

Supreme Court decision in Prest v Petrodel: The 'unyielding rock' of corporate integrity?

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The 'unyielding rock' of corporate integrity?

The divorce case Prest v Petrodel Resources Ltd has excited much comment as to what is fair or right when dealing with one-man companies and divorce awards: should such a company hand over assets to meet a divorce award against its 'controller' or should company integrity be respected?

The Court of Appeal decision last October represented something of a showdown between the company and family law approaches to the integrity of companies. Yesterday, the Supreme Court came down on the side of company law in deciding that a spouse cannot obtain a financial award from a company on divorce simply because it is a one-man company. Only in extremely rare cases will a court be able to justify disrespecting the separate legal personality of the company ('piercing the corporate veil'). Alternatively special facts might enable the court to decide, on well-established trust principles, that the company holds its assets on trust for the spouse and so available to meet a divorce award.

Michael Prest, founder of Petrodel Resources, had claimed that Petrodel's assets did not belong to him and that he was £48m in debt. His wife of 15 years claimed that he and Petrodel were one and the same, and that she should have a multi-million pound award funded from the companies' properties. The Judge at first instance agreed, awarding her £17.5m and ordering the companies to transfer their properties to her. The companies succeeded on appeal. Now Mrs Prest has secured a favourable judgment because, while the Supreme Court confirmed that Petrodel's corporate integrity had to be respected, it decided that the companies' properties were held on resulting trust for Mr Prest, who had provided the funds to purchase them.

This decision is important because it upholds what has been the 'unyielding rock' of company law for over a century: that a company is independent of its shareholders, even if there is a sole shareholder. The corporate veil will not be pierced unless there has been impropriety directed at the misuse of the corporate structure for the purpose of concealing wrongdoing. This 'piercing' is an exceptional remedy, only available if there is no other recourse to address a wrong.

The Supreme Court has also clarified that English divorce legislation – the Matrimonial Causes Act 1973 – does not enable wider principles to be applied in the English Family Court. This puts an end to the practice of the Family Court routinely making financial awards from company assets where one spouse controlled the company. The Supreme Court considered that doing so effectively obliged a third party to satisfy claims against a spouse.

Lord Sumption said '*Courts exercising family jurisdiction do not occupy a desert island in which general legal concepts are suspended or mean something different. If a right of property exists, it exists in every division of the High Court and in every jurisdiction of the county courts. If it does not exist, it does not exist anywhere.*'

In this case the Supreme Court decided that the companies simply did not have the beneficial ownership to the properties because they belonged to Mr Prest. Petrodel itself failed to produce evidence to back up its claim to beneficially own the properties. Mr Prest had failed to disclose his assets, but from the limited facts which were available, as well as from drawing adverse inferences from his repeated failure to provide proper disclosure, it was clear that he, and not the companies, had provided the funds to purchase the properties.

Lord Sumption was careful to point out that this was an exceptional case and the issue was highly fact-specific: '*Whether assets legally vested in a company are beneficially owned by its controller is a highly fact-specific issue. It is not possible to give general guidance going beyond the ordinary principles and presumptions of equity, especially those relating to gifts and resulting trusts.*'

However, Family judges are entitled to be sceptical about matrimonial homes which are owned by a company and occupied by the spouse controlling the company. Family judges should examine the terms of occupation in order to determine whether they are what they are said to be or 'simply a sham to conceal the reality of the husband's beneficial ownership'.

Prest v Petrodel Resources Ltd emphasises the importance of properly and transparently running companies. One of Mr Prest's failings was to provide funding without properly documented loans or capital subscription. Another was to take funds from the companies whenever he wished, without right or company authority. The problem was compounded by the absence of any independent directors on the boards of the companies.

The decision is good news for the preservation of properly created, documented and run structures. It emphasises the need for companies and trusts caught up in a divorce to take advice on whether and if so the extent to which they should engage with the proceedings or risk adverse inferences. The burden will be on respondents and companies involved in divorce claims to show that the company is the beneficial owner of its

assets, but claimants should beware. Claimants need to be wary of the cost of establishing the truth and the practicalities of enforcing any award they achieve.

Authors

James Copson

PARTNER | LONDON

Divorce and family

 +44 20 7597 6044

 james.copson@withersworldwide.com

Dawn Goodman

PARTNER | LONDON

Trust, estate and inheritance disputes

 +44 20 7597 6014

 dawn.goodman@withersworldwide.com

Christopher Groves

PARTNER | LONDON

Private client and tax

 +44 20 7597 6127

 christopher.groves@withersworldwide.com