



THE INTERNATIONAL FAMILY OFFICE

JSC MEZHDUNARODNIY PROMYSHLENNIY & STATE CORPORATION "DEPOSIT
INSURANCE AGENCY" V. SERGEI VIKTOROVICH PUGACHEV ET. AL
[2017] EWHC 2426 (CH)

19th June

Bonnie Steiner
Jur, Dr. , LLM, TEP

BACKGROUND

- This case concerned 5 New Zealand trusts set up by Sergei Pugachev (“SP”)
- SP had founded Mezhprom Bank, a private bank (the “Bank”).
- The Bank had suffered in the financial crash & received emergency assistance from the **Russian Central Bank**. It entered into insolvency in 2010 with liabilities exceeding USD1 bill.
- After falling out with Putin (formerly he had been a member of Putin’s inner circle, an elected official as well as an entrepreneur) a criminal investigation was opened against him in connection with the bank’s insolvency & in 2011 he fled Russia.



BACKGROUND CONT.

- He moved to London in 2011 with his partner & mother of 2 of his children, Alexandra Tolstoy.
- He sought asset protection advice in London and the 1st UK trust was settled late 2011 and then 4 more over the course of next 2 years.
- Whilst in London in 2014 he was served with a worldwide freezing injunction to stop him from spending his wealth.
- In 2015 he fled London for his chateau in the south of France and has not returned.
- He currently faces a 2 year prison sentence in the UK for breaching 12 high court orders .



BACKGROUND CONT.

- The 5 Trusts ruled upon in this case are said to have held collectively assets valued at c. \$950 mill.
- The claimant, Russia's Deposit Insurance Agency (DIA), filed suit in London against SP and the Trusts in 2014.
- The only defendants who were represented at the trial were SP's infant children, with their mother Alexandra Tolstoy acting as their litigation guardian.
- SP did not appear at the trial and the court therefore heard no evidence from SP as to his intentions in settling the 5 Trusts and/or otherwise.



BACKGROUND-FACTS CONT

- The DIA commenced proceedings against the Trustees in London with the aim of enforcing a judgement obtained in Russia from the Trust funds. They challenged the validity of the 5 trusts on **3 alternative grounds**:
 1. The Trusts were illusory and SP had not therefore successfully divested himself of beneficial ownership of the assets (the judge did not favour the term “illusory” and dealt with the claim as a matter of construction); or
 2. The Trusts were shams and SP remained the beneficial owner of the assets; or



BACKGROUND CONT.

3. In the event that the first 2 claims failed and SP was not the beneficial owner of the assets, § 423 of the Insolvency Act 1986 (**transactions defrauding creditors**) should be applied to set aside the transfer of the assets to the trustees thereby returning the assets to SP's estate for the benefit of his creditors.

The court found in favour for the claimants on all 3 claims.



FACTS OF THE CASE

- Although the 5 Trusts deeds contained some differences the court found that they were identical in all significant respects and any differences did not affect his analysis of the 3 claims.
- The Settlor of the assets onto the 5 Trusts was Viktor, SP's eldest son.
- The Trusts were governed by NZ law and set up with the assistance of a NZ solicitor, Mr Patterson (the "Trustee"). He was a shareholder and a director of the 5 dedicated trustee companies. He drafted the Trust deeds and set up the companies. He looked after all of the paperwork concerning the administration of the trusts.
- Mr Patterson was just one of the directors of the corporate trustee companies. The other directors were Mr Patterson's wife, (also a solicitor) as well as two persons from SP's family office.



FACTS OF THE CASE

- SP was the protector of each of the Trusts, with Viktor named as his successor protector. The Trust deeds provided that SP's protectorship would automatically terminate in circumstances where he was **“under a disability”**, a term which included when SP was subject to the claims of creditors. The Protector powers were:
 - Veto distributions of income and capital;
 - Veto the investment of the Trust funds ;
 - Veto any variation to the Trust deeds;
 - Veto the release or revocation of any power granted to the Trustees;
 - Veto the early termination of the Trust period;
 - Veto an amendment to the Trust by the Trustees;
 - Veto the removal of beneficiaries;
 - Add further beneficiaries;
 - Appoint and remove Trustees **with or without cause.**



FACTS OF THE CASE

- SP was irrevocably appointed as a retiring/removed Trustees agent, and empowered to vest the Trust fund in continuing or new trustees.
- Nowhere in any of the Trust Deeds was the Protector's power stated to be either «personal» or «fiduciary». The deeds were silent on this point.
- The Beneficiaries of the 5 Trusts (albeit different variations on each Trust) were SP and his minor children and two adult sons with a former spouse.
- The 5 Trusts were discretionary Declarations of Trust (ie. No settlor was identified on the face of the Instruments.)



1. ASSETS TRANSFERRED BY VIKTOR:

Court found that although the assets had been settled on to the Trusts by SP's eldest son, Viktor, SP was to be treated as the settlor of the trusts as the assets emanated from him and Viktor was in effect acting as his father's nominee and simply doing his father's bidding (para 205).

It reached this conclusion on the basis that:

- No evidence was submitted to show that Viktor had the means to generate this sort of wealth independently of his father;
- Given the provisions of the deeds (some of which made no provision for Viktor) there was no reason why Viktor would wish to transfer his assets onto the trusts;
- Evidence introduced showed Viktor did not get along with Alexandra; and
- Viktor acted in concert with his father and his father's family office in London in setting up the Trusts.



