ASSET PROTECTION TRUSTS

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Advocate Andrew Havard has written in the *Review* (2 OTPR 3 (1991/92) 209) on the likely attitude of the Guernsey Courts to Asset Protection Trusts. He says that 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 his view it is probable that Guernsey law would be limited to cases of alienation in the face of creditors *existing at the time of the transfer.*

The purpose of this Article is to restate the English position and to consider what the attitude of the English Courts might be to attempts by individuals resident and domiciled in England and Wales to take advantage of the law in other jurisdictions which was less favourable to creditors than it is in the UK. The attitude of the Courts in such jurisdictions is also, of course, crucial.

The English legislation aimed at the protection of creditors goes back to the Statute 13 Eliz 1c5. The decision in *Mackay v Douglas* (1872) 14 Eq 106 was on that provision. Malins V C said that if a settlor makes his settlement "with a view of being indebted at a future time, that is, with a view to a state of things in which he may become indebted", the settlement will be "fraudulent just as if he were indebted at the time". Similarly, in *Stileman v Ashdown* 2 Atk 477 Lord Hardwick had said "it is not necessary that a man should actually be indebted at the time he enters into a voluntary settlement to make it fraudulent; for if a man does it with a view to his being indebted at a future time it is equally fraudulent."

Prior to the Insolvency Act 1986 there were two means by which a protective settlement might be attacked by creditors. First, under s.42 Bankruptcy Act 1914 any voluntary settlement made within ten years before bankruptcy (now five years) was liable to be set aside unless the settlor could prove his solvency at the date of the settlement. If the settlement was made within two years before bankruptcy it could be set aside even without insolvency being proved. These provisions are now replaced by s.339 of the Insolvency Act 1986 which also introduced a strict test of solvency by which contingent and prospective liabilities do have to be taken into account (s.341).

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Secondly, a voluntary settlement may be set aside, even if the settlor was solvent and even in the absence of a supervening bankruptcy, on the ground that it was intended to defraud or defeat creditors. S.172 of the Law of Property Act 1925 provided that every conveyance of any property (real or personal) which was made with intent to defraud creditors was voidable at the instance of any person thereby prejudiced.

Even in this provision the reference to fraud added nothing to the intention to defeat creditors. In *Lloyds Bank Ltd v Marcan* [1973] 1 WLR 1387 at p.1390 in reference to a suggestion at first instance that perfectly innocent hindrance or delay to a creditor could come within s.172 notwithstanding the reference in the Elizabethan statute to dishonesty and fraud, Russell LJ said:

> "I am not sure what is meant by a perfectly innocent defeat[2] [*sic*], hindrance or delay. It must be remembered that in every case under this section the debtor has done something which in law he has power and is entitled to do: otherwise it would never reach the section. If he disposes of an asset that would be available to his creditors with the intention of prejudicing them by putting it, or its worth, beyond their reach, he is in the ordinary case acting in a fashion not honest in the context of the relationship of debtor and creditor. And in cases of voluntary disposition that intention may be inferred."

Section 172 of the Law of Property Act has now been replaced by s.423 of the Insolvency Act 1986 which is in wider terms and says that where the settlor has entered into a transaction with any other person at an undervalue and "the Court is satisfied that the transaction was entered into for the purpose of putting assets beyond the reach of a person who is making, or may at some time make, a claim against the relevant person or otherwise prejudicing the interests of such a person in relation to the claim which he is making or may make, the Court may make such Order as it thinks fit for restoring the position to what it would have been if the transaction had not been entered into and for protecting the interest of the person on whose behalf the application is treated as made".

Totty and Jordan on Insolvency at para H 23.17 states that the reference in the side note to s.423 to defrauding creditors suggests that there must be some element of dishonesty or sharp practice and that, accordingly, there will be a heavy burden of proof in establishing the relevant purpose. This statement appears to be open to criticism. First, it ignores the change of wording in the new s.423, which is undoubtedly deliberate. The plain meaning of the section cannot be affected by the presence of the word "defrauding" in the side note (see *Halsbury's Laws* 4th Edition Vol 44 p.819). Secondly, the textbook comment ignores the passage in

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2 Should the word be "deceit"?

