LIFTING, PIERCING AND SIDESTEPPING THE CORPORATE VEIL

James Wibberley, Guildhall Chambers & Michelle Di Gioia, Gardner Leader

1. Limited liability companies provide huge commercial benefits for businessmen, but even larger headaches for lawyers when they are forced to explain to lay clients how wealthy individuals can hide behind the veil of incorporation when a business deal goes south. This is, if anything, a growing problem as individuals and their accountants become increasing sophisticated at manipulating corporate structures to avoid the consequences of litigation in the same way they do tax. The worst offenders are those, such as directors, who seek to use limited companies to avoid personal obligations and liabilities.

2. This talk aims to explore the extent to which the difficulties posed by the corporate veil can be overcome. This includes not simply pursuing individuals or parent companies seeking to avoid their legal obligations, but also actions against those who drive litigation for their own purposes then hide behind corporate entities when their claim or defence fails.

3. In order to address this variety of situations, this talk is divided into two sections. The first looks at the law in relation to *lifting* and *piercing* following the recent decision of the Supreme Court in *Prest v Petrodel Resources Limited* [2013] UKSC 34. The second looks at what we have entitled *sidestepping* the corporate veil, namely the court's jurisdiction to make non-party costs orders under the provisions of section 51 of the Senior Courts Act 1981. Whilst the first part of the talk will highlight the difficulties in establishing liability through the corporate facade, the second will hopefully show that those who seek to engage in litigation from the sidelines are not as safe as they might assume.

<u>The Corporate Veil – the law pre-Prest</u>

4. The concept of the corporate veil dates back to the landmark decision of the House of Lords in *Salomon v A Salomon and Co Ltd* [1897] AC 22, where the legal separation between a company and its shareholders was established. In the view of Lord Halsbury LC, a limited company was to be viewed *"like any other independent person with its rights and liabilities appropriate to itself*". More recently in *Bank of Tokyo Ltd v Karoon (Note)* [1987] AC 45, Robert Goff LJ confirmed the different between commercial reality and legal principle stating that *"we are concerned not with economics but with law. The distinction between the two is fundamental"*.

5. Despite the importance of this distinction, the courts have always been wary that there must be some limit to the protection afforded by limited liability in order to ensure that business dealings remain honest. Just a free market economy relies upon the role of limited liability companies (they allow individuals to take economic risks that they otherwise might not), it also relies on a degree of fairness in the dealings. This was recognised in the dicta of Denning LJ in *Lazarus Estates Ltd v Beasley* [1956] 1 QB 702, where he said at page 712 that:

   "No court in this land will allow a person to keep an advantage which he had obtained by fraud. No judgment of a court, no order of a Minister, can be allowed to stand it if has been obtained by fraud. Fraud unravels everything. The court is careful not to find fraud unless it is distinctly pleaded and proved; but once it is proved, it vitiates judgments, contracts and all transactions whatsoever..."

6. It is this statement of principle that underpinned all of the early attempts to pierce the corporate veil; the court would not allow a corporate personality to be used to protect individuals from wrongdoing. Fraudulent actions would not be protected, nor would those where the limited company was simply being used as a facade or a sham.

7. It is important to emphasise that burden of proving fraud is a heavy one, and that allow the court to interfere with the corporate veil simply to prevent unjust results. This was acknowledged by Lord Keith of Kinkel in *Woolfson v Strathclyde Regional Council* 1978 S.C.

(HL) 90, where he commented at page 96 that *"it is appropriate to pierce the corporate veil only where special circumstances exist indicating that it is a mere facade concealing the true facts"*.

8. A similar comment was made by Slade LJ in *Adams v Cape Industrial Plc* [1990] CH 433, commonly regarded as one of the leading cases on the principle of piercing the corporate veil. Although circumstances would often arise where it would be unfair for an individual to be able to take advantage of the corporate veil, that alone would not be enough for the court to take action (see page 536):

"...the court is not free to disregard the principle of Solomon v A Solomon & Co Ltd [1897] AC 22 merely because it considers that justice so requires. Our law, for better or worse, recognises the creation of subsidiary companies, which though in one sense the creatures of their parent companies, will nevertheless under the general law fall to be treated as separate legal entities with all the rights and liabilities which would normally attach to separate legal entities."

9. The strictness of this approach led to a principle of piercing the corporate veil that existed more as a matter of legal theory than it did a feature of legal practice. Judges were clear when the veil could not be pierced, but, absent a clear case of fraud, less clear about when they could. The leading cases, such as the decision in Munby J in *Ben Hashem v Al Shayif* [2009] 1 FLR 11, seemed to pose more questions than they answered in terms of when the principle could be applied.

10. This confusion is perhaps best illustrated by the decision of Sir Andrew Morritt V-C in *AB v Smallbone (No 2)* [2011] 1 WLR 1177, where he sought to classify the circumstances in which the veil could be pierced as those where (i) the company was a sham or (ii) it was involved in some form of impropriety. As with a test of fraud though, Sir Andrew's formulation is difficult to apply. In what circumstances is a company a sham? Must it be established for a sham purpose or can a legitimate company become a sham company in certain circumstances? Most significantly, what constitutes impropriety for these purposes? Did the company need to be doing something illegal or would simple immorality suffice? In what circumstances would a company have the illegal or immoral actions of an individual imputed to it?

11. These principles then marked the state of the law in relation to piercing the corporate veil preceding the decision in *Prest*.

