have a potential distinct interest … Broadening the range of those who can bring proceedings

[1202] ibid, 208.
[1203] Yan (n1197) 272.
[1204] Keay (n108) 167 and 200.
[1205] Yan (n1197) 276.

increases the chances of a company's interests being protected …' [1206] However, it is difficult to see on this basis how an individual consumer can say that the harm they suffer prejudices the interests of the company. Interestingly, other jurisdictions have shown a greater willingness to extend derivative action to creditors as well as shareholders,[1207] and the Australian Corporations Act 2001, s1324 enables anyone affected, or likely to be affected, by a contravention or proposed contravention of the Act to seek injunctive relief. Keay suggests that UK law could allow an application by `anyone who appears to the court to be interested in the company'.[1208] The permission procedure would ensure the floodgates did not open to an unlimited number of actions. `… a court should be convinced that [the applicants] have either a direct financial interest in the affairs of the company or a particular legitimate interest in the way that the company is being managed'[1209]. Although this might give consumers a right to take action against rogue directors, and thereby make them personally liable for their wrongdoings, any monies recovered would be for the company and not for the consumer who has suffered the loss.

Keay suggests that rather than looking to extend an enforcement mechanism to all stakeholders wanting to protect their own interests, the only enforceable rights should belong to the company, exercisable against directors who fail to maximise entity wealth.[1210] This would leave stakeholders having to look to contract and the market in order to protect their own positions.[1211] This is wholly unsatisfactory for consumers who lack the means to be able to protect themselves adequately through market forces,[1212] who are prevented by the corporate veil from taking action against the rogue director directly, and whose refusal to do further business with the company will be of little concern to the rogue director since the exploitation will already have occurred.

As an unsecured creditor, an exploited consumer could threaten to put the company into liquidation, but again this is likely to be of little concern to the rogue trader who may

[1206] Keay (n108) 256.
[1207] Keay (n108) 257. Canada Business Corporations Act 1985, s238(d); Singaporean Companies Act 1994, s216A.
[1208] Keay (n108) 258.
[1209] ibid.
[1210] ibid, 241.
[1211] ibid.
[1212] ibid,

simply put the company into voluntary liquidation, strip the company of its assets, and set up a new company free from the liabilities of the old company. The preferred position would be if the Secretary of State for Business, Innovation and Skills petitioned the court to wind the company up under s124A of the Insolvency Act.[1213] This would be possible where it is in the public interest for the company to be wound up. However, although most s124A petitions have been applied for where the public have been misled or companies have acted unscrupulously,[1214] it is likely that the number of consumer complaints required before such action is taken by BIS would have to resemble the type of OFT Super-Complaint, and therefore this would not be a likely course of action on behalf of consumers who have been exploited by the rogue director of a closely-held company.

Keay suggests the statutory derivative claim, a mechanism for `corporate-regarding behaviour'[1215] could `ensure that the company receives an appropriate remedy for actions that have prejudiced its interests, and … deter the directors from acting improperly.'[1216] However, unless the law changes to allow other stakeholders to initiate derivative proceedings, something Janice Dean suggests makes sense under the EMS approach,[1217] then it remains of little use to consumers.

Consumer exploitation by rogue directors would be contrary to the EMS theory. Not only would rogue directors be acting against the interests of one of the company's essential stakeholders, but they would also be severely compromising the long-term survival of the company. This has not been a concern for them before now because the loopholes in the Company Directors' Disqualification Act 1996 allow rogue directors to effectively circumvent its provisions by voluntarily winding-up their company and stripping the company's assets for their phoenix company. The EMS theory would therefore create the much-needed directorial accountability that is missing in the
closely-held company.

[1213] ibid, 249.
[1214] ibid, 250.
[1215] ibid, 255.
[1216] ibid.
[1217] Janice Dean, *Directing Public Companies* (Cavendish, 2001) 108

Yan maintains that `maximisation of the value of the company is not dissimilar to what the shareholder primacy approach pursues. Under the shareholder primacy approach, to maximise company wealth is normally the premise by virtue of the residual nature of the shareholders.'[1218] Yan's suggestion that the gain allocation rule values success of the company, since shareholder benefits are tied in to the performance of the company,[1219] appears to overlook the situation in one-man companies. In the context of the closely-held company rogue director, it is clear from 3.9.2 that he has no vested interest in the company's long-term survival or reputation, and neither does he wait to ensure the company's profitability before he claims his financial prize. Keay's EMS model appears rather to support and reinforce the Government's preferred direction of travel demonstrated by s172 and ESV which have not to date gone sufficiently far in protecting the interests of consumers and other corporate stakeholders. The position of consumers and other corporate stakeholders would be quite different under the EMS model. To this extent, it could be said that EMS fully embraces the doctrine of separate legal personality of the company – an end in itself – whereas shareholder wealth maximisation, and arguably ESV, see the company as a means to an end: the creation of wealth for shareholders.

However, such reform of directors' duties could be problematic from a number of different perspectives. What is widely recognised as being a major factor in maximising wealth,[1220] and the same would be true whether it is for the members as a whole or for the company as a whole, is the willingness of directors to take risk. Risk is associated with reward, and some degree of calculated risk is necessary for economic growth of the company. It is where risk-taking is reckless and irresponsible, when directors are able to shift risk onto consumers and other unsecured creditors, that it must be discouraged. When risk-taking does not generate success and reward, but instead leads to corporate failure, this is when directors are normally most at risk of being sued for any losses flowing from their breach of duty, most frequently by the company's liquidator. In the closely-held company, however, directors have no such fear.

However, the position of directors in the closely-held company would be very different

[1218] Yan (n1197) 276.
[1219] ibid.
[1220] Keay (n108) 46.

if the EMS model was applied: if directors' duties are owed to a wider set of corporate stakeholders, then the risk of litigation against directors is all the more likely which can cause the directors to become risk-averse. Therefore, although the EMS model would provide the certainty and accountability enjoyed under the shareholder primacy theory, and the values of trust and fairness associated with the progressive theories,[1221] it is the coupling of these that could promote a more litigious environment, thereby leading to risk-aversion. Therefore, although there are obvious merits of the EMS model, there would need to be much greater parliamentary guidance on the circumstances in which consumers and other corporate stakeholders could exercise any right to sue directors for breach of statutory duty. According to Dean, `[i]f the board had to consider the interests of all relevant stakeholders and the standards expected of directors were more clearly defined in law, the position would become simpler overall.'[1222]

By amending s172(1) so as to omit all words following `the success of the company', Keay believes that any confusion will be removed, and the directors' sole focus will be on the company as an entity.[1223] Under EMS, the directors would

> owe a fiduciary duty to the company as an entity, and, therefore, their duty is to promote its best interests and act with care and skill. Undoubtedly there is room for directors to act opportunistically or to shirk, but this is also the case with … shareholder primacy (and stakeholder theory).[1224]

