And what's yours is mine too

Power, control and ownership: offshore structures under attack in recent commercial cases

By Mark Hubbard

Abstract

- In a recent decision of the English and Welsh Commercial Court in the *Skurikhin* litigation, a receiver by way of equitable execution was appointed over assets which, on the face of it, were beneficially owned by a Liechtenstein foundation and not the judgment debtor.
- This result was reached on the grounds that the debtor, Mr Skurikhin, 'either has a legal right to call for the assets of the Berenger Foundation to be transferred to him or to his order, or has de facto control over the assets of the Berenger Foundation'.
- For similar reasons, in a recent decision in *Pugachev*, the Court of Appeal extended a freezing order to the assets of discretionary trusts, where the settlor held reserved powers.
- It is argued that, in these and other recent decisions of the Commercial Court and the Court of Appeal in commercial cases, a finding that a settlor has 'control' of trust assets has wrongly been used as a substitute for principled analysis of the legal effects of such control, whether exercised informally or by way of reserved powers.
- These decisions may have far-reaching consequences for all those involved in the creation of complex structures, or their administration, or in litigation in which they become in issue.

The *Skurikhin* case[1] has certain features that will be familiar to observers of litigation in the English and Welsh Commercial Court in recent years.

VTB Bank brought proceedings in Russia against Mr Skurikhin, based on personal guarantees given for the liabilities of the SAHO group of companies, which he apparently controlled.

1. *JSC VTB Bank v Skurikhin* [2015] EWHC 2131 (Comm)

It was alleged that Mr Skurikhin's wealth was represented by assets held in complex structures, including the following:

- Pikeville Investments LLP, an English limited liability partnership and the owner of several valuable residential properties in Italy.
- The membership interests in Pikeville were owned by two individuals and a Hong Kong company, acting as corporate and trust service providers (the nominees).
- The nominees held these interests in Pikeville as nominees or bare trustees for the Berenger Foundation, a private foundation formed under Liechtenstein law, of which Mr Skurikhin was a 'beneficiary'.[2]
- There were a number of links between Mr Skurikhin, his wife, Berenger and the nominees.

In support of its Russian proceedings, VTB obtained a freezing order in England which extended to the worldwide assets of Pikeville, which was joined as a respondent to the injunction. VTB alleged that Pikeville was ultimately owned by Mr Skurikhin.

VTB subsequently obtained English money judgments against Mr Skurikhin based on numerous judgments in Russia for the equivalent of approximately GBP15 million. Mr Skurikhin failed to provide disclosure as ordered relating to Berenger. He also failed to appear or produce documents as ordered in response to VTB's application for a private examination under the *Civil Procedure Rules*, part 71. As a result of his default, a committal order was made against him and since then Mr Skurikhin has stayed out of the jurisdiction, remaining in contempt of court. The active participation of Pikeville and Berenger in the English proceedings had ended before the decision described below was made.

As an English LLP amenable to the jurisdiction of the English court and the holder of valuable assets subject to the freezing order, Pikeville presented a tempting target for enforcement. VTB sought the appointment of a receiver by way of equitable execution over the membership interests in Pikeville, and its application came before the Commercial Court in July 2015.

2. This is a term of art in the Liechtenstein law of foundations, and should not be confused with its meaning as a matter of English trust law

RECEIVERSHIP BY WAY OF EQUITABLE EXECUTION

In English law, a judgment creditor can apply under s37 *Senior Courts Act 1981* for the appointment of a receiver over the property of the judgment debtor by way of enforcement, termed a 'receiver by way of equitable execution'.[3] Similar provisions exist in other common-law jurisdictions.

The receiver takes possession of the debtor's property, over which he is appointed, and collects the income arising. Where that property also carries with it rights – for example, in relation to a company or an LLP – the receiver may exercise those rights for the benefit of the appointing creditor. The effect of such an order then would be to allow the receiver to exercise the rights of the members of Pikeville, with a view to realising its assets for the benefit of VTB.

