

Insolvency Law in the Channel Islands:
Modern Themes and Reform Perspectives Friday 14 October 2011



THE PAULINE ACTION IN JERSEY

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What is the Pauline Action?

- Jersey customary law action.
- Origins in Roman law – *actio Pauliana*.
- Modern statement
– *Re Esteem and the No. 52 Trust* 2002 JLR 53.

What type of action is it?

- ‘... [I]f a person has alienated his property in fraud of creditors ... they are allowed to bring an action cancelling the alienation, that is alleging that the property has not been alienated and therefore remains an item in the debtor’s estate.’ (Justinian, Book IV, Title VI, para 679, no. 6)

- Modern description of action by Birt DB in *Esteem*:
 - Personal;
 - Revocatory; and
 - Restitutionary.

Why is it relevant today?

- Useful weapon in addition to usual proprietary and personal claims in defrauded plaintiff's armoury.
- Allows plaintiff (P) to reverse transfers by fraudster (F) of his own assets to third party recipient (R), e.g. *Esteem* case.

What happened in *Esteem*?

- Sheikh Fahad ('SF') defrauded GT of millions, paid some of it and his own money into two Jersey trusts and became insolvent.
- GT obtained judgment for \$800m against SF in UK.
- GT subsequently brought Jersey action against Abacus (Jersey trustees), comprising:
 - Equitable proprietary claim for £1.2m of GT's money received into trust (partly successful);
 - Alternative claim in restitution for the £1.2m; and
 - Pauline action to set aside transfers of SF's own money into trust (partly successful).

What are the elements of the action?

1. P must be a creditor of F.
2. There must be a transfer of assets by F to R when F is insolvent or which renders her insolvent.
3. P must establish an intention on F's part to defraud creditors.
4. P must demonstrate that the transfer has caused her actual prejudice.

1. Plaintiff a creditor of F

- Only a creditor whose debt precedes the transfer may bring a Pauline action.
- P becomes creditor at time of facts giving rise to cause of action.
- Easy to establish as long as elements of cause of action established at time of transfer.

2. Transfer of assets by F to R when F insolvent

- Transfer must be made when F is insolvent or which renders him insolvent.
- If insolvency proved at date of action, burden of proof shifts to person resisting claim.
- Balance sheet test applied.
- Easy for P to prove if F has misappropriated and dissipated funds that exceed the value of her own assets.

3. Intention to defraud creditors

- Transfer to be made by F with intention to defraud creditors.
- Test is one of dishonesty not foreseeability.
- Need not be only or dominant purpose – substantial purpose will suffice.

4. Actual prejudice to P

- Transfer of assets to R must prejudice P.
- Likely to be established if transfer of assets by F plus F's insolvency renders F unable to meet P's claim.
- Unlikely to be established if P's other personal and/or proprietary claims wholly successful.

Is R's state of mind relevant?

- Transfer *'faites pour cause lucrative'*:
 - No value or less than full value given by R for assets received from F.
 - R's intention irrelevant to P's ability to establish cause of action.
- Transfer *'faites pour cause onéreuse'*:
 - Full value given by R for assets received from F.
 - P must prove that R 'privity to the real nature of the transaction' before P can establish cause of action.

To what extent is R liable?

- Original assets (*Esteem*).
- Proceeds of sale of original assets (*Golder v Société des Magasins Concorde Ltd* 1967 JJ 721).
- Profits:
 - If transfer lucrative and R an innocent volunteer – not prior to commencement of proceedings and after that at court’s discretion (*Esteem*);
 - If transfer onéreuse and R privy to real nature of transaction – probably (Domat, ‘Les Lois Civiles dans Leur Ordre Naturel’, Livre II, Section II, Nouvelle Edition, p. 194).

Does R have any defences?

- Change of position defence available if:
 - Transfer was *lucrative*; and
 - R can demonstrate good faith.
- Good faith = absence of unconscionability (*Niru Battery Mfg Co v Milestone Trading Ltd* [2003] EWCA Civ 1446) or unreasonableness (*Abou Rahmah v Abacha* [2006] EWCA Civ 1492).
- Defence limits R's liability to extent of surviving enrichment.
- Prescription period is 10 years (*Esteem - action personnelle réelle*).

What is the relationship with the statutory bankruptcy regime?

- Stands alongside désastre regime.
- Art 17 of the Désastre (Jersey) Law 1990 different in that it:
 - Reverses of transactions at an undervalue made in last 5 years preceding the désastre;
 - Requires declaration of désastre to have been made; and
 - Does not cover transactions for full value.

What happens if P is not the only creditor of F?

- No authority - P only creditor in *Golder* and not in issue in *Esteem*.
- If désastre already started, likely to take priority and P should use that mechanism.
- If Pauline action on foot first but désastre starts before judgment given, intervention by Viscount a possibility.