



# PIERCING OR PEEPING ROUND THE CORPORATE VEIL

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We sometimes come across instances where a UBO sees the underlying assets in a corporate structure as his own, or are asked to advise upon a liquidator's recourse to an entire group on one company entering liquidation. The concept of separate legal personality or the "corporate veil" is the most fundamental principle of corporate law but it is not always sacred or straightforward. Its relevance is not restricted to companies but also foundations, partnerships which have opted to have separate legal personality and limited liability companies (LLCs).

## **The Corporate Veil: Separate Legal Personality**

A company is a distinct legal entity, distinguishable from its directors and its owners. This concept is the foundation of corporate law. Whether it is a 'one man company' (as in *Salomon v Salomon*<sup>1</sup>, the case frequently cited as the authority for veil's existence) or is listed on a stock exchange, the principle is the same: the people that own the company are protected should the company run into financial difficulty, their liability is limited.

The protection of limited liability is generally considered to be advantageous to the health of the economy because it encourages those with the means and resources to take risks and engage in commercial activity. Successful businesses can isolate riskier projects in distinct subsidiaries to avoid putting the whole enterprise in jeopardy should the project fail.

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<sup>1</sup> *Aron Salomon v A. Salomon and Company Limited* [1897] AC 22

### Legal Schizophrenia

On the other hand, the concept of separate legal personality can also lead to situations where creditors are left out of pocket when a subsidiary collapses, despite the parent being in a healthy state; and it can also leave employees or other injured parties (such as a person with a claim for personal injury) unable to receive compensation because the responsible entity has no funds to meet any award ordered and the claimant has no right of redress against other parties who they may see as ultimately responsible.

The concept has also been used by fraudsters to conceal the profits of their misdemeanours; by cunning individuals to attempt to avoid breaching contractual constraints; and by spouses to protect their individual fortunes in divorce.

The courts have therefore sought to stop abuses of the Salomon principle, but this has led to confusion and uncertainty which in turn has the potential to undermine the benefits of the corporate structure and deter entrepreneurial risk-taking.

The family courts have even sometimes followed their own independent line and ignored the concept of separate legal personality to pierce the veil "when it is just and necessary"<sup>2</sup> or where there is a "strong practical reason why the cloak should be penetrable even absent a finding of wrongdoing"<sup>3</sup>.

The Supreme Court decision in *Prest v Petrodel Resources Limited* [2013] UKSC 34 has now become accepted as a leading authority on this issue. In this case, the court recognised that there may be times in which it is appropriate to pierce the veil and ignore a company's separate legal personality to look through to the controlling force behind it where there has been some fraud, but reconsidered previous authorities to show that this has in fact never (or at least very rarely) truly been done, and suggest that courts have instead acted to peep round the veil whilst keeping it intact and upholding the separate legal personality of the company, which the court did in this case.

The *Prest v Petrodel* decision followed another Supreme Court judgment where the issue was considered at length, *VTB Capital plc v Nutritek International Corp and others* [2013] UKSC 5, although the VTB case was decided on another ground so carries less legal weight. With these two judgments the Supreme Court have gone a long way to consolidating thoughts on an issue Lord Sumption described as "burdened by authority"<sup>4</sup>, but some questions still remain.

### The Facts of the Case

Mr Prest had been ordered to pay his estranged wife a large settlement at the climax of their divorce proceedings. The wife wished to enforce this settlement against the Petrodel group of companies (including companies in the Isle of Man) which, as well as conducting oil exploration, owned the couple's marital home and various other lucrative properties in London and which she believed were owned and controlled by Mr Prest.

The problem for Mrs Prest was that, although her husband owned shares in the companies (or at least was presumed to, based on what limited evidence was available to the court because of his refusal to co-operate with the proceedings), the companies were each separate entities in the eyes of the law and it was the companies, not Mr Prest, who owned the title to the properties despite the real likelihood that Mr Prest had financed the purchases. Bluntly, the properties were not Mr Prest's to give away. Making an order to hand the properties to Mrs Prest would require the court to pierce the corporate veil unless, of course, they could find an alternative way.