Lloyds Bank Ltd v Marcan (quoted above). Furthermore, it would seem that (contrary to the statement in *Totty and Jordan*) regarding the burden of proof, in the case of a purely voluntary settlement (see again Russell LJ's judgment quoted above) it appears established that if it is shown that the settlor had, or must have had, in mind the possibility of his present or future insolvency, the burden of disproving intent to defraud creditors passes to the trustees of the settlement attempting to uphold the settlement.

It must follow that s.423 has made it even more difficult than previously for anyone successfully to create a voluntary settlement effectively to put assets beyond the reach of creditors, present or future.

It seems clear that if the Court is satisfied in relation to any voluntary settlement made by a professional man that his purpose, or one of the purposes, in making the settlement was to put assets beyond the reach of clients who might sue him for negligence in the future, the settlement would be liable to be set aside at the instance of any subsequent creditor in the event of the settlor's insolvency. The Court is likely to be so satisfied if the settlement concerned had the effect of putting assets out of the reach of creditors unless, having regard to the amount or terms of the settlement and all the circumstances affecting the particular settlor at the time he made the settlement, the trustees of the settlement can discharge the burden of satisfying the Court that such was not in fact the settlor's purpose.

It would clearly be virtually impossible to discharge such a burden of proof if the relevant circumstances were such that there could be no other rational reason for the making of the particular settlement at the time at which and in the form in which it was made.

It seems impossible to generalise about actual possible motives for the making of a particular settlement. At one extreme, the presence of some tax saving effect would not discharge the onus if the settlement comprised virtually all the settlor's assets or there were at the time actual or potential claims of an amount exceeding the value of assets remaining available outside the settlement. At the other extreme, a wealthy man might be expected to make a settlement of some of his assets on his family (not himself) at a time when no substantial claim was in existence or apprehended and the settlement left him with substantial other free assets.

Every case would have to be considered on its own facts. In every case the Court would require to be satisfied by the trustees of the settlement by evidence that the prejudice of existing or future creditors was not in fact a purpose in the mind of the settlor in making the settlement. Therefore, any settlement which would have had the *effect* of prejudicing creditors is likely to be vulnerable under s.423.

Given, therefore, that in English law it is extremely difficult, if not impossible, for an individual to set assets aside in a settlement so as to be out of the reach of creditors what are the prospects of doing so through the medium of other jurisdictions?

Five offshore financial centres have specifically enacted provisions designed to encourage asset protection trusts. These are the Cook Islands, the Cayman Islands, Gibraltar, the Turks and Caicos Islands and the Bahamas. The new provisions vary considerably in approach.

Three examples are:-

1. The Cayman Islands

The Fraudulent Dispositions Law 1989 was passed on 6th November 1989 and became effective on 1st May 1990. A transfer into trust is voidable at the instance of the creditor thereby prejudiced if made with an "intent to defraud" and at an undervalue. "Intent to defraud" is defined as an intention of a transferor wilfully to defeat an "obligation owed" to a creditor and "obligation" means an obligation or liability, including a contingent liability, which existed on or prior to the date of the transfer and of which the transferor had notice. The burden of establishing "intent to defraud" is on the creditor seeking to set aside the transfer. There is a limitation period of six years measured from the date of the transfer. If a transfer is set aside pursuant to the provisions of the Law the creditor obtains a first charge over the property but subject to the rights of any beneficiary receiving a distribution in good faith. The trustee as transferor is awarded costs of defending litigation if the Court is satisfied that it has not acted in bad faith. Likewise, a beneficiary to whom trust assets have been distributed may also retain them if the Court is satisfied that the beneficiary has not acted in bad faith. The onus is placed on the trustee or the beneficiary to establish an absence of bad faith.

The 1989 law did not alter the pre-existing bankruptcy legislation in the Cayman Islands but this is not likely to be relevant to a settlor of an asset protection trust as the bankruptcy law would apply only to a debtor resident in the Cayman Islands or a debtor resident elsewhere who commits an act of bankruptcy in the Cayman Islands.

