The Abuse of Corporate Veil: A Comparative Analysis of Corporate Veil Lifting Approaches in UK and US laws.

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Abstract

The current research analyses the doctrine of veil piercing using a comparative method of legal analysis between the United States and the United Kingdom. The purpose of the current study was to examine the usage of the veil-piercing doctrine in order to implement its principles in fraudulent bankruptcy proceedings. The study assesses the long history associated with separate corporate identity, its benefits, and drawbacks in context to the markets of the United States and the United Kingdom. It is obvious that the separate corporate form introduced under limited liability companies was to reinvigorate businesses by providing them with a safety net.

However, the research indicates that various instances have taken place that allows individuals to act illegitimately under the guise of a legal separate corporate form. The research also provides a thorough analysis of various bankruptcy measures in the United States and the United Kingdom, in terms of their foundations, legal proceedings, and case conclusions. The current research rationalises that there is a pretext for using the veil piercing doctrine to lift the veil for companies that may be using insolvency and bankruptcy to commit fraud. It is recommended that both the US and UK set precedent in corporate law by enacting legislation that includes these premises of veil piercing to deter individuals from fraud and protect the separate corporate identity.

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1 Introduction

The doctrine of piercing the corporate veil provides individuals such as creditors, consumers, or other businesses that have been wronged to recover or be provided with compensation by individuals who have fraudulent used or misused the corporate identity. It is argued by academics that often a creditor can argue against a company they have lent funds to who does not return it; the argument's premise can be that limited liability characteristics of the business are no longer applicable, especially the separateness of corporate identity[1]. Such a premise allows victims of fraudulent companies to hold the management and its shareholders directly responsible for the fulfilment of corporate obligations. The doctrine holds great weight in commercial law, however, it is sparsely used in the UK and USA.

There are very few instances in which the doctrine is implemented and judges in both countries attempt to find varying solutions to such circumstances. Consequently, it should be noted that the doctrine can provide defrauded creditors with a strong tool to reinforce court decisions against fraudulent companies. In fact, it is likely that the absence of corporate veil lifting would proliferate incidences of violated contracts, bad debt and exploitation of creditors as the corporate veil would be abused. If the aspect of corporate veil piercing were not an option unpaid creditors would constitute a massive externality. Corporate veil-piercing offers courts a means of internalizing these externalities. Since externalities comprise costs that are brought about involuntarily by third entities, legal scholars argue that internalization would culminate in societal wealth gains[2].

1.1. Choice of topic

The present research will conduct a comparative analysis on the various issues related to corporate fraud, abuse of the corporate form, and implementation of corporate veil piercing under the jurisdictions of the United States of America and the United Kingdom. The United States is not a common wealth country, however, it does practice common law which was inherited from the UK

[1] Jonathan Macey and Joshua Mitts, 'Finding Order in the Morass: The Three Real Justifications for Piercing the Corporate Veil' [2014] Cornell Law Review.
[2] Dyck, I.J. Alexander and Morse, Adair and Zingales, Luigi, How Pervasive is Corporate Fraud? (February 22, 2013). Rotman School of Management Working Paper No. 2222608. Available at SSRN: https://ssrn.com/abstract=2222608

under colonial rule. But there are fundamental differences between the use of the doctrine in both countries in terms of how they are interpreted by judges, the development of policies, and legislation development. Previous research has extensively explored the concept of corporate veil piercing in the UK and US jurisdictions, but there is very limited comparative research conducted between the two countries. The gap in the literature is surprising as both the UK and USA are pioneering common law countries that are often used as blueprints for other common law countries. Furthermore, corporate laws enacted in both countries are the most well-known in the world making it highly imperative to comprehend the implementation of their bankruptcy laws, corporate veil piercing doctrine and company rescue programs.

The concepts of separate legal entity and limited liability were enacted to protect individuals in the company such as owners, management, and shareholders from individual liability for the debts of the business and consequences of creditors[3]. The UK has held an unchanged position since established in *Salomon v. Salomon*[4], a critical piece of case law that contextualised the doctrine of corporate veil piecing in the UK. According to Rugani[5] the case helped shed light on the implementation of piecing the corporate veil in the UK jurisdiction in addition to any flaws. The current research will analyse fraudulent activities that are conducted using corporate identity by individuals – this includes phoenix companies in the UK, bankruptcy fraud in the UK and US, and RICO laws in the USA.

The concept of phoenix companies is prevalent in common wealth countries such as the UK, New Zealand and Australia. Such a concept is not labelled with these specific terms in the USA, however, it is used fraudulently under bust-out schemes. The research will analyse the legitimate arrangements and the abuse of corporate forms in phoenix companies of the UK and similar companies in the USA. The research will also examine the histories that are related to corporate veil piercing in the USA and UK and compare them. Lastly, the paper will evaluate ways in which corporate veil doctrine can be used to counteract bankruptcy fraud in the USA and UK.

[3] Peter B Oh, 'Veil-Piercing' (2010) 89 Texas Law Review 81.
[4] *Salomon v Salomon & Co Ltd [1897] AC 22 HL*.
[5] D Rugani, 'Twenty-First Century Equity: Tailoring the Corporate Veil Piercing Doctrine to Limited Liability Companies in North Carolina' (2012) 47 Wake Forest Law Review 899.

1.2. The rationale for this Research Topic

Various studies have analysed the use of corporate veil pricing in terms of tort cases and only certain instances of bankruptcy fraud cases. Corporate identity and its separateness from the individual allow for economic growth in the market making it essential to have such a doctrine in place. However, there have been instances in which the separateness of corporate identity is used for abuse to defraud creditors, investors, or consumers.

In the UK the most common form is the phoenix company, in the USA there are similar forms commonly used in bust-out schemes. Moore[6] has argued that limited liability and separate corporate identity has given rise to phoenix corporations which are used as tools to conduct fraud in the UK and are promoting institutional irresponsibility. Unfortunately, there are limited studies using comparative analysis that determines how different jurisdictions apply fraud bankruptcy laws in terms of convictions and preventions. Very few studies have analysed the bankruptcy fraud schemes in the US and UK to compare how both common law countries tackle these issues.

1.3. Purpose

The main aim of the current thesis is to examine the issues of abuse of corporate form in the US and UK with regard to bankruptcy fraud. This means analysing the UK's Insolvency Acts and the US's Title 7 and 11 Bankruptcy Codes. The thesis aims to analyse how corporate veil piercing can be used to mitigate or eliminate the use of bankruptcy as a tool to commit fraud.

1.4. Goal.

Filing for bankruptcy in the UK and US is not illegal and both jurisdictions aim to participate in corporate rescue in any case in which a corporation files for bankruptcy. However, specific loopholes in the law of each country give rise to individuals who use bankruptcy to commit fraud. The most common form in the UK is phoenix companies; this principle is actually used in corporate rescue but fraudsters have used the relief to commit further fraud. In the United States, the term is not exclusively used however, there are instances in which companies are formed to commit fraud; names of old companies are used to make new companies in order to commit fraud.

[6] Mt Moore, 'A Temple Built on Faulty Foundations: Piercing the Corporate Veil and the Legacy of Salomon v Salomon' [2006] Journal of Business Law.

In the UK, illegal phoenix companies are formulated to cause considerable harm to creditors, authorities and employees.

For the UK, there are limited studies that have been published that focus on reducing the activities of fraudulent phoenix companies. The current research attempts to define and profile fraudulent companies such as phoenix companies in the UK, and fraud companies in the US. The research primarily assesses corporations that commit bankruptcy fraud and how the directors abuse the corporate entity to defraud creditors, investors, and the general public.

The research will undertake a comparative analysis of corporate veil piercing doctrines in the US and UK court context. The research also aims to conduct a comparative analysis on the bankruptcy laws of the UK and USA with regard to their commercial laws.

1.5. Scope of the study

There are several legal topics dealing with the allocation of a company's liability to shareholders under particular circumstances, which fall outside the ambit of this research. This dissertation covers solely the doctrine of corporate veil piercing with respect to fraudulent business activities in the UK and US, primarily in violation of the bankruptcy laws. That is, the violation of the limited liability of a company, and the imputation of liability to its shareholders, owing to fraudulent conveyance leading to abuse of corporate veil. The scope of the study extends to analysing bankruptcy laws that are currently in place for corporate rescue of businesses that may be later used for abuse. These instances will be used to further argue the need for greater implementation of corporate veil piercing in the UK and US. Possible grounds for such court rulings include agency, unfair enrichment, violation of fiduciary obligations, and fraudulent conduct among others[7]. Whereas these elements can lead to the same implications for directors as corporate veil lifting, they are nevertheless part of legal principles which are explicitly distinguishable from one another[8]. Therefore, other than the fraud component, all other justifications for corporate veil piercing will be excluded in this dissertation.

[7] Jonathan Macey and Joshua Mitts, 'Finding Order in the Morass: The Three Real Justifications for Piercing the Corporate Veil' [2014] Cornell Law Review.
[8] Jens Dammann and Matthias Schündeln, 'The Incorporation Choices of Privately Held Corporations' [2011] Journal of Law, Economics, and Organization.

1.6. Methodology

The current research will be conducted through the analysis of primary and secondary materials to examine the issue of bankruptcy fraud and the implementation of corporate veil piercing. It is essential to use primary resources as they provide accurate information and provide a first-hand account that is reliable[9]. Primary resources such as case law and statutes provide a legal framework that is critical for producing essential arguments for the research. The current research uses a comparative analysis of bankruptcy laws in the UK and the USA. Secondary resources are also used to gain a better understanding of concepts based on arguments made by academics.

Hong et al. [10] argue that comparative research techniques are crucial for interpreting and understanding trans-jurisdictional legal systems. Often times a socio-legal approach can be used as a methodology as it's an interdisciplinary perspective that is used to analyse the law, various legal elements, and case laws. Such a methodology is used to help correlate laws with societal elements and it is used in collaboration with comparative legal methods[11]. The present research uses comparative legal methods and socio-legal approaches to analyse bankruptcy laws and courts cases to assess the extent of fraud in bankruptcy.

1.7. Literature Resources Review

The current research will seek to incorporate several primary and secondary sources in order to build arguments to better understand the phenomenon. Primary sources include legislation in the UK and US in addition to case law. The subsequent sections outline examples of some of the sources that will be incorporated into the study's main premises. The current research will use both primary and secondary resources to conduct research in terms of collecting data and analysis. The comparative analysis being conducted makes it essential to ensure that all available literature is analysed to the fullest extent. This means examining current laws, legislation, and court cases. This category of the literature analysed falls under primary sources, they will be used to assess the current laws in place that are used to proceed with fraudulent companies, bankruptcy fraud, and separating the corporate identity. Secondary resources include journal articles, expert analysis, and textbooks that are relevant to the topic. Secondary resources provide the thesis with the analysis

[9] Tom R Tyler, 'Methodology in Legal Research' 130.

[10] Hong Chui Wing, Michael McConville and Wing Hong Chui, 'Research Methods for Law' [2007] Research methods for the arts and humanities.

[11] Adilah Abd Razak, 'Understanding Legal Research' [2009] Integration & Dissemination.

already conducted by esteemed academics. The academics provide premises that can be used to further the thesis's arguments.

1.7.1. Primary Sources

UK Legislation

Insolvency Act 1986 (UK)[12]

The reason Section 216 and 217 of the Insolvency Act 1986 is used is because it helps demonstrate how some UK companies' directors can take advantage of the legal gaps in the two sections to defraud creditors. Its application will be compared with the United States' Bankruptcy Code interpretation.