As indicated above, it was clear that, on the documents, the membership interests in Pikeville were held on bare trust by the nominees for Berenger. VTB's application proceeded on the basis that those membership interests could be regarded, in equity, as the assets of the debtor, Mr Skurikhin. This argument was founded on evidence from which the court was invited to infer that Mr Skurikhin exercised de facto control over Berenger.

As a private Liechtenstein foundation, Berenger was a body corporate and the legal and beneficial owner of its assets, just like an English company. The board members of a foundation act in a similar manner to the directors of a company. The objects of a foundation may include (and usually do include) benefiting individuals. Mr Skurikhin was described as a discretionary beneficiary of the foundation but such 'beneficiaries' have no legal or beneficial interest in either the foundation or its assets.

POWER AND CONTROL CASES BEFORE *SKURIKHIN*

VTB relied on the well-known 2010 decision of the Privy Counsel in *Tasarruf Mevduati Sigorta Fonu (TMSF)*,[4] and on *Blight* v *Brewster*.[5]

3. And that application may be granted in the circumstances established by *Masri v Consolidated Contractors* [2009] QB 450
4. *Tasarruf Mevduati Sigorta Fonu v Merrill Lynch Bank and Trust Company (Cayman) Ltd* [2012] 1 WLR 1721 (Privy Council, Cayman)
5. [2012] 1 WLR 2841

TMSF decided it was possible to appoint a receiver by way of equitable execution over a judgment debtor's reserved powers to revoke Cayman discretionary trusts he had established. The Privy Council responded to the 'new situation' of increasingly complex trust structures by concluding (reversing the Cayman Court of Appeal) that, because the powers of revocation were 'tantamount to ownership' of property in the form of the trust assets, it was free to exercise the court's jurisdiction to appoint a receiver over those powers.

None of the reasoning in *TMSF* would have been necessary if it was arguable (or argued) that, by reason of the power, the trust assets themselves were the property of the debtor. That was clearly not so: unless and until a power to revoke a trust is exercised, the trust assets remain the property of the trustees and subject to the trusts of the settlement.

In *Blight*, the court followed *TMSF* and found that a judgment debtor's absolute right or power to draw down a lump sum from their pension was tantamount to ownership of that sum and it was, therefore, possible for a receiver to be appointed over that right. It was not suggested that the existence of the right to draw down meant that, before that right was exercised, the lump sum was an asset of the debtor.

Perhaps more surprisingly, VTB also relied on a recent judgment of the English Court of Appeal in *Pugachev*.[6] That decision was made in the context of a freezing order and concerned the disclosure to be given in respect of discretionary trusts that were alleged to be under the control of Mr Pugachev but whose assets were not then frozen. The court was prepared to regard evidence of his apparent control as sufficient to raise 'a reasonable possibility, based on credible evidence' that the claimant might ultimately be able to enforce against the assets in question or to regard the ancillary disclosure order as being necessary to render the freezing order itself effective.

POWER, CONTROL AND BENEFICIAL OWNERSHIP IN *SKURIKHIN*

There was no evidence that Mr Skurikhin held any power in relation to Pikeville or the assets of Pikeville. The court was instead invited to infer that Mr Skurikhin was probably able to exercise control over Berenger, possibly by means of an 'overriding' mandatory agreement. There was no direct evidence of the existence of such an agreement or as to its terms.

As VTB's expert evidence of Liechtenstein law made clear, mandatory agreements operate under Liechtenstein law between the economic founder of a foundation and its board, and do so as a matter of contract only. Such an agreement might allow the mandator to give instructions to the board of the foundation, including instructions to transfer 'at least a significant part' of its assets to him. Under Liechtenstein law, such agreements do not, however, allow the mandator to require all the foundation's assets to be so transferred, as this would be equivalent to revocation of the foundation and so inconsistent with its constitution. A mandator's remedy for breach would be against the board members personally, not against the foundation itself.

It might be thought that the contractual nature of a mandatory agreement, the parties to it and the limits placed on the board's ability to act on the mandator's instructions by the constitution of the foundation make the rights it confers in relation to the assets of a foundation rather different in principle to the equitable powers in relation to trust assets that were the subject of *TMSF* and *Blight*. It is questionable whether it is right to regard the mandator's rights under such an agreement as 'tantamount to ownership' of assets of the foundation and, indeed, VTB's expert evidence was that it conferred only 'de facto control'.

