

THE CORPORATE VEIL: WHEN WILL IT BE PIERCED?



Introduction

The corporate veil exists to distinguish a company as a legal person separate from its shareholders. However, where the relevant test has been satisfied, the courts have shown a willingness to pierce the veil. The recent case of *Caterpillar Financial Services (UK) Limited v Saenz Corp Limited, Mr Karavias, Egerton Corp & Others*¹ is one of the exceptional cases in which the court exercised its discretion to pierce the veil. HFW acted for Caterpillar Financial Services in a successful application for summary judgment in respect of a declaration that a company was an *alter ego* corporate vehicle of the defendant. This allowed a judgment obtained against the defendant to be enforced against certain of the company's assets. This decision highlights that although very rare the courts will exercise their jurisdiction to pierce the corporate veil.

The corporate veil principle

The courts are often presented with the question of whether a company is an independent legal

entity in cases where litigants are trying to recover from opponents and it is discovered that the contracting party is a brass plate company with no assets but part of a larger, profitable group. Usually the strict principle of independent corporate existence² is applied and the courts will regard the company as separate from its members and the veil will not be pierced.

Piercing the veil

The courts have demonstrated that the veil will not be pierced where, despite the presence of wrongdoing, the impropriety was not linked to the use of the corporate structure as a device or facade to conceal or avoid liability, nor will the courts pierce the veil merely because the interests of justice so require³.

In certain cases group companies will not be treated as separate, which is contrary to the general principle. This was recently demonstrated where a subsidiary company was no longer in existence and the court imposed a duty of care on the parent company for the

1. [2012] EWHC 2888 (Comm), 5 September 2012, Mr Justice Eder.

2. *Salomon v Salomon Co Ltd* [1897] A.C. 22.

3. *Adams v Cape Industries Plc* [1990].



health and safety of the employees of its subsidiary⁴.

Although it is very rare that piercing of the corporate veil is allowed, there have been sporadic attempts by litigants to do so, such as in a recent Court of Appeal case⁵, which is currently being appealed in the Supreme Court, in which the claimant bank had provided US\$225 million under a facility agreement. The funds were used by the Russian borrower, a company, to facilitate acquisitions from the first defendant which was a British Virgin Islands company, owned and operated from Russia. The borrower subsequently defaulted on the loan. The claimant was unable to recover the loan by way of the security provided and alleged that fraudulent misrepresentation by the first defendant induced it to enter into the facility agreement and that the other defendants were jointly liable. Having obtained permission to serve out of the jurisdiction, the claimant was granted a worldwide freezing order against the fourth defendant, which the claimant alleged controlled the first and second defendants. The claimant made an application to amend its particulars of claim to incorporate a contractual claim and argued that the corporate veil should be pierced so that the defendants could be held jointly and severally liable with the borrower on the basis that they controlled the actions of the borrower and they had used the borrower as a device to conceal their impropriety.

The Court of Appeal decided that it would be contrary to principle and authority and therefore not appropriate to pierce the corporate veil to effect a contractual claim from the claimant against those alleged to be controlling the defendant companies, where

those being pursued were not a party to that contract.

Caterpillar Financial Services (UK) Limited v Saenz Corporation Ltd

Caterpillar Financial Services (UK) Limited (the Claimant) advanced loans to the first and second defendant companies for the purpose of the acquisition and construction of two yachts. The first and second defendants defaulted under the loan agreements. The Claimant made demands on the first and second defendants and subsequently terminated the loan agreements. Demands were also made on each of the guarantors of the loans, the third to ninth defendants.

The defendants are, for the most part, connected to the first and second defendant companies, as well as to the third defendant who is the controlling mind of all corporate defendants and also one of the guarantors. The fourth defendant company entered into a guarantee and indemnity in favour of the Claimant in respect of the loans advanced. The fifth, sixth and seventh defendant companies, each provided guarantees or security to the Claimant in respect of the loans. The eighth and ninth defendants, individuals, both provided guarantees in respect of the loan to the second defendant.

The tenth to sixteenth defendants are alter ego corporate vehicles of the third defendant, who directs and controls the actions of the companies.

The Claimant obtained a judgment against the third defendant (the Guarantor), in the hope that it could be enforced against a residential

property (the Property) declared by the Guarantor as one of his assets prior to the loan being advanced.

Throughout the proceedings the Guarantor had asserted that the Property was owned by the fourteenth defendant (the Company) and that he had no beneficial interest in it. In the Claimant's application, it maintained that, had it been presented with these facts, it would not have considered advancing the loans without sufficient security from the Company, which would allow the Claimant to pursue the Company and ultimately enforce a judgment against the Property in the event of default.

