

Supreme Court pressed into lifting the veil on divorce

Prest v Petrodel Resources Ltd [2013] UKSC 34 presented the Supreme Court with an opportunity to make peace in the ongoing war between the judges of the Family and Chancery Divisions of the Courts of England and Wales. A fragile peace was reached as the Court held that certain properties were beneficially owned by Mr Prest, even though they were legally owned by companies in his control. The court could therefore order that the properties be transferred to his wife. The judgment is likely to have a significant impact on the use of corporate structures to hold what are, in reality, personal assets.

The Wars of the Roses

Following the Court of Appeal decision in *Petrodel Resources Ltd v Prest* [2012] EWCA Civ 1395, our November 2012 briefing note *Corporate assets and divorcing couples: a modern day Wars of the Roses?* compared the ongoing war between the judges of the Family and Chancery Divisions of the Courts of England and Wales to the Wars of the Roses fought between the Houses of Lancaster and York for the throne of England in the fifteenth century. Family Division judges saw themselves as having the flexibility to do whatever they sought fit, regardless of traditional notions of property law in order to achieve a just outcome in a divorce. The Chancery Division riposted sternly that fundamental principles of corporate and property law did not cease to apply at the doors of a divorce court. The Family Division was not a law unto itself.

The appeal to the Supreme Court (*Prest v Petrodel Resources Ltd* [2013] UKSC 34) presented the Court with an opportunity to make peace. Lord Sumption took on the improbable role of a modern day Henry Tudor, who deposed Richard III and united the two warring Houses. But peace is by no means assured as the Supreme Court has not ruled out further incisions in the corporate veil and has opened alternative, potentially controversial, means for the Family Division to achieve its aims.

Opening salvos

Mr and Mrs Prest were married for nearly 20 years. They amassed significant wealth over that time, including a number of London properties held in the name of three companies owned and controlled by Mr Prest. On Mr and Mrs Prest's divorce, the key questions for the trial judge charged with splitting the assets between them were the extent of Mr Prest's wealth, including the nature and extent of

Key points

- The corporate veil can only be pierced in rare cases where no other remedy is available and a company or corporate structure has been interposed to evade an existing obligation.
- The Matrimonial Causes Act does not provide the Family Division with a special tool that they can use to pierce the corporate veil.
- The Supreme Court ordered the respondent companies to transfer the relevant properties to Mrs Prest as it found that they were beneficially owned by Mr Prest.
- The Supreme Court's judgment has not solved all problems for wealth managers. A majority of the Supreme Court held that new grounds to pierce the corporate veil might emerge, and it is not clear in what circumstances courts will in future hold that assets in corporate entities are held in trust.

his interest in the companies, and whether the court could make orders directly against properties held in the name of the companies.

At trial, the Judge neatly side-stepped more than a century of precedent that distinguished between the assets of a company and the assets of the owner of the company. He decided that properties in the names of Petrodel Resources Limited (PRL) and another company ultimately owned by Mr Prest, Vermont Petroleum Limited (Vermont), were caught by the provisions of the Matrimonial Causes Act 1973 (the Act) and ordered that the properties be transferred to Mrs Prest. The companies, not Mr Prest (now safely outside the court's jurisdiction in Monaco), appealed.

The battle in the Court of Appeal

The Court of Appeal was split on the issues. Thorpe LJ of the Family Division delivered a judgment strongly in favour of the original trial judge, saying that the judge had sought to do justice and that was enough to justify the orders made. Mr Prest controlled the companies; the companies owned the properties; Mr Prest therefore controlled the properties and could be ordered to secure their transfer to Mrs Prest.

Conversely, Rimer LJ delivered a long and detailed judgment in favour of the appellant companies. He relied on *Salomon v A Salomon & Co Ltd* [1897] AC 22, which provides that a duly incorporated company is a legal entity separate from those who incorporate it, with rights, liabilities and property of its own. Mr Prest's control of the companies did not make the companies' assets his assets. The court could not therefore order that

the companies' assets be transferred to Mrs Prest.

Patten LJ agreed with Rimer LJ, and the Chancery Division therefore triumphed.

