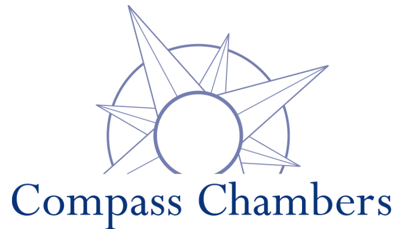

Piercing the Corporate Veil in Regulatory Cases

by

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Introduction

Those of you who practise in the field of regulatory crime know that the law in this field is highly structured.
For ease of reference, we are going to focus on health and safety law.
It is the area most commonly encountered in enforcement proceedings and prosecutions in Scotland.
Most commonly, you will be dealing with corporate clients who are accused of health and safety breaches.
When they are accused once you have set out how prosecution work in Scotland, one of the first questions you will be asked is how much is this going to cost?
We will come back to that later.

In order to consider that question you have to know exactly what you are dealing with.

What is the nature of the client?

If the client is a single limited company, your advice is straightforward.
If the client is part of a group of companies, you will have to consider how that group and those companies are structured.

Why does that matter?

The Health and Safety Offences, Corporate Manslaughter and Food Safety and Hygiene Offences Definitive Guideline which came into force in England and Wales on 1 February 2016

On 12 May 2016, Scottish Power Generation Limited pleaded guilty to a contravention of section 2 of the 1974 Act at Dunfermline Sheriff Court.
The plea was causative of severe injury, permanent disfigurement and impairment.
On 31 May 2016, the Sheriff fined the company £1.75 million which was modified from £2.5 million to take account of the early plea.

On 3 November 2016, Scottish Power's appeal against sentence was heard by the Appeal Court.

Scottish Power Generation Limited v HM Advocate 2017 JC 85

The Appeal court refused the appeal and in its decision the court said:

The Sheriff, in selecting the penalty, had used the matrix in the 2016 guidelines. He said in his report to the Appeal court that he determined that he should have regard to the new guidelines.
There was no reason for levels of fine to be different north and south of the border.
He also said that he looked at the level of fine 'through the prism of the pre-guideline Scottish decisions' and, apart from the level, which was higher in the guideline, he considered that he took into account the factors which had been considered relevant in the Scottish cases.

The Appeal court went on to say:
The court has, on several occasions, encouraged sentencers to 'have regard to' guidelines from south of the border in appropriate cases, notably, but not exclusively, those involving UK statutory offences.

Quoting earlier cases, the court said this:

While the court has encouraged sentencing judges to **"have regard"** to the English Guideline in death by dangerous driving cases, it has not said that it should "be interpreted and applied in a mechanistic way".

In order to ensure a degree of consistency in this jurisdiction, albeit paying due regard to local circumstances, it may be equally important to have regard to existing precedent'.

The court continued quoting from earlier cases:
Guidelines from the Sentencing Council will often provide a useful cross-check, especially where the offences are regulated by a UK statute.

What happens in practice?

Since Scottish Power, the courts in Scotland have routinely used the matrix in the sentencing guidelines to reach a sentence that the Sheriff considers to be just having regard to all the circumstances.
The courts routinely receive a "submission on sentencing" from the Crown which directs the court's attention to the sentencing guidelines and to Scottish Power and earlier Scottish cases.

We consider it is unlikely that a court imposing a sentence in Scotland for a health and safety breach would not refer to the sentencing guidelines.

What has this got to do with piercing the corporate veil?

Step 2 of the guidelines is “Starting Point and category range”
It states
“Having determined the offence category, the court should identify the relevant table for the offender on the following pages. There are tables for different sized organisations.
At step 2, the court is required to focus on the organisation’s annual turnover or equivalent to reach a starting point for a fine. The court should then consider further adjustment within the category range for aggravating and mitigating features.
At step 3, the court may be required to refer to the other financial factors listed below to ensure that the proposed fine is proportionate.
Step 3 states in bold
“The fine must be sufficiently substantial to have a real economic impact which will bring home to both management and shareholders the need to comply with health and safety legislation.”
It also states “The court should examine the financial circumstances of the offender in the round to assess the economic realities of the organisation and the most efficacious way of giving effect to the purposes of sentencing”

In terms of the guidelines, the offender is expected to provide comprehensive accounts for the last 3 years, to enable the court to make an accurate assessment of its financial status.

