Kluwer Arbitration Blog

Extending Arbitration Clauses after the Decisions of the English Supreme Court in VTB and Prest

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When seeking to extend an arbitration clause to a third party who is not a signatory to the clause, common law practitioners will often have resort to an argument that the corporate veil should be pierced – in other words, that the court or tribunal should disregard the separate legal identity of a company on the grounds that it is a façade or sham. Most often, the argument will be that the separate corporate identity of the company that signed the arbitration clause should be disregarded and the arbitration clause thereby extended to its parent company, or to an individual who owns or controls the signatory.

Two recent decisions of the English Supreme Court have cast doubt on whether this argument is a viable one. On the one hand, the Court confirmed that the power to pierce the corporate veil is and should be a part of English law – something which the Supreme Court has not expressly decided before. On the other hand, both decisions made clear that the remedy is only available in certain limited circumstances.

In the first case, decided on 6 February 2013, *VTB Capital plc v Nutritek International Corpn* [2013] UKSC 5, the Supreme Court considered the case of a bank, VTB, which had lent money to a Russian company to finance the purchase of a dairy business from the first respondent, Nutritek. VTB was later surprised to discover that Nutritek and the borrower were in fact under common control. It accused Nutritek of misrepresenting its links with the borrower, as well the true value of the dairy business. VTB asked the court to pierce the corporate veil of the borrower and treat certain of the respondents as signatories of the finance agreement, jointly and severally liable with the borrower.

The respondents' reply to this argument was to invite the Court to find that it did not, as a matter of general principle, have the power to pierce the corporate veil. Lord Neuberger, giving the leading judgment on this question, declined to decide this general point and instead held that on the facts of this particular case, piercing was not justified. He commented that VTB's argument involved a significant extension to the circumstances where it has traditionally been held that the corporate veil may be pierced. The court had never before pierced the veil in order to treat the person sheltering behind the veil as a party to a contract signed by the company.

For Lord Neuberger, such an extension would be a step too far. He noted that contracts must be

understood in the light of the intentions of the contractual parties. In this case, none of the actual parties to the agreement intended to contract with the third party sheltering behind the veil.

In the second case, decided on 12 June 2013, *Prest v Petrodel* [2013] UKSC 34, the Supreme Court took the bull by the horns and addressed the question of whether the power to pierce the corporate veil exists in English law. It held that such a power does exist, but that the circumstances in which it may be used must be carefully limited.

The case concerned ancillary relief proceedings following the divorce of Michael and Yasmin Prest. The husband was owner and controller of several companies which owned property in the UK. The question was whether the court could order the transfer of these properties to the wife as part of the divorce settlement notwithstanding that they were legally owned by the companies and not the husband.

Three ways of getting at the properties were discussed: through piercing the corporate veil, through the use of Section 24(1)(a) of the Matrimonial Causes Act 1973 or by finding that the beneficial ownership of the properties was with the husband and not the companies. The Supreme Court eventually found in favour of the wife on the basis of the last argument, but the lion's share of the discussion was dedicated to the question of piercing the corporate veil.

Lord Sumption, delivering the leading judgment, started his analysis with the venerable principle established by the House of Lords in in *Salomon v A. Salomon & Co Ltd* [1897] AC 22, that a company should be treated as a person by the law, legally distinct from its shareholders with rights and liabilities of its own. However, he went on to consider the case law which has held that this separate personality may be disregarded by the courts in certain specific circumstances. He stated that

> "the consensus that there are circumstances in which the court may pierce the corporate veil is impressive… 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" (§27).

Lord Sumption then tackled the problem of identifying exactly what these *"carefully defined circumstances"* might be. He noted that there is much confusion on this question in the prior case law, and suggested that two principles underlie the situations in which piercing the veil may be relevant: the concealment principle and the evasion principle.

The first principle concerns the use of one or several companies to conceal the identity of the real actors. In such case the court would take the necessary steps to establish and pursue the real actors where legally relevant. Lord Sumption noted, though, that in these circumstances the court does not in fact pierce the veil at all – more just peek around it. For example, if a wrongdoer transfers money to a company for the purposes of concealment, a court ordering the company to account for the money does not disregard the company's separate legal personality; it rather applies conventional legal principles such as recognising that the company received the money as the wrongdoer's agent or nominee. The court therefore does not need to pierce the corporate veil.

The second principle concerns the situation where 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. It is only in this second situation that the court may be entitled to pierce the veil.

Lord Sumption concluded that *"[f]or all of these reasons, the principle has been recognised far more often than it has been applied"* (§35), and declined to pierce the veil on the facts of this case.

Strictly speaking, Lord Sumption's distinction between concealment and evasion does not appear to form part of the ratio of the Supreme Court's judgment as it was not wholeheartedly adopted by the other members of the Court. While Lord Neuberger broadly agreed with Lord Sumption, Lady Hale, Lord Mance and Lord Clarke all expressed uncertainty as to whether this neat division should be used to foreclose future arguments on piercing the veil. There will no doubt be further case law developments on this question in due course.

