Busting Trusts and Piercing the Veil

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I INTRODUCTION

1. “The mists of metaphor” in company law: Cardozo CJ: "starting as devices to liberate thought ... end up often by enslaving it."

2. Sham trusts, but it is either a trust or it is a sham: they are mutually exclusive.

3. "(P)iercing' seems to happen freakishly. Like lightning, it is rare, severe and unprincipled."

4. Better than these labels is to work what are the mischiefs which need redress and to analyse the responses of the law.

5. Whether it is busting trusts or piercing the corporate veil, the common factual situation is the right of a creditor faced with a defendant who says “you can’t get me because it’s all in the trust or company”

I BUSTING TRUSTS

II THE TRUST

1. The debtor has settled his assets into a trust. Either he has only a bare legal title or the assets belong to a trustee.

2. In those circumstances, under English law those assets would fall outside his estate because a bare legal interest is not embraced within the broad definition of a bankrupt’s assets within section 283 of the Insolvency Act or they belong to a settlor.
III  NO EFFECTIVE TRUST

1. Scenario 1:
   Trust lacks formal requirements for a trust i.e. intention to create a trust, definition of subject matter of trust and definition of objects of trust.

2. Scenario 2:
   There is a trust but there was a common intention of the parties to the trust that the assets should remain those of the settlor i.e. the trust was a sham. per Diplock LJ in Snook v London & West Riding Investments [1967] 2 QB at 801
   “It is, I think, necessary to consider what, if any, legal concept is involved in the use of this popular and pejorative word. I apprehend that, if it has any meaning in law, it means acts done or documents executed by the parties to the ‘sham’ which are intended by them to give to third parties or to the court the appearance of creating between the parties legal rights and obligations different from the actual legal rights and obligations (if any) which the parties intend to create”.

3. Put more shortly, a sham exists where the parties say one thing intending another.

4. Note:
   a. Unilateral or subjective intention not sufficient. Must be common intention (laws of England, Jersey and New Zealand);
   b. Must be intention at the time of the creation of the trust.
   c. Either the trust is valid or not at its inception. It therefore cannot become an invalid trust by virtue of subsequent conduct: see A v A [2007] EWHC 99 (Fam) Munby J;
   d. It is a fraud on third parties or the court i.e. a very serious allegation.

5. Relevant evidence as to whether there is no trust
   b. What happens where trustee follows every instruction of settlor;
   c. Strong and natural presumption against holding a trust to be a sham;
d. Might be conduct only after the event leading to breach of trust of trustee and dishonest assistance of the settlor.

6. The consequences of a finding of a sham is that the trust is a nullity and so void, thus the assets transferred to a trustee will be held on resulting trust for the settlor and thus available for enforcement.

7. **Scenario 3:**

Although there was a trust the property was never settled into the trust and remained with the settlor (see *Dadourian Group International v Simms* [2006] EWHC 2973 (Ch) Warren J).

### IV INSOLVENCY OF SETTLOR

1. In addition to any rights of judgment creditors, there may be greater rights of a trustee in bankruptcy. They include:

   a. recovering assets transferred under void transactions i.e. what happens with sham trusts;
   b. pursuant to the powers under the Insolvency Act (s.284), recovering assets transferred during the period between the presentation of the bankruptcy petition and the date of bankruptcy: these transactions can be ratified but only usually for the benefit of the creditors as a whole;
   c. transactions at an undervalue which will include gifts settles into the trusts, can be set aside if they took place within 5 years ending with the petition date where the settlor was insolvent at the time of or as a result of the transaction: other cases 2 years (s.339);
   d. Trustee may exercise the power to revoke the trust and take the assets as after acquired property. In *TMSF v Merrill Lynch* [2011] EWPC 17 the PC ruled that that power could be exercised in that case by a receiver appointed by a creditor by way of equitable execution.
2. Public examination: another power of value to trustees in bankruptcy is public examination of the bankrupt to seek information relating to the trust pursuant to s.290 of the Insolvency Act 1986. These questions are normally dealt with in correspondence but where the trustee is uncooperative a court hearing can be sought.

