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PETRODEL V PREST

AN ASSESSMENT OF THE SO-CALLED "CHEAT'S CHARTER"

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Twelve years on from the pivotal decision of the House of Lords in White v White, the Court of Appeal has recently tackled yet another thorny issue in the realm of Ancillary Relief. It is not necessary to be a family lawyer, or even a lawyer for that matter, in order to appreciate the tabloid headlines whenever a "big money" case is reported on the front page. One only has to consider the McCartney-Mills debacle and anyone with even the slightest awareness of celeb culture will know that the division of assets upon divorce can be an expensive and often lengthy struggle – particularly where those assets are plentiful. The same can be said of the recent decision in Petrodel v Prest.

As the opening paragraphs of the Court of Appeal Judgment explains, Mr and Mrs Prest are both in their 50's and have dual Nigerian and British citizenship. Both are noted in the judgment as being highly educated. The couple were married in 1993 and have four (now teenage) children. Mr Prest is a successful businessman, working in international oil development and trade. The family had a very high standard of living – the final matrimonial home in London is worth approximately £4 million and the family also enjoyed properties in the Caribbean and Nigeria. Most of those properties were held in the name of three companies which the Husband controlled, and therein lies the problem.

S. 24 (1) (a) Matrimonial Causes Act 1973

Essentially, Mrs Prest's case throughout had been that her Husband was worth significantly more than had been assessed. She contended that the Husband's net assets were "tens if not hundreds of millions of pounds", rather than the mere £48 million that Moylan J had assessed them as. It was Mrs Prest's case that s.24 (1) (a) of the Matrimonial Causes Act 1973 enabled orders to be made against some of the companies her Husband controlled, thereby allowing her a claim to the assets of said companies.

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As Rimer LJ sets out at paragraph 87 of the judgment, s 24(1)(a) is *"a clear and uncomplicated provision"*. The section provides that property to which the respondent spouse is beneficially entitled to, either in possession or reversion, may be the subject of a property adjustment order. The court therefore must first identify property to which the spouse is beneficially entitled to, and then consider whether to make a property adjustment order in relation to that property. Rimer LJ continues; *"The inquiry will show that the asset in question either is, or is not, property of the respondent spouse. If it is, it is vulnerable to the exercise of the section 24 jurisdiction. If it is not, it is not."*[1]

The issue for the Court of Appeal was whether the property owned by Mr Prest's companies was subject to the s.24 (1) (a) jurisdiction. Mrs Prest's argument centered around the fact that her husband largely controlled the companies as a single shareholder, and therefore she argued that they amounted to his "alter ego". It was either on this basis, or the fact that the companies held shares and assets as bare trustee for the Husband, that he was in possession of such assets for the purpose of s.24 (1) (a). Mr Prest's appeal was struck out for failure to comply with various orders. The appellants were three of the companies which Mr Prest controlled. They maintained that the assets of the companies belonged to the companies alone and could not be acquired by the wife. In order for the company assets to become subject to the s.24 (1) (a), said the companies, the corporate veil would have to be lifted, and there are only a few circumstances in which that can happen. The companies argued that this was not one such circumstance.

1. Rimer LJ para 87 Petrodel v Prest [2012] EWCA Civ 1395

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Piercing the Corporate Veil

Companies are separate legal entities which can own property and which have their own rights and obligations. That may seem obvious, but it was not always so. In the landmark decision of *Salomon v A. Salomon & Company Limited*[2] the House of Lords dealt with the position of the "one man" company. It was argued that a company which was controlled by one person was not distinguishable from the person who controlled it, even if the formal requirements of incorporation had been complied with. That proposition was robustly rejected: Lord Halsbury saying[3]:

> *"Either the limited company was a legal entity or it was not. If it was, the business belonged to it and not to Mr Salomon. If it was not, there was no person and no thing to be an agent at all; and it is impossible to say at the same time that there is a company and there is not."*

Lord Macnaghten said[4]:

> *"It has become the fashion to call companies of this class "one-man companies." That is a taking nickname, but it does not help one much in the way of argument. If it is intended to convey the meaning that a company which is under the absolute control of one person is not a company legally incorporated, although the requirements of the Act of 1862 may have been complied with, it is inaccurate and misleading: if it merely means that there is a predominant partner possessing an overwhelming influence and entitled practically to the whole of the profits, there is nothing in that that I can see contrary to the true intention of the Act of 1862, or against public policy, or detrimental to the interests of creditors."*