Section 1157 of the Companies Act (2006)[13]

The reason why *s 1157* of the Company's Act 2006 is because its application in some cases fails to protect creditors; while some UK directors may form a company with the aim of swindling creditors, the court has previously used *s 1157* to exonerate directors citing honest and reasonable intentions on the part of the directors. Thus, a comparison with US' legal perspective would be relevant to the study.

US Legislation

The US Bankruptcy Code[14]

The United States bankruptcy code is governed by federal law. Chapters of the bankruptcy code allow entities to receive relief under the Bankruptcy Code according to their circumstances. The US Bankruptcy Code's Title 11 holds nine chapters that provide an outline of how to file a petition and rules that govern bankruptcy cases. The thesis will include an analysis of bankruptcy crimes that are found within sections 151 to 158 of Title 18 of the US. Penal Code. This analysis of the resources will provide insight into bankruptcy fraud which includes filing for bankruptcy petition or other documentation in bankruptcy code for the purpose of attempting to execute or conceal a scheme with the intention to commit fraud. There are also instances in the US law that outline

[12] UK Legislation, Insolvency Act 1986 1986.
[13] UK Legislation, Companies Act 2006 2006.
[14] Title 11- Bankruptcy Code 1984.

offences with regards to fraud in connection with bankruptcy cases that can be categorised as Racketeer Influenced and Corrupt Organizations Act (RICO). All such sources will be analysed throughout the thesis to better understand bankruptcy fraud in the US in order to conduct a comparative analysis with UK law.

UK Case Law

Salomon v A Salomon & Co Ltd [1897] A.C. 22[15]

The reason for using this case law is because if forms the basis for a company and directors' limited liability in the UK, US company case laws have also drawn from it.

Prest v. Petrodel[16]

The case is a landmark UK company decision by the UK Supreme Court about the nature of piercing the corporate veil. The significance of the case is that it suggested piercing the corporate veil as a last resort and that remedies can be achieved using equity and the law of tort to achieve the results based on the facts of the cases. This case is analysed in length within the thesis.

First Independent Factors & Finance Ltd v. Mountford[17].

The case is a decision on the UK Insolvency Act 1986, specifically analysing section 216. The case examines the attachment of personal liability to the debts of a company and the director. This case is vital in understanding the application of corporate veil piercing and bankruptcy fraud.

US Case Law

United States v. Hewes.[18]

The case is important as it provides an in-depth look into fraud bankruptcy and the application of the RICO laws. The case also analyses the various examples of phoenix companies in the US context. Although the case does not explicitly use the term it does provide an example of having corporate separateness and corporate law can be exploited for fraud.

[15] *Salomon v Salomon & Co Ltd [1897] AC 22 HL.*
[16] Prest v Petrodel Resources Ltd [2013] UKSC 34
[17] First Independent Factors & Finance Ltd. v. Mountford [200] EWHC 835 (Ch)
[18] United States of American v. Hewes, 729 F.2d 1302, 1310-11 (11th Cir. 1984)

Lowndahl v. Baltimore O. R. Co.[19]

The case provides an extensive look into how corporate identity is defined and its take on corporate veil piercing. The case extensively analyses insolvency and inadequacies of consideration for finding constructive fraud.

Stegman v. the United States[20]

The case examines the provisions of bankruptcy with regards to how individuals cover all methods by which a bankrupt or another individual can defeat the Bankruptcy Act in order to keep assets from being distributed to creditors.

1.7.2. Secondary Sources

Secondary sources are imperative to conduct a thorough analysis for research. Therefore, the current research analyses various secondary resources such as articles, books, and commentary related to the topic. Secondary resources from various academics can provide insight into the various ways UK and US courts have interpreted corporate veil piercing and its implementation to uncover fraudulent activities related to bankruptcy. Academics can also provide a unique commentary on how bankruptcy laws in both countries may lack in certain aspects. A complete study of the secondary resources can provide gaps in the literature that can be analysed in order to provide critical arguments and recommendations.

[19] Lownendahl v. Baltimore & O. R. Co. [1936] 287 N. Y. S., 62, 76
[20] Stegeman v. United States, [1970] 425 F 2d 984, 986.

2 Corporate Veil Piercing Doctrine

2.1 Introduction

Academics like Boote and Beile[21] have described literature reviews as the "foundation and inspiration for substantial, useful research". The purpose of this chapter under the current study is two-fold. First, it provides an examination of existing pieces of research acting as the foundation for identifying information and terminology that is relevant to the research. Second, it provides a critical evaluation of quality scholarly literature. The chapter will identify academic commentary related to the doctrine of piercing the veil under US and UK common laws for comparative purposes. The chapter will set out the conceptual framework for identifying the main themes of the study.

The current chapter provides an in-depth discussion of various principles and processes outlined in both US and UK common law pertaining to corporate rulings associated with the doctrine of piercing the veil. The chapter seeks to understand the various ways in which the doctrine under analysis has been used under both jurisdictions to protect creditors from fraudulent corporations, violated contracts, and bad debt. The chapter also looks to identify the origins of this doctrine in addition to comprehending the historically rise of corporate law.

2.2 History of Corporate Law

Modern corporate law practised in the UK and the US originates from the mid-19th century, with business associations being developed even before that[22]. Pre-Industrial revolution England at the time was looking to build a strong mercantile Empire prompting the government to create corporations under a Royal Charter or an Act of Parliament, granting a monopoly over a specific territory[23]. A famous and well-known example was the establishment of the British East India company in 1600 who was granted exclusive rights to trade with all countries east of the Cape of Good Hope[24]. At the time, corporates were actors on the behalf of governments, bringing in

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[21] David Boote and Penny Beile, 'Scholars before Researchers: On the Centrality of the Dissertation Literature Review in Research Preparation' [2005], Educational Research, 3, 36.

[22] Thomas K Cheng, 'The Corporate Veil Doctrine Revisited: A Comparative Study of the English and the U.S. Corporate Veil Doctrines' (2011)

[23] David Millon, 'Piercing the Corporate Veil, Financial Responsibility, and the Limits of Limited Liability' (2006

[24] Cheng Han Tan, JiangYu Wang, & Christian Hofmann, 'Piercing the Corporate Veil: Historical, Theoretical and Comparative Perspectives', (2019), Forthcoming The Berkeley Business Law Journal.

revenue from their trade activities in foreign territories. Similarly, a chartered company South Sea Company was established in 1711 to trade in Spanish South American colonies. However, the company was unable to conduct business in the region successfully due to the Spanish remaining hostile and only allowing a single ship to entire the area annually. Investors in English were unaware of the issues and enticed by promoters who bought thousands of shares in the company making South Sea Company wealthy enough to assume the public debt of the English government by 1717[25].

As a result, the share price was further accelerated by inflation and coupled by an Act of 1719[26] whose motive most likely was to protect the South Sea Company from competition adding to the rise in share price. By the end of 1720, the South Sea bubble had burst which tanked share prices from 1000 to 100 causing mistrust in society in both the US and UK against corporations. This was reflected in Adam Smith's *Wealth of Nations* in which he argues that "mass corporate activity was unable to match private entrepreneurship because people in charge of other people's money would not exercise as much care as they would with their own"[27].

In 1811, New York became the first state to have simple public registration to start corporations for manufacturing businesses[28] and allowed investors to have limited liability, in the case the company went bankrupt investors would lose their investment but not extra debts run up by creditors. The US Supreme Court decision *Trustees of Dartmouth College v. Woodward*[29] asserted that once a corporation was established state legislature could not amend it; this caused states to react by reserving the right to regulate future dealings of corporations[30] which were reflected in *Gibbons v. Ogden*[31]. Later in *Louisville C&CR Co. V. Letson,* it was established by the US Supreme Court that a corporation is "capable of being treated as a citizen of the [State which created it], as much as a natural person"[32], while *Marshall v Baltimore & Ohio Railway Co.* established that "those who use the corporate name, and exercise the facilitates conferred by it

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[25] Ibid 4
[26] David K. Millon, 'Piercing the Corporate Veil, Financial Responsibility and the Limits of Limited Liability' {2007), Emory Law Journal 56(5)
[27] Adam Smith, 'An Inquiry into the Nature and Causes of the Wealth of Nations (1776) Book V, ch.1, s..107
[28] Ibid 1320
[29] Dartmouth College v. Woodward (1819) 17 US 518.
[30] Willian A. Klein and John C. Coffee, *Business Organization and Finance* (2004)
[31] Gibbios v Ogden (1824) 22 US 1.
[32] Louisville C.&CR Co v. Letson, (1844), 43 US 497.

should be presumed conclusively to be citizens of the corporation's State of incorporation"[33]. This meant that corporates were the subject of legal rights and duties; they could hold property, commission torts, and make contracts.

Simultaneously in the UK, William Gladstone the chairman of a Parliamentary Committee on Joint Stock Companies helped pass the *Joint Stock Companies Act 1844*[34] making it possible for ordinary people to incorporate using a simple registration process. It was later in 1855 with the passage of the *Limited Liability Act* that investors were allowed to limit their liability in the circumstances of business failure to the amount invested in the company. These concepts would eventually be codified to produce the world's first company law – the *Joint Stock Companies Act 1856*, eventually leading to various *Companies Acts* currently present in the *Companies Act 2006*.

2.3 General Perspective of Corporate Law

In corporate law, the underlying principle is that shareholders in a corporation are not liable for the obligations of the company that goes beyond the investment they have placed in exchange for shares. The result of this principle is that the corporation is considered an entity separate from its shareholders, directors, and officers. With limited liability's emergence in the mid-nineteenth century in the US and the UK, parties are able to allocate the risk of a corporation to a more efficient risk-bearer under specific circumstances.

The purpose of limited liability was to encourage investment in risk-averse investors who were afraid that a failure of a business would allow creditors to take their nonbusiness assets[35]. Under limited liability companies, creditors bear more risk than creditors who can pursue noncompany assets of the investors[36]. According to Posner[37] shifting liability to creditors produced advantages for society as creditors are more efficient at evaluating and bearing specific risks. Blumberg[38] notes that limited liability also takes away risks in other circumstances to claimants such as tort victims

[33] Marshall v. Baltimore & Ohio Railway Company (1853) 57 US 314.
[34] Report of the Parliamentary Committee on Joint Stock Companies (1844) British Parliamentary Papers, 7.
[35] Adolf A. Berle, Jr. 'The Theory of Enterprise Entity' (1947) Columbia Law Review 47(3).
[36] Ibid 349
[37] Richard A. Posner, *The Rights of Creditors of Affiliated Corporations* (1976) University of Chicago Law Review
[38] Phillip I. Blumberg, 'Accountability of Multinational Corporations: The Barriers Presented by Concepts of the Corporate Juridical Entity' (2001), Hastings International & Comparative Law Review, 297.

and small uninformed creditors allowing some costs of doing business to be shifted to other parts of society and away from corporations.

Manne[39] argues that limited liability has encouraged the creation of public markets for stocks resulting in investors receiving benefits from liquidity and diversification that comes from public markets. If limited liability was not developed, the risk that investors would experience in investing in a company would turn in part on the wealth of other investors[40]. If such a system still existed it would include search costs and other expenses that would cause investors to make fewer large investments in the case that risk assessment data were available, which would likely result in decreased economic activity impacting the whole economy[41].