<u>Practice in the Family Division</u>

12. Before moving on to consider the decision in *Prest*, a few brief comments are needed about the practice within the Family Division of the High Court during the development of the line of case law discussed above. The need for this discussion will be evidence from the facts in *Prest*.

13. Whilst it was commonly accepted within the Chancery Division that *the interests of justice* were not a sufficient basis for seeking to pierce the corporate veil, the Family Division took the opposite view. From the mid 1980s onwards it became common for the corporate veil to be pierced in ancillary relief proceedings due to concern about divorcing spouses (usually the husbands) seeking to conceal their assets. In cases such as *Green v Green* [1993] 1 FLR 326 and *Mubarak v Mubarak* [2001] 1 FLR 673, orders were made against company property when it was *just and necessary* to do so.

14. Bizarrely, different divisions of the High Court had adopted contradictory approaches to the same problem. One viewed the concept with suspicion (some even doubting that it in fact existed). The other would happily embrace it when the interests of justice so required.

<u>Prest v Petrodel Resources Limited</u>

15. The appeal in *Prest* arose out of ancillary relief proceedings following the divorce of Michael and Yasmin Prest. Those names might be familiar to some of those reading theses notes as the actions of multi-millionaire oil tycoon Mr Prest received the attention of the national media between 2008 and 2011. Although the division of assets was itself simple enough (Moylan J

awarded Mrs Prest £17.5 million plus £24,000 per annum and the school fees of the four children) those assets, mainly in the form of residential property, were held by various companies owned and controlled by Mr Prest. Throughout the proceedings, Mr Prest argued that as the companies were not being used for any improper purposes (the properties were held by the companies for tax purposes long in advance of the divorce) the properties could not be touched due to the operation of the corporate veil.

16. At first instance, Moylan J ordered both Mr Prest and the seven companies he controlled to transfer the matrimonial home and a further seven properties into Mrs Prest's name. He also made three of the companies jointly and severally liable for 10% of Mrs Prest's legal costs. Interestingly though, the judge reached these decisions not on the basis of piercing the corporate veil (he accepted the argument that this was something he could not do absent clear impropriety), but concluding that he had a wider discretion under section 24 of the Matrimonial Causes Act 1973. This approach was then overturned by the Court of Appeal, with a majority holding that such orders could only be made where (i) the corporate personality of the company was being abused a purpose which was in some relevant respect improper, or (ii) on the facts of a particular case, it could be shown that an asset legally owned by a company was held on trust for the husband. Mrs Prest appealed.

17. The leading judgment in the Supreme Court was given by Lord Sumpton JSC. Having outlined the developments in the case law, including the debate about whether a power to pierce the corporate veil truly existed, he summarised the position of the law at paragraph 27 as follows:

> *"In my view, 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. It is true that most of the statements of principle in the authorities are obiter, because the corporate veil was not pierced. It is also true that most cases in which the corporate veil was pierced could have been decided on other grounds. But the consensus that there are circumstances in which the court may pierce the corporate veil is impressive. I would not for my part be willing to explain that consensus out of existence. This is because I think that the recognition of a limited power to pierce the corporate veil in carefully defined circumstances is necessary if the law is not to be disarmed in the face of abuse. I also think that provided the limits are recognised and respected, it is consistent with the general approach of English law to the problems raised by the use of legal concepts to defeat mandatory rules of law."*

18. He then turned at paragraph 28 to address the key unanswered question from the previous cases, namely the nature of the impropriety that was required in order for the veil to be pierced:

> *"The difficulty is to identify what is a relevant wrongdoing. References to a "facade" or "sham" beg too many questions to provide a satisfactory answer. It seems to me that two distinct principles lie behind these protean terms, and that much confusion has been caused by failing to distinguish between them. They can conveniently be called the concealment principle and the evasion principle. <u>The concealment principle is legally banal and does not involve piercing the corporate veil at all. It is that the interposition of a company or perhaps several companies so as to conceal the identity of the real actors will not deter the courts from identifying them, assuming that their identity is legally relevant</u>. In these cases the court is not disregarding the "facade", but only looking behind it to discover the facts which the corporate structure is concealing. <u>The evasion principle is different. It is that 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, and a company is interposed so that the separate legal personality of the company will defeat the right or frustrate its enforcement</u>. Many cases will fall into both categories, but in some circumstances the difference between them may be critical. This may be illustrated by reference to those cases in which the court has been thought, rightly or wrongly, to have pierced the corporate veil."* (Emphasis added).

19. Lord Sumption then went on to analyse a number of cases where the corporate veil was said to have been pierced (*Gilford Motor Co Ltd v Horne* [1933] CH 935, *Jones v Lipman* [1962] 1 WLR 832, *Gencor ACP Ltd v Dalby* [2000] 2 BCLC 734 and *Trustor AB v Smallbone (No 2)*

[2001] 1 WLR 1177). In his view, only the first two of those cases actually involved the evasion principle – a true piercing of the veil – whilst the others, and indeed most so-called piercing cases, involved nothing more than the concealment principle. The court had repeatedly regarded itself as piercing the corporate veil when, in fact, it was doing nothing of the sort.

20. Following his discussion of the piercing cases, Lord Sumption summarised the requirements for the evasion principle to be established, stating at paragraph 35 that:

"I conclude that there is a limited principle of English law which applies when a person is under an existing legal obligation or liability or subject to an existing legal restriction 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. 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 ... But the recognition of a small residual category of cases where the abuse of the corporate veil to evade or frustrate the law can be addressed only by disregarding the legal personality of the company is, I believe, consistent with authority and with long-standing principles of legal policy."