The Claimant made an application for summary judgment for a declaration that Company was the *alter ego* corporate vehicle for the Guarantor and that the corporate veil should be pierced to allow the judgment obtained against him to be enforced against any or all assets belonging to the Company.

The decision in Caterpillar Financial Services (UK) Limited v Saenz Corporation Ltd

The relevant tests

The relevant tests that must be met before the corporate veil may be pierced⁶ and which have been applied by the courts⁷, can be summarised as follows:

- Ownership and control of a company are not sufficient in themselves to allow the veil to be pierced.
- Nor can the veil be pierced, where there is no unconnected third party, purely on the basis that to

4. *Chandler v Cape Plc* [2012]

5. *VTB Capital Plc v Nutritek International Corp and others* [2012]

6. *Hayshem v Shayif & Anor* [2008]

7. *VTB Capital Plc v Nutritek International Corp and others* [2012] and *Caterpillar Financial Services (UK) Limited v Saenz Corp Limited*



do so would be in the interests of justice.

- There must be evidence of impropriety; however impropriety alone is insufficient to pierce the veil. It must be further evidenced that the impropriety is linked to avoidance or concealment of a liability through the use of the company structure.
- For the court to pierce the veil the wrongdoer's intentions may be considered, but in any case it must be shown that they controlled the company and used it as a facade to conceal their wrongdoing.
- Whether or not the company was incorporated with deceptive intent, the courts will want to see that it was being used as a facade at the time of the relevant transaction(s) and a remedy will only be provided in respect of the particular wrong that has been committed.
- In order to show that a corporate structure has been used as a device to conceal impropriety, the impropriety must first be identified to the court.

Applying the test

A number of documents, including those that confirmed that the Guarantor was receiving bank documents on behalf of the Company, showed that the Guarantor was controlling and directing the actions of the Company. The first requirement of control was satisfied on this basis.

It was evidenced that the first defendant was residing at the

Property and using the address for the registration of and correspondence for a number of other companies. In addition, the Guarantor was trying to sell the Property at the time of the freezing injunction application. The Judge took the view that although these matters may well be correct they did not go to the satisfaction of the fifth principle.

One of the most persuasive factors considered by Mr Justice Eder when considering the fifth principle was that the documentary evidence showed the Guarantor to be the ultimate owner and controller of the Company. The documents included a letter that the Guarantor had written to the Claimant prior to the funds being advanced attaching a net worth statement from a Greek certified public accountant that showed one of the Guarantor's assets as a "residence in Fulham, 3,500,000 USD". A further net worth statement provided by the same accountant 16 months later also identified the Guarantor's assets to include a "residence in Fulham" with a current value of US\$3.2 million. The Judge accepted that the reference to a "residence in Fulham" was a reference to the Property which the Guarantor asserted that he did not own at the time of the summary judgment hearing nor at the relevant period. In light of the documentary evidence the Judge decided that the assertions of the Guarantor were not credible. The Judge went on to say that "exceptionally...this is a case where there are no contemporaneous documents whatsoever to support the assertions made by [the Guarantor], whereas the contemporaneous documents which emanate from the [the Guarantor] himself are completely to the contrary...".

Mr Justice Eder emphasised that at the time the loan agreements were entered into, the Guarantor had told the Claimant that the Property was his asset and no mention of the Company had been made nor had the third defendant indicated that his interest in the Property was by way of a shareholding in the Company. This, according to Mr Justice Eder's judgment, satisfied the fifth principle.

Mr Justice Eder said that "the court will only pierce the veil so far as is necessary to provide a remedy for the particular wrong which those controlling the company have done. Here it seems to me that the particular wrong which [the Guarantor] has done, is that he has mis-used the company as a device, in effect, or is now seeking to do that." On this basis Mr Justice Eder found that the Claimant was entitled to a declaration that it could lift the corporate veil as far as the Property was concerned and that any judgment against the Guarantor could be enforced against the Property.

The resilience of the corporate veil

Where litigants can show that the relevant test is satisfied, the courts will allow them to obtain judgment against assets that were intentionally placed out of their reach. However these cases are and will remain exceptional.

Shipowners frequently and legitimately structure their group companies by incorporating single purpose vehicle companies as vessel-owning entities. Owners have historically relied on this structure to provide themselves with the security that a corporate veil exists to protect assets owned by other entities in the event that unjust attempts are made to pierce



it. Only where it can be proved that the corporate structure is being used to conceal or avoid a liability will the protection ordinarily provided by the corporate veil be at risk.

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