2. Gibraltar

Gibraltar made amendments to its Bankruptcy Ordinance on 8th March 1990 aiming specifically at transfers into trusts made by non-resident individual settlors and providing for a system of confidential registration with the Gibraltar authorities. If a transfer to a trust made by an individual is duly registered and at the date of the transfer the individual transferor is not insolvent, and does not thereby become insolvent, the transfer is not voidable. In any other case the transfer is voidable. The definition of "insolvent" in relation to a transferor includes any of his liabilities, actual, contingent or prospective , subject to the proviso that a claim is only deemed to be a contingent or prospective liability if the transferor had at the time of the transfer actual notice of the claim or of the facts and the circumstances which might render him liable. The registration requirements require any proposed trustee of an asset protection trust to be specifically authorised by the Gibraltar authorities as having adequate financial and administrative resources. In addition, any such trustee must obtain the approval of the authorities to the trustee's "forms of inquiry" with regard to solvency which must be put to the settlor.

The Gibraltar provisions specifically make the equivalent provisions of the UK Elizabethan statute inapplicable to trusts that are duly registered.

The Gibraltar provisions do not, however, include any requirement or test of the transferor's intentions. They do not deal with the treatment of distributions to a beneficiary in the event of the initial transfer to the trust being held to be voidable.

3 The Bahamas

The Bahamas legislation is the Fraudulent Dispositions Act 1991 which came into effect on 5th April 1991. The provisions are based on the Cayman Islands' legislation but are not as detailed. However, they are generally more favourable to transferors.

The provisions about dispositions of property made with an intent to defraud and at undervalue are similar to those in the Cayman Islands' legislation. The onus of establishing "intent to defraud" is on the creditor. The limitation period for commencing proceedings is two years from the date of the relevant disposition.

If a disposition is set aside, then beneficiaries who have already received distributions may retain them unless the Court is satisfied that such beneficiary has acted in bad faith. The trustee is given a first charge over the trust fund for its own costs, again unless the Court is satisfied that the trustee has acted in bad faith. The burden of proving that either the trustee or a beneficiary has acted in bad faith is placed upon the person making the allegation. This, therefore, is the opposite of the position in the Cayman Islands.

There is, therefore, some uncertainty for trustees as to what will amount to "bad faith". It would seem necessary for the trustees to take certain steps to establish the settlor's solvency.

The bankruptcy legislation of the Bahamas is not changed. Jurisdiction for Bankruptcy Act purposes does not require the debtor to be resident in the Bahamas but exists irrespective of his domicile or residence if one of the acts of bankruptcy enumerated in the Act is committed. These include execution of a fraudulent conveyance. However, the territorial scope of the Bankruptcy Act limits its jurisdiction in regard to acts of bankruptcy committed outside the Bahamas to debtors who are citizens of the Bahamas or foreign persons who are resident in the Bahamas.

It is suggested that the English Courts would take a robust attitude to the attempted use of these new provisions. First, let us look by way of analogy at their attitude under the matrimonial legislation to offshore settlements. For example, in *Browne v Browne* [1989] 1 FLR 291, the husband had no substantial means whereas the wife had an interest in two trusts, both derived from her mother, one set up in Jersey and the other in Liechtenstein. It appears that she was the sole beneficiary of the Jersey trust. The Judge ordered the wife to pay a lump sum of £175,000 to the husband and costs which she was unable to pay personally. The Court of Appeal held that although it would be wrong for the Court to make Orders designed to put pressure on discretionary trustees, nevertheless the Court must look at the reality of the situation and the evidence demonstrated that the trustees had acted throughout in accordance with the wife's wishes and that she had immediate access to funds whenever she required them. Furthermore, the money due to be paid by the wife could be paid, and would be paid, if the trustees were satisfied that she needed the money. Therefore, the Judge had been right to hold that the wife had effective control over the trust funds and in making the Order he had exercised no improper pressure upon the trustees.