21. On that basis of Lord Sumption's two principles, Mrs Prest could not succeed against her husband by piercing the corporate veil. Mr Prest had not been under an existing legal obligation that his companies had sought to frustrate or avoid so this evasion principle did not apply. The veil could not, on a proper understanding of the term, be pierced. Further, the corporate veil did not act to hide the true relationship between Mr Prest and his companies. The concealment principle was not therefore made out.

22. Sadly for Mr Prest though (if not for anyone else), the Supreme Court went on to find that the companies held the relevant properties for him on trust, thus giving him an interest to which the provisions of the Matrimonial Causes Act could attach. The battle on the scope of the corporate veil had been won, but the war lost.

<u>The Two Principles</u>

23. The two principles outlined by Lord Sumption are worthy of further analysis because of the way in which they completely dissect over 80 years of case law. There is no longer a single principle governing when the protection provided by limited liability can be overcome. Further, we should no longer look to identify a facade or sham company, or impropriety touching both the individual and the company. We should instead look to identify one of two separate circumstances (albeit both may occur at the same time) in which the corporate personality can be cast aside.

24. <u>The concealment principle</u>. This is where a corporate personality is simply being used to hide the true position. Where this occurs, the court will look to 'lift' the corporate veil to reveal the true picture. As Lord Sumption explained at paragraph 31, the court will not be deterred by the legal personality of a company from enquiring into the legal relationship between a company and an individual. Importantly, the concealment principle does not rest or rely on a finding of impropriety, simply the fact of concealment (see paragraph 32).

25. This principle will apply where a company is acting as agent or nominee of an individual and receiving property on their behalf. A common example will be a director setting up a limited company to receive secret profits, or moneys obtained in breach of fiduciary duty. Where this occurs, there will be an equitable claim for the money against both the company and the individual.[1] The principle will also be seen where an individual tries to use a company to hide

[1] Technically this principle is not confined to the use of corporate personalities, but in fact any situation where an agent or nominee is used, and where the funds cannot otherwise be recovered by establishing the they are held on trust for the individual.

actions that are actually his. This will commonly be seen within the context of restraint of trade clauses.

26. Where the concealment principle applies, the remedy will be straightforward, with the court able to make any order against the individual that it would be able to 'but for' the interposition of the company. The company will in turn be susceptible to remedies that could be ordered against the individual on the basis that it is simply acting as the individual's agent. Further, discovery of the true legal relationship between the individual and the company will make the imputation of knowledge between the two much easier to achieve.

27. For the sake of completeness, the writers take the view that the boundaries of this principle are extremely unclear. Whilst it may be easy to identify where a company receives funds on behalf of an individual, determining when the actions of a company are being used to conceal those of an individual are less clear cut.

28. <u>The evasion principle</u>. This is the only situation in which the protection provided by limited liability will actually be impugned or pierced. It rests on the principle of an individual being under an *existing* obligation that he seeks to avoid through the use of a corporate personality *under his control*. The simple fact that a corporate personality is used to incur a liability and shield the individual is not sufficient; it must be to protect the individual from a claim (or enforcement of a claim) pre-dating the involvement of the company.

29. The best example of the evasion principle is the case of *Jones v Lipman* discussed by Lord Sumption. There, an individual entered into a contract for the sale of a property before changing his mind. In order to avoid a claim for specific performance of the contract, he sold the property to a company he had purchased, hoping to protect himself from an action for specific performance. The evasion principle allowed an order for specific performance to be made against the company; the individual's attempt to avoid his contractual obligations meant that the legal distinction between the two could be pierced and the same remedy ordered against each.

30. Within a wider commercial context, a director who establishes a limited company to carry out acts that would, if carried out by the director personally, amount to a breach of fiduciary duty, will also be an example of the evasion principle. In these circumstances though, the concealment principle would also apply.

31. Where the evasion principle applies, the remedy is an assignment or sharing of any remedy that would be available against the individual between the individual and the company. The concept has attracted much criticisms (how, for example can a further source of liability simply be created absent an assignment), but appears to be the intended outcome following *Prest*.

<u>What the Other Judges Thought</u>

32. Despite the clarity of Lord Sumption's judgment, his views were not universally accepted by the Supreme Court, with even those who agreed with him stating some degree of reservation about the extent to which the principle of piercing the corporate veil could be defined.

33. Whilst agreeing with Lord Sumption's analysis, Lord Neuberger expressed the view that the doctrine should only be invoked (or rather the court should only allow it to be invoked) where all other means of enforcement had failed (see paragraph 62). To this extent, he expressly disapproved of the view taken by the Court of Appeal in the earlier case of *VTB* [2012] 2 Lloyd's Rep 313.

34. Further, much of Lord Neuberger's judgment was actually directed at questioning whether the doctrine in fact existed, and to the extent it did, whether it had ever been successfully invoked. Although he accepted that the Supreme Court should not disregard the doctrine as it provided a potentially useful tool to undo wrongdoing (see paragraph 80) this conclusion was reached with a great deal of hesitation. He was also clear (see paragraph 83) that the doctrine may not need

to be invoked at all in many cases as the requirement that the company was under the control of the individual meant that often concepts of agency or trusteeship would apply. [2]

35. Lady Hale (with whom Lord Wilson agreed) questioned the distinction drawn by Lord Sumption between concealment and evasion, suggesting at paragraph 92 that there might simply be a principle that *“individuals who operate limited companies should not be allowed to take advantage of the people with whom they do business.”* She also drew a distinction between an action to pierce the veil to go after an individual (accepting Lord Sumption’s view of the need for an existing obligation etc) and converting the liability of an individual into that of the company, something that in her view would rely on concepts of agency and the *“directing mind”*.

