Piercing the corporate veil: Supreme Court clarifies the English law position

Prest v. Petrodel [2013] UKSC 34

The Supreme Court has recently issued a decision confirming that English law permits a claimant to ignore the separate legal identity of a company, and “pierce the corporate veil” in certain circumstances. However, this remains an exceptional remedy.

The background facts

Prest v. Petrodel came before the Supreme Court on appeal from a decision in a divorce case. Michael and Yasmin Prest married in 1993 but the marriage ended in 2008. Mr Prest was a wealthy oil trader who had previously worked for Marc Rich and later went into business on his own account, operating through a number of companies over which he had complete control (the “Companies”). The Companies had legal title to real estate within the UK, including the couple’s matrimonial home.

In the divorce proceedings Mrs Prest obtained an order from the family courts requiring her husband to pay her a lump sum of £7.5 million plus annual payments. To satisfy this judgment, the Judge ordered the Companies to transfer title to the marital home and seven other properties. The Judge based this order on Section 24 of the Matrimonial Causes Act which provides that the court may order that “a party to the marriage shall transfer to the other party... such property as may be so specified, being property to which the first-mentioned party is entitled...”. The Judge also decided that the matrimonial home was held by one of the Companies on trust for Mr Prest, who was the beneficial owner of the property.

Importantly, the Judge in the High Court recognised that the companies had a separate legal personality from Mr Prest, as they were not being used for an improper purpose, and the Court of Appeal agreed. It is this point that is of significance in a commercial context and is the focus of this article.

Saloman v. Saloman

The starting point for a legal analysis is the case of Saloman v. Saloman in 1897. Mr Aron Saloman was a sole trader who set up a limited liability company (“A. Saloman & Co Ltd”) through which he conducted his leather and boot making business, in which Mr Saloman and certain members of his family were the only shareholders. When the business failed, the creditors sought to hold Mr Saloman personally liable for the debts of his company.

At first instance, the High Court held that the company was effectively just Mr Saloman in another form. The Court of Appeal agreed and also considered that Mr Saloman was using the company as “a device to defraud creditors”. The House of Lords, however, did not consider that there was any fraud, and held that the company was a separate legal person from Mr Saloman and that he was not therefore liable for the company’s debts. As Lord Sumption said in Prest: “The separate personality and property of a company is sometimes described as a fiction, and in a sense it is. But the fiction is the whole foundation of English company and insolvency law.”

What is “piercing the corporate veil”?

It has long been established that the courts can in certain circumstances disregard the separate legal personality of a company from the shareholders. This is known as piercing
or lifting the corporate veil. Numerous cases have set out various legal tests for the very limited circumstances in which this doctrine may be invoked by the courts, but the principles on which the courts can do so are not clear.

The first point to be dealt with in *Prest* was whether English law recognises the concept of piercing the corporate veil at all. Earlier in 2013, the Supreme Court in *VTB v. Nutritek* heard argument that there is in fact no principle of law which allows a court to disregard the separate legal personality of a company. The Supreme Court in *VTB* expressed some support for that argument, but held that they did not need to decide the point. In *Prest*, the majority of the members of the Supreme Court, however, confirmed that the doctrine of piercing the corporate veil is a well-established one.

**When can a court pierce the corporate veil?**

In *Prest*, Lord Sumption attempted to clarify the doctrine as follows:

1. The term “piercing the corporate veil” means disregarding the separate personality of a company and occurs when the court applies an exception to the rule in *Saloman v. Saloman*.

2. The doctrine can be distinguished from a situation where the law attributes the acts of a company to those individuals who control it, but without disregarding the company’s distinct legal personality.

3. Lord Sumption identified two scenarios where there is some form of wrongdoing which might lead to the person in control of a company being held liable:

   a. The first is the “concealment principle” which Lord Sumption considered did not in fact involve piercing the corporate veil. This is where a company or companies are interposed in a transaction so as to mask the true principals to the transaction. In other words, the parties attempt to employ a “façade” to disguise their activities. In such cases, the Court does not disregard a company’s separate legal existence, but unveils the true facts which the corporate structure is designed to conceal.

   b. The second is the “evasion principle”. The Court may disregard the separate legal personality of a company if there is a legal right against the person in control of the company and the company is deliberately interposed in order that the separate legal personality of the company should defeat the enforcement of that right against the controlling party. The Court may then pierce the corporate veil, but only for the purpose of depriving the company or its controller of the advantage they would have obtained by reason of the company’s separate legal personality.

The principles enunciated by Lord Sumption and endorsed by Lord Neuberger were not entirely accepted by the other five members of the Court, and this analysis therefore represents a minority view. The majority of the members of the Court were reluctant to define the scope of the doctrine at all, with Lord Mance stating his view that it is “often dangerous to seek to foreclose all possible future situations which may arise and I would not wish to do so.” Nonetheless, the above principles are the clearest modern statement from the highest Court in England and Wales as to when a court may pierce the corporate veil, and they are likely to be highly persuasive in future cases.

**Outcome for Mrs Prest**

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Having defined the relevant test, the Supreme Court unanimously agreed with the Judge in the High Court that it was not permissible to pierce the corporate veil on the facts of this case. The Judge at first instance had not found any relevant impropriety on the part of Mr Prest. Although Mr Prest had acted improperly in many ways (for example, by misapplying the assets of the Companies for his own benefit) he was not concealing or evading any legal obligation owed to his wife. In particular, it was relevant that the legal title to the properties was vested in the Companies before the marriage broke up. It could not be said that Mr Prest was using the Companies to evade his obligation to pay the divorce settlement to his wife.

The Court, however, found that the properties, whilst legally owned by the Companies, were in fact beneficially owned by the husband and so could be transferred to the wife.

**Protection of assets**

*Prest* upholds the principle established in *Saloman v. Saloman* that assets which are held within corporate structures will not be considered to be the property of the controller of the company unless it is possible to rely upon the evasion principle.

The *Prest* decision does, however, demonstrate that a court has other tools at its disposal where it wishes to ensure that a wrongdoer cannot create an artificial façade and hide behind the separate legal personality of a company. In *Prest*, the Court inferred that the Companies held the UK properties on trust for Mr Prest. In reaching this conclusion, Lord Sumption observed that many of the Companies were not actively trading, that the Companies could not have funded the purchase of the properties they owned and that ownership of the property had nothing to do with the business of oil trading.

While it is not possible to be precise about the circumstances in which a court will seek to look behind the separate legal personality of a company, *Prest* suggests that this is most likely to occur where a court is convinced that the doctrine is being used for an improper purpose. Mr Prest was using the companies under his control to run his personal affairs, and as his own money box. By contrast, the legitimate use of corporate structures for asset planning and distribution of risk and liabilities should not be affected by the decision.

The decision does, however, show that individuals need to be careful about how they structure their affairs, and how they exercise control over companies, if they want to protect their assets from claimants. The courts can be inventive in finding a justification to ignore the separate legal personality of a company in order to deal with an illegitimate attempt to hide behind a company structure.

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