

Construction Law Update

Economic Torts And Piercing The Corporate Veil – Can You Make A Claim Against Former Directors?

In the recent case of *Palmer Birch (A Partnership) v Lloyd & Anor [2018]*, the TCC considered the requirements to establish economic torts as causes of action and whether a contractor was entitled to pursue the individuals behind an insolvent limited liability company.

Background

In January 2012, Palmer Birch (A Partnership) (“PB”) was engaged by Hillersdon House Limited (“HHL”) under a JCT Standard Building Contract with Quantities 2011 (the “Contract”) to carry out refurbishment works to Hillersdon House. HHL was a new company set up by the defendants, Christopher and Michael Lloyd, who were respectively, the sole director and sole funder of HHL. Michael Lloyd ultimately intended to use Hillersdon House as his UK residence.

By the end of 2014, Michael was having trouble securing funding for the project and HHL consequently failed to pay two of PB’s invoices. By April 2015, Michael had secured the necessary funding to pay PB and complete the project. However, rather than transfer those funds to HHL, the funds were set aside for a new company (“CSEL”) which Michael set up to succeed HHL. HHL’s solicitors then sent a letter to PB explaining that HHL had run out of funding and was terminating the Contract with immediate effect (HHL later accepted this was a repudiatory breach as there was no provision in the Contract entitling HHL to terminate on such grounds). HHL subsequently entered into voluntary liquidation.

As HHL was insolvent and had very little in terms of realisable assets, PB sought to claim against Michael and Christopher under three economic torts: inducing a breach of contract, unlawful interference and unlawful means conspiracy. Michael and Christopher’s

principal defence was that PB’s claims should fail as an impermissible attempt to pierce the corporate veil.

Inducement of Breach of Contract

In respect of PB’s claim for inducement of breach of contract, the Court found that Michael had no primary legal obligation to fund HHL, and therefore, because inducing a breach of contract is a tort of secondary liability, Michael’s failure to provide funds did not amount to an inducement of breach but a mere prevention of performance. However, the Judge concluded that Michael had “crossed the line” from prevention to inducement of breach when (contrary to HHL’s commercial interest) he caused HHL to repudiate the Contract by diverting funds away from HHL to CSEL. Michael and Christopher’s argument that PB was attempting to pierce the corporate veil was dismissed as “Michael’s conduct was not a reflection of HHL’s separate corporate personality but an abuse of it”.

Unlawful interference

In respect of PB’s claim for unlawful interference, the Court found that there was nothing unlawful about Michael’s decision to stop funding HHL. Michael had fulfilled the original funding arrangement (a £5m loan) and therefore PB’s claim for unlawful interference failed.

Unlawful Means Conspiracy

However, the Court determined that PB’s claim for unlawful means conspiracy was successful. On the facts, the Court found that by no later than January 2015, Michael and Christopher had colluded to bring about the liquidation of HHL so that it might escape from any existing and anticipated claims from PB whilst benefitting from PB’s works.

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Analysis

There are several important points to take away from this case. Firstly, this case demonstrates the risks of contracting with new, underfunded limited liability companies. Contractors should always review the financial standing of their prospective employers, and where possible, obtain a guarantee in respect of the employer's contractual obligations.

Secondly, where a contract has been breached due to a lack of funds, to establish inducement of breach of contract, it is necessary to establish that funds have been diverted away as opposed to merely withheld.

Lastly, this case serves as a reminder that when directors fail to comply with their statutory obligations to act in the best interests of their company, they can be held personally liable in tort.

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