36. Lord Mance expressly left open the possibility of extending the doctrine, whilst at the same time echoing the wider view that due to the wide range of tools open to the court (i.e. concepts of agency and trusteeship) any further extensions are unlikely to arise.

37. Lord Clarke, agreeing with Lord Sumption, echoed the same reservations as Lord Neuberger that the doctrine must be a matter of last resort where all conventional remedies have proved of no assistance (see paragraph 103).

38. Finally, Lord Walker, whilst accepting that the doctrine existed, remarked that it was often nothing more than an incoherent label to describe the disparate occasions on which the court had created exceptions to the distinction drawn between individuals and companies in *Salomon*. His view was that these exceptions could arise as a matter of statute, tort, unjust enrichment, equity or the law of trusts.

Cases Following Prest

39. Perhaps unsurprisingly given the limited scope of the doctrine following *Prest*, there have been very few cases dealing with the concept of piercing the corporate veil. The writers’ own experience is that judges are now incredibly wary of seeking to pierce the veil given the strict criteria laid down in *Prest*. They are though more likely to use other methods of enforcement, such as the law of agency and concepts of trusteeship, safe in the knowledge that these tools do not involve an assault on the corporate facade.

40. For civil practitioners, the most helpful case is probably the decision of Mrs Justice Rose in *Pennyfeathers Limited v Pennyfeathers Property Company Limited* [2013] EWHC 3530, a case involving the proposed residential development of a parcel of farmland. The two original investors (C2 and C3) took out an option to purchase the land, before being joined by two further investors (D2 and D3) with whom they formed a limited company (C1) to exploit the opportunity. All four men became directors. Following further negotiations it was agreed that D2 and D3 would buy-out C2 and C3 and obtain complete control of C1.

41. In anticipation of the buy-out, D2 and D3 formed their own company (D1) which purchased the farm and began to take out options on surrounding parcels of land. A dispute then arose between the four individuals (to which the companies became parties) about whether D2 and D3 had placed themselves in a conflict of interest between C1 and D1, and moreover whether they had breached the fiduciary duties they owed as directors of C1. D2 and D3 sought to avoid liability be arguing, *inter alia*, that D1, a separate limited company, had undertaken the purchase.

42. Giving judgment for the claimants, Rose J applied both the concealment and evasion principles in order to prevent D2 and D3 from sheltering behind D1. In terms of the initial purchase, should found (at paragraph 117) that D2 and D3 had acted in breach of their fiduciary duties in seeking to direct the opportunity to develop the farm to another entity. The concealment principle meant that the law would not allow D2 and D3 to hide their conduct behind the actions of D1.

[2] This is of course the basis upon which Mrs Prest’s appeal ultimately succeeded.

43. More importantly, Rose J held that the evasion principle meant that the benefits of the contracts entered into by D1 would be held on trust for C1 as if they had been entered into by D2 and D3 themselves (n.b. D2 and D3 did not actually own D1 directly, but through two further holding companies). Interestingly, Rose J held that she did not need to find that D1 was controlled by D2 and D3 for the evasion principle to apply,[3] and therefore specifically refused to make findings on the state of knowledge of D1.

44. It has to be said that *Pennyfeathers* is probably a better example of facts giving rise to the principle of piercing the veil than it is a helpful analysis of the law. In the writers' view, Rose J's reading of *Prest* is questionable, not least as her comments at paragraph 119 seem to contradict the clear test for the evasions principle set out at paragraph 35 in *Prest*. It is also questionable whether this is a case that actually sees the correct application of the concealment principle. By way of example, D2 and D3 would not have been able to hide behind D1; their breach of fiduciary duty was to pass on the information about the opportunity to purchase the farm to D1, not the exploitation of that opportunity.

45. A slightly more unusual invocation of the doctrine came in the case of *Antonio Gramsci Shipping Corporation v Lembergs* [2013] EWCA Civ 730, in the context of a dispute over jurisdiction. The claimant in that case sought to pierce the corporate veil in order to bring proceedings in England against an individual based overseas (Mr Lembergs) who was accused of interposing a company to conceal his own wrongdoing.

46. Most of the argument in the case involved principles of EU law and whether the defendant could be said to have consented to the jurisdiction of the English courts. The *Prest* point only constituted a fallback 'policy' argument on the approach the court should take. Despite this, the comments of Court of Appeal give useful clarification on the proper interpretation of *Prest*, stating at paragraph 65 that:

"The references in Lord Sumption's judgment in Prest v Petrodel Resources Ltd and others [2013] UKSC 34 (at [27] and [34]) to "abuse of corporate legal personality" as justifying piercing the corporate veil may appear to give some support to a policy-based approach. But it is clear from the decision of the Supreme Court that, in the present state of English law, the Court can only pierce the corporate veil when "a person is under an existing legal obligation or liability or subject to an existing legal restriction which he deliberately evades or whose enforcement he deliberately frustrates by interposing a company under his control": see [35], [60] and [98]. Lord Mance and Lord Clarke (see [100] and [103]) did not want to foreclose further development of the law, and Lady Hale's approach (at [91] – [92] appears to be to the same effect, but that is where English law stands at present. In the light of the decisions in VTB Capital and Prest v Petrodel, the submission that it is possible to pierce the corporate veil in this case to deem Mr Lembergs to have consented to the jurisdiction clause is untenable."

