

# Freezing orders; the difficulties introduced by the decision in *Prest v Petrodel Resources Limited*

by Simon Duncan

## INTRODUCTION

Lord Sumption's leading speech in *Prest v Petrodel Resources Limited* [2013] UKSC 34 has received much scrutiny over the last 18 months. However, the effect of his judgment has been most keenly felt in applications for freezing orders before the Chancery Division and the Commercial Court, rather than in applications that seek to persuade the court to pierce the corporate veil per se. The impact of this is explored in two recent cases where the applicants sought freezing orders against non cause of action defendant companies.

The 'evasion principle' was described by Lord Sumption in these terms:

*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...by interposing a company under his control (at para 35).*

It was this principle, as opposed to the "concealment principle," that his Lordship considered to be a true exception to the position that the legal personality of a limited company be preserved. It defined the circumstances in which the corporate veil could be "pierced" rather than simply "lifted."

This is a narrow principle. The corollary is that applicants should expect the court to uphold a company's legal personality except where this principle can properly be applied.

## GROUP SEVEN LIMITED V ALLIED INVESTMENT CORPORATION

A freezing order granted on the following terms was at issue in *Group Seven Limited v Allied Investment Corporation* [2014] 1 WLR 735:

*The freezing provision applies to all the respondent's assets whether or not they are in his name and whether they are solely or jointly owned. For the purpose of this order the respondent's assets include any asset which he has the power, directly or indirectly, to dispose of or deal with as if it were his own. The respondent is to be regarded as having such power if a third party holds or controls the asset in accordance with his direct or indirect instructions. This is the CPR Part 25 precedent.*

The claimant was seeking a declaration in the Chancery Division that a €100 million loan agreement with the first defendant (Mr Sultana) was null and void and/or rescinded for fraudulent misrepresentation. Mr Sultana was the sole shareholder of Wealthstorm Limited (Wealthstorm) and the only director. He caused the company to invest US\$ 500,000 in Digital Archives Inc (Digital Archives).

Mr Sultana caused Wealthstorm to compromise the debt due to it from Digital Archives in an amount of US\$ 200,000. The claimant made an application for committal for contempt against Mr Sultana.

In order to prove that Mr Sultana was in contempt, it would be necessary to show that the debt owed to Wealthstorm was to be treated as one of Mr Sultana's assets. In other words, the court had to be satisfied that the last two sentences of the standard form precedent applied to the exercise of power vested in Mr Sultana over a company of which he is the sole shareholder and director.

Leading counsel for the applicant made the following statement:

*If any authority [for this proposition] were necessary, Gee on Commercial Injunctions confirms that the last two sentences cover the common situation where a defendant controls an offshore company and uses its assets as its own.*

For Mr Justice Hildyard, the matter could be determined by the application of established company law principles. It is long established that a company is a separate legal person. The company owns its assets whether the company itself is owned and controlled by one person or otherwise. It follows that Wealthstorm owned its assets. Mr Sultana did not have, by virtue of his ownership and control of Wealthstorm, any beneficial interest in its assets. Both *Salomon v Salomon* [1897] AC 22 and (at that stage what was the Court of Appeal's decision) *Prest v Prest* [2012] EWCA Civ 1395 applied. Mr Sultana was not in contempt.

From the applicant's perspective, this was a disastrous result. The hearing lasted for six days in court with solicitors and leading counsel on both sides.

## LAKATAMIA SHIPPING COMPANY V NOBU SU

### Commercial Court judgment

The judgment in the *Group Seven* case was handed down on 6 June 2013, and on the same day Mr Justice Burton in the Commercial Court gave his decision in *Lakatamia Shipping Company v Nobu Su* [2013] EWHC 1814 (Comm). The issue was the same, and the facts were as follows.

The claimant sought to recover US\$ 48 million from the defendant pursuant to a freight derivative contract. The defendant counter-claimed for US\$ 40 million. The claimant was granted a freezing order on the short form commercial court precedent, the wording of which is the same as that cited above.

Mr Su's companies were F3, F5 and IM3. The first two were owned by Mr Su directly. IM3 was owned by Great Elephant Corporation, a Taiwanese company itself 67 per cent owned by Mr Su. The balance was owned by TMT Energy, a company registered in the Marshall Islands, and wholly owned by Mr Su. Mr Su was a director of all three companies. The assets held by the companies included significant shareholdings in listed entities and a ship, the Iron Monger 3.

