



# FOCUS

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## Sham - To Be or Not To be?

*A summary of the Mezhprom Bank v Pugachev decision*

Theominique Nottage



On 11<sup>th</sup> October 2017, the English High Court of Justice, Chancery Division published its decision in *JSC*

*Mezhdunarodniy Promyshlenniy Bank, et al v Sergei Viktorovich Pugachev et al* [2017] EWHC 2426 (Ch) ("*Mezhprom Bank v Pugachev*").

### **Background**

The Claimants in these proceedings were JSC Mezhdunarodniy Promyshlenniy Bank (*Mezhprom Bank*), a Russian bank which

entered into liquidation in late 2010 and its liquidator, the Deposit Insurance Agency ("*DIA*").

The first Defendant was Sergei Viktorovich Pugachev (*Pugachev*), the owner and founder of the Mezhprom Bank. The second to tenth Defendants were trust companies. The eleventh Defendant was one of Pugachev's sons, while the twelfth to fourteenth Defendants were the minor children of Pugachev and Alexandra Tolstoy.

Between December 2011 and November

2013, five discretionary trusts were created by Pugachev; (i) the London Residence Trust, (ii) the Kea Three Trust, (iii) the Rivera Residence Trust, (iv) the Wiltshire Residence Trust and (v) the Green Residence Trust (collectively, “the Trusts”).

The terms of each of the Trusts were essentially the same in that the First Protector of the Trusts was Pugachev and in the event of his death or incapacity, his son Victor Pugachev (as Protector). The third to fifth defendants were the trustees of the Trusts while Pugachev and various members of his family were discretionary beneficiaries. During 2014 and 2015, trustees of the Trusts advanced substantial sums to Pugachev as unsecured loans and when they refused to make additional advances, the trustees were replaced and the new trustees entered into a funding agreement with Pugachev.

In connection with the liquidation of MezHProm Bank, legal proceedings were commenced in Russia against Pugachev and later in the United Kingdom (as enforcement proceedings) which resulted in a worldwide freezing injunction against the assets of Pugachev and directions that Pugachev disclose further information about the Trusts, including details of the trustees, beneficiaries, and the location and value of trust assets.

The Claimants submitted that the beneficial interest in the assets of the Trusts belonged to Pugachev and sought a declaration to this effect.

### **Issues**

The issues for determination were:-

- i) Whether the trusts were effective in divesting Pugachev of his beneficial

ownership of the assets held by the Trusts? (the “*True Effect of the Trusts*” claim);

- ii) Whether the Trusts, or strictly the trust deeds, are shams? (the “*Sham*” claim); and
- iii) Whether there was a proper claim under Section 423 Insolvency Act 1986? (the “*S. 423*” claim).

### **The “*True Effect of the Trusts*” claim**

It was concluded that the real Settlor of the Trusts was Pugachev. At first glance, the Trusts were set up for a well-defined class of discretionary beneficiaries. However, upon its true construction, the trust deeds conferred powers on Pugachev (as First Protector) to be exercised freely for his own benefit. The conferred powers were personal in nature and gave the Protector the ability to act in his own best interests.

The powers were not constrained by a consideration of the interests of the discretionary beneficiaries as a class. Due to the extensive nature of the Protector’s powers combined with the fact that the First Protector is the Settlor of all the trust assets and one of the named discretionary beneficiaries, it was concluded by the Court that on their own terms the Trusts did not divest Pugachev of the beneficial ownership he had of the assets transferred into them. In substance, the trust deeds allowed Pugachev to retain his beneficial ownership of the assets.


### **The “*Sham*” claim**

The Court found that although the operation of the Trusts was consistent with their being genuine discretionary trusts for the class of discretionary beneficiaries as a whole, it did not allow one to distinguish between that and the

retention of beneficial control by Pugachev of the trust assets.

At all material times Pugachev regarded all the assets in the trusts as belonging to him and intended to retain ultimate control. The point of the Trusts was not to cede control of Pugachev’s assets to someone else; it was to hide his control of them. As such, given the intentions of Pugachev, the finding on the “*True Effect of the Trusts*” claim means that the Trusts were not shams as they fulfilled the true intention of Pugachev to retain control.