Onwards to the Supreme Court

Whilst the Chancery Division held the upper hand in the Court of Appeal decision, the war continued as Mrs Prest appealed to the Supreme Court. The seven Supreme Court Justices were faced with the task of healing the divisions within the court.

The case has attracted significant interest from the press, which became a medium for lobbying from those on either side of the divide. Leading family law practitioners railed against the "cheat's charter", suggesting that the Court of Appeal's decision would allow one spouse to hide assets behind a corporate shield to protect them from divorce judgments, leaving the other in poverty. On the other hand, corporate lawyers pointed out (as had Rimer LJ) that the courts were already more than capable of looking behind a sham transaction, and the sanctity of the corporate veil did not need to be violated.

Ultimately, the seven justices in the Supreme Court styled their own Tudor rose, accepting the corporate and proprietary analysis of the Chancery Division but still finding a way to achieve the outcome desired by the Family Division. This really may be peace or it may merely point to the location of the next battleground.

The decision of the Supreme Court

Lord Sumption gave the principal judgment in the Supreme Court. He

noted that "properly speaking" piercing the corporate veil "means disregarding the separate personality of the company." Whilst there are a number of situations in which the law attributes the acts or property of a company to those who control it without disregarding its separate legal personality, piercing the corporate veil refers only to those cases which are true exceptions to the rule in *Salomon v Salomon*, i.e. where a 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.

Lord Sumption's judgment reviewed the case law where judges have either purported to pierce the corporate veil, or have considered whether the option was open to them but ultimately declined to do so. Lord Sumption concluded that in many cases judges had not, in fact, pierced the corporate veil at all. Rather they had been applying established legal principles in order to reach their decisions, sometimes erroneously suggesting that they were piercing the corporate veil.

Lord Sumption drew out "two distinct principles" behind the cases, which he referred to as the "concealment principle" and the "evasion principle".

Those cases where a company has been interposed in order to conceal the identity of the real actors fall within the former principle. Lord Sumption said that where the court is looking behind the façade to discover the facts concealed by the corporate structure, the court is not disregarding the corporate structure nor piercing the corporate veil. The court is merely identifying the true nature of the transaction and giving effect to it.

Conversely, it is in evasion cases where the corporate veil may truly be

pierced in order "to prevent the abuse of corporate legal personality." Lord Sumption concluded 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". In these cases the corporate veil may be pierced by the court "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."

Lord Sumption noted that the corporate veil could be pierced only when there was no alternative remedy, and that it would only be appropriate in "a small residual category of cases." Lord Neuberger specifically agreed with this point, stating that the corporate veil could only be pierced "when all other, more conventional remedies have proved to be of no assistance."

Having confirmed that English law does indeed have a doctrine permitting the corporate veil to be pierced in these very limited circumstances, Lord Sumption stated that, as there was no "relevant impropriety", the corporate veil could not be pierced in *Prest v Petrodel*. Whilst Mr Prest had "acted improperly in many ways", Mr Prest had not sought to interpose a company or group of companies in order to prevent the distribution of assets of a marriage upon its dissolution. The properties had been held in the name of the companies long before the threat of divorce appeared on the horizon. Accordingly, "the piercing of the corporate veil cannot be justified

in this case by reference to any general principle of law."

Section 24(1)(a) of the Matrimonial Causes Act 1973

Lord Sumption then turned to the Act to consider whether it provided a special tool which could be used by the Family Courts to pierce the corporate veil.

Lord Sumption noted that the family courts "do not occupy a desert island in which general legal concepts are suspended or mean something different." Accordingly, section 24(1)(a) of the Act, which empowers the court to order one party to the marriage to transfer to the other "property to which the first-mentioned part is entitled, either in possession or reversion" must be read in line with established legal meanings.

Whilst section 25(2)(a) of the Act provides that a spouse's ownership of

"On granting a decree of divorce... the court may make... an order that a party to the marriage shall transfer to the other party...such property as may be so specified, being property to which the first-mentioned party is entitled, either in possession or reversion."