Since directors' general duties are owed to the company, any remedies are provided to the company itself. This is because `the law regards the company as the victim',[1225] and is consistent with the statutory derivative claim, about which former Attorney-General Lord Goldsmith noted: `there will continue to be tight judicial control of cases'[1226] and the judiciary are expected to deal with applications in a circumspect manner,[1227] and to show respect for commercial judgments.[1228] Lord Goldsmith continued: `We have to strike a careful balance between protecting directors from vexatious and frivolous

[1221] ibid, 173.
[1222] Dean (n1217) 108.
[1223] Keay (n108) 226.
[1224] ibid, 226.
[1225] Keay (n108) 186.
[1226] Lord Goldsmith, HL Deb 27 February 2006, Vol 679, cols GC4-5.
[1227] ibid, GC5.
[1228] ibid.

claims and protecting the rights of shareholders.'[1229] One of the ways of ensuring this is by paying damages `not to individual shareholders but to the company itself, and yet it is the shareholders, the members who bring the action, who may be required to bear heavy legal costs.'[1230] Even if consumers were permitted to apply to the court to sue rogue directors under similar provisions, there would be little incentive if the same principle applies. Therefore, although statutory derivative claims could theoretically be an effective way of controlling unscrupulous conduct on the part of directors, they are unlikely to be utilised as long as consumers stand to lose so much and gain so little. As risk-takers, rogue directors would recognise that the odds were stacked in their favour and therefore any deterrent value of introducing such provisions for creditor derivative claims could be very short-lived.

4.3.4 Piercing the Corporate Veil at Common Law

Chapter 3 described the nature and effect of the corporate veil, and the common law exceptions to the doctrine of separate corporate personality, particularly where the corporate form has been abused in order to evade an existing legal obligation or some other fraudulent purpose.

In order to explore the potential for further reform of the company law regime, and to take account of the fact that there remains much uncertainty about this area of the law post-*Prest*, the various grounds for piercing the veil that have existed at various points since *Salomon* will be referred to in turn in order to assess the extent to which each may be applied to resolve the difficulties with rogue HRI companies. It is because all-too-often closely-held HRI companies are grossly under-capitalised such that any court decision in a consumer's favour is little more than a paper judgment due to the effects of the doctrines of privity, separate personality and limited liability that it is fundamentally important to clearly identify and apply any potential exceptions to the *Salomon* principle. The focus of this part will therefore be on discussing the different grounds for veil-piercing that have been proffered from the lower courts in *Salomon* right up until the *obiter* comments of the SC in *Prest.*[1231] This will then provide some basis on which to

[1229] ibid.
[1230] ibid, col GC4.
[1231] N80.

examine the case law in this Chapter to assess any merit for veil- piercing in favour of exploited consumers, irrespective of whether there may be alternative remedies available to them under other legal regimes.

It is interesting to note that Keay's EMS model `turns on the company being regarded as a distinct legal entity'.[1232] What is ironic is that it is the company's distinct legal entity that serves to deny consumers the right to sue rogue directors, qua shareholders, directly for any detriment they suffer. Since *Salomon*, the courts have been extremely reluctant to disregard the corporate form to expose those who do not deserve its protection. There has been a plethora of case law where the courts have sought to widen the limited exceptions to the *Salomon* decision. However, in the absence of any Parliamentary intervention on this subject, the courts have not been prepared to depart from the *Salomon* judgment. It is clear that separate corporate personality, combined with limited liability, facilitates abuse of the corporate form by rogue traders of closely- held HRI companies. Despite the fact that this has caused significant consumer detriment, and the great potential for law reform in this area, it is surprising that Parliament has not seen fit to intervene to settle the ongoing and somewhat one-sided debate.

Although both lower courts in *Salomon* saw the company as a distinct legal personality, they ordered the veil of incorporation to be pierced and Mr Salomon to be made personally liable for the company's debts. However, they did so on very different reasoning.

4.3.4.1 Agency as an exception

Vaughan Williams J in *Salomon*[1233] found that Mr Salomon's company was the mere nominee of Mr Salomon and, as such, was entitled to be indemnified by its principal against business liabilities since it had contracted with creditors at the direction of the principal, and Salomon as principal had exerted absolute control over the company. Although both the CA and the HL disagreed with this analysis, the CA in *Adams* confirmed that an agency relationship can arise in the context of group companies. In

[1232] Keay (n108) 176.
[1233] *Broderip v Salomon* [1893] B 4793.

Stone, the HL said that the normal rules of attribution would apply where the claimant is an innocent party, but where the company sues a director who has breached his duty to the company, then the director should be liable personally.

Rogue HRI directors, who merely use the company as a vehicle through which they can gain access to the protections of the corporate form in order to exploit consumers, will be in contravention of most if not all of the general duties under the CA 2006. Although they would not, as shareholders, commence action against themselves as directors, they would be unable to ratify their own acts under CA 2006, s239, and therefore the liquidator of the insolvent company would be able to sue the rogue director personally. This may present a problem where the IP has been appointed by the director to conduct a pre-pack administration because he may not be strictly impartial and may therefore be unlikely to commence action against the controlling shareholder-director. Any accountability of the rogue director would then rely on consumers being owed a fiduciary duty by him on account of the company being financially distressed.[1234] However, it should be recalled that any monies recovered would have to be paid towards the company's assets and the consumers would bear their own legal costs, and therefore it is very unlikely that this would offer an effective remedy for exploited consumers. This would not, however, constitute veil-piercing, even though the corporate form is disregarded; the cause of action would be under ordinary agency principles on the basis that the company is the alter ego of its controlling shareholder.[1235] It would, however, offer some limited degree of deterrence value.

4.3.4.2 The Director as a Trustee

The CA instead asserted that the relationship between Salomon and his company was governed by the law of trusts and therefore, as a beneficiary under that trust, Salomon was liable to pay the company's debts. Lindley LJ said: `I should rather liken the company to a trustee for him - a trustee improperly brought into existence by him to enable him to do what the statute prohibits.'[1236] Lindley LJ regarded the company as a device incorporated or at least utilised in furtherance of a fraud. It was the coupling of

[1234] N1188.
[1235] *Clegg* (n776). *Prest* (n80).
[1236] [1895] 2 Ch. 323, 337–340.

control and improper use of the company that led him to find the company was a trustee for Salomon. It must be seen that it is in his capacity as controlling shareholder that Salomon's beneficial interest must arise since the shareholder wealth maximisation approach to company law places the beneficial interests firmly in the collective hands of the shareholders.

When one considers this view of the company as trustee of property for the beneficial interest of the director-shareholder in the context of rogue HRI trading cases, the case of *Thobani*[1237]seems to support the view that in the absence of fraud the director-shareholder may be able to treat company-held funds as his own. *Thobani* was a case involving phoenixing, where Faruk Thobani had been transferring assets from Everybrand Limited into two other companies he controlled in order to put these beyond the reach of the company's creditors.