Separating a corporate entity from its individuals, often used to protect those behind the veil from added liability, also serves to indemnify shareholders' entitlement to specific benefits which wouldn't be obtainable if the line between the corporation and its shareholders were omitted[42]. Advantages that are seen with this principle include shareholder-employees being qualified for benefits; an entity being divided which are subjected to government regulations (i.e. securities, communications, insurance, or banking) from parts of the entity that don't fall within a regulated area[43]. Such purposes support the general rule of thumb that the separateness of corporations will usually be respected. However, this principle is not absolute and courts can disregard the entity when it's being used for illegal or illegitimate purposes.[44]

2.4 Comparative Analysis of Piercing of the Veil Doctrine

The previous sections of the chapter provide a conceptual framework behind the doctrine piercing of the veil. Subsequent sections will provide a comparative analysis with regards to judicial reasoning in veil piercing cases and the specific factors that US and English courts take into consideration when deciding on connected issues presented.

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[39] Henry G. Manne (1967) *Our Two Corporations Systems: Law and Economics*, Virginia Law Review, 259.
[40] Ibid.
[41] Jonathan R. Macey and Joshua Mitts (2014) Finding Order in the Morass: The three real justifications for piercing the corporate veil. *Cornell Law Review, Forthcoming; Yale Law and Economics Research Paper* No. 488.
[42] Charles P. Kindleberger, '*A Financial History of Western Europe*' (2006). Routledge; Taylor & Francis Group: London.
[43] Macey and Mitts (2014).
[44] Ibid.

2.4.1 England

English courts have begun to move forward from the use of metaphors like "façade" as the underlying foundation by which to disregard corporate personality when hearing a case. Courts in England are beginning to recognize the real issue of identifying if misuse of the corporate identity has taken place or if there is abuse attached to such identity. One major uncertainty that is related to England is the range of veil piercing doctrine, as Lord Sumption had once limited it to a category of "evasion" cases[45], specifically those in which a business company had been created to particularly to aggravate the implementation of an autonomous legal right that exists in contradiction of the controller of the company[46].

Under the case *Prest v. Petrodel* the majority of judges in the final decision had left the matter open causing others to suggest that it is difficult to understand why other circumstances of veil piercing need to be excluded if the foundational basis is an abuse of the corporate firm[47], subject to the requirement that no other legal principles/doctrines exist that can handle what is thought to be the amount of abuse present. However, it should be noted that Lord Sumption also stated that the second category of cases – "concealment" cases were not considered to be involved in veil piercing. Lord Sumption had rationalized that the intervention of a company to conceal the identity of their real actors can't stop a court from ascertaining who the actual parties are to the transactions or activities if they are pertinent.

Under this circumstance, the doctrine of the lifting of the veil is not needed as the court is only looking behind the corporate structure to what it is hiding. This particular doctrine goes beyond piercing of the veil; as stated by Diplock in the case *Snook v. London and West Riding Investments Ltd*, referring to what is known as "sham" transactions defined as acts conducted or documents executed by concerned parties with the intention of giving the appearance of legal rights and obligations created that are different from the actual legal position between involved parties[48]. What this means is that a company is being used to create the illusion that it is the actual party of a transaction only to hide who the actual parties are. The concept does not involve actual veil-

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[45] Prest [2013] 3 WLR 1 [35]
[46] Gilford Motor Co Ltd. v. Home, [1933] Ch 935
[47] Tan 2018, 31
[48] Snook v. London and West Riding Investments Ltd [1967] 2 QB 786, 802.

piercing but the impact or outcome of its use is similar, but there is no evidence to the extent of how much other judges in England agree with this point of view[49].

Other examples of this concept include the case *Re FG Films Ltd*[50], where the court concluded that the film in question, which was subject of an application to be classified as a British film, could not be classified as so due to the purposes defined in the Cinematograph Films Act 1938. The claimant business had only a share capital of 100 GBP and it was not to be said that this "insignificant company" took the responsibility in a real sense to make the film which was amounted to a cost of 80,000 GBP. Under this premise, it was held that the applicant business was an agent of an American company that was the actual financer of the film.

The decision of the court was based on the principles of agency, however, there is a possibility that the method was justified under the concealment principle since the judge deliberated that the claimant's company was "purely colorable"[51]. Furthermore, another example of these principles is seen in the case *Gencor ACP v. Dalby*[52] where the applicant company had no structure to conduct business such as a lack of a sales force, technical team, administrative employees and others capable enough of carrying out any business. Thus, it was concluded that the applicant company's only function was to make and receive payments, hence, the controller of the company was concluded to be the alter ego of the actual company.

2.4.2 United States of America

In US courts, it is the plaintiff who is seeking the use of piercing of the veil to establish the following: "(a) the 'unity' of the shareholder and the corporation and (b) an unjust or inequitable outcome if the shareholder is not held liable"[53]. The method for establishing unity includes courts looking at components such as "a failure to observe corporate formalities, a commingling of individual and corporate assets, the absence of separate offices, and treatment of the corporation as a mere shell without employees or assets."

To better explain the "unjust outcome" is difficult, but a common example that is used constantly is a shareholder that has all their vital assets taken away from the corporation through the use of

[49] Ibid
[50] Re FG Films Ltd [1953] 1 WLR 483
[51] Ibid para. 487
[52] Gencor ACP v. Dalby [2000] EWHC 1560
[53] Klien et al., 'Business Organization and Finance: Legal and Economic Principles' (2010); Thomas Reuters: London.

dividends, lavish salaries, or other unspecified payments for services. Another common example is found in an uncertain basis in which a business is found to be underfunded at its inception so it is seen to be unable to pay any future debts[54]. Even though the US corporate law's foundation is in individual state's laws, it is seen that all jurisdictions within the country traditionally apply one of the traditional justification for employing the veil piercing doctrine. These are the three-factor "instrumentality doctrine" and the "alter ego" doctrine[55].

The instrumentality principle was first outlined in *Lowndahl v. Baltimore O. R. Co.*[56] where it requires more than just mere control of the corporate personality and liability is dependent on "complete domination, not only of finances, but of policy and business practice in respect to the transaction attacked so that the corporate entity as to this transaction had at the time no separate mind, will or existence of its own". Further the principles stated require that this type of control is used by the defendant to "commit fraud or wrong, to perpetrate the violation of a statutory or other positive legal duty, or a dishonest and unjust act in contravention of the plaintiff's legal rights". Lastly, it is required that the control and reach of duty must have caused injury or loss of the plaintiff.

The requirements are executed in RRX Indus, Inc. vs. Lab-Con, Inc.[57] where the court states that the alter ego principles apply where "such a unity of interest and ownership exists that the personalities of the corporation and individual are no longer separate, and (2) an inequitable result will follow if the acts are treated as those of the corporation alone." These are thought to be separate tests, however, no real difference between the two is seen. This is because at their core they both require some form of wrongdoing that has come about from the control of another person or people leading the corporation to be unable to function in its capacity as a separate entity in its own right. Further analysis of US court decisions on this matter it is evident that the US has a more liberal approach in its practice of piercing the veil doctrine. Courts are commonly known to argue that corporate form will be overlooked or omitted with reluctance on their part or for exceptional cases.

[54] Ibid
[55] Blumberg (n 41)
[56] Lownendahl v. Baltimore & O. R. Co. [1936] 287 N. Y. S., 62, 76
[57] RRX Indus, Inc. v. Lab-Con, Inc, 772 F.2d 543, 545

However, case law in the US takes into consideration a variety of variables or factors compared to their English counterparts. A focal cause for this may be that the approach employed in the US is more focused on policy. Hence, in the cases. *Wm. Passalacqua Builders, Inc. v. Resnick Develops South, Inc*., the US court held it needed to decide if "the policy behind the presumption of corporate independence and limited shareholder liability — encouragement of business development—is outweighed by the policy justifying disregarding the corporate form—the need to protect those who deal with the corporation."[58]

It seems as if the courts in the United States place greater importance on the needs of individuals that may be dealing with business corporations to protect them; while other common law jurisdictions place a strong focus on *caveat emptor*.

To illustrate a broader understanding of wrongdoing in the United States the case *Parker v Bell Asbestos Mines, Ltd*[59] can be analysed. The primary issue that the case focuses on is the magnitude by which a parent company can be protected by any of its subsidiaries when trying to resolve tort related harm, in this case, it was related to asbestos. This same case was tried in England in which the court ruled in favour of the parent company; with greater stress on the purpose of incorporation – limiting the potential of any future liabilities. In the Parker v. Bell Asbestos Mines, Ltd, the court had provided the following key ruling on drawing distinction[60]:

> "(1) carrying out the everyday affairs of corporate business (e.g., the mining and sale of asbestos)—the sort of activity which traditionally merits the privilege of limitation of liability bestowed by the protective corporate form; and (2) carrying out legal manoeuvres aimed at maximizing the limitation of liability to a point of near invulnerability to responsibility for injury to the public. In our view, the latter, which may well be the situation here, constitutes an abuse of privilege, which in an equitable analysis of competing public policy considerations must surely fail."

[58] Wm. Passalacqua Builders, Inc v. Resnick Developers South, Inc., 933 F.2d 131, 138
[59] Parker v Bell Asbestos Mines, Ltd, 607 F. Supp. 1397
[60] Parker v Bell Asbestos Mines, Ltd, 607 F.

3 Phoenix Companies

3.1 Overview

The concept of phoenix activities revolves around the idea that a second company that often times is newly incorporated from the "ashes" of its failed forerunner; where the newly incorporated company's controllers and business are virtually the same. It should be noted, phoenix activity can be both illegal and legal; legal phoenix activities cover circumstances where previous controllers start the same business when their previous entity fails to rescue its business. On the other hand, illegal phoenix companies use similar activities but have the intention of exploiting the corporate identity to the disadvantage and harm of unsecured creditors such as tax authorities and employees. A common phoenix company activity includes a business in financial constraints is placed into liquidation, voluntary administration, or is left dormant. Before this occurs, the company's assets are transferred to a newly incorporated company, or to an existing entity like a related company in a corporate group.

There are instances when phoenix activity is completely legal, particularly when the failed company's assets are maintained and the employees are secured with their prerogatives and job. This is often termed as "business rescue", but the constant resurrection of a company can be challenging even with a controller's best intentions, especially if the creditor and employees are provided with bare minimum benefits. The behaviour can also become illegal if the controller's intention is to use the failure of a business to avoid paying its creditors which otherwise would have received had the business's assets been dealt with appropriately. The concept is viewed differently in the US legal perspective which categorises these principles under the U.S. Bankruptcy Codes, Chapter 11.

3.2 Legal phoenix company arrangements

Wood[61] described a phoenix company as "a company that has been 'reborn' soon after (and in some cases before) its failure". This new company then takes with it's the business of the failed company, at times using the failed company's name, the same management, and assets. Phoenix companies are born out of the companies that existed previously which is often termed as the 'original company'. The reason that certain businesses may use the phoenix process is to because

[61] J. W. Wood, "Corporate Rescue: A Critical Analysis of its Fundamentals and Existence" (2013), *University of Leeds*.

the original company may have certain aspects that are advantageous such as lucrative contracts or it may have bolstered disadvantageous such as crippling liability. Such circumstances may have led the original company to seek liquidation. In order to avoid the negative impact of liquidation, the directors of the original company look towards implementing a phoenix arrangement.

Using the arrangement, a new company is formed – a phoenix company, usually before the original goes through liquidation, allowing the management of the original company to transfer the profitable portions of the business to the newly formed phoenix company. This arrangement allows them to become directors of the newly formed company and transfer the business's assets and staff to the new company. The new company will have a similar name to the original and in every aspect of business, it is exactly the same. What is left behind in the original business is its creditors and unprofitable components of the business that were pushing it towards liquidation.