Section 24(1)(a) of the Matrimonial Causes Act 1973

a company and ability to extract money from it is relevant to any assessment of his or her resources for the purposes of calculating the size of any order against them, it does not follow that these assets are specifically transferable under section 24(1)(a). Lord Sumption therefore concurred with the Court of Appeal that section 24(1)(a) of the Act does not provide a method by which the Family Division can pierce the corporate veil. If section 24(1)(a) had done so, it would have "cut across the statutory schemes of company and insolvency law" making the wife, in effect, a secured creditor.

Lord Sumption noted that if section 24(1)(a) of the Act were to be read as allowing a spouse access to assets of any company in which the other party to the marriage was the sole shareholder, there was no need for any evasion (or even concealment) to permit the piercing of the corporate veil. This would mean that "the corporate veil does not matter where the husband is in sole control of the company". He concluded simply by stating that "this is plainly not the law."

Peace between the Divisions

Whilst Lord Sumption's analysis of the corporate veil suggested that the Wars of the Roses between the Chancery and Family law judges would result in a crushing victory for the former, he continued in order to allow the appeal and try to find a diplomatic resolution to the conflict.

Contrary to many headlines written about the judgment, Lord Sumption and his fellow justices of the Supreme Court did not pierce the corporate veil in order to uphold Mrs Prest's appeal. They all agreed that neither the

general law nor section 24(1)(a) allowed it in this case. The Supreme Court chose instead to conclude that there was no veil that needed piercing. The properties were beneficially owned by Mr Prest. Mr Prest was accordingly entitled to the properties in reversion for the purposes of section 24(1)(a) of the Act.

"It follows from the above analysis that the only basis on which the companies can be ordered to convey the seven disputed properties to the wife is that they belong beneficially to the husband..."

Lord Sumption

Mrs Prest had argued that all the investment properties were held beneficially for her husband although the respondent companies held the legal title. Lord Sumption found that it was a "fair inference" from the respondent companies' continued refusal to engage with the court process in order to show that they were the true beneficial owners of the properties, that the main, if not the only, reason for this failure to co-operate was to protect the London properties. In turn, Lord Sumption inferred that "proper disclosure of the facts would reveal them to have been held beneficially" by Mr Prest.

Lord Sumption went on to examine each property in turn. Three of the properties owned by PRL had been transferred to the company for

nominal consideration, and two further properties had been transferred to PRL for substantial consideration which Lord Sumption believed had been funded by Mr Prest. As a result, Lord Sumption held that these properties were, and had always been, beneficially owned by Mr Prest.

Two other properties were acquired by Vermont for substantial consideration with funds provided by PRL. Lord Sumption inferred that these purchases were, ultimately, funded by Mr Prest and noted that an oil trading company like PRL had little reason to purchase residential properties in London. He concluded, based in part on the established pattern of behaviour, that these two properties were also beneficially owned by Mr Prest.

Having found that the properties were all beneficially owned by Mr Prest and were therefore held on trust for him by PRL and Vermont, Lord Sumption restored the order of Moylan J to the extent that it required that the properties be transferred to Mrs Prest. He noted, however, that whether assets legally vested in a company are beneficially owned by its controller is a highly fact-specific issue upon which he was not willing to give general guidance beyond the ordinary principles and presumptions of equity.

A Tudor dynasty?

Lord Sumption's judgment protects the doctrine of corporate separate legal personality to satisfy the lawyers of the Chancery Division. At the same time, it secured a just outcome for Mrs Prest by providing a route to access assets which genuinely belong to her spouse, to the satisfaction of the Family Division.

The other justices of the Supreme Court broadly agreed with the fundamental points of Lord Sumption's judgment, including his rejection of the argument that section 24(1)(a) of the Act could be a tool to pierce the corporate veil and also his finding that the properties were beneficially owned by Mr Prest.

Lord Neuberger (from the Chancery Division) said that he had been initially reluctant to accept that the corporate veil could ever be pierced but he ultimately he agreed with Lord Sumption's "clear and limited doctrine".