2. Salomon v A. Salomon & Company Limited [1899] AC 22
3. Page 51 ibid
4. Page 53 ibid

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That remains the starting point and is usually the finishing point when attempts are made to argue that a company's assets are "really" the assets of its 100% or substantial majority shareholder. Nevertheless courts are astute to curb the worst abuses of incorporation with limited liability and so the judge made doctrine of "piercing the veil" has evolved. Put simply, in certain very limited circumstances, a court is entitled to *treat* the assets of a company as though they were the assets of the controlling shareholder: it should be noted that even this is a subtly different thing from saying that they *are* the assets of that shareholder: a distinction which is emphasised repeatedly in Rimer LJ's judgement.

The courts have repeatedly made it clear that no shareholder, even a 100% shareholder, has any right to any item of property owned by the company. Only the company, not the shareholder or any creditor, has any legal or equitable interest in the company's property. In *Petrodel Rimer* LJ referred[5] to the common misconception of lay people that a husband is "entitled" to a house which is owned by a company which he owns, and said of it that *"a lay person might so think but he would be wrong"*. He pointed out that the same lay person carrying on a business through a company would be quick to assert that the *liabilities* of the company were its alone, to be met out of its assets alone. That, said Rimer LJ, is what limited liability is about.

So, when will the veil be pierced? The most recent authoritative word on the subject in the commercial context is the Court of Appeal decision in *VTB Capital PLC v Nutritek International Corporation*[6], in which Rimer LJ was one of the judges. That decision recognised and reaffirmed the strict limitations identified in earlier authority as to the only factual circumstances in which it would be open to a court to pierce the veil. Thus, in *Woolfson v Strathclyde Regional Council*[7] the House of Lords said that:

> *"it is appropriate to pierce the veil only where special circumstances exist indicating that it is a mere façade concealing the true facts."*

5. Rimer LJ para 102 ibid
6. VTB Capital PLC v Nutritek International Corporation [2012] EWCA Civ 808
7. Woolfson v Strathclyde Regional Council [1978] SLT 159

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In *Adams v. Cape Industries Plc*[8] the Court of Appeal said:

> *"... save in cases which turn on the wording of particular statutes or contracts, the court is not free to disregard the principle of Salomon v A. Salomon & Co Ltd merely because it considers that justice so requires."*

In *Ord v Bellhaven Pubs Ltd*[9] the issue was whether, where a company had insufficient assets to meet its liabilities, it was open to the court to substitute as defendants its parent company and another subsidiary which had taken over its trading operations. The trial judge had approached the case on the basis that it was open to her to regard the companies as one economic unit and to disregard the distinction between them and then to say that since the company cannot pay, the shareholders who are the people financially interested should be made to pay instead. Reversing the decision, the Court of Appeal said that this approach was radically at odds with the whole concept of corporate personality and limited liability.

In *Trustor AB v Smallbone and others (No 2)*[10] Sir Andrew Morritt V-C said, at paragraph 23, that *"the court is entitled to pierce the corporate veil and recognise the receipt of the company as that of the individual(s) in control of it if the company was used as a device or façade to conceal the true facts thereby avoiding or concealing any liability of those individual(s)".*

It is fair to say that a rather different and less hard edged approach has evolved in the family courts. The origin of this is probably the decision of *Nicholas v Nicholas*[11] in which Cumming-Bruce LJ said:

> *"if the company was a one-man company and the alter ego of the husband, I would have no difficulty in holding that there was power to order a transfer of the property"*

10. Trustor AB v. Smallbone and others (No 2) [2001] 1 WLR 117
11. Nicholas v Nicholas [1984] FLR 285

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He went on to say that there was "abundant authority" for this proposition, without actually citing any of it.

In *Petrodel*[12] , Rimer LJ speculates that Cumming-Bruce LJ was probably referring to dicta of Lord Denning MR in *Wallersteiner v Moir*[13], which were later to be discredited by the Court of Appeal in *Adams*[14]. Nevertheless, Nicholas has been repeatedly followed and in extreme cases, such as *Green v Green*[15], the veil was pierced by reason *only* of the fact of 100% ownership.

