MP Bank v Pugachev [2017] EWHC 2426 (Ch), 20 ITELR 905

Russian bank and its liquidator, enforcing Russian judgment in England vs P, sought declarations that assets held under discretionary trusts belonged to P, a wealthy Russian oligarch. Heard in the English Chancery Division.

P settled substantial assets on five discretionary trusts under NZ law with corporate trustees. P and family are beneficiaries. P is first protector of each trust, with his first successor (P's son Victor) pre-appointed. Protector's consent required for the exercise of most trustee powers and he had a power to appoint/remove trustees which could be exercised "with or without cause". Victor also settled assets into the trusts.

Held by Birss J. on 10 October 2017 that assets were held on bare trust for P:

1. **Failure of trusts**

    a. Court should construe the powers and duties as a whole and work out what was happening as a matter of substance, *Clayton v Clayton [2016] NZSC 29, [2016] WTLR 955*.

    b. Protector's powers held not be not fiduciary and could be exercised for sole benefit of protector (including power to fire and hire trustees).

    c. On true construction of trust instruments, particularly with reference to protector's powers assets held on bare trust for P (paras 157-169, 265-275, 278, 454-455).

2. **Sham trust**

    a. The unilateral intentions of the settlor were not enough to establish a sham; there had to be a common intention. Reckless indifference would be taken to constitute a common intention, *A v A* [2007] EWHC 99 (Fam), [2007] 2 F.L.R. 467.

    b. P did not intend to divest himself of "ultimate control". The point of the trusts was not to cede control of his assets to someone else, it was to retain them and hide his control of them. He intended to use the trusts as a pretence to mislead other people, by creating the false appearance that the property did not belong to him. His family would benefit from the use of the trust assets, but only on his say so.

    c. No person involved in setting up the trusts had any intention independent of that. The trustees had gone along with the first defendant's intention recklessly. (paras 150, 424-425, 434-437, 456).

3. **Setting aside under insolvency legislation**

    Court would have found that the first defendant's purpose in setting up each of the trusts satisfied the test in s.423 of the Insolvency Act 1986 and hence would have set aside trusts on this ground also (paras 443-447).

4. **Relief**

It was appropriate to make declarations, but the question of what other relief was appropriate was not straightforward and submissions would be needed in that respect (paras 449-452).

Apparently no appeal no funds?

Comment:

1. **Failure of trusts**

a. Agreed that relevant English and NZ law of trusts is the same.

b. NZ has no reserved powers or settlor powers legislation.

c. The NZ court had already found the Protector's powers to be subject at least to the fraud on a power rule (paras 253-264).

d. Odd selection of text books and authorities cited (e.g. no Lewin, Hubbard or Holden).

e. Nothing very unusual about the terms of the NZ trusts.

f. Nothing very unusual about P's motives in setting up trusts.

g. No powers of Protector/Settlor that could be exercised to obtain any trust assets for P without exercise of trustees' dispositive powers, contrast *TMSF* (power of revocation) and *Clayton v Clayton* (general power of appointment).

h. Analysis of fiduciary/non-fiduciary protector powers and effect of holding P held personal powers appears flawed, particularly paras 180-181, 186, 188 – contrast 203 which appears to summarise the conventional approach.

i. Construction of trusts appears to assume what it sets out to find by way of construction of the terms of the deeds themselves (that P is unscrupulous and had no intention of parting with "control" over trust assets), particularly paras 187.

j. Critically power of veto plus non-fiduciary power to appoint/remove trustees does not on the face of it amount to a power of appointment over the assets, contrast paras 245-246.

k. Reasons for conclusions as to nature of P's powers also appear flawed, particularly emphasis on P's status as settlor and beneficiary, paras 268-278.

l. If English law applies, power to appoint trustees is on authority necessarily fiduciary, *Re Shortridge* [1895] 1 Ch 278 CA, see *Lewin* 14-40.

m. No comment on many offshore authorities that have reached contrary conclusions on similar facts.

n. What of the Hague Convention on the Recognition of Trusts? Comity?

o. An accident waiting to happen?

2. Sham

a. In context "recklessness" implies that the purported trustee signed documents without knowing or caring what they said or what their effect purported to be. Not this case.

b. Claimants' case was based mainly on evidence that trustees acted like nominees for P and that this should lead to inference that they were nominees for P and trusts were shams.

c. The relevant individual (found to be the directing mind of the corporate trustees for these purposes) appears to have acted as a professional trustee would and knew exactly what the trust deeds said but failed to question P to see if his subjective intentions were consistent with the contents of the trust deeds when he had grounds for inferring that if they were effective trusts they did not, paras 434, 435.

d. The judge did not appear to think the "Nelsonian blindness" he described on the part of the trustee was enough to find dishonesty (which was not apparently alleged and is not mentioned in the judge's analysis here). Was it? *Ivey v Genting* [2017] UKSC 67 (decided just after *Pugachev*).

e. The conduct of the trustees in relation to the trusts provided plenty of ammunition for a sham argument and lessons should clearly be learned.

f. Note comments about trusts and the "Angora cat", paras 438-442.

g. Will an overly "flexible" approach to the validity of trusts in some jurisdictions lead to their downfall?

3. IA1986, S.423

a. Perhaps the strongest claim but treated very briefly in the judgment (paras 443-448).

b. Illustrates the problem in English law of any structure designed with a view to asset protection (even if this is not its primary purpose).

c. The s.423 claim may explain the absence of an appeal.

4. What to do now ?

a. Look at limiting reserved/protector powers in new trusts.

b. Look at defining reserved/protector powers more fully in new trusts.

c. Look at amending existing trusts to take account of the attacks in *Pugachev*.

d. Remind TSPs of the dangers of the "client" based model of trust administration.

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Nov 2018