Wood[62] argues that phoenix companies can be advantageous for the company, the economy it operates in, and its creditors which also includes its employees; under the pretext that the transfer of assets from the original company is for full market value which causes no injustice to be done to any of the parties involved. This allows the original company to pay off any debt to its creditors while the phoenix company can go about conducting its profitable business. These types of circumstances and transactions are termed legitimate phoenix arrangements[63] and they can be favourable for all concerned parties.

The reason that it is preferred to liquidation is it allows the preservation of all parts of the business that produce value that may have otherwise been lost, the most critical being the goodwill of the business. Legitimate phoenix arrangements save the jobs of existing employees while creditors may agree to transfer business to a phoenix company in exchange for discounted return on debt, once they realise that recovering the full amount of their debt is not practical. Lastly, directors of the original company can continue to successful aspects of the original company while avoiding mistakes that had previously been done which caused liquidation.

[62] Ibid
[63] V. Finch, *Corporate Insolvency Law: Perspectives and Principles*, (2002): Cambridge: CUP.

3.3 Corporate Rescue Perspectives and Interpretations

There are fundamental differences in the UK and US insolvency laws with both countries having declared reorganization features legislatively for failing or ill companies in addition to establishing provisions for liquidation. As discussed previously, phoenix arrangements when done legitimately are forms of corporate rescue. The primary focus of corporate insolvency has various components that are developed with the purpose of creating opportunities for action instead of just making consequences for restricted measures in business[64].

Corporate insolvency is a system that mainly relies on the participation of actors that operate within a distressed company's domain to recognise the need for action and what recourse is needed to aid the company in such situations. Hence the reason why rescue models seek to be associated with promoting a positive and active role in a distressed company in order to place corrective and disciplinary measures. This is why the UK and USA corporate rescue models seek to develop a system in which actors have access to available technical knowledge to inform and encourage them to seek aid when distress in the business has been identified and provide a level of confidence that the legal system will not punish them for seeking these corrective measures.

It should be noted that merely identifying a company that is financially distressed is not a simple procedure as it depends on the initial assessment of the financial state of a company and how it is conducted. For courts to order companies to be wound up or appoint an administrator the cash flow test is used which uses the premise that a company is unable to pay its debt as it falls due. The second test used for the purpose of suing directors to compensate creditors or their disqualification a balance sheet test is used when a company is shown to have fewer overall assets than liabilities. [65]

3.4 Abuse of the corporate form

Corporate identity is not without negative aspects that are often noted as its drawbacks. Thus there is a potential for abuse of the idea of limited liability, especially in closely held companies. Documented examples of this form of abuse are often attributed to 'reckless-trading' although a

[64] Ibid

[65] P. Miller and M. Power, 'Calculating Corporate Failure', in Y. Dezalay and D. Sugarman (eds.), Professional Competition and Professional Power: Lawyers, Accountants and the Social Construction of Markets, (London: Routledge, 1995)

voluntary creditor has adjusted their terms on which credit is made available, however, doing so allows the creditor to lose this ability. Academics have made concerns that after the credit is extended to a business it may begin to participate in a risky activity that creditors may not be able to compensate for. But the possibility of this occurring decreases as long as the business is able to go to the market to take out credit[66].

The issue arises when a business is no longer able to take out funding for its activity, which causes it to spiral into the circumstances of insolvency. By that time, shareholders have lost their ability to contribute, resulting in the business undertaking an investment that is "riskier but alone offers the possibility, albeit remote, of a bonanza payoff that will prevent insolvency"[67].

These circumstances often led to the rise of the phoenix company which is made with a transfer of undervalue. This means that the phoenix company pays less than the market value of the business and takes away from the original company the chance to pay off its creditors, resulting in the "illegitimate phoenix arrangement"[68]. This arrangement not only puts creditors at a disadvantage, put provides directors that had already mismanaged the company to keep control and possibility conduct the same mistakes.

Creditors that are unaffected by the phoenix arrangement are possibly not aware of the circumstances that have taken place. This may occur if a phoenix company pays a specific creditor to retain their trading partnership. There is also the possibility that a slight name change between the phoenix company and the original company may not have been noticed by creditors that would be interested in becoming trading partners[69]. Miller and Power[70] note that this strategy may be used to confuse creditors into thinking that they are trading with the original company from which the phoenix company has been born.

A great skill that phoenix companies have is keeping goodwill with markets and trading partners. This means any goodwill that was established by the original company is automatically assumed

66 Ibid.
67 J Coffee, "Shareholders Versus Managers: The Strain in the Corporate Web" (1986), *Michigan Law Review*, 85(1), pp. 1-109.
68 Miller and Power'Calculating Corporate Failure', in Y. Dezalay and D. Sugarman (eds.), Professional Competition and Professional Power: Lawyers, Accountants and the Social Construction of Markets, (London: Routledge, 1995)

69 Ibid.
70 Ibid.

to have by the phoenix company due to the similarity in name and business[71]. There are times when an original company may change its name before going into liquidation which causes the phoenix company's goodwill to be unaffected by the liquidation of the original company[72].

The rise of an illegitimate phoenix company arrangement is most likely to take place before the original company is placed into liquidation[73]. At this point, the company is still in the hands of its original directors and the transfer for less than market value is more plausible before actual liquidation takes place. Under the circumstances of liquidation, the sale of the company's assets become the responsibility of the liquidator.

Their responsibility is to act in the best interests of the creditors and retain the highest price for the business's assets. It should be noted that the UK business community hold the belief that a "friendly" liquidator can be found with their fee being set in advance and the transfer taking place of assets at its undervalue which is previously agreed upon[74]. These factors give the image of the transfer being legitimate, Lynne Taylor once argued that "inappropriate phoenix activity may also arise in voluntary liquidations if a 'director friendly' liquidator is appointed who sells the company's business to its directors at an undervalue"[75].

4 Chapter- Profiling Fraudulent Activities of US Companies

4.1 Overview

In the United States, bankruptcy fraud is argued to be an under prosecuted crime that impacts the honesty and integrity of the administering powers of the complete bankruptcy system[76]. The federal banking system of the United States of America is dependent on providing full disclosure by debtors, creditors, and professionals involved in the system to decide differences and apportion assets as intended[77]. For this reason, the provisions of Title 18 of the Bankruptcy Codes were enacted which assert "to preserve honest administration in bankruptcy proceedings and to ensure

[71] Ibid.
[72] [72] V. Finch, Corporate Insolvency Law: Perspectives and Principles (2nd edn, Cambridge University Press, 2009)
[73] R. Goode, Principles of Corporate Insolvency Law (3rd edition, Sweet &Maxwell, 2005)
[74] V. Finch, Corporate Insolvency Law: Perspectives and Principles (2nd edn, Cambridge University Press, 2009)
[75] L Taylor "The Regulation of Director Involvement in Phoenix Companies Under Sections 386A to 386F of the Companies Act 1993" (2008)
[76] Clement, Leia, A. A study on bankruptcy crime prosecution under title 18: Is the process undermining the goals of the bankruptcy system? *Emory Bankruptcy Developments Journal*, 31, 409-430 [2015].
[77] Singh v. Attorney Gen. of the U.S., 677 F.3d 503 (3d Cir. 2012)

the distribution to creditors of as large a portion of the bankrupt's estate as possible"[78]. The primary aim of these bankruptcy laws was to provide debtors – corporate or individual; with a fresh start, ensure that distribution of assets to creditors was conducted with equity, and to serve the imperative interests of the United States government. For this reason, the federal bankruptcy system is dependent on the United States Trustee Program, whose primary functions include the identification of bankruptcy fraud and abuse in order to act in ways to prosecute such behaviour[79].

The U.S. Bankruptcy Code Title 18, sections 152-157[80] provides the methods with which to combat bankruptcy crime as well as protects the government's and private citizens' interests. The six sections can be treated into four universal categories of bankruptcy crimes beginning with the concealment of assets[81]. Concealment of assets occurs when an insolvent or their appointed attorney seek to circumvent the forfeiting of specific possessions to the bankruptcy estate[82]. The next category includes intentionally filing false or incomplete forms[83].

It is often seen that both these categories of bankruptcy crime occur in conjunction with one another since both groups are concerned when the insolvent or their attorney conceals or fails to disclose concealed assets in financial schedules[84]. The third category of financial includes crimes attributed to filing bankruptcy many times within a specific time frame to filing bankruptcy simultaneously in numerous states[85]. The last category is bribery and extortion of court-appointed trustees and third parties[86]. According to the case, *Stegman v. the United States*[87] all discussed provisions are developed in an attempt to "cover all the possible methods by which a bankrupt or any other person may attempt to defeat the Bankruptcy Act through an effort to keep assets from being equitably distributed among creditors"[88].

The purpose of these provisions goes further than this as it actively seeks to protect the economy and court system from adverse consequences that may come about from bankruptcy crimes and

[78] U.S. Department of Justice, *Bankruptcy Fraud*, Criminal Resource Management, 838.
[79] Ibid.
[80] 18 U.S.C. s.s. 152–157
[81] Ibid. s. 152(1)
[82] Singh v. Attorney Gen. of the U.S., 677 F.3d 503 (3d Cir. 2012)
[83] 18 U.S.C. s. 152(2)–(4) (2012)
[84] United States v. Hughes, 396 F.3d 374 (4th Cir. 2005)
[85] 18 U.S.C. s. 152(9)
[86] Ibid. s. 156(6)
[87] Stegeman v. United States, [1970] 425 F 2d 984, 986.
[88] Ibid.

frauds. This is because bankruptcy crimes have the ability to impact tax revenues on the state and federal levels[89]. There is an increased possibility in the increase of lending costs as lenders suffer a decrease in their return on investment caused by the costs that are incurred from aspects that are not factored into the cost of lending money[90]. This is because lenders begin to believe that they are absorbing losses from an increase in frequent bankruptcy crimes, making them react by increasing lending costs to offset the reduced return on investment[91].

This results in costs being passed on to borrowers. Lastly, a greater frequency of fraud and financial crimes has the ability to weaken public confidence in the integrity of the bankruptcy system[92]. The chapter provides a detailed discussion of profiling bankruptcy crime including fraudulent characteristics and scenarios in which bankruptcy fraud may be occurring. The chapter details primary methods of identifying bankruptcy fraud and its prosecution.

4.2 Common Fraud Schemes in the United States Involving Bankruptcy

Concealing assets or making false statements in the bankruptcy proceeding is a major factor of bankruptcy fraud, however, there are other fraud schemes used in the bankruptcy system which are complex and designed to maximize the retention of assets in bankruptcy. A majority of these schemes use the automatic stay provided by the U.S. Bankruptcy Codes to conceal a previous crime, increase profits from an uncompleted fraud scheme or the perpetrator is finding time in order to uncover ways to avoid victims.