Petrodel brings all this to a full stop – unless the Supreme Court decides otherwise: see below. In a lengthy and important passage[16] the court noted its own approval, in *VTB,* of Munby J's summary, made in a family context, of when it is appropriate to pierce the veil. In *Faiza Ben Hashem v Shayif*[17]. Munby J said:

> *"First, ownership and control of a company are not themselves sufficient to justify piercing the veil. Second, the court cannot pierce the veil, even when no unconnected third party is involved, merely because it is perceived that to do so is necessary in the interests of justice. Third, the corporate veil can only be pierced when there is some impropriety. Fourth, the company's involvement in an impropriety will not by itself justify a piercing of its veil: the impropriety "must be linked to use of the company structure to avoid or conceal liability". Fifth, it follows that if the court is to pierce the veil, it is necessary to show both control of the company by the wrongdoer and impropriety in the sense of a misuse of the company as a device or façade to conceal wrongdoing. Sixth, a company can be a façade for such purposes even though not incorporated with deceptive intent."*

12. Rimer LJ para 129 ibid
13. Wallersteiner v Moir [1974] 1 WLR 991
14. Page 543 ibid
15. Green v Green [1993] 1 FLR 326
16. Rimer LJ para 125-126 ibid
17. Faiza Ben Hashem v. Shayif and Another [2008] EWHC 2380 (Fam)

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Summarising the effect of Ben Hashem, and the commercial cases, Rimer LJ said[18]:

> *"The decision showed that what is required is nothing less than proof of impropriety directed at the misuse of the corporate structure for the purpose of concealing wrongdoing."*

Wrongdoing in that sense was not present in *Petrodel* and so the veil should not have been pierced. It followed that the court also rejected Mrs Prest's further argument that by reason of Mr Prest's ability to compel the companies to transfer assets to himself the companies held those assets as bare trustees for him: that is to say on trust on terms such that there was no beneficiary other than Mr Prest and so that the trustees had no power or obligation to resist his demands. Characterising this argument as "power equals property", Rimer LJ gave it short shrift:

> *"The proposition was simply the fruit of a judicial attempt to shoehorn into section 24(1)(a) assets which manifestly do not fit there"*[19].

Nicholas, and the cases which have followed Cumming-Bruce LJ's observations in it, are no longer to be followed. Rimer LJ said[20]:

> *"In my judgment, the dicta in Nicholas cannot stand with: (i) the prior House of Lords guidance in Woolfson as to the only circumstance in which a judicial piercing of the corporate veil is appropriate, or (ii) with the subsequent adoption of that approach by the Court of Appeal in Adams and Ord, or (iii) with the first three principles identified by Munby J in Ben Hashem, and accepted as correct by this court in VTB, as to the pre-conditions of a veil-piercing exercise. Whilst Nicholas was not cited in Adams or VTB, there is no basis on which its dicta can be defended as establishing a separate, free-standing, legitimate principle of English law..."*

18. Rimer LJ para 126 ibid
19. Rimer LJ para 105 ibid
20. Rimer LJ para 132 ibid

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> *"They involve a head-on disregard of Salomon. They were not advanced on the basis that they were directed at a special type of case justifying special treatment. In any particular case, an inability on the part of the court to make a property adjustment order in relation to property held by the husband's company rather than by the husband himself may be perceived as producing the potential for injustice; but Adams made clear that, by itself, such a consideration is no basis for assuming a jurisdiction to pierce the corporate veil: the court cannot disregard Salomon 'merely because it considers that justice so requires.' The husband and his company are separate legal persons and each owns his and its separate assets. Those differences must be respected and cannot be ignored merely because it is perceived as convenient to do so. A condition of the accepted basis for a piercing of the corporate veil is that the controller of the company has misused the fact of its separate corporate identify for the purpose of hiding facts or concealing wrongdoing. The rationale is that a wrongdoer cannot benefit from his dishonest misuse of a corporate structure for improper purposes. There was no suggestion in Nicholas that any such condition must be met before the veil could be pierced. The dicta were, in my judgment, wrong and should not be followed."*

Delivering the coup de grace, in a short judgement, Patten LJ said[21]:

> *"I wish particularly to support Rimer LJ's criticism of the dicta in Nicholas and his view that these cannot be relied upon as a correct statement of the law following the decision of this court in Adams v. Cape Industries plc. They have led judges of the Family Division to adopt and develop an approach to company owned assets in ancillary relief applications which amounts almost to a separate system of legal rules unaffected by the relevant principles of English property and company law. That must now cease."*

So, hard edged company law principles prevailed.