On appeal to the House of Lords, their Lordships felt there could be no agency relationship in a one-man-type company since `this would be to defeat the very objective of incorporating this type of company.'[1238] In refuting Vaughan William J's assertion of an agency relationship, Lord Herschell seemed to be lending support to the Court of Appeal's finding of a trust relationship: `In a popular sense, a company may in every case be said to carry on business for and on behalf of its shareholders …'[1239] though Lord Davey was dubious since there was `… no express trust for the appellant; and an implied or constructive trust can only be raised by virtue of some equity' and there appeared to be none in this case.[1240]

This again raises the concept of the consumer as being owed a fiduciary relationship by the rogue director when the company is financially distressed.[1241] In *Prest*, the majority of the SC endorsed the view that the concealment principle may be effected through the application of principles of trusts, or more likely agency principles in the context of rogue HRI companies.[1242] Therefore, although the corporate veil was pierced in *Gencor,*

[1237] N1252.
[1238] Griffin (n985) 324.
[1239] *Broderip v Salomon* [1895] 2 Ch 323 (CA) 43.
[1240] ibid, 56.
[1241] N1188.
[1242] N80; 4.3.4.

Trustor and *Clegg*, the same result could have been reached under trust or agency principles using *Prest's* concealment principle.

4.3.4.3 **Fraud Unravels Everything**[1243]

In addition to finding a trust rather than an agency relationship, the CA also found that Salomon's action of incorporating his business was a mere scheme to give him access to limited liability, and thereby to give him priority as a debenture holder over the company's unsecured creditors.

As the title of this section suggests, the courts have been willing to pierce the veil to hold rogue directors liable when a company has been set up to perpetrate a fraud,[1244] or evade an existing legal duty.[1245] In *Komercni Banka AS v Stone and Rolls Ltd*[1246] both director and company were held liable under the tort of deceit. The key distinction between rogue traders and legitimate traders is the former's intentional abuse of the corporate form in order to both escape personal liability for their bad faith conduct towards consumers of their former company, or to exploit consumers of their phoenix company.

Gilford[1247] and *Jones*[1248] are the two leading cases where the evasion principle was successfully applied. In *Gilford*, Horne's intention for incorporating a new company was to escape liability under a restrictive covenant in an employment contract, and in *Jones* the veil was pierced after Lipman tried to escape an order for specific performance by transferring the land he was selling to a ready-made company he had purchased off-the-shelf.

It is unclear how the evasion principle applied in the cases of *Trustor AB v Smallbone*[1249] and *Gencor.*[1250] As Griffin notes, both cases involved the controller of

[1243] N769. *Lazarus Estates Ltd v Beasley [1956] 1 QB 702 CA*, 712.
[1244] *Re Darby, ex parte Brougham* [1911] 1 KB 95; *Gilford (n27)*; *Jones* (n27); *Prest* (n80).
[1245] *Gilford* (n27); Jones (n27). *JSC BTA Bank v Solodchenko* [2015] EWHC 3680.
[1246] [2002] EWHC 2263 (Comm); [2003] 1 Lloyd's Rep 383.
[1247] N27, 5.
[1248] N27.
[1249] [2001] EWHC 703 (Ch).
[1250] N754.

the company breaching a fiduciary duty to a third party but `contrary to a strict adherence to the evasion principle, the said impropriety was not hidden behind the corporate veil of the sham company.'[1251] In fact the company was already in existence when the breach occurred. It is doubtful that this latter factor should influence to any great extent the court's evaluation of whether an off-the-shelf company has been set up for a legitimate purpose or not, particularly when that new company has never traded. It is common practice[1252] amongst rogue directors of closely-held HRI companies to purchase a ready-made company so that when his existing company begins to fail, or when a judgment order is granted in a consumer's favour against his existing company, he is ready to transfer his business and assets to the new company and commence trading, leaving the debts of the existing company behind him. This is effectively known as `phoenixing'.

According to Griffin:

> In reality, in both *Trustor* and *Gencor,* the corporate veil of the respective sham companies was pierced to ensure that a third party's claim for the sum of misappropriated funds was enforceable. In the context of the relevant improprieties in both Gencor and Trustor, the scope of the evasion principle was extended to cover a monetary loss, traceable directly to the actual impropriety (the breach of duty), a monetary sum that was subsequently hidden behind the corporate veil. In common, however, with the cases of both *Gilford* and *Jones,* the respective companies in *Trustor* and *Gencor* were both incorporated to an ultimate objective of pursuing an illegitimate purpose to the benefit of their respective controllers.[1253]

What is interesting about this observation is that it could, it is asserted, equally apply to cases where consumers have suffered monetary losses as a result of being exploited by rogue directors of closely-held HRI companies, particularly where an off-the-shelf company has been purchased without any lawful purpose in mind at the time of incorporation. In fact, where such a company is used to facilitate phoenixing with the

[1251] Griffin (n985) 329.
[1252] *R v Thobani* [1998] 1 Cr App R (S) 227.
[1253] Griffin (n985) 330.

aim of putting the company's assets beyond the reach of consumers, then there is scope for arguing that it was established for an unlawful purpose. The apparent relaxation of the requirement for there to be a pre-existing legal obligation shows some scope for including the type of impropriety described in the rogue trading cases at 4.2, and it should be remembered that such a relaxation would not be inconsistent with Lord Halsbury's and Lord Macnaghten's *obiter dicta* comments in *Salomon*.[1254]

This thesis has demonstrated that this is the primary motivation for rogue HRI directors to incorporate their businesses and to set up phoenix companies, and examples of the kind of bad faith conduct that constitutes a fraud has been discussed at 4.2.1.4. This exception to *Salomon* does not rely on the insolvency of the company and therefore should provide consumers with the means of holding rogue HRI directors personally liable. It is right that directors should not use the corporate form to protect their illegitimate behaviour.[1255] If the courts are prepared to pierce the veil for fraudulent conduct, one wonders why this principle should not be extended to other forms of egregious conduct on the part of rogue HRI directors.

One way in which this exception may be said to relate to rogue HRI directors is when phoenixing occurs since, quite openly through pre-pack administrations, directors set up a new company specifically to avoid pre-existing legal obligations. The difficulty with this is that, because of the doctrine of separate corporate personality, they are the obligations of the defunct company rather than of the rogue controller. It will be recalled at 3.6.2 that IA 1986, s216 seeks to prevent rogue directors from exploiting the goodwill of their failed business by setting up a new phoenix company prior to liquidation of the first and using the same or a similar name to the failed business.

Under s216(3) the director is prevented from being involved in the management of the new company where it bears the same or similar name as the first company. Moreover, the director will be personally liable for the relevant debts.[1256] However, a rogue HRI director who has exploited his company's consumers is unlikely to be relying on repeat custom, and would be more likely to give his company a name similar to a reputable

[1254] N28.
[1255] David Millon, "Piercing the Corporate Veil, Financial Responsibility, and the Limits of Limited Liability" (2007) 56 Emory LJ 1305, 1307.
[1256] IA 1986, s217.

competitor's so that he can exploit their goodwill instead. A similar case arose in *Twinley* where the rogue HRI trader provided customers with false information about himself and passed his business off as that of the market leader in the hope of confusing customers into believing he was that company, or at least associated with it. Had he incorporated his business, then the corporate veil would have been pierced and he and his company could have been sued under the tort of passing-off.