47. The court then went on to explore the possibility of extending the doctrine as envisaged by Lord Mance, stating at paragraph 66 that:

"As to further development of the law, doing so by classical common law techniques may not be easy. In Prest's case Lord Sumption (at [28]) identified two underlying principles which he called "the concealment principle" and "the evasion principle". But Lord Neuberger was of the view (at [75]) that there is a "lack of any coherent principle in the application of the doctrine of "piercing the corporate veil", and Lord Walker's view (at [106]) was that it is not a doctrine in the sense of a coherent principle or rule of law but a label. Lady Hale (at [92]) was "not sure whether it is possible to classify all of the cases in which the courts have been or should be prepared to disregard the separate legal personality of a company neatly into cases of either concealment or evasion". <u>Absent a principle, further development of the law will be difficult for the courts because development of common law and equity is incremental and often by</u>

[3] We have slightly simplified the facts as there were two holding companies between D1 and D2/D3 intended to give a sufficient degree of separation for tax purposes (the evidence was that D1's board took its own independent decisions, albeit it acted on recommendation from D2 and D3). The judge found though that the beneficial ownership of the shares in D1 was, through these companies, owned by D2 and D3, thus allowing the benefit of the contracts to be transferred.

analogical reasoning. ... The position in this context appears similar to the former position in the area of law now recognised to be governed by the principle against unjust enrichment. So, in Orakpo v Manson Investments Ltd [1978] AC 95 at 104 Lord Diplock stated the circumstances in which a person who discharged the debts of another may recover the sums so paid defeated classification except as an "empirical remedy". He stated that made "particularly perilous [is] *any attempt to rely on analogy to justify applying to one set of circumstances a remedy which has been held to be available in another and different circumstances"."*

48. It appears therefore, for the time being at least, extensions of the principle will not be easy to come by.

49. The final case is *Regina v Peter Sale* [2013] EWCV Civ 1306, an appeal against a confiscation order made under the provisions of the Proceeds of Crime Act 2002. The case is interesting as it deals with the interplay between the civil law on corporate separation and the approach taken by the criminal courts to the separation between individuals and companies for the purposes of recovering the proceeds of crime.

50. The underlying criminal proceedings involved illegal payments (both direct and by way of hospitality) made to a Network Rail employee by Mr Sale with the intention of winning work for his company. Although the employee in question died before the case could reach trial, Mr Sale was convicted of corruption and fraud by false representation. The Crown then sought to recover the sums paid to the company (n.b. not simply the profits received by Mr Smith) as being the proceeds of crime.

51. The leading judgment of the Court of Appeal was given by Lord Justice Treacy, who summarised the application of the principles in *Prest* at paragraph 39:

"The first question for us is the correct approach to the finding of a benefit figure. Should it be assessed by reference to the Appellant's personal position or by reference to the activities of the company? It is clear to us from Lord Sumption's analysis of the concept of piercing the corporate veil in Prest, that there has in the past been some confusion of nomenclature in this respect. We are not persuaded that this is a case coming within the evasion principle referred to at paragraph 28 of Prest. This is because in this case there was no legal obligation or liability which was evaded or frustrated by the interposition of the company in this case whereby the interposition of the company would mean that the separate legal personality of the company would defeat the right or frustrate its enforcement. This was a company which existed long before this corrupt conduct, and which existed for bona fide trading purposes: there was no interposition of the sort described.

52. Before turning to the concealment principle at paragraph 40:

We do, however, consider that in the circumstances of this case, the effect of POCA is that this matter falls within the concealment principle. Thus, we accept the Crown's argument, rather than that put forward by Mr Goose, who himself accepted that the matter was one of fact and degree. In the circumstances of this case, where the Appellant was the sole controller of the company, and where there was a very close inter-relationship between the corrupt actions of the Appellant and steps taken by the company in advancing those corrupt acts and intentions, the reality is that the activities of both the Appellant and the company are so interlinked as to be indivisible. Both entities are acting together in the corruption."

53. The writers would query whether this analysis of the concealment principle is correct. The heart of the Court of Appeal's reasoning was that the effect of POCA was to ensure that the case fell within the concealment principle, but this statement does not make sense. As per Lord Sumption at paragraph 31 in *Prest*, the concealment principle is concerned with the court ascertaining the correct legal relationship between the individual and the company (i.e. the company being mere agent or nominee). The statutory backdrop provided by POCA does not have any bearing on the relationship between Mr Smith and his company. More importantly, the company was not being used to hide Mr Smith's illegal actions; those legal actions only

took place to benefit the company. It was not a situation where the company received payments from Network Rail as a nominee of Mr Smith.