Concealment and evasion aside, however, the decision of the Court makes clear that the doctrine of piercing the veil, while it exists in English law, is much narrower than previously thought. All members of the Court agreed that situations in which the corporate veil should be pierced are rare and exceptional.

The *VTB* and *Prest* cases, taken together, are worthy of note for a party seeking to argue that an arbitration clause governed by English law should be extended to a third party on the basis of the doctrine of piercing the corporate veil.

If Lord Sumption was right to say, in *Prest*, that the corporate veil can only be pierced where the company has been interposed in order to evade or frustrate a pre-existing right, a party to an arbitration would have to demonstrate (1) the presence of such a pre-existing right and (2) the use of the company structure itself to evade such right, in order for the doctrine to be relevant to the extension of an arbitration clause. Lord Sumption did not give much explanation as to how such a scenario would operate, but it is not easy to imagine how the argument could succeed in the context of an arbitration clause contained in a contract that creates rights rather than varying pre-existing rights. In any event, the mere existence of an arbitration clause signed by a company would not, without more, justify the extension of the clause to a third party who owns or controls the company, even if the third party is guilty of wrongdoing.

In fact, seeking to argue for such an extension could be said to be analogous to the position adopted by the bank in *VTB*. The court in that case was clear that the doctrine of piercing the corporate veil could not, in general, be used to extend liability under a contract signed by a company, to the owner or controller of the company even if he was guilty of misrepresentation.

Of course, it remains open to a party to an arbitration clause to argue that the clause should be extended on what the court in *Prest* called *"more conventional"* legal grounds. There are a number of alternatives – for example, the party may be able to argue that the company signed the arbitration clause as the agent of a third party to whom, in appropriate circumstances, the clause may be extended. Indeed, this is the approach encouraged in *Prest*: Lord Mance labels piercing no more than a *"final fall-back"* option (§100). However, like the Supreme Court in *Prest*, one should also not exclude that there might be exceptional factual circumstances that justify piercing the corporate veil so as to extend an arbitration clause in rare cases.

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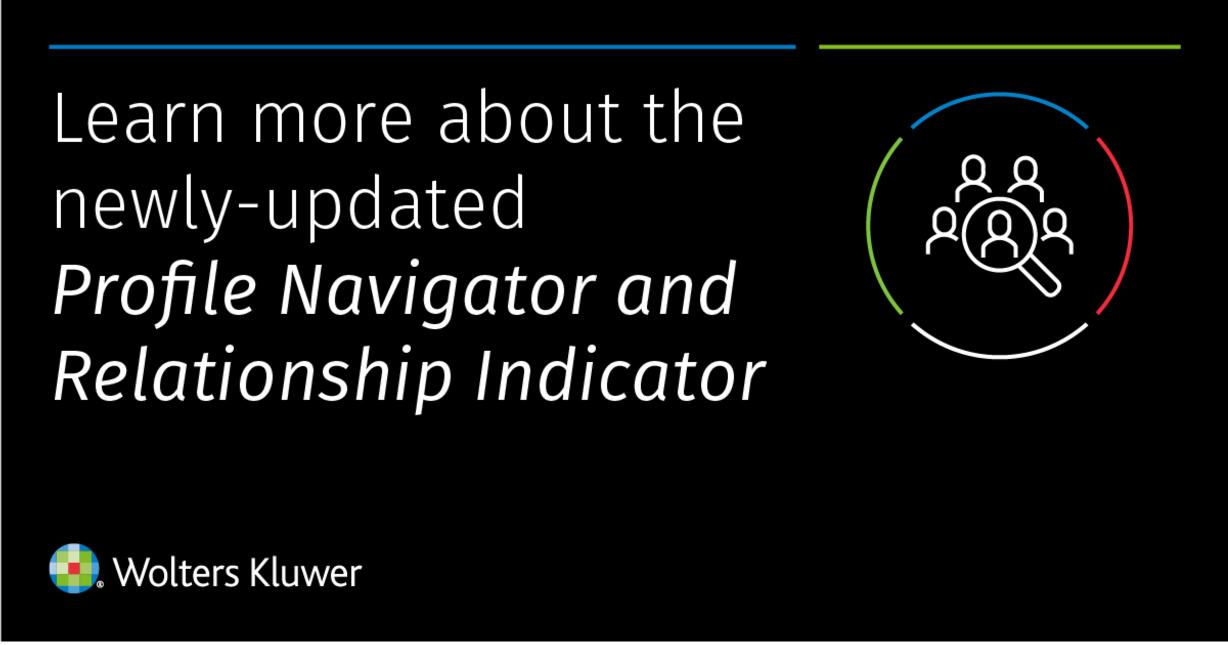

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