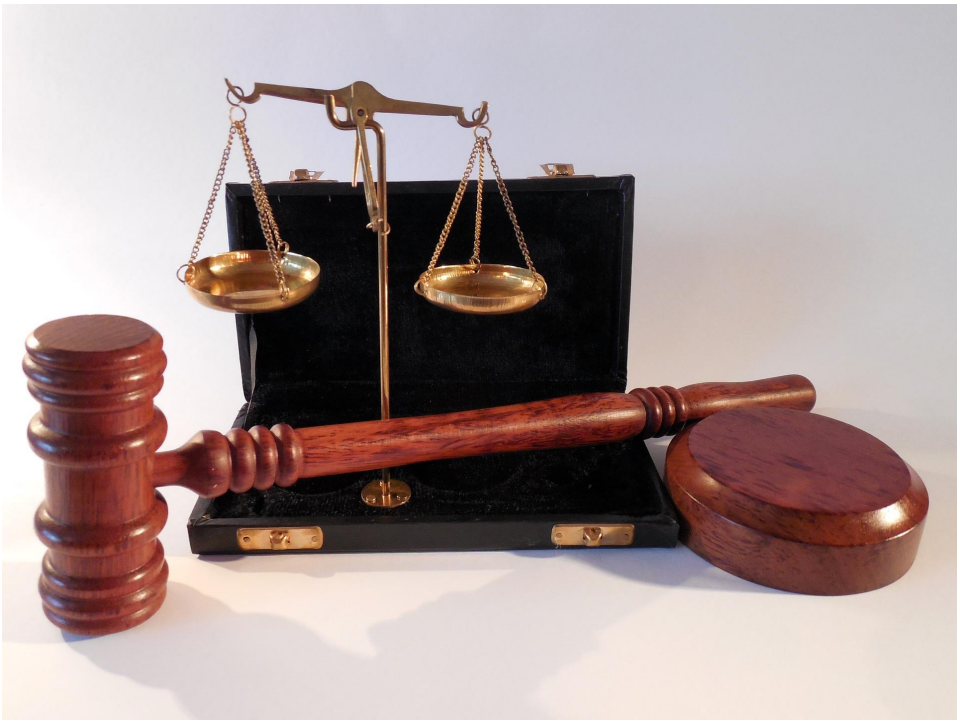
Mezhprom v Lenux (2021): When should offshore trustees participate in foreign proceedings?

LYNSEY MCINTYRE, PARTNER & BETHANY DRAYTON, TRAINEE, MCDERMOTT WILL & EMERY, 20/12/2021



A recent decision in a British Virgin Islands court case has raised a number of questions regarding the enforcement of foreign judgments in offshore jurisdictions that have implemented firewall legislation, and highlights issues facing offshore trustees that do not have the protection of such firewall legislation.

Choosing to do nothing in the face of foreign proceedings may result in a foreign judgment that is binding on the trustee in jurisdictions where trust assets are situated. As such, trustees should consider discussing a unified response with the beneficiaries, settlor and protector to determine whether the action in the foreign court should be fought and, if so, discuss which party is best placed to lead that fight.

A case in the British Virgin Islands (BVI) earlier this year has highlighted the need for trustees to liaise with others interested in a foreign trust when faced with proceedings in a foreign court concerning the validity of the trust or dispositions made to it.

JSC Mezhdunarodniy Promyshlenniy Bank et al v Lenux Group Limited 2021 (*Mezhprom v Lenux* (BVICH (COM) 2020/0188)), is part of long-running litigation between a Russian bank (Mezhprom) and Sergei Viktorovich Pugachev. Mr Pugachev founded Mezhprom Bank in 1992. Following the financial crisis in 2008, Mezhprom became insolvent and a liquidator was appointed.

The liquidators' investigations suggested that Mr Pugachev had unlawfully extracted approximately US$1 billion from the bank (although Mr Pugachev denies this), $95 million of which Mr Pugachev settled on five discretionary New Zealand law trusts. Mezhprom commenced legal proceedings in Russia and obtained judgment against Mr Pugachev for US$1 billion and then issued proceedings in England to enforce the Russian judgment.

Default judgment was obtained and proceedings were commenced in the English High Court of Justice against the trustees of the five trusts. The bank attacked the validity of the trusts on various grounds and sought a declaration that Miharo, a New Zealand company and trustee of one of the trusts, held shares in a BVI company called Lenux on bare trust for Mr Pugachev. Lenux held shares in a Russian company which in turn owned a valuable country estate in Russia.

Although they were named as defendants in the English proceedings attacking the validity of the trusts, Mr Pugachev, as the settlor and beneficiary of the trust, and Miharo, as trustee, did not take part in the proceedings. Miharo had previously challenged a freezing order made against it, but expressly reserved its right to challenge the English court's jurisdiction.

