ASSET PROTECTION TRUSTS IN GUERNSEY

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An Asset Protection Trust ("APT") as I currently understand it is a form of trust designed or intended specifically to protect the assets of the Settlor against depredation by creditors of the settlor. As a trust practitioner I can say that virtually all trusts have always had that as part of their overall effect, but what makes an APT special is that it is most likely to be established by a professional man (e.g., a surgeon, accountant or lawyer) who is not intrinsically fraudulent and has no dishonest intent; it is designed to protect his assets against the extraordinarily high awards of damages which are now so common a feature of negligence suits, particularly those with a transatlantic element. These high levels of damages push up the cost of indemnity insurance and mean that one is seeing more and more frequently that practitioners decide to "run bare", i.e., work as a professional without PI cover.

In these circumstances, the natural result of an error is an award of damages against the perpetrator which could lead to his bankruptcy. It was, in the past, more usual to associate bankruptcy with the financially irresponsible, the speculator or the fraudster; but now that it not so; bankruptcy can strike the most moral and diligent of professionals either through his own error or through that of his staff or partners. Trusts to protect against this are much sought after, with the result that legislation has been passed in some offshore jurisdictions in an attempt to mitigate the severity with which legal systems have dealt with the matter.

I would like to state clearly that the views expressed here are my own, they follow no party line.

In the absence of any specific Guernsey precedent, we have a tendency to look to English law as "persuasive", however, it is clear that under the provisions of Guernsey law, an individual may not divest himself of assets in the face of creditors and it seems likely that any transfer which has that effect would be set aside. In all probability (and I only say that because there are no specific decisions on the point) Guernsey law would be limited to cases of alienation in the face of creditors existing at the time of the transfer.

There have been recent proposals by the local finance industry that a law similar to that in the Cayman Islands should be passed. This has been supported with enthusiasm in some quarters and met with grave misgivings in others.

The thrust of the Cayman Islands' law is to cut out the uncertainty which exists because of the 19th Century English cases, in particular *Ex Parte Russell, Re Butterworth* (1882) 19 ChD 588 which held that a settlement could be set aside at the

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instance of a creditor even though at the time of establishment of the settlement the settlor had no creditors and was merely prudently arranging his affairs to protect himself and his family as he was about to commence a risky business venture.

Personally, I can see nothing wrong in that but there are those who are very concerned about protecting the potential creditor. Perhaps sometimes not enough consideration is given to the protection of the family of a professional. This is really a moral question - is it right that creditors should benefit to the detriment of family?

The purpose of this article is to consider where the line should be drawn between the legitimate protection of assets and the defrauding of creditors. Here are a selection of different scenes in which I invite readers to consider whether they feel that the creation of a trust into which the majority of the Settlor's assets are tipped would be legitimate protection or blatant fraud. They start with the most obvious and graduate into areas which are more and more difficult.

1. The Settlor has had judgment entered against him and execution proceedings are being undertaken.

2. The Settlor has had judgment entered against him but an appeal is pending.

3. The Settlor has had proceedings instituted against him but denies liability.

4. The Settlor has had proceedings threatened against him.

5. The Settlor knows (for example) that a patient could sue him successfully but the patient doesn't know. (The sort of scene where the Settlor (a surgeon) has left a scalpel inside his patient and is hoping that in a few days, nature will take its course and the scalpel will emerge. The Settlor is clearly a candidate for gamblers anonymous and the patient might be described as sitting on a time bomb!).

6. As a result of something that the Settlor has already done, something *might* happen which might lead to an obligation on the Settlor.

7. The Settlor thinks somebody might sue him but doesn't believe he will succeed.

8. A liability has arisen of which the Settlor has no actual knowledge.

9. The Settlor is about to embark on a particularly hazardous venture.

10. The Settlor is becoming less confident of his ability but wants to carry on with his profession.

11. There is no reason in particular to think that a liability has been incurred or is likely to be incurred but the Settlor wants to protect his assets "just in case".

We may think that it would be dubious to set up a trust in circumstances 1 - 7 but numbers 8 - 11 would be okay as there is no intention to defraud, but look at what might fit into these latter categories:-

(a) a bus company off-loading its assets in case someone gets run over;

(b) a husband disposes of assets to keep them away from his wife who is threatening divorce, or perhaps even because *he* fancies changing partners;

(c) a plastic surgeon is about to undertake an operation on a top Hollywood actress and wants to make sure he is not worth suing if something goes wrong;

(d) a lawyer (obviously from a jurisdiction other than Guernsey!) who has not read a law book in 20 years is worried about the size of some deals he is advising on and tries to protect his personal fortune from any possible negligence action.

The answers to these questions are not easy and I expect there to be careful consideration of them before any proposal is put forward to change the law in Guernsey. Are there then any existing provisions of the law which clarify the position for an intending Settlor?

Section 1 of The Trusts (Guernsey) Law 1989 as amended (the "Trust Law") clearly removed any doubts as to the ability of a person to make a settlement under Guernsey law and a gift of personalty to trustees of a settlement is good.