In the United States, criminal requirements with regards to bankruptcy fraud were included to ensure that administrations in businesses during bankruptcy proceedings remained honest. The purpose was also to ensure the distribution of assets to creditors with as a large portion of the bankrupt's estate as possible. The criminal accounts were detailed in Title 18, sections 152 – 157 in the United States Code. It is known that sections 152 to 157 can be applied to any proceeding under the US Bankruptcy Code Title 11. Bankruptcy fraud contains a plethora of activities which includes the concealment of assets, falsifying an oath or account, providing false statements, using

[89] Stegeman v. United States, 425 F.2d 984, 986 (9th Cir. 1970)
[90] Craig Peyton Gaumer, Bankruptcy Fraud: Crime and Punishment, 43 S.D. L. REV. 527, 536 (1998).
[91] Nicole Forbes Stowell & Katherine Barker, Fraud, Fraud, Fraud: Mortgage Fraud and Bankruptcy Fraud, 40 REAL ESTATE REV. J. 6 (2011)
[92] Ibid.

false social security numbers, false claims, receipts of property that may be fraudulent, robbery, bribery, embezzlement, extortion, bust out schemes, falsifying records, concealment of a plan to defraud, and more. Primarily bankruptcy fraud includes the concealment of property, many prosecutors of US courts also are known to apply money laundering statutes.

It is in section 3057(a) in the US. Title 18 codes that a judge, receiver or trustee needs to have a responsible premise to believe that any such violation has taken place, especially with regards to insolvent debtors, reporting of all facts to the US attorney, receiving or reorganizing plans that have already been committed. If such a report is found, then the US attorney needs to decide if an investigation needs to be opened into the matter. With the completion of an investigation; if it takes place, the US attorney provides the decision of whether or not criminal actions need to be taken against the accused. However, a report by persons such as receiver, trustee, or judge for possible violation is not a precedent that is used for the starting of investigations.

4.2.1 Bankruptcy Fraud Using Bustouts

The two most common bankruptcy fraud schemes are planned bankruptcy also known as "bust-out" and the fraudulent concealment of assets during or in process of bankruptcy. A bust-out scheme may be conducted in several forms but it generally involves the intention of obtaining loans or purchasing inventory on a credit basis and then hiding or abandoning the proceeds before any creditors are paid. In the process of these fraud schemes insolvency is declared and bankruptcy is filed. However, creditors find that no assets are left or available from which they may be paid. Under the circumstances that this fraud works perpetrators are able to obtain the cash proceeds or inventory but escape any liability for the unpaid debts.

The planned bankruptcy scheme usually involves setting up a new company or using an already established company for types of bust-out schemes. In the first bust-out type a fraudulent person(s) may set up a new company and begin to operate it through legitimate means for a small period of time in order to establish credibility to investors and acquire credit with banks or suppliers. It is often found that these newly established companies may use a similar name of existing or reputable companies in order to trick unknowledgeable lenders and suppliers to believe they are dealing with a subsidiary or affiliate of a legitimate company. These fraudulent companies may also misstate their financial positions and profitability through falsified financial reports.

The second type of bust-out scheme includes fraudulent(s) quietly buying an established company that has already built a good reputation with its lenders, suppliers, and credit ratings, in order to take over its management.

Generally, credit-rating agencies do not take into notice the management change or new ownership of the company. These fraudsters then use the already established good credit rating to receive credit from suppliers and loans from banks. Regardless of which bust-out scheme is used, the perpetrators end up buying large amounts of inventory based on their credit rating. At the beginning of the operation, the perpetrators pay their lenders or suppliers on time to increase their credit rating which develops trust and incentive for suppliers to continue to increase their credit amount. The cash that these schemes use to pay their suppliers is obtained from loans taken out or products being sold at a discounted rate with the help of their co-conspirators in markets. This is because at often times the goods bought are of the type that can be quickly disposed of in the market at any cost.

As the scheme continues, perpetrators begin to buy increasingly larger amounts of inventory on credit while stopping their payments to suppliers. Perpetrators then stockpile these goods; they hide these goods for later sale in another location or begin to secretly liquidate the products at bargain prices. It is noted that in bust-out schemes that if bank loans are obtained, some small portion of it is drained off or all the loans can be shifted to different accounts in "shell" companies. In the end, fraudsters will claim insolvency and file for bankruptcy or just go about closing up shop without the need for bankruptcy and running off with the assets. At this stage, the company appears to be insolvent.

Examples of these types of bust-outs include retail bust-outs, tax bust-outs, credit card bust-outs, travel agency bust-outs, and distribution of consumer products. According to a report published by the Executive Office for U.S. Trustees, nearly ten per cent of all bankruptcies contain some element of fraud[93]. Several examples are found in U.S. case law in terms of identifying bust-out schemes and convicting those perpetrating such felonies.

[93] U.S. Department of Justice, Criminal Division, Fraud Section, *Activities Report Fiscal Years 2000 and 2001*.

A prime example of the use of a bust-out is seen in *United States of America v. Mohammad*[94] which was reviewed in the 7th Circuit Court of Appeals. According to record, prior to the case being presented in the 7th Circuit Court of Appeals, a four-week trial was held in which a jury convicted defendants Mohammad S. Mohammad and Asad Saleh for conspiracy and multiple counts of bankruptcy fraud, mail fraud, wire fraud and violations of sections 371, 152, 1341, 1343, and 31 of 18 U. S.C pursuant to Currency Transaction Reporting Act violations, in addition to U.S.C 31 section 5322.

An investigation carried out by the Federal Bureau of Investigation against Discount Merchandise, Inc. (DMI) brought on it 26 counts of criminal indictments against the appellant. According to an investigative report presented as evidence the appellant Mohammad, Saleh, and others were charged with being involved in a bust-out scheme that defrauded the trade creditors of DMI. According to investigators, the scheme included the following;

1. Ordering on credit goods and services valued at 3.1 million US dollars, with Mr Mohammad and crew having no intention of paying.
2. Reselling these products at a lower or wholesale cost.
3. Diverting monies of an estimated value of 1.7 million US dollars to numerous bank accounts held by family members, many of which were held outside of the US, primarily Jordan.
4. Hiding the diversion of monies.

The original justice of the court had convicted Mr Mohammad of four counts of concealing assets under 18 U.S.C section 152. The section states; "knowingly and fraudulently conceals from a custodian, trustee, marshal, or another officer of the court charged with the control or custody of property, or, in connection with a case under title 11, from creditors or the United States Trustee, any property belonging to the estate of a debtor shall be fined under this title, imprisoned not more than 5 years, or both"[95].

Another example is illustrated in *United States v. Hewes.*[96] An appeals case that reviewed the decision of a 1980 case in which a grand jury in Easter District of Pennsylvania prescribed a 52

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[94] United States of America v. Mohammad S. Mohammad [1995], 7th Circuit, Nos. 93-2837
[95] 18 U.S. Code section 152- Concealment of assets; false oaths and claims; bribery.
[96] United States of American v. Hewes, 729 F.2d 1302, 1310-11 (11th Cir. 1984)

count indictment against defendants: Francis Willam Hewes II, Millard Clifford Haley, Howard E. Caldwell, Gene M. Simpson, Walter Langford, and 17 other individuals. The indictment had charged the defendants with conspiring to participate in the affairs of an enterprise through a pattern of racketeering activity, various counts of mail fraud and wire fraud, and interstate transportation of stolen property. The facts presented in court found that the defendants were operating a series of fraudulent bust-out schemes. Evidence was presented in the testimonies of coconspirators that were involved in the intricacies of the scheme and pled guilty to charges. The indictment charges present five alleged bust-out schemes: Continental Distributing Company, Travel Inn, Inc., Dart Distributing Company, Creative Sales, Inc., and Applied Imports, Inc. The acts alleged in the indictments had occurred between the time frame of January 1974 and January 1981.

Investigators have found that the earliest fraudulent operations conducted by the crew were the Art Sales/Bonanza which began with Haley and Delosky in 1972. The company started by franchising an art course and then recording tape distributorships. In order to act out on the bust-out defendants used common techniques to develop strong credit ratings and appear legitimate to the market. Later on, both defendants sold franchises for a great value of monies with the intent to shut down the company resulting in the franchises becoming worthless. It was then that defendant Hewes was brought into the company to "take it down". Hewes first bough out Delosky's interest in the company, and later bought Haley's share of the company for 1 US dollar. At this same time, the coconspirator and defendant Caldwell was starting another franchising scheme by the name of Allied Productions with the defendant Simpson. It was then that both Haley and Hewes referred potential franchisees to Allied Productions.

The notorious activity of the gang continued into November 1976 in Atlanta with the founding of Allied Imports. The activity is similar to that discussed previously. As it is viewed the patter of the companies discussed leg to the government claiming the existence of a RICO enterprise as defined by the 18 U.S.C.A[97]. The defendants, particularly, Caldwell, Hewes, Haley, and Simpson all contradict that the evidence provided to the court in stating that it is not sufficient to warrant convictions of mail fraud, with Hewes challenging all convictions. However, the appellate court

[97] 18 U.S.C.A s. 1961: Crimes and Criminal Procedure – Racketeer Influenced and Corrupt Organizations – Crimes – Definitions.

concluded that the evidence provided is favourable to the government allowing the verdict to be sufficiently supported. Therefore, the Court of Appeals affirmed the conviction of each appellant except for Caldwell's and Langford's convictions on counts 49 and 50, with them being reversed.

4.2.2 Bankruptcy Fraud using Investor Fraud/Ponzi Schemes

In the US a Ponzi scheme is often used to defraud investors and the U.S. bankruptcy system. The fraud involves the solicitation of investments by promising interest rates that are above average from the market rate. Investors that are early to the scheme recover their investments with the promised rate of return which allows them to reassure other investors to invest in the scheme, this is often termed as a pyramid scheme. Once the actual fraud begins to take place, late investors are unable to recover their investments and interest is no longer paid to them. Under these circumstances, fraudsters file for Chapter 11 bankruptcy which allows them to continue with the scheme. Once the scheme deteriorates before bankruptcy a case is filed which can be either involuntarily or voluntarily. The foundation of this fraud scheme is the high return on investment, but as it fails many investors are unwilling to file a case as they believe that they have made a bad investment. Therefore, it becomes imperative to recognise and contact these investors are they make credible witnesses.

There is no finite definition for what a Ponzi scheme is, but the 9th Circuit Court in the case of *Donell v. Kowell* defined it as

> ". . . a financial fraud that induces investment by promising extremely high, risk-free returns, usually in a short time period, from an allegedly legitimate business venture. The fraud consists of funnelling proceeds from new investors to previous investors in the guise of profits from the alleged business venture, thereby cultivating the illusion that a legitimate profit-making business opportunity exists and inducing further investment"[98].

Under the assessment of a Ponzi scheme, three assumptions are made. The first presumption made is; the transfers that are made from the fraudster to further the Ponzi scheme are made with fraudulent intent. When a court applies the "fraudulent intent" presumption when analysing a Ponzi scheme, the trustee handling the case needs to prove that the debtor acting as the transferor

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[98] *Donell v. Kowell,* 533 F.3d 762, 767 n.2 (9th Cir. 2008).

was using a Ponzi scheme and made payments to the transferee or defendant. This shifts the burden of proof onto the transferee who then needs to prove that they accepted payment under the conditions of (i) exchange for reasonably equivalent value, (ii) good faith. Courts in the U.S. have used this presumption that a transfer of property was used in the furtherance of a Ponzi scheme to a fraudulent extent. It was applied in cases like *Janvey v. Brown*[99], *Donnell v. Kowell*[100], *Klein v. Cornelius*[101], *and Wiand v. Lee*[102].

The 2nd presumption made is that the debtor that is running the Ponzi scheme is presumed to be insolvent. This is not necessarily required for the fraud to be considered a Ponzi scheme, but trustees are known to allege constructive fraud, in such cases an imperative element is an insolvency or financial distress. Various cases have used the insolvency presumption to determine the presence of a Ponzi scheme including *Warfield v. Byron*[103], *Donnell v. Kowell*[104], *Klein v. Cornelius*[105], *and Wiand v. Lee*[106].