21. Patten LJ para 161 ibid

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The Implications of the Decision in Prest for Family Disputes

It is fair to say that Mr Prest was not the most cooperative of Respondent's. Thorpe LJ assessed the various strategies employed by the Husband throughout the proceedings, and notes that;

> *"These sort of manoeuverings in the interlocutory stages gravely impede the court and waste large sums of money. The trial judge faced a formidable task when he sat between 13th and 30th June 2011 to conduct the final hearing."*[22]

Thorpe LJ gave a dissenting judgment. He dismissed the appeal by the appellant companies and agreed with the reasoning of Moylan J. Citing *Prest* as an exceptional case, it appears that Thorpe LJ agreed that the complete absence of boundaries between the Husband and the companies enabled Moylan J to treat the Husband as entitled to the companies assets as required by s 24 (1) (a). Thorpe LJ felt that *"the Husband's companies were milked to provide him and his family with an extravagant lifestyle"*[23]. Further, if the Court was bound by strict principles of company law, *"in many cases [a Judge] would be unable to make orders fair to applicant wives."*[24]

What is *fair* when balancing competing corporate and family interests is open to interpretation. The idea that family interests should take precedence is a consideration that Rimer LJ and Patten LJ struggled with. Why family justice should be any different from other kinds of justice was a question directly posed by Rimer LJ. The family courts at times appear to adopt a "Robin Hood" role, developing idiosyncratic practices which allow for a flexible approach. Of course, family practitioners will recognise that the Family Justice System simply could not function without huge amounts of flexibility. The law cannot regulate or assist in family life without such an approach. But when it comes to eroding established principles of company law, is this a step too far? Rimer and Patten LJ clearly thought so.

22. Thorpe LJ para 18 ibid
23. Thorpe LJ para 64 ibid
24. Thorpe LJ para 52 ibid

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Despite Mr Prest's reluctance for full and frank disclosure, his "manoeuverings" did not amount to the kind of *impropriety* which is needed before any of the companies assets (the properties in this case) became subject to the s.24 (1) (a) jurisdiction. Rimer LJ made clear that:

> *"...it was only if relevant impropriety could be shown that the corporate veils in consequence could be pierced, following which it would be open to the court, so far as it might think fit, to treat certain of the companies' assets as the Husband's and make transfer orders in respect of them".* [25]

Moylan J would have had to find that the corporate structure had been used in some way to conceal or dissipate assets; assets which in truth should have been included in the matrimonial reckoning. No such finding was made. In fact, Moylan J found that the family had used the corporate structure for typical reasons including wealth protection and the avoidance of tax. Moylan J expressly stated at paragraph 219 of his judgment: "*I do not consider that the wife has established impropriety in this case*"[26]. Although Moylan J assessed the Husband as using the companies "effectively [as his] money box at will", as Rimer LJ pointed out, this *"might have been contrary to accounting or legal principles... [but] such use did not undermine the legitimacy of the establishment of their structure."*[27]

Moylan J had concluded that the fact that Mr Prest was effectively in sole control of the companies, and was therefore the effective sole owner, amounted to beneficial ownership. He found that if a controller of a company has the right and ability as ultimate shareholder, to transfer assets to himself then he is entitled in possession to that asset. The suggestion that a company in the sole ownership of an individual can hold none of it's assets beneficially, because the individual owner is entitled to them, *"involves a misunderstanding of s 24 (1) (a) and is wrong."*[28]

25. Rimer LJ para 88 ibid
26. Moylan J para 219 Prest v Prest [2011] EWHC 2956 (Fam)
27. Rimer LJ para 89 Petrodel v Prest [2012] EWCA Civ 1395
28. Rimer LJ para 95 ibid

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Rimer LJ agreed with Moylan J, in the sense that there was no finding of impropriety – essential before the corporate veil can be pierced. It is useful to set out his concluding comments at length:

> *"There is no factual basis upon which this court can conclude that these long-established companies were incorporated, or were used, as a cloak or mask to hide the... properties from the court's gaze; or, more particularly, as part of an attempt to hoodwink the court into believing that assets that belonged beneficially to the husband were now the companies' assets and so escaped the wife's reach The wife also contended that the judge was wrong not to find that the relevant... properties were held by those companies as nominees of trustees for the husband... there is, I consider, nothing in his judgment that could enable this court to find that he ought nonetheless to have found that the specified properties... belonged beneficially to the husband. I would also reject this argument advanced by the wife."*[29]

A Cheat's Charter?

