Corporate Governance and Piercing the Corporate Veil – Supreme Court rules to extend exceptions

Introduction

The Supreme Court's decision in the case of *Petrodel v Prest*, handed down today, marks a crucial shift in the extent to which the courts will allow the *"piercing of the corporate veil"*. Although the case revolved around a matrimonial dispute, it has profound implications for corporate governance.

The Facts

In October 2011, the High Court ruled that Mrs Prest (**"W"**) was entitled to a divorce settlement of £17.5 million from Mr Prest (**"H"**), a wealthy oil trader. Since H failed to comply with court orders by failing to give full and frank disclosure of his finances during proceedings, his appeal was dismissed at a preliminary stage. The award therefore stood regardless of later court decisions concerning enforcement.

In terms of enforcement of the award, Moylan J ordered that properties in London and overseas, owned by Petrodel Resources and two other companies (collectively **"X"**) were assets of H and formed part of the divorce settlement since they were beneficially owned by H as the sole shareholder. Whilst Moylan J found there had been no impropriety in relation to X, so as to permit the corporate veil to be pierced, he nevertheless held that H, exercising complete control over X both in terms of their operation and management, was 'entitled' to the relevant properties within the meaning of s24(1)(a) Matrimonial Causes Act 1973 (**"MCA"**), despite not personally owning the assets.

X appealed to the Court of Appeal, submitting that in order for company assets to become subject to s24(1)(a) MCA, the corporate veil would have to be pierced and this only occurred in exceptional circumstances, this not being one of them.

Court of Appeal's decision

In October 2012, the Court of Appeal allowed X's appeal (Thorpe LJ dissenting) and overturned the High Court's decision, holding that the High Court was wrong to conclude that H was the beneficial owner of X's assets because the shareholders of a company have no interest in or entitlement to the company's assets which instead belonged to the company. In Rimer LJ's view, it made no difference to a company's separate legal personality that a single individual controlled all of its shares, stating *"a one-man company does not metamorphose into the one man simply because the person with a wish to abstract its assets is his wife"*.

W appealed to the Supreme Court. The key issue was whether corporate law principles should be sacrificed to do justice on the facts of a matrimonial dispute.

Supreme Court's decision

The Supreme Court found in favour of W, giving her the right to force X to turn over assets as part of the £17.5 million divorce settlement. According to the Supreme Court, there were three legal bases on which X's assets may be available: (1) piercing the corporate veil; (2) applying s24(1)(a) MCA as a distinct power to pierce the corporate veil in matrimonial cases; and (3) holding the properties were held by X on trust for the husband in the particular circumstances of this case. In allowing W's appeal, the Supreme Court based its decision not on piercing the corporate veil, nor s24(1)(a) MCA (agreeing with the Court of Appeal in this regard), but on the fact that the properties in question were held by X on trust for H. Key to the Supreme Court's decision, therefore, was the relationship between H and X, which was so close as to create an exception to the traditional separation of corporate and personal assets.

Piercing the corporate veil

Despite dismissing the appeal in so far as it relied on piercing the veil of incorporation, the UK's most senior judges went out of their way to acknowledge the existence of a general exception to the rule, based on the so-called "evasion principle". Specifically, Lord Neuberger stated *"if piercing the corporate veil has any role to play, it is in connection with evasion"*. Furthermore, Lord Sumption stated *"there is a limited principle of English law which applies when a person is under an existing legal obligation...which he deliberately evades or whose enforcement he deliberately frustrates by interposing a company under his control. The court may then pierce the corporate veil for the purpose, and only for the purpose, of depriving the company or its controller of the advantage that they would otherwise have obtained by the company's separate legal personality"*.

It is worth noting that the judges were keen to stress that exceptions to the rule against piercing the corporate veil will not be easy to establish. Lord Clarke, agreeing with Lord Mance and others, stated *"the situations in which piercing the corporate veil may be available as a fall-back are likely to be very rare"*. In addition, Lord Sumption stated *"The principle is properly described as a limited one, because in almost every case where the test is satisfied, the facts will in practice disclose a legal relationship between the company and its controller which will make it unnecessary to pierce the corporate veil."*

Nevertheless, in accepting a general exception to the rule against *"piercing the corporate veil"* today, this represents an extraordinary decision and the implications on corporate governance are potentially huge.

Conclusion

The Court of Appeal's decision was condemned by some as a "cheat's charter". Whilst it is unclear at this point how the Supreme Court's landmark decision will be viewed in practice, corporations and lawyers will be poring over the case and corporate structures to see if they are at risk of offending this potentially wide "evasion principle".

If you have any questions on *Petrodel v Prest* or any related issue, please contact:

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