The challenge failed and Miharo took no further part in the action. The minor beneficiaries of the trusts, Mr Pugachev's children, did participate in the English proceedings through a litigation guardian and defended the claim on the basis that the trusts were proper discretionary trusts.

Judgment was given in favour of Mezhprom, finding that the trusts were invalid such that the trustees held the trust assets on bare trust for Mr Pugachev, with the effect that the trust assets were available to his creditors. Consequently, Miharo was ordered to execute a stock transfer form transferring the Lenux shares to Mezhprom.

Mr Pugachev and Miharo failed to take the steps they were obliged to take under the order, so an English judge executed the necessary documents to effect the transfer of the Lenux shares. Lenux had also been struck off the BVI companies register, so the transfer could not be completed. Mezhprom therefore sought an order from the BVI court for rectification of the register of shareholders and the making of a new register of members so that Mezhprom could restore Lenux to the register of companies and complete the transfer of shares.

The issue in the present case was whether the English court had jurisdiction over Miharo as a matter of BVI law, to compel the transfer of the Lenux shares to Mezhprom. Whilst the judge in the BVI court, Mr Justice Jack, accepted that the English court had jurisdiction over Miharo under its own rules, this was irrelevant to whether the English court had jurisdiction in the BVI under international private law.

He rejected Mezhprom's arguments that Miharo had submitted to the jurisdiction of the English court but, interestingly, drew Mezhprom's counsel's attention to an English Court of Appeal decision, *House of Spring Gardens Ltd v Waite (No 2)* ([1991] 1 QB 241).

In that case, the claimant had successfully sued three defendants in Ireland. Two of the defendants later issued proceedings in Ireland attacking the judgment on the basis it was obtained by fraud, but this challenge was dismissed (the third defendant did not participate in this challenge). The claimant then brought an action against all the defendants in England to enforce the Irish judgment, and the defendants all sought to defend the action on the basis that the Irish judgment had been obtained by fraud.

The claimant was granted summary judgment and the defences by the first two defendants were dismissed because they were estopped from arguing that the judgment was obtained by fraud, as the Irish court had already ruled on this point. The third defendant argued that he was not estopped from alleging fraud as he was not involved in the Irish proceedings.

However, the judge held that there was privity of interest between all of the defendants because (i) they were joint tortfeasors, (ii) the judgment against them was joint and several, (iii) if the Irish court had found in favour of the two defendants and set aside the judgment for fraud, the third defendant could have relied on that decision to his benefit, and (iv) the third defendant was content to sit back and let others fight his battle at no expense to himself.

The judge therefore held that this was sufficient for the third defendant to be bound by the Irish judgment against him.

Mr Justice Jack thus similarly held that Miharo, as trustee, had a common interest with the minor beneficiaries in defeating Mezhprom's assertions that the trusts were invalid and Miharo was perfectly happy to sit back and let the minor beneficiaries argue their case.

Therefore, although the BVI court could not accept the validity of the transfer of shares executed by the English judge, it did recognise the English judgment with the effect that Miharo held the shares in Lenux on bare trust for Mezhprom. Miharo was therefore bound by the English judgment in respect of the assets held in the BVI, even though it had not taken any positive act to accept the jurisdiction of the English court.

It remains to be seen whether this decision will have an impact on enforcement of foreign judgments in offshore jurisdictions that have implemented firewall legislation. Such legislation is designed to ensure that any issues arising in relation to a trust (including challenges to the validity or effect of a trust) must be determined according to the law of the jurisdiction of the trust.

The BVI firewall legislation was not considered or applied in this case, as the trusts were not BVI law trusts. It is unlikely that the BVI court would recognise a foreign judgment that purported to find that a BVI law trust was invalid, unless the BVI court had previously ruled that the foreign court was the appropriate forum to determine such issues under BVI law.

However, the *Mezhprom v Lenux* decision is potentially concerning for trustees that do not have the protection of firewall legislation, as choosing to do nothing in the face of foreign proceedings might still have the result that the foreign judgment is binding on the trustee in jurisdictions where trust assets are situated, if other parties interested in the trust do participate in the foreign proceedings.

This case demonstrates the importance of everyone involved in the trust being on the same page, particularly as those parties who are not trustees may not have access to all of the facts necessary to respond to the issues raised in the foreign proceedings.

Trustees can no longer simply sit back, as they may have privity of interest with a party who chooses to submit to the jurisdiction by defending an action even if the trustees choose to remain uninvolved. Trustees should therefore consider discussing a unified response with the beneficiaries, settlor and protector to determine whether the action in the foreign court should be fought and, if so, discuss which party is best placed to lead that fight.

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Contact

Editorial
news@eprivateclient.com

Article Reprints
amiddleton-pink@paminsight.com

Subscription Sales
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Technical Support
support@eprivateclient.com

Advertising
advertising@eprivateclient.com

Address

PAM Insight Ltd
107 Cheapside
London
EC2V 6DN
United Kingdom

Tel: +44(0) 207 967 1601