

## Will Cayman companies be *Prest* by litigators?

The Supreme Court decision's effect on offshore companies seeking to defend their assets from their principal's creditors

*Prest vs Petrodel Resources & ors* [2013] 2 AC 415

Orlando Fraser Q.C.

### Introduction

1. *Salomon v Salomon* vs Piercing the Corporate Veil – a traditional battlefield for offshore companies.
2. Piercing of the Corporate Veil has been used successfully vs offshore companies, including in Cayman, many times:
  - a. *Trustor v Smallbone* [2001] 1 WLR 1177 – Gibraltar company
  - b. *Gencor v Dalby* [2000] 2 BCLC 734 - BVI company
  - c. *Gramsci v Stepanov* [2012] BCC 182 - BVI companies
  - d. *Penny Feathers Ltd & Ors vs Pennyfeathers Property Co & Ors* [2013] EWHC 3530, a Jersey company
  - e. *Bonotto v Boccaletti* [2001] CILR 120, and in *Alqaisibi v Saad Investments* (2010), re Cayman companies.
3. PCV in various other common law jurisdictions, although the test has been applied differently. In New York, it must be shown that the company is the principal's "alter ego". Alter ego findings are expressly restricted to cases of fraud – *Morris v New York* (1993) 82 NY 2d 135.
4. In England, the Supreme Court last year in *Prest v Petrodel Resources Ltd & Ors* [2013] 2 AC 415 examined this question once again, in the context of a matrimonial dispute, but set out principles of general application.
5. Will *Prest* affect Cayman companies, their vulnerability to claims from their principal's creditors, or the Cayman insolvency process?

**Piercing the Corporate Veil before *Prest v Petrodel***

6. Introduction of limited liability to members of joint stock companies by Parliament in 19<sup>th</sup> century not universally welcomed by Judges . *In re Baglan Hall Colliery* (LR 5 Ch 346) in 1870, VC Malins complained strongly re 1862 Companies Act (fn 1, at page 349-350):

*“Their intention in doing this [ie incorporating] was to go on..without being liable, whatever the extent or effect of their trading might be, to be called on by any labourer, by any tradesman who supplied them with goods, by any person who lent them money, or by any person whatever, to pay a single farthing... if the laws of the country sanction such a proceeding they are in a most lamentable state...”*

7. House of Lords seeks to crush dissent in *A Salomon v A Salomon & Co Ltd*, overturning Court of Appeal, and laying down that incorporation of a company really did mean that a company had a separate life from its owner, even if 100% owned by a single owner. Lord MacNaughten, page 51:

*“When the memorandum is duly signed and registered, though there be only seven shares taken, the subscribers are a body corporate “capable forthwith” to use the words of the enactment “of exercising all the functions of an incorporated company”. Those are strong words. The company attains maturity on its birth..The company is at law a different person altogether from the subscribers to the memorandum and, ....the company is not in law the agent of the subscribers nor trustee for them. Nor are the subscribers as members liable in any shape or form, except to the extent and manner provided for by the Act.*

8. Subsequent judicial development of doctrine of “*piercing the corporate veil*” to get round *Salomon v Salomon*.
9. *Gilford v Horne* 1933 Ch 935, the Court of Appeal granted an injunction restraining Mr Horne’s alter ego company from carrying on a business which he himself had personally covenanted to his previous employers that he would not carry on – on the basis that he had set up his company as mere “*cloak or sham*” to enable him to avoid his restrictive covenant (p961, Hanworth MR).
10. *Jones and Lipman*, 1962 1 WLR 832, Mr Justice Russell granted an order of specific performance to a claimant purchaser against a creature company which had been intentionally set up by the defendant vendor Mr Benny Lipman to hold the property for him so that he could not complete a conveyance to the said purchaser. The Judge held (at page 836) that such a company was “*a device and a sham, a mask which he holds before his face in an attempt to avoid recognition in the eyes of equity*”.

11. After obiter approval of doctrine in Privy Council in *Woolfson v Strathclyde Regional Council* 1978 SC (HL) 90, and CA consideration of it in *Adams v Cape Industries* [1990] Ch 433, VC Morritt gives it modern impetus in *Trustor v Smallbone* 2001 1 WLR 1177, when puppeteer had siphoned off company funds to a Gibraltar offshore puppet wholly under his control in order to defraud his company, and disguise his involvement in it. In finding that the puppeteer was liable to account for the funds the alter ego puppet company had received, the VC was treating receipt by the puppet as being receipt by the puppeteer. Morritt's test:

*"In my judgment the court is entitled to pierce the veil and recognise receipt of the company as that of the individual (s) in control of it if the company was used as a device or facade to conceal true facts thereby avoiding or concealing any liability of those individual(s)."*

