

→ KEY POINTS

WHAT IS THE ISSUE?

A number of court decisions have demonstrated that discretionary trust assets are not always immune from freezing injunctions obtained against settlors/beneficiaries.

WHAT DOES IT MEAN FOR ME?

A freezing injunction is likely to impact the trustee's duties and the day-to-day administration of the trust, and may lead to trustees being dragged into proceedings even if they are not alleged to have been involved in or aware of wrongdoing on the part of the settlor.

WHAT CAN I TAKE AWAY?

An understanding of the approach of the courts, including those in Jersey, to this issue.

The purpose of a standard freezing injunction is to freeze the defendant's assets,¹ on an interim basis or post-judgment, so that they are available for the enforcement of a future judgment. In circumstances in which valuable assets can be moved to an obscure jurisdiction on the basis of a simple share-transfer form, the freezing injunction is an essential part of a litigator's armoury.

However, if a defendant has settled their assets on discretionary trusts, they no longer own them. Even if the defendant is a beneficiary, their rights do not confer any legal or beneficial interest in the trust assets.² Such assets will therefore not be caught by a standard freezing order and would not be available for enforcement.

The idea that sophisticated defendants should be able to abuse trust structures to make themselves judgment-proof is obviously unattractive. Courts' desire to do justice in such circumstances has, on occasion, led to decisions that have raised eyebrows among trust practitioners by seeming to ignore the fundamental principles of trust law.

Aside from obvious policy concerns, the practical implications for a trustee who becomes subject to the terms of a freezing order can be serious.³ The restrictions imposed on the trustee by the injunction may well conflict with the day-to-day administration of the trust, but a breach of the order can lead to a finding of contempt. Can distributions be made? What about investments? What are the trustee's disclosure obligations, and how do these tie in with the duty of confidentiality?

Should applications be made to the court for directions? All these questions are likely to arise, and the answers will not always be straightforward.

BENEFICIAL OWNERSHIP

It is well established that, if it can be shown that a trust was invalidly settled, the court can and will bring the trust assets within the scope of a freezing order – assuming that the other requirements for the granting of an injunction have been met. Alternatively, if the claimant can assert their own proprietary claim in respect of the trust assets – for example, if they are able to make out a claim in constructive trust – they may be entitled to a proprietary freezing injunction over the trust assets.

The simple question in these cases is whether the defendant (or, in the case of a proprietary claim, the claimant) ultimately has some ownership right to the trust assets that will enable a judgment to be enforced against them. So far, so simple.

SUBSTANTIVE CONTROL

A number of decisions have seen the courts move away from the beneficial-ownership test when it has appeared too restrictive to enable justice to be done. As Deputy Judge Bartley Jones QC said in *Dadourian Group International Inc v Azury Ltd*: 'I do not believe that it is necessary to establish beneficial ownership in the strict trust law sense... [the jurisdiction to freeze trust assets] can still be exercised if the defendant has some right in respect of, or control over, or other rights of access to the assets. The important issue... is substantive control.'⁴

Unsurprisingly, many trust practitioners, particularly those in Jersey and other jurisdictions with well-regulated trust industries, consider that the *Dadourian* decision rode roughshod over fundamental principles of trust law.

In *Algozaibi v Saad Investments Co Ltd*,⁵ the Cayman Court of Appeal endorsed this sentiment, ruling that 'substantive control' is not, of itself, sufficient to found jurisdiction to grant Mareva relief: 'It is necessary to identify some process of enforcement which would (or might) lead to the assets of the [trust] becoming available to satisfy the judgment which the claimant may obtain.'

WHERE ARE WE NOW?

These principles have recently been examined in the decision of the England and Wales Court of Appeal in *JSC Mezhdunarodniy Promyshlenniy Bank v Pugachev*.⁶ Lord Justice Lewison's leading judgment in that case has been interpreted in some quarters →

COLD COMFORT

Richard Brown provides a Jersey perspective on the recent freezing injunctions against discretionary trusts by the English Court of Appeal

as endorsing a more relaxed approach to applications to freeze discretionary trust assets. However, a proper examination of the judgment does not necessarily justify such a view.⁷

The Court of Appeal ruled that there was jurisdiction to order a defendant to provide disclosure, pursuant to a worldwide freezing order over his assets, of information relating to trusts (of which he was a discretionary beneficiary) and their assets, even though the trust assets were not at that time within the scope of the freezing injunction.

The claimant had initially set out extensive evidence supporting its belief that the trust assets were still owned and controlled by the defendant. The defendant and trustees disputed this evidence. The Court held that it was not able to reach a view one way or the other.

The enhanced disclosure provision ordered by the Court would provide the claimant with an ‘opportunity to test its assertion that [the defendant] is the effective owner of those assets against his (and the trustees’) assertion that he is not. If its assertion is correct, it may then be in a position to apply for the scope of the freezing order to be widened.’⁸ Lewison LJ stated that the purpose of the order was to enable a conclusion to be reached as to whether ‘by one means or another trust assets would be susceptible to enforcement’.⁹ In so ruling, the Court appeared tacitly to endorse the stricter approach in *Algoasibi* and not the more lenient approach in *Dadourian*.