It is surprising that more has not been made in subsequent cases of what Stephen Griffin sees as the implied inference from their Lordships' *obiter dicta* in support of veil-piercing if the company had been `incorporated to pursue an illegitimate purpose, namely a fraudulent, dishonest or mythical design'.[1257] Their Lordships could find nothing to support the Court of Appeal's suggestion that Mr Salomon had behaved fraudulently or dishonestly, and therefore did not see the need to explain what type of wrongdoing would lead to a finding of illegitimate incorporation. Griffin continues,

For example, in establishing a fraud, was it necessary to establish that a controlling shareholder subjectively or objectively intended to exploit the incorporation process to deceive an innocent third party? Or, alternatively, could the term fraud be equated with an equitable fraud, objectively identifiable by the unconscionable behaviour of the individual who controlled the company?[1258]

By undervaluing the company and issuing himself fully paid up shares and a charge, this amounted to what would once have been regarded in a court of equity as a 'constructive fraud'.[1259] Constructive frauds did not necessarily involve bad faith or the desire for self-enrichment - equity's concept of fraud was much wider than that at common law. As equity had jurisdiction to intercede in all cases of fraud, they saw no problem in piercing the corporate veil. The HL, however, took the view that there was no fraud, partially because of Mr Salomon's unblemished trading record and the fact his business had been trading profitably prior to incorporation.

[1257] Griffin (n985) 324.
[1258] ibid.
[1259] *Salomon* (CA) (n1239).

Had Lord Halsbury or Lord Macnaghten gone on to explain their *obiter dicta*, then it is quite likely that the corporate veil would have been pierced in the vast majority of cases where rogue directors of closely-held HRI companies behave unscrupulously and/or dishonestly towards consumers, causing consumer detriment. This would have created a fair and just ground for veil-piercing, which would have been a very welcome addition to the very limited grounds established by the House of Lords in *Salomon*, namely fraud, evasion of a pre-existing legal obligation,[1260] and agency in the context of group companies.

4.3.4.4 The Interests of Justice

According to Griffin, had the HL in Salomon fully explained their *obiter* comments, a new ground based on justice[1261] could have embraced `a wide range of misconduct to include instances of unfair conduct, undue influence, abuse of confidence and unconscionable bargains.'[1262]

A justice criterion for veil-piercing was adopted by Lord Denning in *Littlewood*[1263] and *Wallersteiner v Moir,*[1264] by Cumming Bruce LJ in *Re a Company,*[1265] and by Richard Southwell QC, deputy High Court judge in the case of *Creasey v Breachwood Motors Ltd,*[1266] and by Clarke J in *the Tjaskemolen.*[1267] However, without any clear ruling by the House of Lords on the matter, there was equal measure of judicial disapproval of the justice criterion, for example the House of Lords' disapproval was implicit in *Woolfson v Strathclyde Regional Council*[1268]and expressly disapproved in *Adams.*[1269] In *Adams*, the CA ruled that there was only one veil-piercing ground, and that is where the

[1260] Irrespective of whether the `sham' company was incorporated before or after the pre-existing legal obligation arose, and even if it was not incorporated with any deceptive intent. `What counts is whether it was used as a facade at the time of the relevant transactions.' (Cheong Ann Png, `Lifting the veil of incorporation: Creasey v. Breachwood Motors: a right decision with the wrong reasons' (1999) Comp Law 122).
[1261] Per the dicta of Lord Halsbury and Lord Macnaghten.
[1262] ibid, 325.
[1263] N749.
[1264] [1974] 1 WLR 991.
[1265] [1985] 1 BCC 99, 421.
[1266] [1993] BCLC 480.
[1267] [1997] CLC 521.
[1268] [1978] SC (HL) 90.
[1269] N36.

company is used as a sham or a façade, ie, where there is an agency relationship,[1270] or an evasion of a pre-existing legal duty; the veil could not be pierced when it was in the `interests of justice' necessary to do so. Although the CA in the post-*Adams* case of *Conway v Ratiu,*[1271] ruled that the veil should be pierced in the `interests of justice', this did not create a precedent and the SC in *Prest* confirmed that no such exception to *Salomon* existed. It is therefore surprising that the court in *Creasey* did not follow the precedent in *Adams*. Clearly, on the facts of *Creasey*,[1272] there was some impropriety on the part of Creasey's employers and there will have been no surprise that the veil was pierced and the directors made personally liable. However, the CA in *Ord*[1273] overruled the decision. *Ord* made it clear that without the presence of dishonesty the veil should not be pierced, marking the end to this much-needed and flexible counter-measure to the harshness and intransigence of *Salomon*.

Daniel Bromilow suggests that the Judge's decision was misinterpreted as falling under the `interests of justice' head when it was actually decided on the basis of evasion of an existing legal duty.[1274] The misinterpretation is understandable when one considers that the Judge made reference to *Jones* and *Gilford* but made no declaration that *Creasey* fell under the fraud exception; on the contrary, he found there was no intention to defraud. He also distinguished those cases on the basis that Breachwood had been incorporated before Mr Creasey's dismissal whereas *Jones* and *Gilford* involved the evasion of an *existing* legal duty. If *Creasey* did not fall within the factual boundaries of the fraud exception, then it must have been decided, contrary to *Adams*, on the basis of the former `interests of justice' exception – in which case it was only a matter of time before it would be overruled.

In the context of rogue HRI directors, and the detriment their exploitative conduct causes to consumers, it stands to reason that an injustice results if these rogues are permitted to profit from their bad faith and often illegal conduct. A logical head, therefore, under which consumers could seek redress against the rogue directors personally would be in the `interests of justice' that they be made personally liable. As

[1270] Their Lordships in *Salomon* suggested only in relation to group companies.
[1271] [2005] EWCA Civ 1302
[1272] N742.
[1273] N759.
[1274] Bromilow (n762).

Ziegler and Gallagher note,[1275] the number of subsets under the *interests of justice* umbrella term demonstrated the courts' desire to prevent injustice by holding rogue directors personally liable. In the rogue HRI director cases of *Jones, Thobani* and *Shamrez*, the courts had no doubt about the rogue directors' criminal liability arising from their bad faith conduct and the courts' condemnation of bad faith conduct in other rogue HRI trader cases discussed above. Slade LJ, however, in *Adams* stated that the court is not free to disregard the *Salomon* principle merely on the grounds that justice requires it. However, if the interests of consumers are being harmed by rogue HRI directors, then it is difficult to understand why such an exception should not exist, particularly as the courts have proved unwilling to tolerate bad faith and illegal conduct in relation to the fraud exception.

4.3.4.5 Conclusion

Ever since *Salomon*, the courts and academics have lamented the rigidity of its precedent and the confusion and uncertainty that has ensued. And when considering the rogue HRI director who dishonestly exploits consumers and intentionally transfers assets from his existing company into a new phoenix company in order to place them beyond the reach of the now insolvent company's consumers and other unsecured creditors, it is difficult to understand why the higher courts are so opposed to such a `catch-all' exception, particularly when so few direct rights of redress are available to consumers under company law.