Secondly, the Courts may seek assistance from s.426(4) of the Insolvency Act 1986 which provides that the Courts having jurisdiction in relation to insolvency law in any part of the United Kingdom shall assist the Courts having the corresponding jurisdiction in any other part of the United Kingdom or "any relevant country or territory". Subsection (5) provides that for the purposes of subsection (4) a request made to a Court in any part of the UK ("the forum court") by a Court in any other part of the UK or in a relevant country or territory ("the requesting court") is authority for the forum court to apply, in relation to any matters specified in the request, the insolvency law which is applicable by either Court in relation to comparable matters falling within its jurisdiction, and in exercising its discretion under this subsection a Court must have regard in particular to the rules of private international law.

"Any relevant country or territory" means any country or territory designated for the purposes of s.426 by statutory instrument, and countries and territories so designated include Australia, the Bahamas, Bermuda, the Cayman Islands, Gibraltar, the Republic of Ireland, the Turks and Caicos Islands and the British Virgin Islands. These territories (and others) were presumably designated on the basis that reciprocal facilities would be granted by them under their insolvency legislation. It is noteworthy that the countries designated do not include (except for the Republic of Ireland) any EC member countries or the United States. The 1968 Brussels Convention on jurisdiction and the enforcement of judgments in civil and commercial matters, which was given the force of law in the UK by the Civil Jurisdiction and Judgments Act 1982 on 1st January 1987, specifically excludes all forms of insolvency proceedings from its provisions. However, it will be seen that the territories to which s.426 has been extended include several territories, namely the Bahamas, the Cayman Islands, Gibraltar, and the Turks and Caicos Islands which have, as mentioned above, introduced amendments to their insolvency legislation to facilitate the creation of asset protection trusts in those territories.

Can one then envisage a scenario where a UK resident who is domiciled in England and Wales makes a settlement in (say) the Cayman Islands, is subsequently made bankrupt in England, an attempt is made to set aside the settlement under s.423 and the English Court seeks the assistance of the Cayman Court pursuant to s.426?

The concept of reciprocity between jurisdictions in bankruptcy matters seems to have been undermined by the recent enactments in the five territories named above.

How then should an English solicitor advise a UK resident and domiciled client who asks whether it would be worthwhile setting up an asset protection trust in one of the jurisdictions which have sought to attract that type of business, e.g., Gibraltar or the Bahamas?

Clearly, the advice should first refer to ss.339-341 of the Insolvency Act 1986 and should explain the wider provisions of s.423 and the possibility of s.423 being enforced under the provision of s.426 in the chosen territory.

It would seem that apart from the usual background information and professional references, the proposed trustee would need to be satisfied, so far as possible, that any settlement could not be impugned. It would need to be satisfied that the settlor is not subject to any significant claims by creditors and is not seeking to avoid any liability, actual or potential, so arising. In the case of a professional person, it would be almost impossible to be sure that either he or his firm is not potentially liable to claims of negligence in excess of the current available insurance cover.

Another difficult area would be the possibility of divorce. As to the powers of the English Courts under the Matrimonial Causes Acts, see *Browne v Browne* mentioned above.

It would seem very desirable that all relevant information, including evidence of the settlor's solvency, is recorded in writing and that a suitable form of Statutory Declaration is sworn before the proposed settlement is executed.

The assets to be settled should ideally be "spare", i.e., assets to which the settlor is not likely to need immediate access for his own or his family's living expenses.

The form of trust also needs consideration. Normally it would be irrevocable and discretionary and, depending on the circumstances, the settlor would probably be excluded from benefit. If it is decided that the settlor will be capable of benefiting at some future time when the liability to creditors is no longer likely (e.g., after retirement) this could be achieved by the settlement becoming revocable by the settlor after a certain period. The settlor would be excluded from appointment as a trustee and would not have power to remove trustees.

An English solicitor will, therefore, proceed with great caution in advising any client who seeks advice on offshore asset protection trusts. He will seek to satisfy himself as to his client's motives, his financial position and the state of his marriage. He will make a careful record of all these things.