54. Despite these reservations though, it appears that *Smith* slightly extends the concealment principle allowing it to be applied where an individual and company act in tandem. Where that occurs, the individual will not be able to disavow payments received by the company.[4]

Conclusions following Prest

55. It seems to the writers that the following points can be taken from judgments of the Supreme Court in *Prest* and the cases that have followed it:

i. The clear distinction between corporate and personal liabilities as established in *Salomon v Salomon* has been confirmed;

ii. The primacy of the separation between personal and corporate liabilities can be overcome in the case of fraud. The breadth and depth of this principle is unclear though as it was not addressed by the Supreme Court (n.b. the principle of piercing the corporate veil was developed on different grounds meaning by implication that fraud was not required for the principle to be made out);

iii. The historic cases have made mistakes of classicisation and have described the veil as being pierced when it is not. The court should distinguish between piercing of the veil and its mere lifting. The former will be very rare and usually accompanied by the latter;

iv. Lifting the corporate veil applies where a company is being used to *"conceal the identity of the true actors"* (paragraph 28). Obvious examples of this are where a company receives funds for an individual, and where an activity is carried out in the name of a company to hide the fact it is actually being carried out by an individual. The boundaries of this principle are though incredibly unclear;

v. Piercing the veil only applies where *"a person under an existing legal obligation or liability or subject to an existing legal restriction which he deliberately evades or whose enforcement he deliberately frustrates by interposing a company under his control"* (paragraph 35). The case of *Pennyfeathers* though suggests that actual control over the company might not be needed;

vi. The veil can only be pierced as a matter of last resort (paragraphs 35, 62 and 103);

vii. There may be some scope for extending the principle (paragraphs 100 and 103) though the Court of Appeal thinks that this is unlikely in practice (see *Antonio Gramsci Shipping*);

viii. The courts have had, and are likely to continue to have, trouble applying the newly restricted scope of the doctrine;

ix. There is actually no need to have a company to allow the concepts of evasion and concealment to be applied. It works with two individuals (or alternatively different companies); and

x. All of this may well be irrelevant if, on the facts, you can establish that a company holds assets on trust for an individual or vice versa. The court has a number of tools at its disposal that allow the corporate veil to be overcome without it being pierced (n.b. these will always be extremely fact sensitive).

[4] This concept of acting in tandem obviously owed much to concepts of criminal law. It is questionable if an individual and a company would act in tandem in the same way for the purposes of civil proceedings..

Non-Party Costs

56. The above discussion on lifting and piercing the corporate veil is mainly of assistance to those bringing claims; the doctrine is used to access assets that might otherwise be unavailable, or to attack conduct that might otherwise be protected. What then of the opposite situation where a claim is brought by a corporate entity and successfully defended, only for the successful party to realise that they are unable to recover their costs as the party brining the claim has little or no assets at their disposal? In these circumstances, we turn to consider what for the purpose of this talk has been called sidestepping the corporate veil; the court's jurisdiction to make non-party costs orders.

57. It is important to stress at the outset that the law relating to non-party costs orders is legion; there is simply not time to consider it all here. Instead, this talk is confined to those situations where the jurisdiction is used to go-behind the corporate personality and make costs orders against the person or persons in control of a company (i.e. the directors and shareholders). Although similar generic considerations apply to non-party costs orders against other entities (such as indemnity insurers) the particular nuances in those cases would be the subject of a further talk.

The Law

58. The ability of the court to make costs orders is conferred by section 51 of the Senior Courts Act 1981, which states as follows:

"(1) Subject to the provisions of this or any other enactment and to rules of court, the costs of and incidental to all proceedings in—

(a) the civil division of the Court of Appeal;

(b) the High Court; and

(c) any county court,

shall be in the discretion of the court.

(2) ...

(3) The court shall have full power to determine by whom and to what extent the costs are to be paid."

It was initially thought that this power could only be exercised as between parties to proceedings; however, this view was overturned by the decision in *Aiden Shipping Company Limited v Interbulk Limited (The Vimeira) (No 2)* [1986] AC 965., where the House of Lords held that the statutory provision contained a wide discretionary power that should not be regarded as being subject to any implied restriction on its use.

59. Following the landmark decision in *Aiden Shipping*, guidance on the exercise of the court's discretion was given by the Court of Appeal in *Symphony Group Plc v Hodgson* [1993] 3 W.L.R. 830. Giving the leading judgment, Balcombe LJ identified at pages 193 and 194 nine points of principle:

i. A non-party costs order will always be exceptional;

ii. It will be even more exceptional where the non-party could have been joined to the action at the outset as the party seeking the non-party costs order has or had a cause of action against him;

iii. Even if there is a good reason for not joining a non-party against who there is a cause of action, the non-party should be warned at the earliest possible opportunity of the intention to apply for costs against him;

iv. An application for non-party costs should normally be determined by the trial judge;

v. The fact that the trial judge may have expressed views on conduct during the course of proceedings should not be considered actual or apparent bias;

vi. The procedure is a summary one and judicial findings on matters of fact between the parties will not be binding as against the non-party;

vii. The ability to order non-party costs against an individual or a company they represent is an exception to the rules that witnesses should be able to give evidence without fear of suit or prosecution;

viii. The fact that an employee gives evidence in an action it does not necessarily mean that the company is taking part in the action; and

ix. The judge should be alert to the fact that an application for non-party costs might simply be sought out of frustration at not being able to recover costs from a legally aided person.

60. More recently, a gloss has been placed on these comments by the decision of the Privy Council in *Dymocks Franchise Systems (NSW) v Todd* [2004] UKPC 39, [5] where Lord Brown substantially watered down the requirement of ‘exceptionality’, stating at paragraph 25 that:

“Although costs orders against non-parties are to be regarded as ‘exceptional’, exceptional in this context means no more than outside the ordinary run of cases where parties pursue or defend claims for their own benefit and at their own expense. The ultimate question in any such ‘exceptional’ case is whether in all the circumstances it is just to make the order. It must be recognised that this is inevitable to some extent a fact specific jurisdiction and that there will often be a number of different considerations in play, some militating in favour of an order, some against.”