THE JERSEY COURT’S APPROACH

The Jersey Royal Court is, unsurprisingly, generally unwilling to depart from trust-law orthodoxy. In *Re Esteem Settlement*,¹⁰ the Royal Court held that principles of ‘piercing the veil’ did not apply to trusts, and that there was no halfway house between validity and invalidity. A plaintiff wishing to enforce a judgment against discretionary trust

assets needed to show that the trust was invalidly settled, or that the act of settling the assets on trust was a voidable transaction defrauding creditors.

In *Tantular v AG*,¹¹ the Court held that: ‘In our judgment, it is incompatible with fundamental principles of trust law to assert that a discretionary beneficiary of a trust is “beneficially entitled” to all – or indeed any – of the assets of the trust. The true position is that he has no right to any of those assets unless or until the trustees decide in their discretion to make an appointment to him and he then becomes beneficially entitled only to such assets as are appointed to him.’¹²

Despite these strident rulings, however, discretionary trust assets are not immune from freezing injunctions in Jersey. In *Esteem*, the Court accepted that, when freezing injunctions were sought without notice, in circumstances where assets ‘seemed to have disappeared into offshore structures of one sort or another amid allegations of fraud’, there were likely to be grounds to bring such assets within the scope of the freezing order.¹³

As the then Deputy Bailiff of Jersey said in *Africa Edge v Incat Equipment Rental Ltd*: ‘It is clear... that the courts do, on occasion, grant a freezing injunction in respect of trust assets where there is a claim against a settlor or a beneficiary, because at that stage it is not known whether there will be some ground for attributing the assets in the trust to the alleged debtor. For example he may have put the assets in there at a time when he was insolvent, or the trust may be a sham, or other matters.’¹⁴

DRAWING THE LINE

There are clearly cases where a plaintiff may get the benefit of the doubt at the *ex parte* stage when there are unanswered questions as to the ownership of the trust assets. But where will the line be drawn?

The Royal Court of Jersey regards English and Welsh case law as highly persuasive, if not authoritative, in this area – see the *Algoasibi* enforcement test endorsed in *Pugachev*. However, a plaintiff will have some prospect of obtaining a freezing order that includes the trust assets if they present sufficient evidence at the *ex parte* stage that a trust may be invalid, or that there is some other ground to suspect that the defendant retains some degree of ownership or control, and where there is evidence of a real risk of dissipation if a freezing order is not granted. Such an order will bind the trustee, as a party cited, even where there are no allegations of wrongdoing or involvement on the part of the trustee.

If the defendant or the trustee objects to the injunction, then either or both of

them may apply to set it aside by opposing the evidence put forward by the claimant. The impact of the *Pugachev* decision may be that, where the court is not able to reach a view as to ownership of the trust assets, it now has the option of extending the disclosure provisions of the injunction before making a final decision on whether to include the trust assets within the scope of the freezing order itself.

The lesson for trustees is that discretionary trust assets are not immune from freezing injunctions, even where there are no allegations of wrongdoing or culpable knowledge on the part of the trustee. This is not necessarily the result of fundamental principles of trust law being cast aside by courts in freezing injunction cases. Rather, it is the result of courts of equity taking steps, in appropriate cases, to prevent legitimate trust structures from being abused to the detriment of creditors. Where exactly the line will be drawn, however, continues to be unclear.

- 1 Or, in the case of a proprietary freezing injunction, assets (which may be in the hands of a third party) to which the plaintiff asserts an ownership right
- 2 *Gartside v IRC* [1968] AC 553, confirmed by the Jersey Royal Court in *Tantular v AG* [2014] JRC 128
- 3 In England, the trustee might be joined as a ‘non-cause of action defendant’, although the terms of the standard freezing order are considered broad enough to bind third parties who are served with the order and who are within the jurisdiction of the court. In Jersey, the trustee would be joined to the proceedings as a ‘party cited’, whose obligations under the order are explicitly spelled out, but usually include disclosure obligations and orders restraining the trustee from disposing of assets
- 4 [2005] EWHC 1768 (Ch), paragraph 30
- 5 CICA 1 of 2010, 15 February 2011
- 6 [2016] 1 WLR 160
- 7 While a subsequent decision of the Court of Appeal in the same case ([2015] EWCA Civ 906 (14 August 2015)) did endorse the extension of the freezing orders to the trust assets, that decision was made in the context of flagrant and serious breaches by the defendant of the Court’s previous orders (including the disclosure orders previously made by the Court), as well as the presentation of further evidence satisfying the Court that the trust assets were in reality the defendant’s assets
- 8 [2016] 1 WLR 160 per Lewison LJ at paragraph 58
- 9 *Ibid*, paragraph 59
- 10 [2003] JLR 188
- 11 [2014] JRC 128
- 12 *Ibid*, paragraph 30 (see also *AG v Rosenlund* [2016] JRC 062). Similar principles will apply to Jersey foundations – s25 of the *Foundations (Jersey) Law 2009* specifically provides that a beneficiary of a foundation has no interest in its assets
- 13 *Re Esteem Settlement* [2003] JRC 092, paragraph 96
- 14 [2008] JRC 175



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