

Piercing the corporate veil – applying founding company law principles to modern family law cases

The recent Court of Appeal decision in *Petrodel Resources Limited v Prest* has (for now) clarified the basis on which courts in matrimonial cases are entitled to look behind the principle of separate legal personality for companies.

From a company law perspective, the decision sends a strong message that simply treating the company's assets as though they are assets of a spouse should only be done in limited circumstances, and also made clear that a number of previously decided cases on this point in the family courts were incorrect.

From a family law perspective, the decision has caused concern particularly for those cases whereby complex company or trust structures are used to hide, divest or divert wealth or create obstacles for the non-owning spouse or the Court when assessing financial claims on relationship breakdown.

The Facts

Section 24(1)(a) of the Matrimonial Causes Act 1973 states that assets can be the subject of an order in divorce proceedings where a party to the marriage is entitled to them either in possession or reversion (notwithstanding that they might be legally owned by a third party).

The order for financial provision made by the trial judge in this case had included provisions whereby, pursuant to the above provision, the husband was ordered to transfer certain properties not owned by him, but instead owned by companies under his effective sole control, to his wife.

The various companies involved appealed against this decision.

The Consequences

The trial judge in this case had analysed the corporate structure which the husband had put in place and had concluded that the relevant provisions of the 1973 Act could apply here, as the husband was effectively the sole owner and controller of the various companies concerned.

By a majority of 2 to 1, the Court of Appeal rejected this argument and upheld the appeal of the various companies.

The majority decision emphasised the importance of the basic company law principle of "separate legal personality", namely that there should be a clear distinction between the respective legal personalities, rights and liabilities of a company and those of its shareholders.

According to the Court of Appeal ruling, the shareholders in a company, whether there were many shareholders with various shareholdings, or one 100% shareholder, should not be regarded as having a direct beneficial interest in the assets of the company. The mere fact that

a company might be owned and controlled by the same person did not mean that person was entitled to the assets of the company.

The relevant provisions of the 1973 Act were concerned with identifying assets which a party to the marriage beneficially owned. Accordingly, as under general law the doctrine of separate legal personality would not apply if, for example, the relevant company simply held the assets as a nominee for the individual concerned. In that case it was relatively clear that the individual concerned still retained beneficial ownership.

There were also limited circumstances in which it might be appropriate to "pierce the corporate veil", and look behind the legal personality of the company to attribute its assets and liabilities directly to the individuals behind it. However, this doctrine was applied rarely in practice and should only be used in cases of "impropriety". This impropriety had to be more than simply a failure of the controllers of the company concerned to follow applicable company law provisions. It would need to involve, for example, an improper attempt to avoid or conceal liability – more than using a corporate structure to benefit from limited liability or tax planning. The trial judge had explicitly acknowledged that no such impropriety existed in this case.

The majority also noted that following this reasoning several recent cases in this area in the family courts appear to have been wrongly decided. It was emphasised that these cases, stemming from the judgment in *Nicholas v Nicholas* in 1984, should no longer be followed and that Section 24 of the 1973 Act did not allow the family courts to apply a different set of rules in relation to legal personality than in other areas of English law.

The Outcome (as it stands now)

This case reaffirms the importance of the basic principle of separate legal personality for companies, first clarified by the House of Lords in *Salomon v Salomon & Co Ltd* in 1897, and the courts' general reluctance to go behind this.

In order to pierce the corporate veil, there needed to be a genuine element of impropriety, rather than a simple failure to observe principles of corporate governance, or the use of corporate structures for common purposes such as tax planning. For example, the situation, relatively common in practice, where a company is owned and controlled by one individual who treats the company's funds broadly as his own may give rise to various other legal and accounting concerns but in itself is insufficient to justify disregarding the principle of separate legal personality.

The Appeal

The decision has generally been welcomed by company lawyers whilst causing concern for family lawyers. Mrs. Prest has been granted permission to appeal to the Supreme Court. The appeal will be heard on the 5th and 6th March 2013.

The Lesson

The case highlights the tensions between a formal approach applying the company law rules which have acted as the foundation for limited liability companies for over a century, and a more pragmatic approach reflecting commercial reality in a context where those historic rules were not really designed to operate and in an effort to resolve disputes fairly. It will be interesting to see how these tensions are resolved when the appeal is heard.

Ultimately, in any family matter, constructive resolution and agreement should be the objective. Russell-Cooke's Family Team offer resolution through negotiation, mediation, collaborative practice or through the courts if necessary. We have four trained mediators and eight trained collaborative lawyers. Our Family Team regularly work alongside our company and commercial teams in matters which involve family companies and business with the intention of securing an outcome that is suitable for both the family and the business.

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