“Normally, only information relating to the organisation before the court will be relevant, unless exceptionally it is demonstrated to the court that the resources of a linked organisation are available and can properly be taken into account”

That is what this has got to do with piercing the corporate veil.

In sentencing, can the court look behind the distinct legal persona of a limited company, and go on to consider the financial position of “the Group” in assessing the appropriate level of penalty?
This is generally referred to as “piercing the corporate veil” of linked companies and this issue of linked companies has been considered in a number of English cases.

R v Tata Steel UK Ltd 2017 EWCA Crim 704

Tata Steel was a wholly owned subsidiary within the Tata Steel Europe Ltd Group. The ultimate parent company was Tata Steel Ltd (TSL).

Its 2015 Report and Accounts stated that the directors had a reasonable expectation that it had adequate resources, including the support of TSL to continue in operational existence for the foreseeable future.
It had a turnover of £4.17 billion in the year ended March 2015 (£4.49 billion for 2014) but recorded a loss after taxation of £851 million. During that accounting year, restructuring and impairment costs had been £314 million.

The Court of Appeal said that it accepted that the financial circumstances of the offender are to be taken into account, as the Guideline recognises under Step 3 and that a small profit margin relative to turnover, or a loss-making business, may warrant a downwards adjustment (in the fine);

that the financial circumstances of the offender were to be examined "in the round to assess the economic realities of the organisation";

that in that regard, Step 2 of the Guidelines provides that "normally" only information relating to the "organisation before the court" will be relevant, unless "exceptionally" it is demonstrated that the resources of a "linked organisation" are available and "can properly be taken into account".

The court said it kept well in mind the separate corporate personalities of Tata Steel and TSL in their approach to the matter.

The Court looked at Tata Steel's Report & Accounts 2015 which included the following paragraph:

"Going concern
After making enquiries, the directors have a reasonable expectation that the Company has adequate resources (including the support of its ultimate parent, Tata Steel Limited (TSL)) to continue in operational existence for the foreseeable future. Accordingly, they continue to adopt the going concern basis in preparing the financial statements."

The Court said 'On that footing, it seems to us that this is one of those exceptional cases within Step 2, where the resources of TSL, as well as those of Tata, can properly be taken into account.
Indeed, as the support of TSL is plainly of the first importance in ensuring that Tata could continue to prepare its accounts on a "going concern" basis, it would seem to me wrong *not* to take the position of TSL into account—the removal of TSL's resources would produce a misleading and unrealistic picture of Tata's financial circumstances."
It continued "It is …. recognising the economic reality of the situation."

Faltec Europe Limited v Health and Safety Executive [2019] EWCA Crim 520

Faltec was a wholly owned subsidiary of a Japanese holding company ("the holding company").

It had been incorporated in 1989 and traded since then as a manufacturer of car parts for Nissan's European plants. In the years leading up to 2019, it had had a turnover of between £33m and £39m per annum.
It reported a profit in 2015, but ran at a loss in 2016 and 2017, subsisting largely on loans and share capital supplied by the holding company.
The holding company had a worldwide turnover of between £550m and £600m per annum and an accounting annual profit of between £10 and £20m per annum in each of the last three years.
It was agreed that Faltec was a medium sized organisation in terms of step 2.

The Court noted that at step 3 of the Guideline, the Guideline contemplates the decision-maker stepping back and considering proportionality.

