Recent developments

The Supreme Court has been busy. Two final appeals in matters of interest to trust practitioners have been heard in the past fortnight. Judgment is awaited on the appeals in *Petrodel Resources Limited & others v Prest & others* (1) and the conjoined appeals in *Pitt v Holt and Futter v Futter* (2). The note below should whet the appetite for those judgments.

**Petrodel**

*Petrodel* concerns the jurisdiction of English courts (in particular the Family Division of the High Court) to make property transfer orders in matrimonial proceedings relating to assets held by companies, as opposed to assets held either legally or beneficially by the husband (**H**) or wife (**W**). Section 24 (1)(a) of the Matrimonial Causes Act 1973 permits the court to make an order that one party to a marriage transfer to the other party any “property to which the first-mentioned party is entitled, either in possession or reversion”. This is of interest to trustees who hold (for example) English real estate through offshore SPVs. The extent of the section 24(1)(a) jurisdiction affects the ease with which divorcing spouses may be able to enforce ancillary relief orders against that company-owned real estate.

In a simple case, where **H** is the legal and beneficial owner of a property in England, he can be ordered pursuant to section 24 (1)(a) to transfer it to **W**. If he fails to do so he risks committal for contempt and the necessary conveyance can in any case be effected pursuant to an order of the court. But what if the property is owned by an offshore company, which itself is legally owned by third parties, but is seemingly under the close control or influence of **H**? Such was the case in *Petrodel*. **H** conducted a successful oil exploration business through companies incorporated in the Isle of Man, including Petrodel Resources Limited (**PRL**). **PRL** owned several English properties. **H** was neither a shareholder nor director of **PRL**. However, he had enjoyed free access to its assets to support his and his family’s lifestyle throughout the marriage. That was enough for Moylan J. in the Family Division, who ordered **H** to transfer several of **PRL**’s properties to **W**. He held that the order was necessary to achieve fairness in the allocation of matrimonial assets and that section 24(1)(a) granted the court jurisdiction to make such an order where **H** enjoyed effective power over the assets of **PRL** and no third party interests (i.e. shareholders of **PRL** independent of **H**) would be prejudiced.

On appeal, Lord Justice Thorpe agreed with Moylan J.’s reasoning, thinking it consistent with authority in both the Family Division and Court of Appeal over the past 20 years. Lord Justices Rimer and Patten, however, were unimpressed (to put it mildly) and held as follows. Section 24(1)(a) bites only on property owned beneficially by one party to a marriage. The assets of a company are beneficially owned by the company itself, and the company’s shareholders have no interest, legal or beneficial, in its assets. Thus creditors of a company cannot enforce against the assets of the shareholders and creditors of the shareholders cannot enforce against the assets of the company. That is the essence of limited liability, which applies even where the company is owned and managed by one person.

The court may only “pierce the corporate veil” and treat a company’s assets as belonging to its shareholder(s) in very limited circumstances. Impropriety linked to the use of the corporate structure to avoid or conceal liability is a necessary condition for veil piercing. In *Petrodel*,...
there was no such impropriety. Despite H having
taken several leaves out of Iqbal Mubarik’s seminal
book Cunning Ruses for the Better Thwarting of
English Court Processes (3), PRL was
nevertheless a genuine company, properly
incorporated under the laws of another jurisdiction,
for legitimate trading and tax planning reasons.
For those reasons, section 24(1)(a) did not give
the court jurisdiction to make a property transfer
order against the assets of PRL.

In Petrodel the Family Division’s overriding duty to
achieve a fair result on the division of matrimonial
assets crashed head on into the concept of limited
liability, a fundamental principle of company and
property law underpinning corporate economic
activity in this country. Lord Justice Thorpe in his
dissenting judgment noted that the strict
application of company and property law principles
would deprive the Family Division of a crucial tool
for delivering effective justice between divorcing
spouses. By lessenning the threat of direct
enforcement against trust assets, Petrodel may
have enabled trustees to participate in the debate
about division of assets more effectively on their
own terms. The Supreme Court decision will,
therefore, have a major effect on the balance of
power in matrimonial disputes over corporate
assets.

Pitt v Holt; Futter v Futter

In March 2011 the Court of Appeal rewrote the law
relating to the circumstances in which a trustee’s
exercise of discretionary dispositive powers can be
set aside if an unforeseen, undesirable
consequence (usually a tax charge) follows. For
35 years, following the case of Re Hastings Bass
(4), trustee dispositions could be set aside if the
trustee failed to take into account relevant matters
or took into account irrelevant matters in the
exercise of the discretion. Failing to take into
account the true effect of tax legislation could
trigger the jurisdiction, to the relief of remorseful
trustees and unhappy beneficiaries. This was an
aspect of equity’s capacity to intervene in the
administration of trusts to protect the interests of
beneficiaries.

However, that 35 years’ jurisprudence was in fact
wrong, said Lord Justice Lloyd on appeal in Pitt.
Trustee dispositions are only void if outside the
trustee’s powers or made for an improper purpose.
They are voidable at the instance of the
beneficiaries if tainted by breach of fiduciary duty.
This was intended to bring the law as it affects
trustees into line with the law as it affects everyone
else.

Lord Justice Lloyd went on to say that in the
context of private discretionary trusts, bound up as
they generally are with considerations of tax
mitigation, failure to consider the tax implications of
a disposition could amount to a breach of fiduciary.
That produced a curious result. If the trustee fails
to take proper tax advice before effecting a
damaging transaction, the beneficiaries may bring
a claim alleging breach of fiduciary duty against
the trustee. The trustee may defend that claim,
particularly if his exoneration clause does not
appear to protect him from liability.

If the beneficiaries are successful there would be
cost implications for the trustee, but the
beneficiaries may elect to set aside the
transaction. Beneficiaries and trustee (but not the
taxman) are relieved. But if a trustee, as he
should, takes specialist tax advice but that advice
turns out to be wrong, the trustee will not be in
breach of duty, the transaction cannot be
unwound, and the only recourse to recover losses
for the beneficiaries will be professional negligence
litigation with the trustee’s tax advisor. The
beneficiaries might prefer their trustees to have
been in breach of fiduciary duty (5).

The Supreme Court must now finally determine
whether trustees, dealing with assets held on
behalf of others, have any greater protection from
the unforeseen consequences of their actions than
anyone else.

Stephen Hayes, Associate
(1) [2012] EWCA Civ 1395
(2) [2011] EWCA Civ 197
(3) See Mubarak v Mubarak [2007] EWHC 220 (Fam)
(4) [1975] Ch. 75
(5) For a more detailed description of the ins and outs of Re Hastings
Bass, see our June 2011 newsletter found in News and Updates, at
http://www.fladgate.com

Further information?

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