61. Lord Brown then continued to explore the circumstances where a non-party costs order would or would not be made. Having made the above comment, he stated elsewhere in paragraph 25 that a non-party costs order would not usually be made against a pure funder of litigation (i.e. someone who does not seek to benefit from it), but that it would where a non-party not simply funds, but also controls litigation or seeks to benefit from it. This was justified by Lord Brown on the basis that *“the non-party in these cases is not so much facilitating access to justice by the party funded as himself gaining access to justice for his own purposes.”* [6]

62. Following *Dymocks*, the question is whether the non-party can be considered to be *‘a real party’* to the litigation. Use of the word *‘a’* is deliberate as Lord Brown was clear at paragraph 25 that the non-party did not need to be the only real party to the litigation (i.e. with the claimant acting as a nothing more than a nominal claimant) so long as the non-party was a real party in important and critical respects.

63. As well as watering down the requirement of exceptionality, the decision in *Dymocks* also saw the requirement of the need for a clear causal relationship between the actions of the non-party and the costs sought to be recovered. Although Lord Brown stated at paragraph 20 was that it would *“ordinarily”* be necessary to establish causation, Richards J interpreted this comment in *Total Spares & Supplies Ltd v Antares SRL* [2006] EWHC 1537 as meaning that causation could not be considered a necessary pre-condition. Both cases do though stress that causation will often be a vital factor, and – save for cases of fraud – the writers struggle to see circumstances where the court would exercise its discretion absent such a causal link.

<u>The Requirement for Notice</u>

[5] Although not binding, the approach taken by the Privy Council was approved by the Court of Appeal in *Goodwood Recoveries Ltd v Brown* [2005] EWCA Civ 414.
[6] See also the earlier comments of Philips LJ in TCA Chapman v Christopher [1998] 1 WLR 12, where the non-party insurers were described as *“...defendants in all but name”*.

64. The most controversial aspect of the guidance set out by Balcombe LJ in *Symphony* is the requirement that the non-party is put on notice of the application to apply for a costs order against them. In the early days following *Symphony*, this was seen as a threshold requirement, with courts refusing to make orders where notice had not been given. This of course led to a further debate on what notice needed to be given of and when.

65. More recently, it has been accepted that there is no threshold requirement for the non-party to be put on notice (see in particular the decision of Proudman J in *Europeans Ltd v Commissioners for HM Revenue and Customs* [2011] EWHC 948). Failure to give notice though is seen by the court as a highly material consideration, such that the making of an order will be unlikely where notice is not given.

66. It also follows that the earlier notice is given, the better, with Lewison J commenting in *Brampton Manor (Leisure) v McLean* [2007] EWHC 3340 that it was appropriate on the facts of that case to restrict entitlement to until a reasonable period of time the notice had been given to enable a party to consider its position. The ideal notice will therefore be that which warns the non-party that their actions are inappropriate, and warns of non-party costs consequences if they do not stop. This will not be appropriate in all cases (for example you might not know that the company is worth buttons until the end of the litigation), but is best does as soon as the suspicion that the director or shareholder is driving the litigation arises.

<u>Claims against Directors and Shareholder</u>

67. The most striking case of a court making a non-party costs order against a director was that of *Secretary of State for Trade and Industry v Aurum Marketing Limited* [1999] 2 B.C.L.C. 498, in which a director (who was also the sole shareholder) was ordered to pay both the costs of both the Secretary of State and the company of winding up proceedings. The costs order was made on the basis that the company was being used by the director to swindle members of the public. Despite the findings of misconduct though, the case is significant as it saw Court of Appeal emphasise that there did not need to be bad faith, abuse of process, impropriety or procedural manipulation in order for a non-party costs order to be made. It was sufficient that it was *just* for an order to be made.

68. A slightly different approach was taken in the case of *Secretary of State for Trade and Industry v Backhouse* [2001] EWCA Civ 67 where the Court of Appeal overturned a costs order made against a director. The view taken was that, absent special circumstances, the director should not be made personally liable where he had a bona fide belief that (i) the company had an arguable defence; and (ii) it was in the company's best interests to defend the claim. These two elements are seen by some as providing a threshold that any application would need to come. Whilst the writers would not necessarily go that far bearing in mind subsequent authority, these two elements should form the first part of any assessment of the merits of a claim against a director.

69. Despite the protective approach in *Backhouse*, it appears to be settled law that there is no requirement to find impropriety on the part of a director before he can be made the subject of a non-party costs order.[7] In *Goodwood Recoveries Ltd v Breen* [2005] EWCA Civ 414, the Court of Appeal held that a costs order could be made against a director who became 'a real party' by controlling litigation for his own benefit (n.b. he did not need to fund it as his solicitors were acting on a CFA) even where he acted in good faith. The same approach was taken in *BE Studios Ltd v Smith and Williamson Ltd* [2005] EWCA Civ 1583 where the director was shown to have taken control of proceedings for his own benefit; Lombe J found there was no need to establish impropriety on the part of the director in the prosecution of the claim by the company.

70. A further example of where a non-party costs order will be made is where the case hinges around the involvement of the director, such as in *Brampton Manor (Leisure) v McClean* [2007] EWHC 3340. Following *Symphony Group*, Lewison J in *Brampton* found that the key issue in

[7] At paragraph 33 of *Dymocks*, Lord Brown stated (albeit obiter) that whilst impropriety or the pursuit of speculative litigation would support a non-party costs order, their absence would not preclude it.

the exercise of his discretion was the closeness of the director to the party to the action, rather than the quality of his judgment in deciding to fight the claim. Here, the case was fought solely on the basis of facts known by the director, with him effectively running the litigation.. Although directors obviously have a prominent role in the decision to litigate, the court found that however widely the director's duties were drawn they did not include funding and conducting litigation on behalf of the company.