COURTS FINDINGS

2. THE PROTECTORS POWERS WERE ALL PERSONAL:

In reaching this holding the court stated:

*“when considering what powers a person actually has as a result of the trust deed, the court is entitled to construe the powers and duties as a whole and **work out what is going on as a matter of substance.**”*

The court placed considerable emphasis on the fact that SP was also the settlor and one of the named beneficiaries. It is clear that had the protector powers been held by a third party, not a beneficiary, a different result might have followed.



3. THE TRUSTS WERE BARE TRUSTS:

Despite the appearance of these trusts being discretionary & for a range of beneficiaries, they were really bare trusts held for SP alone.

In reaching this holding on the “illusory trust claim”, the court referred to the NZ supreme court decision in Clayton v Clayton.

It noted that SP could veto distributions to anyone & could also remove a Trustee who refused to distribute assets to him and appoint a trustee who would do his bidding.

This concentration of powers in SP meant he had not ceded control of the assets to the Trustee **without the power to get them back** and was therefore, as a matter of construction, still to be treated as the beneficial owner.



4. THE TRUSTS WERE SHAMS:

If the Protector powers were Fiduciary then the Trust deeds were, alternatively, shams.

A Sham Trust requires that :

1. The parties to a Trust deed must have intended (subjectively) to create different rights and obligations from those appearing in the Trust doc;

(ie. They must have intended to give a false impression of those rights & obligations to third parties);



4. THE TRUSTS WERE SHAMS:

2. There must be a common intent to sham (ie. the party alleging sham must prove the settlor & Trustee shared a common intention to create a legal arrangement which is different from the trust);
and
3. The intent to mislead must be at the time the document is created.



COURTS FINDINGS

4. THE TRUSTS WERE SHAMS:

Court concluded, on the evidence submitted, that SP's intention was "**not to cede control of his assets to someone else, it was to hide his control of them. In other words [SP] intended to use the Trusts as a pretence to mislead other people by creating the appearance that the property did not belong to him**"-

The role of the protector was the means by which he did this.

&

The court held, on the evidence, that no other individual involved in setting up the Trusts had "***an intention independent of Mr Pugachev***".

In other words the Trustees shared the shamming intent.



COURTS FINDINGS

4. THE TRUSTS WERE SHAMS: EVIDENCE INTRODUCED SHOWED:

Mr Patterson was an experienced Trust lawyer, had published articles on Trust law and trustee obligations etc.

Mr Patterson & the Lieutenants referred to SP as «The Client», the «UBO».
(para. 338)

Emails showed that the Lieutenants always contacted SP first for approval.
(para. 395)

Claimants successvully argued «**Mr Patterson's role was akin to that of a corporate service provider. He drafted resolutions & prepared formal documents but did not make decisions in relation to the Trusts assets**».
(para 381)



COURTS FINDINGS

IMPACT ON A PROFESSIONAL TRUSTEE:

If a court find a Trust to be a sham, trustees might find themselves subject to tax penalties whilst at the same time losing any protection afford to them by indemnities or exoneration clauses.

Trustees might find themselves subject to an investigation by the financial services regulator into their conduct as Trustees.

At the very least their professional reputation will suffer from the publicity surrounding the judgement.

Will likely be required to reimburse all fees charged to the Trust fund.

May be sued by Beneficiaries for breach of trust.

Their license to conduct Trust company business may be revoked with key persons possibly facing fines or perhaps criminal sanctions.



5. THE TRUSTS VIOLATED §423 OF THE INSOLVENCY ACT 1986 (TRANSACTIONS DEFRAUDING CREDITORS) :

Court noted there will be no protection for Trusts assets if at the time of making the transfer to the Trust the settlor is already insolvent (or becomes insolvent as a consequence of the transfer) **or the transfer is made with a view to avoid creditors.** (The statutory basis for this in England and Wales is in §339-423 of the Insolvency Act 1986).

And the “**avoidance of creditors**” need not be the main motive of creating the Trusts for the transaction to be set aside. It is sufficient if it was a real substantial purpose .

The reality of the situation will be of paramount importance and the courts will carefully examine all the evidence.



5. THE TRUSTS VIOLATED §423 OF THE INSOLVENCY ACT 1986 (TRANSACTIONS DEFRAUDING CREDITORS) :

There will be no protection for Trust assets if at the time of making the transfer to the Trust the settlor is already insolvent (or becomes insolvent as a consequence of the transfer) or the transfer is made with a view to avoid creditors. The statutory basis for this in England and Wales is in §339-423 of the insolvency Act 1986.

The “avoidance of creditors” need not be the main motive of creating the Trust for the transaction to be set aside. –it is sufficient if it was a real substantial purpose. The reality of the situation will be of paramount importance and the courts will carefully examine all the evidence.



CONCLUSION

POINTS TO TAKE AWAY FROM THIS CASE:

- Trustees need to know their beneficiaries & Settlers.
- Trustees need to «have asked» & know why a settlor is settling a Trust & record the reasons in writing.
- The importance of striking the right balance of reserved powers.
- It would be best if the Trust deed made it clear what the purpose of the Trust is.
- A Protector should not be a beneficiary and if this occurs the Trustee must explain & record the legal ramifications of the office (ie. Fiduciary obligation restrictions of the office).



CONCLUSION

POINTS TO TAKE AWAY FROM THIS CASE:

- The Trustee's intention to take control of the Trusts assets must be «independent» of the Settlor and well documented.
- Good Governance is key!



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