Strictly speaking, an exploited consumer should have a remedy under agency principles, since impropriety and degree of control would both be satisfied within the closely-held company. In some cases where monies were paid for work that was not done, it may be possible for consumers to establish the presence of a common intent constructive trust, in which case they could claim compensation directly from the rogue director. In relation to fraud and evasion of an existing legal duty, then the rogue HRI trader cases discussed in this Chapter demonstrate an abundance of fraudulent conduct and, in *Thobani*, it can be said that by phoenixing his old company and leaving the unsecured creditors with no assets against which to claim, there is clear evidence of evading an existing legal duty.

[1275] N702.

However, it is clear from the research conducted that consumers are unlikely to sue for the veil to pierced and it is suggested this is because discovery of such a cause of action would involve seeking legal advice and representation; this would obviously lead to costs and, in the case of high value contested cases, High Court action could prove prohibitively costly for consumers. Furthermore, it would be very difficult for a solicitor to advise them on their likelihood of success since, under company law principles, there remains great uncertainty and confusion even post-*Prest.* It is submitted that the case of *Creasey* should not have failed just because it was not clear under which exception the case was decided.

Provided director impropriety is involved, then they should not benefit from the protection of the veil of incorporation and an exception such as `interests of justice' would lead to far more predictable outcomes for exploited consumers than any of the other exceptions. This is clear just by reviewing the judicial comments made in summing up in the rogue HRI trading cases above. As Browne-Wilkinson VC stated in *Tate Access Floors Inc v Boswell*,[1276] `In my judgement controlling shareholders cannot, for all purposes beneficial to them, insist on the separate identity of such corporations but then be heard to say the contrary when discovery is sought against such corporations.'

It is because of the injustice resulting from further narrowing of the veil-piercing grounds, together with the *obiter dicta* inferences made by Lord Halsbury and Lord Macnaghten in *Salomon*, that Griffin proposes a fraudulent incorporation concept. This would form a new ground for veil-piercing `where a company was incorporated by its controller with the specific and dominant intention of pursuing a fraudulent business purpose. In such cases, an intention to defraud may be established in circumstances where the company's controller was aware, or by the notions of ordinary decent business people should have been aware, that the company's incorporation was not a dominant purpose of pursuing a bona fide commercial activity but rather that its incorporation sought to abuse the incorporation process to the financial advantage of its controller and to the detriment of a third party(ies).' Not only would this new ground for veil-piercing serve to protect consumers from the unscrupulous practices of rogue

[1276] [1991] Ch 512, 531.

HRI directors, but it would also, according to Griffin, provide a more,[1277] or equally,[1278] suitable ground for some cases where the evasion principle has already been successfully applied, particularly where the impropriety has been for the director's self-enrichment.[1279] Furthermore, `The fraudulent incorporation concept would also apply in a corporate group situation.'[1280]

4.3.5 A Multi-Pronged Reform Strategy on Insolvency

The most effective company law reforms for curbing abuse of the corporate form by rogue HRI directors of closely-held companies, and preventing them from using pre-pack administrations as a means of perpetuating the cycle of abuse/exploitation as soon as there is any risk to their own wealth or any corporate assets will require a dovetailing of both *ex ante* and *ex post* measures. With the emphasis of austerity measures on public services delivering better services for less, this will of necessity involve a joined- up multi-agency approach, described by Ian Fletcher as a `multi-pronged reform strategy'.[1281] This would maximise the opportunities for rogue directors to be identified early and prevent them from becoming serial `offenders'. It is fitting that the IA 1985, CDDA 1986, pre-pack administrations and phoenixing are all covered in one section because they are all triggered when the company becomes insolvent.

4.3.5.1 Statutory Veil-Piercing Exceptions to *Salomon*

Common law exceptions to *Salomon* were discussed at 4.3.4. There are a number of provisions under the IA 1986 which may serve as exceptions to *Salomon*. Section 216 has already been discounted as a potential avenue since it is not though that this would have much application within rogue closely-held HRI companies. Sections 213 and 214, fraudulent and wrongful trading will be considered in relation to phoenixing and some recent Law Commission recommendations relating to prepaying consumers.

[1277] For instance, *Trustor* (n1249) and *Gencor* (n754) and *Drew v HM Advocate* [1995] SCCR 647; [1996] SLT 1062
[1278] As in *Gilford (n27)* and *Jones* (n27).
[1279] For example, *Drew* (n1277); *Antonio Gramsci Shipping Corporation v Stepanovs* [2011] EWHC 333 (Comm); [2012] 1 All ER 293; Griffin (n985) 334.
[1280] Griffin (n985) 331.
[1281] Fletcher (n540).

Following a request by BIS in 2014 for the Law Commission to consider whether prepaying consumers in the retail sector were given sufficient protection, the Law Commission reported back in 2016 that `We do not think that consumers should be protected against all losses. However, we think there is a case for limited reforms to protect consumers in the most serious cases.'[1282] The Law Commission also recommended that the government should have a `power to intervene to require prepayments to be protected in sectors where the risk of consumer loss merits it.[1283] The Law Commission further recommended that, for those consumers who have prepaid more than £250 for goods or services within the last six months prior to the company's insolvency, their ranking in the order of distribution should be elevated to that of preferential creditors, below employees. The report acknowledged that consumers do not gain any special protection when a company becomes insolvent and this therefore would improve their position significantly in recouping at least some of their losses.[1284] The report specifically mentions the problems in the HRI market, and covers those who supply and fit HRI items;[1285] it therefore includes rogue HRI directors. This recommendation would not protect losses sustained as a result of breaches of the CPRs 2008 or breach of contract, but relates only to losses sustained during the company's insolvency. For this reason, it may be it relates to offences committed under the IA 1986. There are a number of insolvency provisions which give rise to statutory exceptions to the *Salomon* principle and these include ss214, 213, 238 and 239. The first three of these will be discussed in relation to phoenixing. It is commonplace for traders in the HRI market to request prepayments as materials and goods supplied under the contract can be expensive. However, with rogue HRI directors, they will often charge excessive amounts or for work not done at all. The rationale for these consumer protections is because consumers are regarded as lenders to the company, but they do so without looking into the insolvency risk of the company, without taking security and without charging interest. It is not uncommon for those companies in financial distress to increase prepayments in order to help their cash flow position.[1286] It may be that a company has been over-optimistic, fully intending to repay the customer or provide the service, and this kind of practice would not come under the above provisions. However, if an HRI company is

[1282] Law Commission*, Consumer Prepayments on Retailer Insolvency Summary* (LC368 2016) 1,9.
[1283] ibid, 1.11.
[1284] ibid, 2.1.
[1285] ibid, 2.4.
[1286] ibid,

carrying on business without any reasonable expectation of the company surviving, then the directors may be ordered to make such contribution as the court thinks proper.[1287] Section 213 is the more serious offence of intentionally defrauding consumers knowing that the company has no chance of surviving. In this situation, the director knows that anyone he takes prepayments from will not be repaid and will not receive their contracted for service. As one of the main distinguishing features about rogue HRI directors is their bad faith and dishonest conduct, it is quite likely that fraudulent trading would be proved against them. The *mens rea* of `intention' requires proof beyond a reasonable doubt that it was the rogue director's `aim or purpose' to defraud the consumer.[1288] Not only would the director be found guilty, but also any other persons who were knowingly involved.[1289] This provision could be used against any `directors' friend' who was the director's IP of choice and who was selling the company's assets at an undervalue[1290] and at the same time knowingly defrauding the company's consumers. Any director found guilty, in addition to any fine or custodial sentence, would be disqualified from being involved in the management of a company, and would be ordered to make such payments towards the company's funds as the court thinks proper. Similarly, the IP who was found to have been knowingly involved would in all likelihood be debarred from serving as a registered IP and would have to contribute to the company's assets I such amount as the court thinks fit.