Lastly, the third presumption that is used in such is limiting "value" to the principal or original investment portion of the obligation. According to sections 8(a) and 8(d) of the Uniform Fraudulent Transfer Act (UFTA) a defendant-transferee is provided with an affirmative defence. Therefore, the defendant needs to prove that it accepted the transfer in "good faith", and that it provided some sort of "value" in the exchange. Under the pretext that the defendant-transferee gave "value" to the debtor, the defendant can keep the property that it received.

5 Profiling Fraudulent Company Activity in the UK

5.1 Overview

One of the largest contributors to the assessment improvement of insolvency laws in the UK was the Cork Report of 1982. Within the report, there have been statements made that candidly describe fraudulent phoenix activity and the need for law reform:

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[99] *Janvey v. Brown,* 767 F.3d 430, 439 (5th Cir. 2014)
[100] *Donell v. Kowell,* 533 F.3d at 770 (9th Cir. 2008)
[101] *Klein v. Cornelius,* 786 F.3d 1310, 1320 (10th Cir. 2015)
[102] *Wiand v. Lee,* 753 F.3d 1194, 1201 (11th Cir. 2014)
[103] *Warfield v. Byron,* 436 F.3d 551, 558 (5th Cir. 2006)
[104] *Donell v. Kowell,* 533 F.3d at 770 (9th Cir. 2008)
[105] *Klein v. Cornelius,* 786 F.3d 1310, 1320 (10th Cir. 2015)
[106] *Wiand v. Lee,* 753 F.3d 1194, 1201 (11th Cir. 2014)

> "The activities of "cowboys" and "fly-by-night" operators are much publicised. They clearly constitute an ever-present risk to ordinary members of the public. . .. [I]t will never be possible to stamp out entirely practices of this kind; nor is it easy to devise satisfactory solutions to the problems. It will, however, be a matter of reproach if the law remains complacent and fails to make any attempt to deal with everyday problems created by firms or companies which cease to trade, leaving work which has been paid for in advance uncompleted, but whose promoters are at liberty immediately to start afresh under a new name."[107]

The Cork Report is responsible for bringing about the various changes in the Insolvency Act 1986 that have been discussed in length in previous sections. Although the report has several misgivings about phoenix companies, its legacy rests in the promotion of rescue culture in the UK which encouraged the saving of insolvent businesses. This culture of rescue has become an integral part of British Insolvency and was further amplified with reform introduced in the Enterprise Act 2002. One major reform was the replacement of the term "serial entrepreneurs" with "responsible risk-takers"[108].

The main purpose of rescuing savable businesses is described thoroughly in the Insolvency Act 1986, where the first aim of the appointed administration is "[rescuing] the company as a going concern, failing which the administrator should maximize returns to creditors as a whole or realize property for distribution to secured or preferred creditors"[109]. When the administrator or the company itself is attempting a genuine rescue there is a need to ensure that the rights of the creditors are maintained, which means they are paid the sum they are owed without phoenixing becoming an issue. However, buyout of the business from a third party, either before or after a liquidator is appointed, and if it is to a related third party, causes the creditors to be paid less than the amount that they are originally owed[110].

The enactment of the Enterprise Act 2002 introduced requirements for the appointment of an administrator to be made out of court which has resulted in the increase of pre-packaged

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107 Cork Report (n 2) [1742]
108 G Wilson, "Business, State, and Community: "Responsible Risk Takers", New Labour, and the Governance of Corporate Business" (2000) 27 Journal of Law and Society 151, 172
109 Insolvency Act 1986 (UK), sch B1 [3](1)
110 Anderson, H. (2014). Directors' Liability for Fraudulent Phoenix Activity—A Comparison of the Australian and UK Approaches. Journal of Corporate Law Studies, 14(1), 139–173.

administration[111] since these specific reforms have come into effect[112]. It should be noted that "pre-packs" are not a formally recognised procedure as set in the Enterprise Act 2002. It is stated in the Insolvency Practices (SIP) 16 that "an arrangement under which the sale of all or part of the company's business or assets is negotiated with a purchaser prior to the appointment of an administrator, and the administrator effects the sale immediately on or shortly after his appointment"[113].

It is noted that pre-packs that include the sale of the business instead of its continuation are not corporate rescue principles-based, and thus need to be justified by the administrator that is appointed for corporate rescue duty[114]. This becomes imperative in situations where no rescue of the corporation would result in a better return for creditors causing the administrator to firmly advocate this decision. Legal experts and academics have argued for the preservation of the business as it has a better possibility of saving jobs and goodwill[115], the faster this is accomplished the better the results that creditors can experience[116].

5.2 Common Phoenix Companies Fraud Schemes

The UK's main provision to address fraudulent phoenix activity is awakened when a new business uses a similar name to a non-operational business. The Cork Report was the origin of section 216 of the Insolvency Act 1986, as the report had noted that "[t]he dissatisfaction is greatest where the director of an insolvent company has set up business again, using a similar name for the new company, and trades with assets purchased at a discount from the liquidator of the old company"[117].

It should be noted that the report did not recommend the "similar name" disqualification, the recommendation instead was much broader by imposing liability for the debts of a second business where "a person had taken part of the management of one business any time during two years prior

[111] S Frisby, "A Preliminary Analysis of Pre-packaged Administrations (Report to The Association of Business Recovery Professionals)" (2007)
[112] The Insolvency Service, "Report on the First Six Months" Operation of Statement of Insolvency Practice 16" (July 2009
[113] The Institute of Chartered Accountants in England and Wales, "Statement of Insolvency Practice 16: Pre-packaged Sales in Administrations England and Wales" (January 2009) SIP 16
[114] Insolvency Act 1986 (UK), s. B1 [3](3)
[115] The Insolvency Service, Enterprise Act 2002—Corporate Insolvency Provisions: Evaluation Report (January 2008)
[116] Ibid.
[117] Cork Report para. 1813

to its insolvency, where they take part in the management of a second company that starts a business or continues trading within 12 months of the insolvent liquidation of the first company and where the second company itself goes into involvement liquidation within three years of the insolvency of the first company"[118].

In contrast to these provisions is that of section 216 of the Insolvency Act which applies to those who were directors of the first company in 12 months before the company's insolvent liquidation. The section reiterates that without leave of the court or unless prescribed circumstances apply[119], the person is banned from being a director of another company with the same or similar name as the first within five years of the company's liquidation. There are various examples of its application includes *First Independent Factors & Finance Ltd v. Mountford*[120]. In this case, the honourable judge Lewison was required to consider numerous issues under the Insolvency Act 1986 sections 216 and 217.

The main purpose of these sections as discussed above was to deal with "phoenix syndrome", where section 216 prohibits directors of the insolvent company from re-using the insolvent company's name or that which is similar. The case also involved analysis of section 217 of the Insolvency Act 1986. The honourable judge concluded that the context with which the two names were used suggested an association that was prohibited with relation to the defendant (Mr Mountford)[121]. The honourable judge then decides that the defendant cannot be relieved from personal liability under section 727 of the Companies Act 1985 (i.e. now section 1157 of Companies Act 2006) by the court[122]. It was concluded in the case that the defendant is personally liable for the debts of the company Classic Conservatories & Windows Ltd[123].

Other leading case law on this matter includes *Throne v. Silverleaf*[124], which provided evidence that an individual can become personally responsible for all debts of a phoenix company because the required Insolvency Rules set out in 4.226 to 4.230 of the Insolvency Rules 1986 are not followed. The case revolved around Mr Throne (plaintiff) who was the director of three companies

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118 Ibid para 1827.
119 Ricketts v Ad Valorem Factors Ltd [2004] 1 All ER 894
120 First Independent Factors & Finance Ltd. v. Mountford [200] EWHC 835 (Ch)
121 Ibid
122 Ibid
123 Ibid
124 Throne v. Silverleaf [1994] B.C.C. 109

over a period of 25 years which include: (a) Mike Spence (Reading) Limited, (b) Mike Spence (Motorsport) Limited, and (c) Mike Spence (Classic Cars) Limited. The first two companies had previously gone through liquidation under Mr Throne as director. The third company was then formed and investment was procured from Mr Silverleaf (defendant). The defendant had found default in agreement by the plaintiff and demanded the drawing up of accountants' report on the company which put the plaintiff indebtedness to Mr Silverleaf at 135,000 GBP.

A judgment was made against the plaintiff personally and the company under sections 216 and 217 of The Insolvency Act 1986. The plaintiff made the argument that the defendant was aiding and abetting the crime, but was rejected by the appellant court. The honourable judge concluded that the plaintiff had not profited from the act and was entitled to debt in any event. It also concluded that the plaintiff had only participated in the management of the company to the extent that institutional lenders would do in any case to monitor the loan. The court also found that the name of the company was indeed a prohibited name under and the defendant was liable to criminal sanctions under section 215(4) of The Insolvency Acts 1986.

Further evidence of personal liability under section 217 of the Act[125] was in HM Revenue and Customer v. Yousef[126]. The court held that there was no right to indemnity between persons liable for the company's debts under section 217 or between them and the company; either by reason of section 217 or under the Civil Liability (Contribution) Act 1978.

5.3 Methods for Identifying Bankruptcy Crimes in the UK

The corporate insolvency laws of the UK validate its primary function as a tool for corporate rescue which finds its foundation in traditional values that are found in English contract law[127]. The UK's bankruptcy systems and its methods of identifying bankruptcy crimes is based on three major features which are (1) entitlement of a creditor, (2) entitlement of secured creditor to enforce personal security regardless of consequences, and (3) *pari passu* principle, which is equal distribution of the debtor's wealth to unsecured creditors[128].

[125] The Insolvency Act 1986
[126] HM Revenue and Customes v. Yousef [2008] EWHC 423 B. C. C. 805
[127] Goode (2005) 19
[128] Insolvency Act 1986, Order 2003 (SI 2003/2097)

Bankruptcy offences are significantly highlighted in the Insolvency Act 1986, Second Group of Parts, Part IX, Chapter VI. These offences listed can be triable in the magistrates' court or the Crown Court. There are various instances in which a trustee or administrator that is responsible for managing the debtor may believe that some sort of bankruptcy crime has taken place. One of the most cited is the failure to deliver up a property, concealment of criminal property and failure to account for losses as established in section 354(1) of the Insolvency Act 1986. The section deals with the offensive of removal of property and failing to account for or legitimately explain the loss of property[129].

In the case of *R v. Kearns*[130] the court held the opinion that section 354 of the Act[131] is a proportionate legislative response to the issues that are faced with administering and investigating bankrupt individuals and estates. It was held that a bankrupt individual needs to assist in giving information that is required by the officers appointed to handle the case. The honourable judges held that it is in the public interest that the dealings of bankrupt needs to be investigated, with the assets, traced, and distributed fairly to creditors[132].

Similarly, *Simmonds v. Pearce*[133] was stated by Lady Justice Gloster as "the clearest possible case of deliberate and calculated non-cooperation with the trustee" which not only made the case relating to the Insolvency Act (1986) but of contempt of court. The case begins with a Bankruptcy Order being made on April 27th 2015 against Mr Pearce (Respondent), leading to a licensed insolvency practitioner succeeding as the Official Receiver as Mr Pearce's Trustee in Bankruptcy [134]. The red flags that indicated a fraud bankruptcy was from Mr Pearce's lack of cooperation to his Trustee summarised as failure to disclose truthful information about documents to financial affairs, lying about financial affairs, concealment of information from Trustee, and general lack of cooperation[135].

