

## Piercing the corporate veil and fraud

*This article summarises the principles by which a court may pierce the corporate veil in cases of fraud in light of recent case law.*

### Introduction

The principle of separation between corporate entity and shareholder has been enshrined in English law since the House of Lords' decision in *Salomon v A Salomon and Co Ltd*<sup>1</sup>. Shareholders are often said to exist behind a "corporate veil", protected from liability for the actions of the company. "Piercing" the corporate veil refers to "*treating the rights or liabilities or activities of a company as the rights or liabilities or activities of its shareholders*"<sup>2</sup> and is a controversial step.

The most common and debated reason for potentially piercing the veil is the fraud exception, ie, where a company exists only to disguise the nefarious actions or liability of its shareholders. While recent case law on the topic has generated confusion about the precise application of this exception, the Court of Appeal (as endorsed by the Supreme Court) has now clarified the limitations of this exception.

### Conflicting High Court decisions

In *Antonio Gramsci Shipping Corp and others v Stepanovs*<sup>3</sup>, Burton J held that there was a good arguable case that where a company had been used by its ultimate beneficial owner as a device to commit fraud against the claimant through a series of contracts, the corporate veil should be pierced and the claimant permitted to enforce those contracts against the beneficial owner. It was considered desirable that a victim should be able to enforce agreements against both a puppet company and the puppeteer owner pulling the strings.

In *VTB Capital plc v Nutritek International Corp*<sup>4</sup>, Arnold J criticised this decision. VTB claimed it had been defrauded by the defendant into entering a loan facility with a Russian company, RAP. The loan facility was subject to the non-exclusive jurisdiction of the English courts. The claimant sought to pierce RAP's corporate veil, thus holding the defendant liable under the contract between VTB and RAP. The purpose of this was, in the context of an application by the defendant to set aside the claimant's service out of the jurisdiction, to anchor the claim to England.

Arnold J rejected the claimant's argument and held that *Antonio Gramsci* was wrongly decided. Arnold J considered that courts have only previously pierced the corporate veil when the beneficial owner is using the company in an attempt to protect himself from liability from the consequences of wrongdoing existing outside the company, ie, the independent wrongdoing of the beneficial owner. Arnold J also disagreed with the "puppeteer" reasoning in *Antonio Gramsci*, noting that attempts to make the puppeteer liable on the puppet's contracts give rise to considerable problems.

<sup>1</sup> [1897] A.C. 22, HL

<sup>2</sup> Per Lord Staughton in *Atlas Maritime Co SA v Avalon Maritime Ltd (No.1)* [1991] 4 All ER 769 at 779

<sup>3</sup> [2011] EWHC 333 (Comm)

<sup>4</sup> [2011] EWHC 3107 (Ch)

There were therefore conflicting judgments at first instance, but both judgments were appealed to the Court of Appeal.

### The Court of Appeal decision in VTB

In a landmark judgment, the Court of Appeal dismissed the appeal by VTB, upholding Arnold J's judgment at first instance. The Court of Appeal affirmed the principle of the legal separation between a company and its owners by explicitly rejecting the notion that piercing the corporate veil results in the puppeteer being treated as liable on the puppet's contract. The Court held that English law already provided VTB with a remedy for the harm inflicted on it by way of the tort of deceit, and that the corporate veil could not be pierced simply to alter a contractual claim, rendering the puppeteer, rather than the puppet, liable on fraudulent contracts.

In addition, the Court provided guidance summarising the principles by which a court may pierce the corporate veil:

1. ownership and control of a company are insufficient to justify piercing the veil;
2. a court cannot pierce the veil merely because to do so would be in the interests of justice;
3. the corporate veil can only be pierced when there is impropriety;
4. impropriety "*must be linked to use of the company structure to avoid or conceal liability*";
5. it is necessary to show both control of the company by the wrongdoer *and* impropriety; and
6. a company can be a façade even though it was not incorporated for that purpose – the question is whether it is being used as a façade at the time of the relevant transaction(s).

This decision was confirmed by the Supreme Court on appeal. The Court of Appeal in *Antonio Gramsci* followed suit.

### Implications of the VTB ruling

It is now a clear principle of English law that there is no basis on which a party can pierce the corporate veil in order to make a company's controller a party to a contract entered into by that company. While the ruling clarifies what was otherwise an uncertain area of law, it undoubtedly restricts the English courts' ability to exercise jurisdiction over foreign parties in cases of fraud.

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