The main drawbacks of these actions is that the action against the director would ordinarily be initiated by the liquidator and, if the rogue director has chosen his own IP then such transactions are less likely to be detected, and any monies paid would go towards the company's assets rather than direct to any consumers who had been defrauded. If the recommendations of the Law Commission are implemented, then at least the defrauded consumer would take in priority to unsecured creditors and floating chargeholders.

The Small Business Enterprise and Employment Act 2015 (SBEEA 2015) has made a number of amendments to the IA 1986 and CDDA 1986. These changes will hopefully

[1287] IA 1986, s214(1).
[1288] R v Mohan [1975] 2 All ER 193.
[1289] IA 1986, s213(2).
[1290] IA 1986, s219.

improve the prosecution rates under these Acts as the bureaucratic wheels of the Insolvency Service are known to turn slowly. It was the Service's tardiness in detecting and investigating cases within the 2-year period allowed that meant that many rogue HRI directors were escaping capture. The period in which an insolvent company's rogue HRI director can be given a disqualification order for unfitness has been extended from 2 to 3 year by Part 9 of the Act, amending s7(2) of the CDDA 1986. Schedule 1 of the SBEEA 2015 also broadens the list of factors to be taken into account when determine the director's unfitness[1291]

Problems with enforcing directors' duties should not present a reason *per se* for failing to advance the communitarian stance in future law reforms. Until a satisfactory solution can be found for overcoming the problems outlined above, then any breach of duty to protect consumers' interests would at least provide some evidential value of bad faith conduct on the part of rogue directors. This includes the extent of their involvement in various transactions, such as giving a preference and participating in wrongful trading. And a new s246Z has been inserted by the SBEEA 2015 into the IA 1986 which covers fraudulent trading committed whilst the company is in administration. The CDDA 1986 has received a lot of bad publicity in the past, but it is to be hoped that, armed with these new amendments, it will become more fit for purpose in preventing rogue HRI directors from gaining access to the corporate form, or from being involved in the management of the company under any guise.

Similar problems with phoenixing have been identified in Australia, where phoenixing is estimated to cost the economy $3 billion a year. There the government is amending its Corporations Act 2001 to introduce new provisions to prevent this lucrative, cheap and largely transparent practice.[1292] Directors of Australian companies will be given a unique Directors Identification Number (DIN) which will allow authorities to track them through government databases and chart their relationships with other directors and companies. Legislation will also be introduced to target `"pre-insolvency advisers" who helped company directors carry out phoenixing'[1293] or who manipulated `the corporate

[1291] CDDA 1986, new s12C.
[1292] ABC News, `Company 'phoenixing': New laws to target dodgy company directors' 12 September 2017 <http://www.abc.net.au/news/2017-09-12/new-laws-to-target-dodgy-company-directors-and-phoenixing/8895444> accessed on 19 December 2017.
[1293] ibid.

system by installing "dummy" directors in companies to shield the real directors from liquidators, creditors and the Australian Taxation Office'.[1294] These are the very same people that may be charged under IA 1986, s213 and ordered to contribute towards the company's funds. Under the Australian reforms, these advisors/facilitators will be penalised in the same way as those who promote tax avoidance schemes.[1295] Rogue directors suspected of phoenixing may also be required to pay a security deposit, from which future unpaid tax debts can be recovered.[1296] Furthermore, the government will target the most egregious phoenix operators by designating them/their company as a "High Risk Entity" where a director has been disqualified, or has been a director of two companies which have gone into liquidation within the last seven years, or where an IP has reported them.[1297] Remedies may include civil and criminal penalties, compensation orders and clawback.[1298]

It seems there are no plans to cease pre-pack administrations as they are regarded by many as being valuable in helping failing companies to keep running as a going concern, and therefore good for the economy. However, by making phoenixing a more risky business for the rogue HRI director and particularly his IP, it is to be hoped that directors are increasingly obliged to use more reputable IPs in the future; this should result in more timely reports to the Secretary of State for BEIS being made as to the director's unfitness and more actions are taken to reclaim consumers' money from rogue HRI directors.

Often, as Ian Fletcher notes,[1299] less reputable IPs will avoid detection `by refraining from becoming involved in any gross or flagrant breaches of the law'.[1300] More stringent `quality control' checks could be introduced for all IPs, whether appointed by the State or by the rogue director. For example, they should be placed under an obligation to consult any centrally-held database which records consumer complaints against a rogue director or his company, before entering into any pre-pack administration agreement

[1294] ibid.
[1295] Clayton Utz, `Phoenix activity in Federal Government's sights' 28 September 2017 <https://www.claytonutz.com/knowledge/2017/september/phoenix-activity-in-federal-governments-sights> accessed on 19 December 2017.
[1296] ABC News (n1292).
[1297] Clayton Utz (n1295).
[1298] ibid.
[1299] Fletcher (n540).
[1300] ibid, 276.

with a rogue director who is looking to start a phoenix company. Unless the IP is satisfied that adequate arrangements are in place to settle the claims of any exploited consumers, then no company assets should be transferred to either the rogue director or any person connected with him.[1301] The IP should then be under a duty to report any patterns of abuse to the Insolvency Service in order that disqualification proceedings could be instituted against the rogue director. This could very well result in a surge in the number of shadow directors, where the rogue directors seek to control the running of a new company without being identified as a director of that company. This would present liability issues for those who are complicit in such arrangements; such issues, however, will not be considered in this thesis. Whilst this would not offer any immediate remedy for those consumers who have already been exploited, it would at least make it more difficult for directors to `exploit and run' as freely as they currently do.

4.3.5.2 Conclusion

This section demonstrates how the government is aware of the abuses of the corporate form and the pre-pack administration scheme but, rather than reinvent the wheel, the government is attempting to develop closer working and sharing of intelligence between different agencies by adopting a gradual, multi-pronged insolvency law reform strategy. This makes sense because, as the introductory section demonstrated, there are many stages in the abuse cycle at which interventions can be made and, for best effect, any reforms need to dovetail for maximum effect. Too strong a focus on any single strategy could risk the government becoming a victim of its own success due to its lack of additional resource funding available. Furthermore, care must always be taken not to penalise legitimate traders and to maintain a strong economy.