[129] The Insolvency Act 1986, section 354 (1) – (3)
[130] R v. Kearns, [2002] EWCA Crim 748
[131] The Insolvency Act 1986, section 354
[132] R v. Kearns, [2002] EWCA Crim 748
[133] Simmonds v. Pearce [2017] EWHC 3126
[134] Ibid.
[135] Ibid.

6 Mitigating the Abuse

6.1 Overview

6.1.1 US Bankruptcy Provision for Mitigating Fraud

The primary source of regulation and identification of bankruptcy crimes in the US fall under the United States Trustee Program which is a division of the United States Department of Justice (DOJ) who indicates that its main aim is to "promote the efficiency and protection of the integrity of the Federal bankruptcy system"[136]. It is the responsibility of this division to oversee the behaviour of all involved that partake in the bankruptcy proceedings and administrative responsibilities in order to "further the public interest in the just, speedy and economical resolution of cases filed under the Bankruptcy Code."[137] This department also works with the Office of United States Attorney, the Federal Bureau of Investigation (FBI), and designated law enforcement agencies for the identification and investigation of all crimes related to bankruptcy and abuse of bankruptcy[138].

Several jurisdictions in the United States allow a trustee to work directly under the United States Attorney Office with the crime report or manage the case with the United States Trustee, who is then privy to share the information with the U.S. Attorney[139]. The decision then lies with the United States Attorney to present the case to a grand jury or "decide that the ends of public justice do not require investigation or prosecution"[140] but only after all the facts of the case have been adequately assessed by the U.S. Attorney. Currently, the United States Trustee Program has four main processes for identifying fraud, error, or abuse of bankruptcy which includes:

a. Review of bankruptcy cases by private trustees
b. Review of bankruptcy cases by the United States Trustee Program field offices.

[136] About the Program, U.S. DEP'T OF JUSTICE (Mar. 16, 2019) http://www.justice.gov/ust/eo/ust_org/index.htm.
[137] Ibid
[138] Ibid
[139] EXEC. OFFICE FOR U.S. TRS., U.S. DEP'T OF JUSTICE, HANDBOOK FOR CHAPTER 7 TRUSTEES 8-47 to - 48 (2001), available at http://www.justice.gov/ust/eo/private_trustee/library/chapter07/docs/7handbook0301/ch7hb0701.pdf.
[140] 18 U.S.C. s. 3057(b) (2012)

c. Receiving information from individuals who "could have a grievance with the debtor or who might be offended by the debtor's behaviour and misuse of the bankruptcy system" [141]. by the United States Trustee Program.
d. Performing debtor audits by the United States Trustee Program

The duties and responsibilities of private trustees are encoded under 11 U.S.C. section 704[142]. In cases dealing with Chapter 7 bankruptcy, the trustee is responsible for collecting and liquidating the property of the debtor's bankruptcy estate[143]. In Chapter 13 bankruptcy cases, the trustee is responsible for successfully executing duties that are outlined in section 704(a)(2) to (9)[144] in addition to assisting and evaluating the debtor's performance in his or re-payment plan[145]. Regardless of what chapter of bankruptcy is filed, trustees have the responsibility of investigating the financial actions of the debtor and reporting any potential bankruptcy-related crimes to the Office of the U.S. Attorney[146].

This responsibility is bestowed on trustees due to their duties of overseeing the financial actions of each case making them better aware of the parties that are involved in the bankruptcy process which will allow them to quickly identify and report any crimes related to bankruptcy[147]. It should be noted that trustees review all the documentation manually and none of the documentation that is made available is data-enabled for computer equipment or other machines to identify any important indicators of bankruptcy crime; this causes trustees to focus their review on a small number of bankruptcy cases [148]. Another important aspect that is used to mitigate fraud with regards to trustees is that they are required to aid the U.S. Attorney's Office to carry out prosecutions that may be based on their referrals[149].

To better combat fraud and assist in mitigating fraud actions, the United States Trustee Program have field offices across the country that are used to check on trustees[150]. To perform this check

[141] Noreen Clancy & Stephen J. Carroll, Identifying Fraud, Abuse, And Error in Personal Bankruptcy Filings 1, 10 (2007)
[142] 11 U.S.C. s. 704
[143] Ibid s. 704(a)(1)
[144] Ibid s. 704(a)(2)–(a)(9)
[145] Ibid s. 1302
[146] Ibid s. 704(a)(4)
[147] Clancy, & Carroll [2007]
[148] Ibid
[149] 28 U.S.C. s. 586(a)(3)(f)
[150] Clancy, & Carroll [2007]

on trustees, the means test[151] is performed on the entirety of bankruptcy cases to assess the presence of income abuse[152]. Under the circumstances that a debtor's bankruptcy filings cause suspicion of bankruptcy crime, the field offices begin to pursue a detailed review of the cause through a paper audit of the documents that the debtor has filed for bankruptcy[153].

There is also a possibility of the field office performing its investigation through the use of online databases or requesting subsequent financial information from the debtor in question[154]. It is stated under U.S.C 11 section 343 that any private trustee, examiner, creditor, or U.S trustee can assess the debtor under oath as prescribed using a section 341 meeting [155]. These types of assessments or under the Federal Rule of Bankruptcy Procedures 2004, "may relate only to the acts, conduct, property or to the liabilities and financial condition of the debtor, or to any matter which may affect the administration of the debtor's estate, or to the debtor's right to discharge"[156].

Furthermore, the U.S. Trustee field offices use fraud indicators that have been developed by the U.S. Trustee Program to improve the revision or examination of cases[157]. The financial indicators that are used to assess fraud include claims of theft, large gambling losses before the occurrence of filing, unfiled tax returns, no indication of prior bankruptcies, no ownership interest in residential property or personal residence, or repayment to family or friends with very little to no documentation[158]. It is required for the United States Trustee Program, private trustees, and law enforcement to investigate the presence of fraud indicators in order to assess if prosecutable bankruptcy crimes exist, this must be done in a case where there was no fraudulent actions or behaviour[159].

6.1.2 UK Bankruptcy Provision for Mitigating Fraud

The UK has various agencies in place that are responsible for curbing the attempt of bankruptcy fraud across various stages of insolvency and bankruptcy. The Department for Business, Energy, and Industrial Strategy developed an executive agency known as The Insolvency Service whose

[151] 11 U.S.C. s. 707(b)
[152] Clancy, & Carroll [2007]
[153] Ibid
[154] Ibid
[155] 11 U.S.C. s. 343
[156] Fed. R. Bankr. P. 2004
[157] Clancy, & Carroll [2007]
[158] Ibid
[159] Ibid

main purpose is to deliver economic confidence by supporting those in financial distress, tackling financial wrongdoing, and maximising returns to creditors[160]. The most used asset for mitigating fraud is as receiving a court order for Bankruptcy Restriction Orders (BROs) against the bankrupt [161]. The BRO extends the period of restrictions that are originally placed from bankruptcy for a period of 2 to 15 years. There are a set of behaviours that can result in a BRO being issued which includes;

1. Dispersion of assets or sale for undervalue
2. Paying specific creditors by preference over others.
3. Further borrowing of funds that can't be paid.
4. Neglect of business for an increase in debts
5. Non-cooperation with the official receiver
6. Fraudulent behaviour (i.e. providing false information for obtaining further credit)

In addition to these behaviours, there is a pretext of examining whether the bankrupt was bankrupt for a second time in six years, although this is not a primary consideration factor, it does provide sufficient proof for the application of BRO.

Primary disqualifications and effects of BRO are included in the statutory consequences as outlined in Company Directors Disqualification Act 1986[162] which states:

> "It is an offence for a person to act as a director of a company or directly or indirectly to take part in or be concerned in the promotion, formation or management of a company, without leave of the court at a time when… (b) a bankruptcy restrictions order… is in force in respect of him."[163]

The statute is also applicable on memberships of a Limited Liability Partnership[164] and the Insolvency Act 1986 section 360 which outlines offences that a bankrupt may be guilty of if he/she individually or jointly tries to obtain credit that is greater than or equal to £500 without providing

[160] 'About Us', The Insolvency Service (accessed April 10, 2019) < https://www.gov.uk/government/organisations/insolvency-service/about>
[161] The Insolvency Service (accessed on April 10, 2019) < https://www.gov.uk/government/publications/bankruptcy-restrictions-orders-and-undertakings/bankruptcy-restrictions-orders-and-undertakings>.
[162] Company Directors Disqualification Act 1986, s.11(1)
[163] Ibid
[164] Limited Liability Partnerships Regulations 2001, Reg. 4(2)

the creditor relevant information about their status[165]. This also includes an offence if the bankrupt under BRO engages, directly or indirectly, in any business using a name other than that which was adjudged bankrupt without disclosing to all individuals with which business transactions are made.

The Insolvency Service was organised in order to fulfil a range of statutory functions which includes exercising powers and duties for the Secretary of State as depicted in the Insolvency Acts 1986 & 2000, the Company's Directors Disqualification Act 1986, and the Companies Act 1985 & 2006. It should be noted that the Insolvency Service takes cases to court under civil law and not criminal law. However, there are several criminal offences associated with a breach of disqualification order and undertaking or restrictions order by acting as a director without the permission of the court. The penalties in place to mitigate fraud ranges from a fine to two years in prison, while also being individually liable for the company's debts while breaching such orders[166].

Investigations can take place if a company has entered into compulsory liquidation in Scotland or non-compulsory formal insolvency proceedings in England, Wales, and Scotland[167] which leads to an insolvency practitioner being appointed to deal with complaints against such companies. These practitioners then have a legal duty to report to the Secretary of State on the conduct of directors. The Insolvency Service itself may investigate individuals who have controlled a company regardless of their position of director or lack thereof. This includes investigating shadow directors or any such individuals instructing directors, who may have been disqualified.

7 Conclusion

7.1 Discussion

The current study investigated in-depth the doctrine of pricing the corporate veil in order to understand its underlying principles and premises. The purpose of doing so was to comprehend when the doctrine may be used in specific cases of court in both the US and UK. The report also analysed various aspects of bankruptcy laws in the UK and US when dealing specifically in the corporate context. It is evident from the research that the doctrine of corporate veil piercing is

[165] 'Schedule of Bankruptcy Restrictions', The Insolvency Service (accessed April 10, 2019) < https://www.gov.uk/government/publications/bankruptcy-additional-effects-of-a-bankruptcy-restrictions-order-or-undertaking/schedule-of-bankruptcy-restrictions#fnref:3>.
[166] G Wilson, "Business, State, and Community: "Responsible Risk Takers", New Labour, and the Governance of Corporate Business" (2000) 27 Journal of Law and Society 151, 172.
[167] Ibid.

hardly used in the context of uncovering fraud related to bankruptcy in the UK and the US. This may be due to legislation, statutes, and case precedent being available for prosecuting individual(s) for illegitimate conduct such as bankruptcy fraud. The United States has several varying penal codes that deal with individuals that may use the aspects of fraud and illegal activities under the guise of a limited liability company. This includes title 18 of the US Penal Code and RICO statutes. However, it should be noted that many high profile cases that have occurred after the 2009 Great Recession do not allude to the doctrine of veil piercing although it may be beneficiary for a public interest, especially when taxpayer monies are involved (e.g. bailout of banks such as Bank of America in the US). The next section justifies the use of the doctrine of veil piercing which is a recommendation as made by the current research.