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<sup>2</sup> Bodey J in *Mubarak v Mubarak* [2001] 1 FLR 673, 682C (a decision which overturned by the Court of Appeal)

<sup>3</sup> Mostyn J at para 46 of *Kremen v Agrest (No 2)* [2011] 2 FLR 490

<sup>4</sup> Lord Sumption at para 19 of *Prest v Petrodel Resources Limited* [2013] UKSC 34

### The court's findings: the principle of piercing exists but has seldom been used

Giving the leading judgment Lord Sumption acknowledged that "the principle that the court may be justified in piercing the corporate veil if a company's separate legal personality is being abused for the purpose of some relevant wrongdoing is well established in the authorities"<sup>5</sup>. Like Lord Neuberger before him in *VTB*, he looked to Mummy J's judgment in the case of *Ben Hashem*<sup>6</sup> to recap the principles which have emerged, namely:

1. Ownership and control of a company are not of themselves sufficient to justify piercing the veil;
2. The court cannot pierce the corporate veil, even where there is no unconnected third party involved, merely because it is thought to be necessary in the interests of justice;
3. The corporate veil can be pierced only if there is some "impropriety";
4. The impropriety must be linked to the use of the company structure to avoid or conceal liability;
5. It is necessary to show both control of the company by the wrongdoer(s) and impropriety; and
6. A company can be a façade even though it was not originally incorporated with any deceptive intent, what is significant is whether it is being used as a façade at the time of the relevant transaction(s). However the court will only pierce the veil so far as it is necessary to provide a remedy to a specific wrong.

The *VTB* judgment added two qualifications to these six principles: (1) it is not necessary that there should be no other remedy available against the wrongdoer and (2) it is not enough to show that there has been wrongdoing, the relevant wrongdoing must be in the nature of an independent wrong that involves the fraudulent or dishonest misuse of the corporate personality of the company for the purpose of concealing the true facts.

Lord Sumption went on to consider what "relevant wrongdoing" is. Dismissing the traditionally used terms "mere façade" and "sham", he instead identified principles of "concealment" and "evasion" which may be present either independently or combined:

- **Concealment** is the interposition of a company structure to hide the identity of the real actors; to look through the structure does not involve disregarding the separate legal personality of the companies.
- **Evasion** is the use of the separate legal personality of a company to defeat a right against another personality or to frustrate the enforcement of a right against another personality; the court may disregard the corporate veil if there is a legal right against the person in control of it which exists independently of the company's involvement.

Lord Sumption reasoned that only where the wrongdoing is evasion is the corporate veil truly pierced. Where the veil is used purely to conceal a person, it does not need to be pierced to peep around it and see who is underneath as the distinct legal personalities of the entities involved continue to be recognised.

Lord Sumption applied the concealment and evasion principles to the established case law and highlighted that only in a minority of cases the wrongdoing which justified the court's "piercing" was evasion and that consequently the veil had not truly been "pierced" many times when courts had used that word.

### The court's findings: applying the principles to the facts

On the facts of the case the court did **not** consider that the grounds were made out to pierce the corporate veil and ignore the separate legal personalities of the Petrodel group of companies. The companies were

<sup>5</sup> Lord Sumption at para 27 of *Prest v Petrodel Resources Limited* [2013] UKSC 34

<sup>6</sup> *Faiza Ben Hashem v Abdulhadi Ali Shayif and others* [2008] EWHC 2380 (Fam)

incorporated years before the Prests' marriage broke down and were not established with dishonest intentions to conceal assets in a divorce but rather for "wealth protection and the avoidance of tax"<sup>7</sup>.

Further, although Mr Prest had ignored the separate legal personalities of the companies and had treated their bank accounts as his own, "it cannot follow that the court should disregard the legal personality of the companies with the same insouciance as he did"<sup>8</sup>. It is the court's role to act within, and to apply, the law: it cannot ignore separate legal personality simply because the purported wrongdoer in question did so.