However, equally, the government should not adopt a *laissez-faire* attitude.

[1301] CA 2006, s252.

4.3.6 Conclusion to Company Law Reforms

Given that consumer exploitation by rogue directors of closely-held HRI companies is a significant problem in the UK, and given that under the current company law regime this problem shows no signs of abatement in either the short- or the long-term, the case for a more stakeholder-oriented approach to company law is all the more imperative, unless non-company law regimes are to be relied upon. Separate corporate personality and limited liability deprive consumers of a contractual remedy against the rogue director responsible for and deriving a direct benefit from any breach of contract; shareholder primacy further trumps the position of consumers in their capacity as corporate stakeholders. It is for this reason that this thesis advocates a more progressive approach to company law, in the form of communitarianism[1302] or alternatively an approach that represents less of an extreme and a more workable alternative – Keay's EMS approach.

It is clear that, by being permitted to focus on their own self-interest as the closely-held company's controlling shareholder, rogue HRI directors feel no sense of moral obligation to consider consumers' welfare and would be more likely to respond to clearer directives and awareness of the consequences of breaching their duties. Such a shift would need to be complemented with a wider range of stakeholders who can enforce these duties on behalf of the company. This may be by derivative rights being given to consumers, although as has been discussed consumers would have little motivation for pursuing this route given the likely costs implications for them.

Alternatively something along the lines of an ombudsman scheme may prove more effective as making directors accountable to too many stakeholders would be almost as detrimental as the accountability vacuum that currently exists in closely-held companies. As ombudsmen services are becoming increasingly recognised in certain sectors, it may be that exploited consumers could raise their complaints through a dedicated ombudsman service so that investigations could be commenced into allegations of

[1302] Andrew Keay, `Stakeholder theory in corporate law: has it got what it takes?' Working Paper, 4 January 2010.

consumer exploitation. Intelligence could be shared from and with LATSS and CAS to identify any emerging patterns of consumer exploitation.

Any shift towards a more progressive approach would not disturb the cornerstones of company law, but it would create an obligation on directors to act in the interests of all corporate stakeholders. This is something that can be achieved by EMS. Further modifications to directors' duties of the type described above could provide some *ex ante* protection that consumers need without disturbing the interests of legitimate traders who are more likely to be considering wider stakeholder interests already. These modifications could either involve a redrafting of s172 or supplementary guidance for directors on how they should balance the interests of the various corporate stakeholders including shareholders and consumers. Rather than only recognising consumer interests when the company is in financial distress, approaching insolvency or actually insolvent,[1303] a *prima facie* right to apply to the court for leave to challenge the directors on behalf of the company itself for any breach of statutory duty may help to close the lacuna created by the cornerstones of company law. Such a right would not be available to consumers under the present company law regime in which shareholder wealth maximisation, or at least ESV, remains the dominant approach. Rather it would rely on the more progressive stakeholderism coming to the fore or a more company-centric approach such as EMS.

Having just recently conducted a major overhaul of company law, it is unlikely that Parliament will be in any hurry to make such amendments to the Companies Act 2006.

By making directors too litigious-conscious could be counter-productive and instead make them risk-averse. Whilst this would be no bad thing in the case of rogue directors of closely-held HRI companies, it could stifle the very thing the Government is keen to promote with legitimate businesses – enterprise. Furthermore, it is not clear how much of a deterrent this would provide for rogue directors of closely-held HRI companies since, although an exploited consumer would be able to take derivative action against the rogue director, any claim would be made in the name of the company and any monies recovered would be paid to the company and not to the exploited consumer who initiates the

[1303] CA 2006, s212, like Canada's Business Corporations Act, s238.

claim.[1304] This may of itself deter consumers from taking derivative action against the rogue director, especially as few would be willing or in a position to pay the non-recoverable legal costs[1305] of taking such action. On the other hand, there must be some deterrence value where a rogue closely-held company director is successfully sued in this way because the company assets would swell, which would ultimately help any consumer who then successfully sues the company for any breach of contract[1306]. By tightening the laws relating to phoenixing, insolvency and disqualification, any notion the rogue director has of seeking to asset-strip the company prior to placing it into voluntary liquidation could be met with further action against the director.

To strengthen the position of consumers, it is vital that they are given as many options for claiming against the director personally as possible and this is why *Prest* is such an important case, because it has highlighted different avenues for making a rogue HRI director personally liable other than veil-piercing.

It remains the case, however, and a strongly-held belief in this thesis that company law has caused the problem of consumer exploitation as a result of rogue directors abusing the corporate form. And therefore company law should provide a commensurate response. Lifting the veil of incorporation is an effective way of redressing the balance in favour of consumers, but this area of the law is still complex and arguably unappealing for consumers. This may not be so if the `interests of justice' exception could be resurrected since this provided the kind of flexibility needed. As such an exception would rely on director impropriety/bad faith, there would be no need for legitimate companies to have concern. There would be no greater risk to them than there is already under tort principles.

The government should evaluate the harm that a limited number of rogue HRI directors are causing to the economy, and look more at getting to the root of the problem; that, arguably, is the way that more confidence in companies and in the economy will be engendered in the UK.

[1304] CA 2006 s170(1) duties and remedies owed to company.
[1305] Per Lord Goldsmith, HL Deb 27 February 2006, Vol 679, cols GC4-5.
[1306] Though that may very well not be the same consumer as initiated a derivative action against the rogue director.

It must be recognised that there is a very real possibility, for the first time in many years, of a rather left-wing government being elected in the relatively near future. If this comes to pass, there might be a change in the largely unconditional government policy of putting the interests of the entrepreneurs in control of small companies above the interests of all other stakeholders.

CHAPTER 5

CONCLUSION

From having worked at Trading Standards from 2001 to 2005, the researcher had some prior knowledge of the problems with doorstep crime and how, by cold-calling at vulnerable consumers' homes, rogue HRI traders would set about parting them from their money by offering to carry out invariably substandard and overpriced home repair and improvement work. Those rogue traders that could be tracked down were often not sued by consumers, and all-too-often consumers would not even report to the authorities the fact of their exploitation.

The legislation in place at that time was largely ineffective in dealing with the problem. Much has happened during the course of this thesis which has substantially altered the consumer protection landscape. The EU has introduced excellent new legislation which, though still lacking in certain respects, really targets the bad faith conduct associated with rogue HRI traders, and has proved a popular means for LATSS to prosecute rogue HRI traders generally. When considering that much good has come out of the UK's membership of the EU in terms of consumer protection legislation, it makes one wonder whether Parliament will adopt a similarly proactive stance towards protecting consumer interests post-BREXIT.

One clear conclusion that can be drawn from this thesis is that the problem with consumer exploitation by rogue HRI traders shows no signs of abating, and what this thesis demonstrates is that consumers are at even greater risk when they deal with those rogue HRI traders who have incorporated their business. Ordinarily consumers might associate limited liability status with longevity and goodwill to be protected. But when they are dealing with the rogue HRI director of a closely-held company, this is not the case at all.