It said:
"Here the judge acknowledged that Faltec was trading at a loss. That was not, however, the position of the holding company.
Having regard to the statements in Faltec's 2015, 2016 and 2017 accounts, going to it enjoying the full support of the holding company and its position as a going concern, the judge concluded that "some limited regard" was to be had to the holding company."

The Appeal Court considered the position of the holding company and said:

"There is no dispute as to principles of separate corporate personality;
that criminal liability is personal; and
that a fine should not be imposed on the basis that it will, or might, be paid by a third party.
The question instead is whether, as the Guideline expressly provides, this is an exceptional case where "the resources of a linked organisation are available and can properly be taken into account". In that regard, the court should consider the "financial circumstances of the offender in the round" so as to assess "the economic realities of the organisation".
The decision on this point in *R v Tata Steel Ltd* was based on the economic realities test; that was an "exceptional" case in that it was clear that the support of the parent was of the first importance to ensuring that the offender could continue to prepare its accounts on a "going concern" basis.

Whether the economic realities test is satisfied will depend on a fact specific inquiry in the individual case;
there is no "catch-all" answer.
In any event, the question should be approached with a degree of caution;
ordinarily, it is only the resources of the offender which are to be taken into account;
the fact that companies are members of the same group or have a subsidiary—parent relationship, will not *of itself* satisfy the test;

it is only in exceptional cases that the resources of a linked organisation fall to be considered."

The court concluded that Faltec was an exceptional case and said that the 2015 and 2016 accounts support the judge's conclusion that they were, and went on to say the accounts included the following passage:

"The company meets its day to day working capital requirements by having access to loans from its parent undertaking. The company is dependent on continuing financial support being available from the bank and the continued financial support, should it be required from its parent undertaking.
"The parent undertaking has agreed to provide sufficient funds to the company should they be required, to enable it to meet its liabilities as they fall due and has confirmed the availability of such support for a minimum of 12 months from the date of approval of these financial statements."

The Court said that in those circumstances, as in *R v Tata Steel Ltd* , to ignore the holding company's resources would be wrong and would produce a misleading and unrealistic picture of Faltec's resources.

The Court said that the judge was entitled to have "some limited regard" to the holding company's resources in his proportionality assessment.

R v NPS London Ltd [2019] EWCA Crim 228

NPS London was a joint venture company, 80% of which was owned by NPS Property Consultants Ltd (the NPS parent) and 20% of which was owned by the London Borough of Waltham Forest (the Borough).
The NPS parent was controlled by Norfolk County Council.
The sentencing Judge had treated NPS London as a large organisation for the purposes of the Sentencing Guidelines because he regarded the NPS parent as a "linked organisation" whose resources could properly be taken into account for the purposes of sentencing its subsidiary company.
That was the subject of the appeal.

The Appeal Court said:

"We think it clear that the judge was wrong to read the guideline as entitling him to treat NPS London as, or as if it were, a large organisation for the purpose of sentencing. It is *the offending organisation's* turnover, and not that of any linked organisation, which, at Step 2 of the guideline, is to be used to identify the relevant table.

This reflects the basic principle of company law that a corporation is to be treated as a separate legal person with separate assets from its shareholder(s).

There are circumstances, restated by the Supreme Court in *Prest v Petrodel Resources Ltd [2013] UKSC 34;* in which it is permissible to "lift the corporate veil", and in such circumstances it would be legitimate to treat a corporate defendant as part of a larger organisation for the purpose of sentencing in this context, in the same way as, for example, it can be appropriate to lift the corporate veil in criminal confiscation proceedings: see *R. v Boyle Transport (Northern Ireland) Ltd [2016] EWCA Crim 19;* (p.43).
An example of a case where it would be appropriate to treat the relevant figure for turnover as that of a parent company might be one where a subsidiary had been used to carry out work with the deliberate intention of avoiding or reducing liability for non-compliance with health and safety obligations.
The mere fact, however, that the offender is a wholly owned subsidiary of a larger corporation or that a parent company or other "linked" organisation is, in practice, likely to make funds available to enable the offender to pay a fine is not a reason to depart from established principles of company law or to treat the turnover of the linked organisation as if it were the offending organisation's turnover at Step 2 of the sentencing guideline."