7.2 Recommendations

7.2.1 Justification in Piercing the Corporate Veil for Fraudulent Bankruptcy

Many academics[168] argue that separate identity and limited liability used in modern times is often taken for granted but it should be noted that this concept came about unnaturally and with much difficulty. This concept was accepted because of the ultimate assessment that limited liability benefits outweigh the risks which was comparatively much clearer. It is understood in a majority of corporate legislation that it is a choice to tolerate the risks of limited liability for the overall good. In many US cases[169] and other jurisdictions the following statement has been made:

> "The doctrine that a corporation is a legal entity existing separate and apart from the persons composing it is a legal theory introduced for purpose of convenience and to subserve the ends of justice… It is clear that a corporation is in fact a collection of individuals, and that the idea of a corporation as a legal entity or person apart from its members is a mere fiction of the law introduced for convenience in conducting the business in this privileged way."

[168] *See* Tan Cheng-Han, 'Veil Piercing: A Fresh Start' (2015) Journal of Business Law, 20; Carsten Alting 'Piercing the Corporate Veil in American and German Law – Liability of Individuals and Entities: A Comparative View (1994) Tulsa Journal of Comparative and International Law, 187; Frank H. Eastbrook & Daniel R. Fischel, 'Limited Liability and the Corporation' (1985) University of Chicago Law Review 89.

[169] *See* William Sanders v. Roselawn Memorial Gardens, Inc [1968] 159 S.E.2d 784, 800 [hereingafter *Sanders*]; TLIG Maintenance Services, Inc. v. Deann Fialkowski [2016], 218 So. 3d 1271, 1282 [Hereinafter *TLIG Maintenance Services*].

There are examples of corporate legislation that contain specific exceptions to limited liability[170] which rise due to policy choices that provided benefits of incorporations should not be availed to their fullest extent. There are have been times where courts have gone beyond the legislative exceptions to ignore corporate separateness and limited liability to impose on directors or shareholders of a company liability which is characterised as "piercing the veil". This doctrine gives courts authority to take legal notice of the individuals that may be behind the company to whom personal liability can be attached for responsibilities that, based on first impression, were to be the companies solely.

Therefore, it is recommended that legislatures in both the U.S. and UK begin to incorporate this language to ensure that veil piercing takes place in acts of fraud conducted by businesses. That means that amendments need to be made in legislation in the U.S. Title 18 and in U.K.'s Insolvency Act. Explicit language needs to state that in cases where there is fraud being conducted under the Insolvency Act 1986 in the U.K. or if pheonixing is suspected to have occurred, then courts need to pierce the corporate veil. In the United States, the concept of pheonixing is not exclusive used. In fact, the study concludes that no such term is definitively used in the United States. Hence, it is recommended that U.S. Bankruptcy laws be amended to include the personality, characteristics, and extent of phoenix companies that arise from loopholes in the system.

In major common law countries, this judicial intervention is justified as the process of statutory interpretations gives courts the power to determine the scope of the legislation in terms of its expression in language, its express terms, and the purpose behind it. This was expressed in the judgement of *Salomon v. A. Salomon & Co. Ltd.*, in which Lord Watson stated:

> "In a Court of Law or Equity, what the Legislature intended to be done or not to be done can only be legitimately ascertained from that which it has chosen to enact, either in express words or by reasonable and necessary implications."[171]

However, *Sanders*[172] made it evident that separation of an entity due to limited liability could not be extended to a point that is beyond reason and policy; allowing the court to disregard this

[170] Eastbrook & Fischel (1985)
[171] Salomon v. A. Salomon & Co. Ltd. [1987] AC 22 (H.L.) 38
[172] Sanders 159 S.E. 2d 784

principle if it occurs. An example of this is seen in *Glazer v. Commission on Ethics for Public Employees*[173] in which Justice Dennis states:

> "Separate corporate identity is a privilege conferred by law to further important underlying policies […] Consequently, the privilege may not be asserted for a purpose which does not further these objectives in order to override other significant public interests which the state sees to protect through legislation or regulation."[174]

Tan[175] points out that in common law courts when interpreting corporate legislation, have concluded that it is implied in such legislation that there are limits to separateness provided by limited liability. It is unsurprising to note that jurisdictions in the US and UK vary sparing disregard the corporate personality and there are very few real situations of piercing the veil taking place[176]. Many US courts have affirmed that veil piercing can only occur in instances of exceptional nature, but courts there seem to be more willing to pierce the court veil as will be discussed later. Courts in the UK favour a restrictive approach to veil piercing, with it being argued that a judge shouldn't depart from the *Salomon* principle of corporate personality just because they perceive an injustice of occurring.[177]

In the decision of *Prest v. Petrodel Resources Ltd. & Others*[178] Lord Sumption observed that the law relating to the situations in which it would be justified for the courts to pierce the corporate veil was established in *Adams v. Cape Industries*[179] in which requirements of dishonesty on part of the company member(s) was needed and was not simply a device that could be used to provide justice for a specific case. The honourable Lord observed that the principle was once again affirmed in *Trustor AB v. Smallbone*[180] where it was established that the dishonest most involve company law being used as a "sham or façade" to hide the true ownership of property. His Lordship went on to argue that the lingo of sham and façade needed to be replaced with evasion and concealment. The judgement on *Prest* clarified that piercing the corporate veil would only be

[173] Glazer v. Commission on Ethics for Public Employees [1983] 431 So. 2d 752 [hereinafter *Glazer*]
[174] *Glazer*, para. 754
[175] Tan Cheng-Han, *Veil Piercing: A Fresh Start*, Journal of Business Law, 1, 20-36 (2015)
[176] Prest v. Petrodel Resources Ltd & Others (2013) UKSC 34
[177] Woolfson v Stratchclyde Regional Council [1978] SC 90 (HL) at 96.
[178] ibid
[179] Adams v. Cape Industries Plc. [1990] Ch 433
[180] Trustor AB v. Smallbone (No 2) [2001] EWHC 703

possible when company law had been used to evade liability in addition to applying another area of the law in order to provide a remedy.

This idea of abuse is witnessed in US courts as well for justifying the disregard of corporate separateness. According to the decision in *Glazer*, the court asserted that it may "pierce the corporate veil when the established norm of corporates has been abused in conducting a business that the venture's status as a separate entity has not been preserved."[181] Furthermore, the court held that it respected corporate separateness and personality unless "the legal entity is used to defeat public convenience, justify wrong, protect fraud, and defend crime"[182], acts that exclusively provide evidence of abusive conduct. The US Federal system does not provide a uniform position on piercing of the veil, however, it is generally recognized that elements of wrongdoing need to be present in a situation or circumstance for corporate separateness to be disregarded. Macey and Mitts[183] find that all available piercing cases in the US can be explained as an effort to accomplish one of three identified goals; as a tool for statutory interpretation, remedy what appears to be fraudulent conduct, and for the promotion of what is regarded as "bankruptcy values". The study goes on to assert that courts identify a standard litany for justification for disregarding corporate separateness are used as proxies for one of the three goals as already mentioned; and includes payment of dividends, failure to pay dividends, failure to observe corporate formalities, alter ego, undercapitalization, ownership of all or most stock, mere instrumentality, and others.[184]

7.2.2 Recommendations for Improving UK Bankruptcy Code

It is imperative that the UK's insolvency procedures are kept up-to-date in order for them to remain modern and relevant. Therefore, based on the findings of this paper, it is recommended that a new Insolvency Act be enacted. The new Act needs to update the core areas of UK's personal and corporate insolvency regime. There needs to be greater emphasis on lifting the corporate veil when dealing with bankruptcy fraud and corporate insolvency issues in the UK which is slightly neglected in the current Insolvency Act. As discussed in length, the courts in the UK are placed in a predicament when trying to lift the corporate veil due to issues that may arise from specific

[181] Glazer, 431 So. 2d at 757
[182] United States v. Milwaukee Refrigerator Transit Co. (1905), 142 F. 247, 255
[183] Macey and Mitts (n.1)
[184] Ibid

wording. The doctrine itself has not been enacted in law particularly and therefore it needs to be used specifically for bankruptcy fraud cases.

Another recommendation keeping in with bankruptcy fraud s to strengthen and regularise irregularities. It is critical to provide creditors with rapid remedies against fraudulent insolvents/debtors. Hence, it is recommended that bankruptcy proceedings be expedited where there is a risk that the debtor's assets may be reduced. Unfortunately, the study has also found that the UK is unable to cope with trying to save viable businesses as there are no proper tools or regimes that may be used to help such businesses that may be going through insolvency. Therefore, the UK needs to implement a process that may allow viable businesses with some space to address their business issues and begin restructuring. This process needs to be outside the scope of the current insolvency regime as many businesses that are viable face detrimental consequences for going through insolvency. It is recommended that a moratorium be provided to companies in order to provide them with time to explore options that will aid them in delivering corporate rescue. The new moratorium needs to include the oversite of initial negotiations whose main purpose is to develop an improved proposal, in addition to providing the time needed for approval from creditors or administration. Directors need to be incentivised if the conditions of the moratorium are met, especially if they are able to remove the risk of liability of trading. The entire process needs to be overseen by a supervisor who needs to have a detailed role in this process.

7.2.3 Recommendations for Improving U.S.A. Bankruptcy Code

The United States has produced the Chapter 11 Bankruptcy codes which have served businesses well for many years. However, there still needs to be reform made as the last few decades have seen a rapid change in markets and businesses which includes the expansion of secured credit, increased growth in derivative products, and the distressed debt market. The United States bankruptcy codes actually do a better job than the UK's Insolvency Act to ensure that viable businesses are treated fairly in order to be rescued and that fraudulent businesses and individuals are severely punished for their acts of fraud. The U.S. mostly replies on Title 18 to punish individuals and businesses that may undergo fraudulent bankruptcy. However, improvements can still be made. One such improvement is restructuring the 'debtor in possession' model (DIP) which allows a financially distressed company, specifically its management, to remain in control of the assets and to continue to operate the business. The current study has found that a greater number of companies have used the DIP model to undergo fraud by divesting their assets while it is going through bankruptcy proceedings. It is recommended that the United States incorporate the European model in which an insolvency office holder which a non-debtor connected to the third party, is appointed by the court to oversee the company while it is going through bankruptcy proceedings. The DIP model has many negative aspects that make it illogical to continue its use in the US. Firstly, the debtor's financial difficulties had arisen from their conduct and decision making, making it illogical for them to retain control further. Also, allowing a management team to remain in charge of the during decline rewards sub-par performance and it also undermines the confidence that the process of reorganization may have for all key stakeholders involved. Lastly, under the DIP model, pre-petition board members or management may be motivated by factors or components that do not necessarily align with the best interests of the company.

It has been found, that US courts are more than willing to pierce the corporate veil in instances of Tort cases, a lot more than their UK counterparts. Since the US judicial system is more prone to using the doctrine. It is recommended that legislators enact a law that provides policy principles to the use of corporate veil piercing for bankruptcy fraud. Currently, the US courts rely on Title 18 to allot punishments for fraudulent bankruptcy especially looking towards the RICO acts to find judgement in the use of fraud. However, it is difficult for courts to use the doctrine of corporate veil piercing in cases of fraud as there is no structural or legal skeleton for them to follow other than case law. Therefore, in Title 11 and Title 18 of the Bankruptcy Code of the US, legislators need to amend the code to incorporate the need for corporate veil piercing if there is some evidence that leads prosecutors to believe that individuals are hiding behind their corporate identity to commit fraud.

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