In Thorpe LJ's assessment, recognition of the overriding objective in family law, and consideration of what was fair in all of the circumstances should have been the driving force behind the decision in *Prest.* It may appear to critics of the decision that the inflexibility of black letter law has won out, and the family interest has been diminished. But the sentiment of Rimer LJ's judgment provides all the necessary assurance that such critics should need. Where there is true impropriety, the *Ben Hashem* principles allow for the veil to be pierced and for spouses to engage the s.24 (1) (a) framework. Just as the way in which the standard of living that families enjoy, and the choices they make during the marriage will affect ancillary relief, so too will the way in which they legally organise their financial affairs. As Patten LJ points out *"Married couples who choose to vest assets beneficially in a company for what the Judge described as conventional reasons including wealth protection and the avoidance of tax cannot ignore the legal consequences of their actions in less happy times."*[30]

29. Rimer LJ para 152 – 153 ibid
30. Patten LJ para 160 Ibid

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Mrs Prest has obtained leave to appeal the decision to the Supreme Court, with a hearing set for 5th and 6th March 2013. Whether the position remains settled in its current form remains to be seen.

Principles

Pending any decision of the Supreme Court, the following principles set out at paragraph 154 of Rimer LJ's judgment onwards provide a useful summary of the current position:

- *Solomon is House of Lords authority affirming the distinction between the separate legal personality of a company and its corporators.*
- *It makes no difference to such a distinction that the company has a single corporator with total control overs its affairs.*
- *The separate corporate identity of a company is a fact of legal life that all courts are required to recognise and respect, whatever jurisdiction they are exercising.*
- *It is not open to a court, simply because it regards it as just and convenient, to disregard such separate identity and to appropriate assets of a company in either monetary claims of it's corporate creditors or of the monetary ancillary relief claims of its corporator's spouse.*
- *A one-man company does not metamorphose into the one-man simply because the person with a wish to abstract its assets is his wife.*
- *There may be factual circumstances in which it will be legitimate for the court to pierce a company's corporate veil and, to an appropriate extent, disregard the fact of its separate identity from that of its corporators. This can only be done in limited circumstances, central to which is the demonstration of relevant impropriety in the corporators' use of the company. This is perhaps a relative of the principle that a wrongdoer cannot ordinarily be allowed to profit from his own wrong.*

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The Supreme Court

It is unwise at the best of times to predict the outcome of litigation, so your authors will not embark upon the exercise, but some thoughts on the wider questions facing the Supreme Court may be of interest. We tentatively suggest that the Court of Appeal decision is correct, although it is noticeable that the dissenting judgment came from a family lawyer, with the majority coming from a commercial background. A differently constituted court may have decided the case the other way. The hypothetical lay person of Rimer LJ's judgement (the man on the Clapham omnibus for the internet age?) may feel a lingering sense of unfairness in relation to Mrs Prest. True it is that in the good times they milked the companies to support their lifestyle, but should it follow that in such cases one of them (usually the husband), should keep the entire spoils?

The majority judgments confront head on and reject the implicit assumption of Thorpe LJ that section 24, sotto voce, creates another statutory exception to the *Salomon* principle. Applying a purposive construction, might the Supreme Court say that it does? But if it does, why should a wife in Mrs Prest's position be preferred to the general creditors and, where there are any, other shareholders? And what if the company fails months later? If the assets were always the husbands and not the company's they will presumably not be reclaimable in a liquidation for the benefit of creditors. And if they were the husband's all along, can the tax benefits obtained through use of the corporate structure then be reversed? A decision in Mrs Prest's favour could cause genuine difficulty for one man (or woman) companies, with a real risk of insecurity for lenders and creditors even where no divorce is on the horizon.

We don't yet know who will hear the Supreme Court appeal, but if the bench includes Lady Hale and Lord Sumption, it could be interesting.

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