### **The court's findings: family courts should toe the line**

One argument put forward by Mrs Prest was that family courts had greater powers to pierce the veil, stating that the Matrimonial Causes Act 1973 gave them this wide discretion. Lord Sumption dismissed this proposition, stating "courts exercising family jurisdiction do not occupy a desert island in which general legal concepts are suspended or mean something different"<sup>9</sup>. The statute gives family courts the power to take assets in companies into account when calculating the value of a spouse's capital but does not give the court the power to order their disposal. Where family courts had acted to do so in the past they had been wrong.

### **The court's findings: trusts and peeping**

Despite Mrs Prest's first two arguments failing she achieved her desired result and the court did order that the properties be transferred into her name.

This is because the Supreme Court found another way of peeping round the veil whilst leaving it intact. As Mr Prest had provided the finance to purchase the properties and because the companies had only paid him nominal consideration for the transfer of ownership to them, there was an equitable presumption that he only intended to transfer legal and not beneficial ownership of the properties. In other words, that the companies were holding the properties on trust for Mr Prest as his trustees.

The court ordered the companies to transfer the legal title of the properties to Mrs Prest to reflect the transfer of beneficial ownership arising from the divorce settlement.

Lord Sumption reasoned that this did not pierce the corporate veil. He compared the companies with human trustees, such as relatives, and explained that clearly the separate personality of a human being would not be dismissed or compromised by the making of such an order. The court peeped round the veil between trustee and beneficial owner to transfer the ownership of assets deemed to be held on trust by a company as nominee of their ultimate beneficial owner and controller.

### **Where do we go from here?**

Lord Sumption pointed out that authority that the corporate veil may be pierced came from cases where the court decided not to do so when applying legal theory to specific facts. These comments are therefore obiter and not strictly binding. In the same way, because the veil was not pierced on the facts of the case, *Prest v Petrodel* does not create a binding precedent on when the veil must or may be broken; it only binds lower courts not to pierce the veil in the same circumstances and has discredited the times lower courts have sought to do so. Lord Sumption's obiter comments are helpful guidance and we have now seen them quoted in the Manx courts<sup>10</sup>, but this is not a definitive answer to an ambiguous area of law.

As the court did not act to pierce the corporate veil it is not in tatters. Those advocating its advantages can breathe a small sigh of relief.

However the judgment highlights that there are times when a court will instead peep round the veil to achieve the same practical result: the transfer of assets from a company which is not itself at fault. Just because

<sup>7</sup> Lord Sumption at para 36 of *Prest v Petrodel Resources Limited* [2013] UKSC 34

<sup>8</sup> Lord Sumption at para 36 of *Prest v Petrodel Resources Limited* [2013] UKSC 34

<sup>9</sup> Lord Sumption at para 37 of *Prest v Petrodel Resources Limited* [2013] UKSC 34

<sup>10</sup> For example, *Woman LLC & IOTA Violet and others*, Staff of Government Division August 2016

assets are held by a company (or by extension any third party, the type of vehicle would not appear to be significant) it does not mean that they are safe there. Assets were not beyond the reach of a divorcing spouse so who is to say with certainty that they would not be beyond the reach of a creditor as well?

The judgment also does not sit entirely comfortably with the *VTB* comments that the doctrine of privity of contract means that parties can only seek to enforce against contracting parties, not the personalities behind them. *VTB* stressed the importance of the name on a contract, but *Prest v Petrodel* was decided on equitable principles that place greater emphasis on the beneficial ownership.

This case may have provided ammunition for every side: it was hailed by divorce lawyers as a means of preventing a spouse squirrelling their assets away beyond reach, but equally Lord Sumption was damning in his criticism of how family courts had gone beyond their remit in the past in acting to pierce the veil when they had no authority to do so.

The corporate veil still appears to be intact, but if it can be lifted up or moved aside to does it matter that it can't be pierced?

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