12. The English approach to the PCV doctrine was also adopted in the Cayman Islands. In *Bonotto v Boccaletti* [2001] CILR 120 a trustee over a series of years misappropriated trust assets for his and his wife's benefit. Real properties were purchased by them and placed into the names of companies in the Cayman Islands in an attempt to make themselves judgment proof. Graham J held that the veil should be lifted. See also *Walker International Holdings Limited v the Republic of Congo* [2003] CILR 457, when pcv doctrine considered, but veil not lifted in respect of Cayman companies.
13. *Ben Hashem v Al Shayif* [2008] EWHC 2380 (Fam), Munby J seeks to end Family Division different and looser views on pcv, directs that same narrower principles should apply throughout the Courts – sets out principles as :
1. *".. ownership and control of a company are not in themselves sufficient to justify piercing the corporate veil" – rejecting FD practice*
  2. *"...the Court cannot pierce the corporate veil...merely because it is thought necessary in the interests of justice..." – Ld Justice Cumming Bruce heresy in re a Company 1985*
  3. *"... the veil can only be pierced if there is some impropriety..."*
  4. *"...the impropriety must be linked to the use of the company structure to avoid or conceal liability.." adopting the VC's words in Trustor*
  5. *"..if the Court is to pierce the corporate veil , it is necessary to show both control of the company by the wrongdoer and impropriety, that is say (mis)use of the company by them as a device or facade to conceal their wrongdoing.."*

6. *"...a company can be a facade even though it was not originally incorporated with any deceptive intent. The question is whether it is being used as a facade at the time of the relevant transaction..."*
7. *"the Court will pierce the veil only in so far as is necessary to provide a remedy for the particular wrong which those controlling the company have done. In other words, the fact that the court pierces the veil for one purpose does not necessarily mean that it will be pierced for all purposes.."*

14. *VTB v Nutritek & ors* [2012] EWCA Civ 808 - Court declines to extend the doctrine to making the puppeteer a party to his puppet's contract as a remedy. Confirms Munby J principles in *Ben Hashem*, save decided that PCV did not have to be a remedy of last resort. Endorsed by Supreme Court in *VTB v Nutritek & ors* [2013] 2 AC 337.

***Prest v Petrodel Resources – [2013] 2 AC 415***

15. *Prest* - a divorce where the wife claimed ancillary relief in respect of properties (including the matrimonial home) owned by 2 companies incorporated in the Isle of Man which were controlled by her husband. Main issues for our purposes (1) whether the wife was entitled in matrimonial proceedings to pierce the companies' corporate veils in order to obtain ancillary relief against her husband for properties owned by his companies; and if not (2) whether the companies held the properties on trust for the husband, such as they became his assets for the purpose of the matrimonial legislation.
16. Court of Appeal had by a majority of 2:1 decided that she could not, absent any corporate wrongdoing, pierce the veil just because it was a divorce case. This caused furore in the British press (cheat's charter etc) - Supreme Court gives leave to appeal - hearing before a panel of 7 Supreme Court judges - lead judgment given by Lord Sumption.
17. As regards PCV doctrine:
  - a. Lord Sumption, and the rest of the Panel, confirmed that the Family Courts could not go on a frolic of their own, and confirmed that whatever the PCV doctrine was, it had to be applied by them in the same way as the rest of the Divisions of the High Court.
  - b. As regards the PCV doctrine, Lord Sumption's view that Courts had been applying two separate principles in considering PCV – the "evasion principle" (*Gilford v Horne*); and the "concealment" principle (such as had happened in *Jones v Lipman*).

- c. Lord Sumption concluded that the need to pierce the corporate veil did not arise in concealment cases, but instead was confined to circumstances of evasion: see [35]:

*“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.”*

- d. Test approved by Lords Neuberger, Mance and Clarke.
- e. Technically obiter, but can be considered the authoritative statement on the modern PCV test – has been applied since in the Court of Appeal in *Gramsci v Lembergs* [2013] EWCA Civ 730, and in the Chancery division by Rose J in *PennyFeathers vs Penny Feathers Jersey* [2013] EWHC 3530.
- f. Lord Sumption decides that the corporate veil should only be pierced if no other remedy was available: see [35]. Endorsed by all the other Supreme Court judges.
- g. Lord Sumption and Lord Neuberger additionally considered that the laws of agency had, or could have, determined some of the earlier cases, such as both *Gencor v Dalby* [2000] 2 BCLC 734 and *Trustor v Smallbone* [2001] 1 WLR 117.

- 18. PCV decision obiter because Supreme Court in fact used resulting trust to find in the wife’s favour – finding that the properties were beneficially owned by the husband, rather than the companies, on the basis that the husband had provided the companies with the funds to acquire the properties, and there was no evidence to rebut the presumption against a gift.

**Possible impact on Cayman companies of *Prest v Petrodel Resources***

- 19. Initial views:

- a. Narrowing of the PCV doctrine may well not deter attempts by a principal’s creditors to get at Cayman Island company assets. In this respect:
  - i. Hostile litigators seeking to penetrate the veil of Cayman corporate ownership are likely to reach more often for the resulting trust argument, especially where such companies are not trading entities, but seen to be merely holding assets ultimately for their principal.

- ii. The same litigators might also argue (in light of speeches of Lords Sumption and Neuberger) that such Cayman companies might be in an agency relationship with their ultimate principal, such that assets received by the company are actually received by it on behalf of the principal.
  - iii. PCV doctrine will be invoked vs offshore companies where companies are not susceptible to resulting trust or agency arguments, and where Lord Sumption's evasion test is satisfied. See *PennyFeathers* in November 2013.
- b. Possible Cayman insolvency implications of more resulting trust arguments:
- i. Will limitation periods in Cayman anti-avoidance provisions be undermined ?
  - ii. Will principals be more likely to claim a proprietary interest in such assets on any insolvency of their offshore companies ?