Lady Hale and Lord Wilson, representing the Family Division, agreed both that section 24(1)(a) of the Act did not provide the Family Division with a tool to pierce the corporate veil, noting that the wording of that section clearly referred to a right recognised by the law of property and "does not give the court power to order a spouse to transfer property to which he is not in law entitled."

They also concurred that the properties were held beneficially by Mr Prest and could accordingly be transferred to Mrs Prest, noting that the reasons for this had been "amply explained by Lord Sumption."

On the main issues before the court, therefore, it seems that Lord Sumption had succeeded in uniting the warring factions, steering a path to a decision which could be accepted on both sides of the divide.

When is a unanimous decision not unanimous?

Though it appeared that harmony prevailed, notes of warning were sounded that suggested that this unity

may not be as complete as might be hoped.

Whilst agreeing with the decision reached in this particular case, a number of the justices expressed some doubts as to whether Lord Sumption's approach to the doctrine of piercing the corporate veil was correct or complete. Lady Hale and Lord Wilson queried whether it was possible to classify all of the piercing the corporate veil cases into cases of either concealment or evasion.

"It is...often dangerous to seek to foreclose all possible future situations which may arise and I would not wish to do so... No-one should, however, be encouraged to think that any further exemption... will be easy to establish, if any exists at all."

Lord Mance

Lord Mance (an intruder from the Commercial Court) suggested that it is "often dangerous to seek to foreclose all possible future situations which may arise", refusing to accept that only those cases falling within Lord Sumption's "evasion principle" can properly be remedied by piercing the corporate veil. Lord Clarke (also from the Commercial Court) suggested that the distinction between the evasion and concealment principles "should not be definitely adopted unless and until the

court has heard detailed submissions upon it."

"A glooming peace this morning with it brings"

The vexed issue of piercing the corporate veil has not, therefore, been conclusively settled by the decision in *Prest v Petrodel Resources Ltd*, despite the unanimous decision in Mrs Prest's favour. Lord Sumption and Lord Neuberger might have sought to limit it to evasion cases, but the others left open the possibility of further incisions if the facts merit it.

There is, therefore, scope in future cases for the court to develop (or invent) new bases upon which the corporate veil can be pierced in order to protect spouses deserving of sympathy. The Supreme Court indicated that it would be hard to do so, but that will not stop intrepid parties seeking to do so if that is all that is left to them.

The legal consequences of the peace

Whilst the Supreme Court's judgment offers some comfort to wealth management advisers that legitimate corporate structures are not vulnerable to the corporate veil being pierced in divorce proceedings, there are a number of points arising from the judgment which will continue to cause concern.

Concealment

Lord Sumption's judgment indicates that there is no need to pierce the corporate veil in order to enforce against assets where corporate structures have been used to conceal

the true actors. That is simply a reflection of the fact that the courts will not be fooled by such tactics and have other weapons at their disposal to look through the corporate structures. Those who seek to hide behind companies in this way will not be able to do so.

Evasion

Lord Sumption's judgment says that, if the Court can find no other way to get at the assets in question, where an individual seeks to evade an existing legal obligation by interposing a company or a corporate structure, the Court will, as a last resort, be willing to pierce the corporate veil. Spouses involved in divorce proceedings, or where such proceedings are contemplated, should be aware that they will not therefore be able to evade the potential orders against them in this way simply by transferring their assets to a company. That was ever the case.

Beneficial ownership

Perhaps the main lesson for those in the wealth management sphere is the refresher course in trust law principles provided by Lord Sumption.

Corporate directors (and trustees) should pay careful attention to the source of funds for the purchase of assets by corporations which are controlled by or on behalf of a single individual, particularly where the asset does not appear to be related to the primary business of the company.

Sound corporate governance procedures are key to ensuring that assets in the name of a company are assets of the company. Simply setting up a shell to hold assets which are funded by, and used for the benefit of, an individual may not suffice to

ensure that the assets are not treated as beneficially owned by the controlling individual.

This could be the site of future battles. It is easy to see the family Division being readily persuaded that corporate vehicles hold assets in trust; the Chancery Division may take more convincing that all is not as it seems.