3. Section 423 of the Insolvency Act 1986: misleadingly headed transactions defrauding creditors

   a. No need for fraud: a transaction putting assets beyond the reach of creditors or a future creditor or otherwise prejudicing that person’s interest may be set aside. Where it is a gift or transaction at an undervalue. Thus, would apply to a settlement.

   b. It was not necessary that they were a creditor at the time. A person who subsequently becomes a creditor can bring the assets back into the estate of the debtor.

   c. No need for insolvency: can be brought by a creditor without the need for insolvency. (In the Channel Islands, where there is a Pauline action the jurisdiction is narrower as it is necessary to show that the debtor was insolvent at the time or became insolvent as a result of the transaction).

   d. Sometimes trust companies describe trusts as “asset protection trusts” which renders the transaction liable to be attacked under section 423 because it applies that the purpose was to insulate the assets from creditors.

THE COMPANY – PIERCING/LIFTING THE VEIL

V SUPREME COURT DECISIONS

2. Principle of separate corporate personality even in one-person company.
3. Ownership and control of a company are in themselves insufficient to dislodge the principle of separate corporate identity.


5. June 2013 - Prest v Petrodel [2013] UKSC 34

6. In Prest v Petrodel at para. 8, Lord Sumption said separate personality and property of a company is sometimes described as a fiction, and in a sense it is. But fiction is the whole foundation of English company and insolvency law i.e. basis on which parties deal with companies.

7. Lord Neuberger in Prest (para 74) said over a period of 80 years, no proper or appropriate application of lifting/piercing the veil – either (1) principle rightly not applied to facts of case, or (2) principle applied in circumstances where wrong to do so, or (3) principle applied where other reasoning would support same conclusion. He had considered consigning the doctrine to history.

**VI DIFFERENCE BETWEEN PIERCING AND LIFTING THE VEIL**

1. Lord Sumption in Prest:
   a. Piercing the veil: “the evasion principle”
      i. The separate legal personality of the company is disregarded.
      ii. The person who owns and controls a company is said in certain circumstances to be identified with it in law by virtue of that ownership and control.
      iii. This is wholly exceptional. Otherwise, the certainty of the Salomon principle will be lost.
      iv. Confined to a case of a party has a legal obligation which it seeks to evade by putting a company between him and the legal obligation. Para 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."

b. Lifting the veil: “the concealment principle”.
   i. The company has concealed the identity of the real actors, and the veil is lifted so to discover the facts which the corporate structure is concealing.

   ii. Then engage in conventional causes of action hidden behind the veil e.g. e.g. (1) principal and agent, or (2) joint tortfeasor (company and owner or controller being liable in deceit), or (3) trustee and beneficiary (property owned in law by the company, but on trust for beneficiary).

VII  *VTB CAPITAL v NUTRITEK* [2013] UKSC 5; [2013] 2 WLR 398

1. The facts
   a. VTB is the English subsidiary of a Russian state-owned bank;
   b. Borrower was incorporated allegedly as vehicle for owners to syphon out vast sums for themselves.
   c. Allegation of fraudulent misrepresentation/conspiracy by means of deceit that loan to facilitate purchase of business at arm’s length whereas buyer and seller under common control;
   d. By lifting the veil, Claimants sought to take advantage of non-exclusive jurisdiction clause in favour of the English courts to pursue contract claim as well as tort claim.

2. The intention was to contract with buyer/borrower and not the person controlling it. Defendants successfully contended that RAP, the buyer, was not
a mere façade to conceal the overall controller. No intention to contract with the overall controller.

3. It did not suffice to pierce the corporate veil that there was (i) abuse of the corporate structure; or (ii) impropriety.

4. “Subject to some other rule (such as that of undisclosed principal) where B and C are the contracting parties and A is not, there is simply no justification for holding A responsible for B’s contractual liabilities to C simply because A controls B and has made representations about B to induce C to enter into the contract. This could not be said to result in unfairness to C: the law provides redress for C against A, in the form of a cause of action in negligent or fraudulent misrepresentation” (at 139).”