The issue was whether the freezing order had the effect of freezing the assets of the companies, F3, F5 and IM3. For Burton J the answer was plain.

*I have no doubt whatever that the factual scenario which I have described...brings the position plainly and intendedly into the definition of paragraph 3 of the order. It does not cause any offence against Salomon v Salomon for two reasons.*

*First of all, this is, of course, only an interlocutory order, but, in any case, it depends upon a perfectly traditional analysis of company law provisions, where the owner of a company can, by resolution at the general meeting...access and direct the fate of the assets of the companies which he thus owns or controls.*

This judgment put the Commercial Court at odds with the Chancery Division as to the meaning of the last two sentences of the freezing order precedent. More particularly, it suggests that the application of the *Salomon* and *Prest* decisions is open to different interpretations.

### Court of Appeal judgment

Mr Justice Burton's decision (on the first and second reasons) was reversed by the Court of Appeal in *Lakatamia Shipping Company Ltd v Su & Ors* [2014] EWCA Civ 636, 14 May 2014. The reasoning of Lord Justice Rimer is instructive.

As to his first reason, that it was only an interlocutory order, "that was true but Burton J does not explain, nor do I understand its supposed relevance." As to the second reason, that Mr Su's control of the three companies meant that he was able to access and direct the fate of the assets of the companies which he thus owns or controls, the judge regarded that reasoning as wrong.

*The sole purpose of the second and third sentences (of the commercial court precedent) is to spell out that a defendant's assets will include assets held by others that the defendant is entitled to dispose of as his own...The assets that Burton J was considering were the assets of the companies. There is no suggestion that these assets belonged to anyone other than the companies; and it is trite law that a company's assets do not belong beneficially to their shareholders...*

Rimer LJ also said that Burton J

*preferred the heretical view that because the sole owner of a company is in a position to control the destiny of its assets, the company's assets are his assets within paragraph 3 of the order. That is wrong. First, paragraph 3 is only concerned with dispositions of assets belonging beneficially to the defendant, which these assets do not. Secondly, Mr Su has no authority to instruct the companies how to deal with their assets. All he has is a power, as an agent of the company, to procure the company to make dispositions of its assets. Such dispositions, when made, are made in consequence of decisions made by the organs of the company. They are not dispositions made by the company in compliance with instructions from Mr Su...only the companies have authority to deal with and dispose of their assets" (supra paras 48 to 51.)*

The significance of this timely and authoritative judgment is that applicants for freezing orders should investigate the defendant's companies, and any non cause of action defendant companies, and seek an order that stipulates precisely what assets the applicant wants to freeze. It is unlikely that the standard precedent will answer in these circumstances because of the way a company's personality is regarded.

In the first instant decision, Burton J gave a third reason in

support of his view that the companies' assets were caught by the freezing order.

*If he, being subject of a freezing order, controlling or owning such company, participates in or allows the sale by that company of its assets, then he is in any event diminishing the value of his asset, namely his shareholding in the companies which have thus disposed of his assets.*

The Court of Appeal agreed with this analysis. The fortification of the freezing order was justified on the narrow ground that Mr Su could be restrained from diminishing the value of his shareholdings in the companies. This does not mean that the companies cannot continue with their trading activities. However, it does suggest that a decision by a company to sell a significant asset would be prevented in circumstances where this could not be said to be within the ordinary course of business and where the value of the shares would decline as a result.

It was accepted that a notice provision giving the claimant's solicitors 14 days notice of any impending sale would be a sensible step. This would then afford the claimant the opportunity to apply to vary the injunction in so far as it could

not be agreed by the parties whether the transaction be allowed to proceed or not.

## CONCLUSION

The Prest judgment has made reliance on standard form freezing order precedents problematic where the defendant controls various companies that hold the assets that the claimant seeks to freeze. It has served as a reminder that the court will respect and preserve the corporate veil except in very limited circumstances now narrowly defined in the "evasion" principle.

Applicants should ensure that the wording that they use makes it clear precisely what it is that seek to freeze. The time to raise the issue is on making the application rather than waiting for an argument on the return date because this could have a cost consequence.

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