71. *Brampton* therefore provides a neat counterpoint to *Backhouse*. Whilst a director is perfectly entitled to instruct a company under his control to pursue a claim he considers in the interests of the company, he is not entitled to fund and control that litigation on the company's behalf.

72. An even starker example of when a non-party costs order may be made is where a director gives dishonest or untruthful evidence to support a claim. See *Chantrey Vellacott v Convergence Group Plc* [2007] EWHC 1774, where the director had funded and controlled proceedings that should never have been brought leading to an award of indemnity costs.

73. Further, a non-party costs order was made against a director in *Alan Philips Associated Limited v Dowling* [2007] EWCA Civ 64, in probably the most obvious example of the court seeking to circumvent the corporate veil. The claimant had incorporated a company which he sought to interpose into contracts without customers realising that was what he was doing (stationary, invoices, the VAT number were all the same). Following the failure of his claim, the Court of Appeal found that the similarity of the interests of the director and the company meant that it would be *"unjust for him now to seek to rely on the separate legal personality of that company in order to avoid a liability for costs which, looking at the matter in the round, he plainly should bear."*

74. Finally, a specific word is needed on the distinction between directors and shareholders. The former, particularly in small companies or where there is a sole director, will always have a role in conducting and controlling litigation; the company can only act through their instructions. Before a non-party costs order can be made, it will need to be shown that their degree of control etc has crossed the line between that of director and that of shadow litigant. The position in respect of shareholders is more straightforward as they will not play an active role in the running of the company. This was reflected it the comments of Chadwick LJ in *CIBC Mellon Trust Company v Stolzenberg* [2005] EWCA Civ 628 at paragraph 24:

"[A]... shareholder is not under a duty to the company in relation to the conduct of litigation. He is not required to decide whether it is, or is not, in the interests and for the benefit of the company to bring of defend proceedings. He does not require the protection of the company's separate corporate personality to enable him to fulfil his role as shareholder in relation to the litigation. If he chooses to involve himself in the company's litigation – thereby usurping the role of the directors – he does so at his own risk."

Procedure

75. As per the above, the court's power to make costs orders is fettered only by the relevant rules of court. In the context of non-party costs orders, this is simply rule 48.2, which requires that before an application is made, a person must be added to the proceedings for the purposes of costs only, and given a reasonable opportunity to attend a hearing at which the court will consider the matter further.

76. The requirements of rule 48.2 give rise to a two stage approach. Firstly, the court will need to be satisfied that there is a sufficient prospect of a non-party costs order being made to make it worth adding the additional party. Secondly, the merits of the application will need to be considered at a contested hearing, at which the respondent to the application should be given a full opportunity to protect their position. In the ordinary run of things, this first stage will be undertaken on the papers, with the latter at a hearing before the trial judge.

77. When conducting the first stage of the assessment, the court will be wary of allowing an application for non-party costs where it is likely to give rise to substantial satellite litigation; the

process is intended to be a summary one, carried out by the trial judge speedily after the conclusion of the case. Unless the application appears straightforward, at least in so far as there is a *prima facie* case to be answered, the court may be reluctant to consider it further. Certainly, the court is unlikely to deal with the first stage on the papers alone unless the application can show that proper notice has been given.

Due to the need to establish either funding or control, parties often seek disclosure as part of this first stage in the hope that this will aid their case. Where such disclosure is sought, the court will apply to four stage test set out by Bake J at paragraph 19 of the judgment in *Thomson v Berkhampsted Collegiate School* [2009] EWHC 2374 QB. Before disclosure is ordered, the court will need to be convinced:

i. Of the strength of the application unassisted by disclosure (i.e. that there is a prima facie case to be answered – a similar test to that applied when the court is considering adding a party)
ii. Of the potential value that disclosure would provide to the fair determination of the application;
iii. Whether on a summary assessment it will be possible to tell whether the documents will be the subject of legal professional privilege; and
iv. That the effect of an order will be reasonable and proportionate in all of the circumstances.

78. If an application for non-party costs is likely to hinge on such disclosure, careful attention will need to be paid to the above test. The court will not allow an exercise of disclosure to become a fishing expedition, and is unlikely to order disclosure simply because it may give rise to evidence showing an arguable case.

<u>Conclusion: Lifting, Piercing & Side-stepping</u>

79. The decision in *Prest* marks a watershed in English legal history, reaffirming after over a century the clear distinctions between the corporate and the individual, and emphasising the difficulties facing those who seek to merge the two. Attempts to pierce the veil in the truest sense will be few and far between. That said, the court is likely to utilise its other 'tools' (i.e. concepts of agency and trusteeship) on an increasingly frequent basis bearing in mind the emphasis placed on their use by the other members of the Supreme Court.

80. Simultaneously, it is clear that the courts are taking an increasingly enthusiastic approach to non-party costs orders where individuals manipulate companies for their own ends. This is in large part because the concept of the 'real party' is a type of concealment principle, albeit one formulated long before it was formally devised in *Prest*. Both strands of the law therefore appear to be moving in the same direction; whilst the court will not willingly pierce the corporate veil, it is increasingly willing to look around or under it in order to establish the true facts or events.

James Wibberley
Guildhall Chambers

Michelle Di Gioia
Gardner Leader Solicitors