5. Only pierce corporate veil where no alternative remedy. Following Dadourian v Simms [2006] EWHC 2973

VIII PREST v PETRODEL [2013] UKSC 34; [2013] 2 AC 415

1. The facts

   a. Mr Prest had bought properties both inside and outside of the UK and placed their ownership with various off shore companies of which he was the only shareholder.
   b. The Petrodel Group of companies owned these properties and included the family home in London worth in the region of £4 million.
   c. Mr Prest’s total worth was valued in the region of £37.5 million.
   d. Mr Prest not before the Court, but his companies were.
   e. The issue was whether the assets owned by the companies could be treated as those of Mr Prest for the purpose of the ancillary relief.

2. The issues:
a. Whether corporate veil could be pierced so that the companies could be treated as Mr Prest for the purpose of ancillary relief principles;
b. Whether for the purpose of the Matrimonial Causes Act 1973, any assets controlled by a party, whether or not owned by such party, could be treated as available for distribution in ancillary relief;
c. Whether the assets of the companies were in any event held on a resulting or other trust for Mr Prest irrespective of the answers to the questions in respect of issues (a) and (b).

3. Piercing corporate veil: no scope in Prest

a. At first instance in *Prest* Moylan J had held that there was no "impropriety" sufficient to permit the corporate veil to be pierced. The Court of Appeal agreed, as did, Lord Sumption.

b. Companies formed not to conceal assets from spouse, but for tax avoidance/evasion.

c. In the divorce, Mr Prest lied about the assets. But that was not a relevant impropriety to engage the evasion principle. It engages the concealment principle, to find what is the true position about the assets.

4. No special rule for matrimonial cases.

a. Control without ownership not bring assets into the pot for matrimonial cases.

b. Courts exercising family jurisdiction do not occupy a desert island in which general legal concepts are suspended or mean something different.

c. Were it otherwise, it would cut across the statutory schemes of company and insolvency law. These schemes are essential for the protection of those dealing with a company, particularly where it is a trading company.
5. Resulting trust.

a. Mrs Prest won because of finding that the assets held by companies were held on bare trust for Mr Prest;
b. Based on presumption of resulting trust where assets transferred not for full value;
c. Easily rebuttable, but not in this case because no evidence to explain how and why companies acquired the assets.
d. Consequence of adverse inferences, coupled with no rebuttal of inference of resulting trust

e. Particular inference in MCA case where duty to set out assets, and not fulfilled despite Mr Prest’s knowledge about his assets.

IX  OPERATION OF CONCEALMENT PRINCIPLE

1. Joint tortfeasor liability

a. VTB Capital v Nutritek

b. Dadourian v Simms [2006] EWHC 2973; [2009] EWCA Civ 169: joint liability in deceit because of concert of activity. Where A and B are involved in a common design to achieve some improper purpose but where it is A alone who commits the offending act, B is jointly liable for the tort represented by the offending act – not confined to conspiracy;

c. Procurement of tort at least in conversion and/or intellectual property torts: see C. Evans & Sons Ltd. v Spritebrand Ltd. [1983] Q.B. 310 and MCA Records Inc v Charly Records Ltd (No 5) [2002] FSR 26

d. Usually not in negligence because assumption of responsibility required: see Williams v Natural Life Health Foods Ltd. [1998] 1 WLR 830. No such requirement in deceit: see Standard Chartered Bank plc v Pakistan National Shipping Corp. (No.2) [2003] 1 A.C. 959
2. Trust liability - *Prest v Petrodel*

3. Principal and agent e.g. proper analysis of knowing receipt cases.

4. Equitable remedies ancillary to relief against the company.

X CONCLUSION

1. Distinction between the concealment principle and evasion principle.
2. Not retreat to metaphors, but look rigorously behind the corporate façade and identify as far as one can, legal obligations attaching to someone hiding behind the company.
3. For now, the evasion principle is very narrow indeed: will one day the door be opened a little more?