When a sole trader incorporates his business, he becomes the sole director-shareholder of his newly-incorporated company. He is automatically protected by the cornerstones of company law. Following *Salomon*, the company has a separate corporate personality; it can contract in its own name and, in accordance with the rules on privity, it is the company that must be sued for the wrongs caused by its director, in its own name, rather than the malfeasant director himself. The director, as shareholder, benefits from limited liability and protection of the veil of incorporation which separates the human constituencies of the company from the public; the director-shareholder will only lose any amount outstanding on his shares in the event of the company failing. Due to its understandable desire for a thriving economy, the government has tended to adopt a deregulation policy where small companies are concerned, favouring a *laissez-faire* approach. It is now very easy and cheap to set up or wind-up a company, and a company shareholder need only buy one share which has no minimum value.

The structure of the company is such that ordinarily the shareholders will keep a check on how the directors perform and if the directors breach any of the duties they owe to the company then the shareholders can make a statutory derivative claim in the company's name in order to hold them to account for any gains they may have wrongly acquired. In the closely-held company, often the sole director is also the sole shareholder and therefore an accountability vacuum is created which results in rogue HRI directors behaving as recklessly as they wish without any fear of reprisal. This often manifests itself in consumer exploitation, resulting in significant levels of consumer detriment. It is because of company law therefore that rogue HRI directors are able to behave so irresponsibly, in their own self-interest.

Occasionally, the courts will allow the veil to be pierced to hold the director- shareholder personally liable for the losses he has caused, but the law in this area is complex and the exceptions extremely limited. Since *Prest*, the SC has advised that, even where their *evasion* principle applies - where someone incorporates a company to evade an existing legal duty or perpetuate a fraud – the veil can be pierced only as a last resort. It is unclear why this exception should not cover the types of companies under scrutiny in this thesis since many rogue HRI directors incorporate a company for the sole purpose of defrauding consumers; and many instances of phoenixing arise where the rogue HRI director is seeking to put the company's assets beyond the reach of consumers, some of whom may

already have a judgment order in their favour.

All other surviving pre-*Prest* exceptions now fall under the SC's *concealment* principle and must be decided under ordinary principles of relevant law. For example, façade and sham cases are no longer treated as exceptions to *Salomon* as they can be decided by applying ordinary principles of agency law where the one-man company is legally identified as its controller's alter ego.[1307] For this reason, this thesis has considered other ordinary principles of relevant law and applied them to the rogue closely-held company situation. Because of the doctrine of privity of contract and cornerstones of company law, consumer protection legislation is of less direct assistance to consumers who want to sue a rogue director, and instead they have to sue the company which is often undercapitalised due to the absence of minimum capital requirements, particularly where the director engages in asset-stripping phoenixing. However, no recorded cases have been found where the veil has been lifted to hold rogue HRI directors accountable to consumers, or other creditors.

This thesis is firmly of the view that, as company law has created the problem, some commensurate response should be available under the company law regime and this is why the research question has been answered in the affirmative – Parliament should provide for directors of closely-held companies who engage in unfair trading practices to be held to account to consumers under civil law in circumstances where consumers are adversely affected by such practices.

Various options have been explored in Chapter 4, both *ex ante* and *ex post* measures. The best remedy under company law for consumers would be to create an exception to the *Salomon* principle by resurrecting the *interests of justice* exception, though this would rely on Parliament creating a new statute to reflect such a provision. There is no reason why legitimate traders should be negatively affected and also no reason why such a provision would adversely impact on the economy. On the contrary, it would create a more level playing field for business and greater consumer trust in the HRI sector.

Until 1998, the *interests of justice* exception had offered a positive counter-measure to

[1307] Nn781-782.

the rigidity of the *Salomon* principle. However, for reasons that do not appear well-founded and which Moore describes as confusing, contradictory and the source of much contention,[1308] the CA in *Ord*[1309]overruled the court's decision in *Creasey*. Much of this confusion and contention comes from the fact that *Creasey* was not too dissimilar from cases such as *Gilford* and *Jones* which clearly fall under the *Prest evasion* principle; *Creasey* was a case involving asset-stripping and the new company had been set up as a sham to avoid liability. It is an example of phoenixing and therefore facilitates and perpetuates the cycle of abuse of the corporate form and exploitation of consumers by rogue HRI directors. Given the consumer detriment this causes, it is difficult to understand how it would not be in the interests of justice to allow consumers to hold rogue HRI directors to account personally by allowing the courts to lift the veil of incorporation, particularly in light of the problems presented by the cornerstones and privity rules. It would also appear to amount to the type of conduct that Lady Hale in *Prest* would regard as taking `unconscionable advantage of the people with whom they do business'.[1310]

In the absence of Parliament creating any new statutory exception to the *Salomon* principle, the conclusion that the researcher has reached is that an effective way forward would be to adopt a multi-pronged approach to tackling problems of consumer exploitation resulting from abuse of the corporate form. Those directors intent on abusing the corporate form should be denied access to limited liability, or at least have to inject sufficient capital of their own which must be maintained to meet the company's liabilities. Clearly a blanket move like this would severely penalise legitimate businesses. However, by different agencies adopting a collaborative approach to tackling consumer exploitation and abuse of the corporate form, this would lead to greater efficiencies. For example, eligibility for limited liability status could be based on a checklist where a director's previous history will be examined, including any prior disqualification for unfitness, any prosecutions under the CPRs, number of consumer complaints recorded against any company they are a director of; any compensation orders against them, and so forth. Similarly credit could be given for their membership of Trusted Trader Schemes, and for having made voluntary arrangements with creditors of their previous insolvent companies.

[1308] Moore (n34), nn761-762.
[1309] N759.
[1310] N774.

Similarly, the government could adopt a more stakeholder-driven approach to company law, like communitarianism or, more realistically, EMS which places the company's interests at the fore rather than shareholder wealth maximisation. That could lead to the directors' duties being modified and would create greater opportunity for directors to be held accountable, even if this would not be by consumers on their own account.

More stringent measures would be needed around pre-pack administrations and insolvency procedures which allow directors to choose their own IP. The availability of these could be restricted for any directors who have been identified as at risk of `offending' based on their prior trading records. By making sure that IPs who allow sales at an undervalue are made to contribute towards the company's assets themselves, then the rogue HRI director would not find it so easy or cheap transferring the assets from his insolvent company over to his new company.

It is not possible to explore all possible areas for potential reform in this thesis; that would make for a very interesting and challenging follow-up research project. One thing is certain: that something needs to be done to stop the cycle of abuse of the corporate form at the expense of consumers who are clearly not able to protect themselves against such exploitation. Parliament has the opportunity right now, whilst drafting post-BREXIT legislation, to either prevent the abuse of the corporate form by such companies or at least to respond effectively to such abuses when consumers are adversely affected by these practices. Parliament takes a serious approach to safeguarding vulnerable adults as part of its social care policies – why then should vulnerable consumers who have been exploited by the unfair commercial practices of rogue HRI directors be any less deserving of Parliamentary intervention?

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