Subject to what is mentioned below about fraud, it is clear that an irrevocable settlement by a professional man which absolutely divests him of the settled fund would be proof against his creditors. If the Settlor had reserved some definite entitlement, e.g. a life interest, or a share in the capital, absolute or contingent, then the pursuing creditor could seize that entitlement, absolute or contingent, whatever it is, but no more.

Section 40 of the Trust Law deals with Protective Trusts. Section 40(c) states that the terms of a trust may make the interest of a beneficiary:

> "subject to discretion or termination in the event of a beneficiary becoming bankrupt or any of his property becoming liable to arrest, saisie or similar process of law".

There would seem to be no reason why the Royal Court of Guernsey should not support the validity of a settlement made by a professional person in which he reserves a life interest subject to early termination in the event of his bankruptcy. The term "bankrupt" is defined in s.73(1) of the Trust Law.

If the settlement is a purely discretionary one, with the discretion vested in somebody clearly independent of the Settlor, even if the Settlor is named as a possible beneficiary, the creditor can have no greater power to compel the trustees in the exercise of their discretion than the Settlor/discretionary beneficiary had. I do not rule out the possibility that the Royal Court might hold to the contrary if evidence demonstrated in such a case that the trustee was in fact no more than a "puppet" of the Settlor.

In circumstances where the Settlor is *not* seen unequivocally to have parted with control or power over the destination of an interest in the Trust Fund, then the position is by no means so clear. For example if a Settlor and his wife were the only trustees, or if a co-trustee or sole trustee was adjudged to be a mere puppet of the Settlor, then reserving the power to the trustee for him to appoint additional beneficiaries could be fatal unless the professional man is expressly excluded as a potential beneficiary.

If the Settlor reserves a right of revocation or reserves such a right for a third party such as a Protector and that Protector is regarded by the Court as a puppet of the Settlor, then there must be a strong possibility that the Royal Court would hold that the assets were to be treated as if they were his sole property.

This assumes that there has been no fraud on known creditors. There has been no recent experience in Guernsey of the Court having to consider setting aside a transaction on the grounds that it was in fraud of the rights of creditors. There was a case pending in 1987 in which a Bank was alleging that the conveyance of a house by a husband to his wife for a purely nominal sum should be set aside on the grounds that it was made at a time when the husband knew that the Bank was likely to be making a demand against him under a guarantee of a company's overdraft. That case was regrettably settled out of Court! Our customary rules do provide for attacking a transaction which was made with a deliberate intent to cheat the debtor's creditors of their opportunity to recover what was due to them.

The Debtors and Renunciation Law of 1929 recognises the point and provides that, where fraud is alleged by a creditor, the Court may enable the Law Officers to examine the acts and institute criminal proceedings if necessary. Section 17 provides that if a debtor has within six months of a declaration of insolvency fraudulently removed any part of his property exceeding ten pounds in value, then he is liable to imprisonment not exceeding two years.

That Law contains various provisions as to what are to be deemed to be fraudulent transactions if undertaken shortly before insolvency and as to what constitutes a criminal offence.

The Law of Property (Miscellaneous Provisions) (Guernsey) Law 1979 s.1(2) in relation to set off transactions provides that the Royal Court may direct that an agreement made six months before bankruptcy proceedings may be set aside if the court is satisfied that the transaction was entered into with a view to preferring a creditor fraudulently.

Section 74 of the Trust Law provides that nothing in the Law "validates an otherwise invalid transfer or disposition of property to a Trust". A transfer in fraud of a creditor could be an invalid transfer.

Fraud is a serious allegation and must be strictly proved. The plaintiff would have to show that at the time the transaction was done, the defendant knew of a liability and that the motivation for the transfer was to put the asset involved out of reach of the creditor. This may be difficult to prove *but* an aggrieved creditor is easily tempted into such suspicions and the mere allegation of them, even if subsequently they are not proved, could be quite unpleasant for a professional man.

When considering APTs, one must of course be mindful not only of the proper law of the Trust, but also the situation of the trust assets. A foreign jurisdiction - perhaps where the Settlor and the creditor are resident - might not recognise the validity of the trust, or the placing of assets into that trust. If the trust assets were also in that jurisdiction, the APT would prove to be of no benefit to the Settlor.

In summary, Guernsey has no tailor-made statute and progress towards one is likely to be slow but, in the meantime, an irrevocable settlement of specified assets or an absolute gift to wife or another person can be a valid divesting of the assets settled or given and, in the absence of fraud, a creditor could only claim such rights (if any) as have been reserved by the Settlor or donor. The Trust Law confirms the validity of a protective trust so it should be possible to reserve a life interest terminable on bankruptcy. There are a variety of forms of trust and some may be vulnerable if a professional man arranges his affairs through a trust and tries to have a puppet structure under which he could benefit. There is, however, a worthwhile argument for setting up a structure in Guernsey for the protection of an individual's assets.