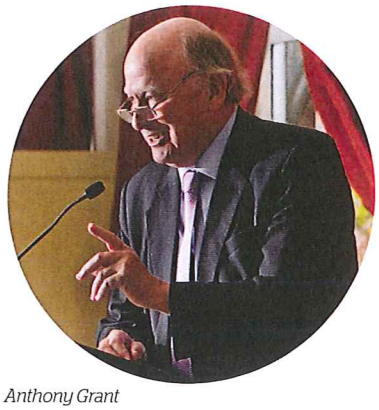
Pugachev: a significant new trusts decision

By Anthony Grant, Trusts & Estates Litigator

Mr Pugachev, a Russian oligarch, had five New Zealand foreign trusts. Before his downfall, he helped fund Vladimir Putin's rise to power but since then he has fallen on hard times, to the extent that judgment has been entered against him in Russia for a sum of about US$1 billion – perhaps the largest judgment debt that has ever been recorded against an individual.



Anthony Grant

The judgment creditor recently obtained a judgment from the High Court in London that none of the five trusts is valid on the grounds that Mr Pugachev had never intended to part with the legal and beneficial ownership of the assets that were settled on them and, in the alternative, that the trusts were shams – see *JSC Mezhdunarodniy Promyshlenniy Bank v Pugachev* [2017] EWHC 2426 (Ch), 11.10.17.

This was a hard case – a man who had taken a billion dollars and put them into foreign trusts was never going to get a sympathetic hearing.

The judge was Mr Justice Birss and his decision is, superficially at least, one of the most significant trust decisions of the year.

These are some of the reasons why.

- The reasoning behind the ruling that the "trusts" were invalid may threaten the validity of many other New Zealand trusts.
- It was contended that the trusts were "illusory". In part reliance on the reasoning in the *Clayton* litigation (*Clayton v Clayton (Vaughan Road Property Trust)* [2016] 1 NZLR 551), the judge held that the notion of an "illusory trust" was "not helpful" (see para [169]).
- The Supreme Court's decision in *Clayton* was discussed at length and Justice O'Regan's analysis of trust powers and their accumulated significance, was said to "command respect" (para [166]).
- The judge upheld the traditional belief that, for a trust to be a sham, the trustees must have had a common intention at the outset to mislead. However, it was held that "reckless indifference" and "*going along with*" a shammer, neither knowing or caring about what the trustee is signing, is sufficient to prove a common intention (para [150]).
- No evidence was given to show the intentions of one of the directors of a corporate trustee. Even so, it was held that the Court could assume that the director was reckless concerning Mr Pugachev's intentions for the trusts (para [283]).
- The retention of "effective control" of a trust has traditionally been a sign that a trust may not be valid. This is because one of the three certainties is missing namely, the intention to vest both the legal and beneficial interests of an asset in the trustees. Birss J has confirmed that this is the relevant test.
- "Effective control" can be achieved by powers that are vested in a trustee, a settlor, a protector, or in another person (para [275]).
- When determining the intentions of a "settlor", the court can disregard the actions of a person who is named as the settlor in a trust deed and look to the substance of the settlement. In this case, the nominal settlor was ignored and the judge held that "the real settlor of these Trusts is Mr Pugachev" (para [214]).
- Substantial assets were settled on the trust by Mr Pugachev's son, and it was held, with little or no evidence, that the son must have obtained the assets from Mr Pugachev. The son was therefore "acting as Mr Pugachev's nominee" with the result that Mr Pugachev was "the settlor of all the trusts" (para [453]).
- The powers that Mr Pugachev had in his capacity as a "protector" were analysed closely. It was held that none of them were fiduciary in nature – "They are purely personal powers which may be exercised selfishly" (see para [454]).

It has been commonplace for businessmen who fail spectacularly in business to survive through their term of bankruptcy on the assets of trusts that were created during their buoyant years. Members of the public commonly think this outrageous. I think it likely that the *Pugachev* judgment will cause judges to take a more aggressive attitude to such trusts in future.

Here is a sample of the judge's criticism of the trusts:

"The circumstances as a whole and Mr Pugachev's character support a credible inference that one of Mr Pugachev's purposes in transferring the property into these trusts was what is euphemistically called 'asset protection', in other words to hide them from possible claims, facilitate a plausible denial of ownership, while retaining control in fact." (para [298])

Readers who have established trusts for asset protection purposes may wonder whether the judge was suggesting that all trusts established for this purpose are contrary to public policy, or is it only asset protection trusts over which a person can exercise effective control?

One of several controversial aspects of the judgment was Birss J's decision to disagree with a judgment that Heath J had given in an earlier New Zealand application.

I understand that, as often occurs with litigation, the trial took some unforeseen and unfortunate turns and the judge may have drawn some incorrect factual conclusions in respect of the New Zealand trustees' actions and beliefs.

Unfortunate as that is for the New Zealand directors of the trustee companies, I think the decision may serve as an inducement for judges to unsettle trusts where a person can exercise "effective control" over their assets, and I strongly recommend that trust practitioners should be informing their clients of the need to diversify trust powers in respect of those trusts which can readily be modified.

Before leaving the case it may be appropriate to say something about Mr Justice Birss. He has had an unusual judicial background. Having got a degree in metallurgy and materials sciences, he went to work for a major accounting firm for two years. He then qualified as a barrister and practised at the Intellectual Property Bar. He became standing counsel for the Comptroller General of Patents, Trade Marks and Designs and, in 2008, Deputy Chairman of the Copyright Tribunal, before becoming a judge of Patents County Court in 2010.

He was a judge there until 2013 when the Government jettisoned the Patents County Court, rebranded it as the Intellectual Property Enterprise Court, and made it a specialist branch of the Chancery Division of the High Court. Judge Birss transferred to the Chancery Division as Mr Justice Birss, where he was nominated as a judge of the Patents Court (a separate Court within the High Court system). In an interview last year, he described himself as "an IP lawyer". A reader of his judgment may wonder whether his lack of background in equity caused him to embark on a more controversial path than other judges of that Division would possibly have chosen.

His judgment may yet be tested, as I understand the time for appeal has been extended and serious consideration is being given to an appeal.