It is to be remembered, however, that VTB did not seek to appoint a receiver over this mandatory agreement, if there was one, but over Berenger's assets, in the form of its beneficial ownership of the membership interests in Pikeville. The argument was that it should be inferred that Mr Skurikhin was in control of Berenger and 'hence' of Berenger's assets, and 'it follows' that these assets were regarded 'in equity' as belonging to Mr Skurikhin – 'thus' a receiver by way of equitable execution could be appointed over them.

THE DECISION IN *SKURIKHIN*

The court ordered the appointment of receivers over the membership interests in Pikeville. It did so on the basis that: i) a receiver by way of equitable execution

6. *JSC Mezhdunarodniy Promyshlenniy Bank v Pugachev* [2015] EWCA Civ 139

may be appointed over whatever may be considered in equity as the assets of the judgment debtor; and ii) property subject to a trust is to be regarded in equity as an asset of the judgment debtor if he has the legal right to call for those assets to be transferred to him, or if he has de facto control of them.

The first proposition is relatively uncontroversial, following *TMSF*. The second proposition (mainly supported by reference to *Pugachev*) appears to find no obvious echo in *TMSF* or *Blight*. In those cases, the judgment debtors had the right in equity to call for assets to be transferred to them, but the court did not conclude that those assets were to be regarded as property belonging to the debtor – only that right itself. Furthermore, neither case had considered whether mere de facto control could itself be considered the property of a judgment debtor and it is hard to see how such control could be so characterised.

It is difficult to see how evidence of de facto control, or such evidence as there was as to the existence of a right to call for the foundation's assets, can have properly led to the conclusion that assets subject to that control belonged 'in equity' to Mr Skurikhin.[7] As discussed above, *Pugachev* concerned quite different issues, arising at an interlocutory stage of proceedings, and cannot be read as equating control and beneficial ownership for the purpose of establishing ultimate liability. There is also the point that a foundation is both the legal and beneficial owner of its assets, just like a company and unlike a trustee. It would, of course, be different if it had been found that the trusts on which the membership interests in Pikeville were held for Berenger were shams or the foundation itself was a sham, neither of which arguments appear to have been made and as to which there seems to have been no evidence.[8]

On the basis of the above, the writer argues that the decision in *Skurikhin* is not based on precedent or principle and should not be followed.

FREEZING TRUST ASSETS IN *PUGACHEV*

After obtaining disclosure in respect of the discretionary trusts, the claimant bank in *Pugachev* applied to extend its freezing injunction to the assets of those trusts. Its application was refused by a judge of the Chancery Division, but, on an *ex parte* appeal to the Court of Appeal, it was successful.[9]

The bank relied on evidence including the terms of the trust instruments themselves and the fact that Mr Pugachev had recently exercised a reserved power to remove the New Zealand trustees and appoint new ones; and on three alternative grounds to establish the threshold test for freezing those assets: that they were in reality Mr Pugachev's assets, that there was a case for setting aside the trusts as transactions at an undervalue under the *Insolvency Act 1986*, and that 'the trustees hold the assets subject to the control of Mr Pugachev, and it is appropriate to infer from that fact that they may be available

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to satisfy a future judgment against him'. These arguments were dealt with briefly in the judgment of the Court of Appeal, given by Lord Justice Bean:

> '... there is a good arguable case that the assets held by the trusts are in reality assets of, or under the control of, Mr Pugachev. As even the above condensed history of this litigation shows (and I have omitted a number of hearings, none of which shows Mr Pugachev in a favourable light), there is at least a good arguable case that he is taking every possible step to keep his assets out of the reach of this court. The terms of the Trust Deeds and the change of trustees on 24 July 2015 reinforce that conclusion. The case appears to me to be a classic one for a *Chabra* order, made in the first instance without notice to either the defendant or the third party said to be acting on his behalf.'