The Court continued:

"Whether the resources of a linked organisation are available to the offender is a factor which may more readily be taken into account at Step 3 when examining the financial circumstances of the offender in the round and assessing "the economic realities of the organisation".
It may certainly be relevant at that stage, when checking whether the proposed fine is proportionate to the overall means of the offender, to take into account the economic reality—if it is demonstrated to the court's satisfaction that it is indeed the reality—that the offender will not be dependent on its own financial resources to pay the fine but can rely on a linked organisation to provide the requisite funds."

Bupa Care Homes (BNH) Limited v R [2019] EWCA Crim 1691

BUPA (British United Provident Association) was the ultimate owner of worldwide and distinct medical, care and hospital service providers.
Bupa Care Homes(BNH) was the BUPA business unit whose undertaking extended to the provision of BUPA care homes in the UK.
BUPA Care Homes CFG Plc (BUPA CFG) was the immediate parent company of BUPA (BNH).

The appeal was against sentence which had taken into account the turnover of BUPA when sentencing BUPA(BNH).

The Court said:

“The starting point, as the Court observed in *NPS London,* is that the Guideline has to be applied in a way which does not infringe ordinary and well-understood principles of company law. Thus, the mere fact that one company may be the wholly owned subsidiary of a larger parent (with larger financial resources) does not mean that the resources of the parent can be treated as available to, or as part of the turnover of, the subsidiary company, because they are not.
The Guideline phrase 'economic realities' cannot be extended to mean that the parent's resources belong to the subsidiary simply in order to justify a large increase in fine at Step Three, any more than they can be taken into account to increase the size of the subsidiary's turnover for the purposes of the tables in Step Two.

To take the latter course would be inconsistent with what was said in *Tata Steel Ltd* , and *NPS London* and this means that the former step would also be wrong, as the Lord Chief Justice made clear in *Whirlpool Appliances Ltd,* at [40], when he said that Step Three 'does not provide an invitation to the court to disregard what has gone before …'.”

It continued:

“In other words, if it is generally wrong to take into account the parent's turnover so as to increase the subsidiary's turnover at Step Two (which it is) then it is wrong to take it into account to increase the fine at Step Three absent some special factor of the type identified in *Tata Steel Ltd* , supra, or *NPS London,* supra.”

It went on to say:

“The defendant in this case was BUPA (BNH) and the offence in question arose out of its breaches of duty.
It did not delegate these to its parent.
It alone bore criminal liability.
The defendant was a large profitable organisation in its own right.
There was no suggestion that it would be unable to pay the fine and require instead the parent to pay it, or that it would not be a going concern absent the financial support of the parent company.
Those were the economic realities.
The fact that, as we were told, BUPA (BNH) remits its profits to its parent is nothing to the point.
Fining BUPA (BNH) would no doubt serve to decrease the amount remitted by it to its parent, but that does not alter the economic realities.”

Conclusion

I said at the beginning that one of the first questions a client will ask you is how much is going to cost.

You can see from the English decisions that if the court can look at the wider financial picture of linked organisations, the financial penalty could be substantially higher than looking at the single accused company.

It is crucially important that you understand the structure of the linked companies and are informed by the client if there is financial support from another company in the group.

Only then can you assess the "economic reality" of what you are dealing with.

For all clients, ultimately this comes down to numbers and it is best to alert them to the worst-case scenario at the earliest opportunity.

A final word- there is salt to be rubbed into that financial wound- the Victim Surcharge. Since 25 November 2019, if the court imposes a financial penalty, it should impose a victim surcharge. There is a range dependant on the fine imposed but if the fine is greater that £10,000, the surcharge is 7.5% of the fine.

On a fine of £1 million, that is an additional penalty of £75,000.