Likeability again

Our briefings on the recent *Pitt v HMRC* and *Futter v HMRC* cases explained how the Supreme Court appears to be developing something of a "likeability test", whereby the courts' discretion may be used to assist a party to whom the court is sympathetic, whilst a less likeable party may find themselves with a more difficult task.

The judgments in the Supreme Court in this case show that Mr Prest and the Petrodol companies had not endeared themselves to the Court. Indeed, on more than one occasion the justices expressed their displeasure at the behaviour of the Respondents.

Lord Sumption noted that Mr Prest's "conduct of the proceedings has been characterised by persistent obstruction, obfuscation and deceit, and a contumelious refusal to comply with the rules of the court and specific

"[Mr Prest's] conduct of the proceedings has been characterised by persistent obstruction, obfuscation and deceit, and a contumelious refusal to comply with rules of court and specific orders."

Lord Sumption

orders." He also referred to Mr Prest's "persistent obstruction and mendacity."

Lady Hale stated that she "fervently hope[s] that the wife will gain some benefit from the outcome of all this litigation", clearly showing her view as to which party was in the right.

Duties to the Court

Lady Hale also noted that "the parties have a duty, not only to one another, but also to the court, to make full and frank disclosure of all material facts which are relevant to the exercise of the court's powers" and that if they do not do so "the court is entitled to draw such inferences as can properly be drawn from all the available

material... in deciding what the facts are."

Accordingly, a party who approaches the proceedings in a less than open manner may find that silence offers not protection but a reason for the court to draw adverse inferences. Acting, or at least appearing to act, in a manner which is as cooperative and reasonable as possible can have material benefits when it comes to the time for the court to reach its decision.

Share and share alike

Many commentators have questioned why the court needed to consider the issue of the ownership of the properties at all, when there appears to be a far simpler option of requiring Mr Prest to transfer his shareholdings to Mrs Prest in order to satisfy the order against him.

Lord Sumption observed in his speech that it will not always be possible to satisfy claims by the transfer of the shares "particularly in cases like this one where the shareholder and the company are both resident abroad in places which may not give direct effect to the orders of the English court".

This, combined with the questionable value of an illiquid shareholding in a private company controlled by the other spouse, would mean that, in

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practice, a transfer of the shares would not have seen justice done for Mrs Prest. Accordingly, alternative remedies had to be sought, ultimately leading to the transfer of those properties which were, whilst legally owned by companies, beneficially owned by Mr Prest.

A mortgaged future?

The Supreme Court ordered the transfer of the properties to Mrs Prest. But some of the properties are subject to mortgages in favour of two banks, and the Supreme Court could not sweep aside the banks' rights. The mortgages will therefore remain in place despite any transfer to Mrs Prest securing, it seems, liabilities of Mr Prest's business ventures. Neither Mr Prest nor the companies complied with orders requiring them to disclose details of loans secured on the

properties.

The level of those liabilities and their effect on Mrs Prest's recoveries could, therefore, mean that the courts will be troubled further. Lady Hale may have hoped fervently that Mrs Prest would gain some benefit from the litigation, but she added wearily that "in the light of the mortgages which apparently encumber the properties, I am not optimistic that she will."

Peace in our time?

Following his final victory at the Battle of Bosworth Field, Henry Tudor became King Henry VII and founded one of England's great royal lines.

However, the end of the Wars of the Roses did not see the end of the feuds which had dominated English royal life. The great families of the time continued to scheme against

each other, with rivals jostling for position and monarchs forced to be on their guard against potential usurpers to the throne.

The Tudor dynasty may have culminated with the golden age of Queen Elizabeth, gilded by the likes of William Shakespeare, Sir Walter Raleigh and Sir Francis Bacon, but it failed to reconcile the political and religious tensions which led to the civil wars of the seventeenth century.

Only time will tell if this judgment secures a lasting peace between the warring divisions of the English Court, or whether the Supreme Court's refusal to settle conclusively the issues around piercing the corporate veil in fact leaves open the possibility of further battles to come.

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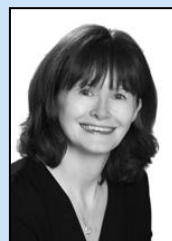
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