This passage seems to confuse evidence of Mr Pugachev's own misdeeds in connection with the proceedings with evidence that the trust assets belonged in reality to him, and also to confuse reserved powers and the exercise of the same with ownership of trust assets, although the details of the relevant provisions of the trust instruments

7. See *Prest* v *Petrodel Resources Ltd* [2012] EWCA Civ 1395 at [103]-[106] per Rimer L.J; *Lakatamia Shipping* v *Nobu Su* [2014] EWCA Civ 636 at [52]
8. See below
9. *JSC Mezhdunarodniy Promyshlenniy Bank* v *Pugachev* [2015] EWCA Civ 906

have been redacted from the published judgment. The Court of Appeal was apparently willing to regard de facto control as sufficient to amount to beneficial ownership, or at least to raise a good arguable case as to ownership sufficient to justify freezing the assets in question.

CONTROL AND DISCLOSURE: *NORTH SHORE VENTURES*

The judgment of the Court of Appeal in *Pugachev* echoes that of Lord Justice Toulson in *North Shore Ventures*,[10] where he observed:

> 'Family trusts are a well known possible device for trying to place assets ostensibly beyond the reach of creditors... The circumstantial evidence gave reasonable ground to infer that there was in truth some understanding or arrangement between the appellants and the trustees by which they were to shelter the appellants' assets, consistent with the appellants' real aim, and that the nature of that understanding and arrangement was such that the trustees would take whatever steps the appellants wished in the administration of the trusts.'

In *North Shore Ventures*, that inferred actual control (again established without any formal attempt to establish that the trusts were shams) was considered a sufficient basis to order settlors to disclose trust documents that were in the possession of offshore trustees.[11]

WHY THESE CONTROL CASES MATTER

If the decision in *Skurikhin* was no more than an isolated example of an apparent misapplication of established principle, it would perhaps not merit further consideration. However, the impulse to equate de facto control with either a legal right or even equitable ownership of trust assets can be observed in a number of recent English decisions, including those of the Court of Appeal in *Pugachev* and *North Shore Ventures*.

Judges of the English Commercial Court, and of the Court of Appeal, particularly those whose legal lives were spent outside Lincoln's Inn, have long expressed dissatisfaction with the proposition that debtors, particularly those who, unlike Mr Skurikhin, are alleged to have engaged in fraudulent conduct or who, like Mr Skurikhin, have breached court orders, can evade enforcement 'by the manipulation of shadowy offshore trusts and companies formed in jurisdictions where secrecy is highly prized and official regulation is at a low level'.[12] This view does not appear to have been at all influenced by any appreciation of the past 20 years of intense regulatory development in offshore financial centres.

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As far as express trusts are concerned, the orthodox position is, of course, that trust assets are owned by the trustees and held by them on the terms of the trust. Actual control by the settlor over the trustee's actions may cause a breach of trust. Unless it can be proved that, from the beginning, the trustee shared a dishonest intention with the settlor, in order to harm a third party, to hold assets not under the terms of trust but on another basis (typically as nominee) so that the trust is a sham, settlor control does not compromise the validity of the trust.[13] This proposition is entirely consistent with the decisions in *TMSF* and *Blight*.

In hostile courts, which plainly currently include the Commercial Court and at least some panels of the Court of Appeal, this orthodoxy is under attack – so far, at least, indirectly. In these circumstances, practitioners need to consider how a challenge based on allegations of de facto control would be met. This should in turn lead to a careful review of the extent of informal reliance on a settlor's guidance, whether under post-settlement letters of wishes or otherwise, and the extent to which the reservation of powers or their grant to a protector may call the robustness of the structure into question.

10. *North Shore Ventures Ltd* v *Anstead Holdings Inc* [2012] EWCA Civ 11
11. M Hubbard, "Puppet masters" beware', *Trusts and Estates Law & Tax Journal*, April 2012
12. *International Credit and Investment Co (Overseas) Ltd* v *Adham* [1996] BCC 134, 136
13. *Shalson* v *Russo* [2005] Ch 281; *A* v *A* [2007] 2 FLR 467

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