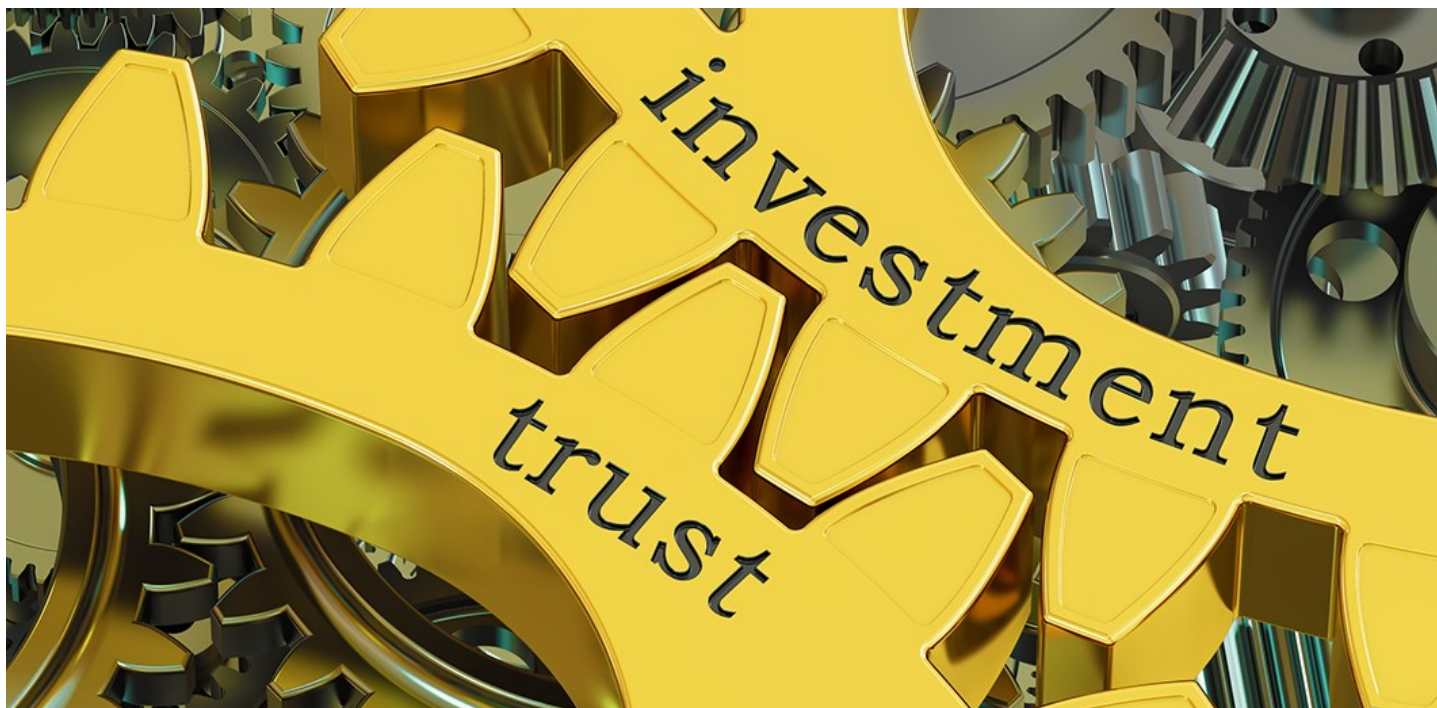
### **The “*S. 423*” claim**

The Court focused on the question of purpose under S. 423 and that of Pugachev at the time of the transactions. The real and substantial purpose must have been to defeat the creditors; that result merely being a by-product is not enough. If the transaction was one which the debtor would have entered into in any event, the Court should not too readily conclude that Pugachev also had the purpose of defeating his creditors. The Court found that because the intention of Pugachev was always to control and use the Trusts as pretence to mislead others about his ownership of the assets, Pugachev’s purpose in setting up the Trusts and the transfer of assets (either himself or by his nominee, Victor) satisfied the test in Section 423. 



Ms. Theominique Nottage is a member of the Firm’s Litigation practice group. Her practice areas include Trusts, Estates and Commercial litigation. [nottage@higgsjohnson.com](mailto:nottage@higgsjohnson.com)

# Trusts in the Cayman Islands



**A** trust is a legal relationship where one party (the “Settlor”) transfers property to the Trustee to hold the legal title to the Trust assets for the benefit of one or more persons (the “Beneficiaries”) or for a specified purpose.

## **Why Cayman?**

The Cayman Islands is an offshore tax-free jurisdiction that has been an attractive place to do business for many years. Cayman is a British Overseas Territory, with an elected government and legal system rooted in the English common law. Cayman is the fifth largest financial center in the world, with world class lawyers, accountants, bankers, investment advisers, and trust administrators that can assist with the set-up, maintenance and management of your trust.

## **Advantages**

Some advantages of establishing a Cayman Trust are:

- *Tax Benefits*

The establishment of a Trust may create tax benefits for the Settlor and the Beneficiaries. There is no income tax or capital gains tax payable in relation to Trust assets in the Cayman Islands. There is also no inheritance/estate tax in the Cayman Islands which would apply upon the death of the Settlor.

- *Confidentiality*

Save for exempted trusts, Trusts are not registrable with the Cayman Government authorities. Information in relation to the Trust and the Settlor are held strictly confidential unless the Trustees are under a legal duty to disclose the information or the Settlor has requested the disclosure of the Trust information.

- *Asset Protection*

Due to the transfer of the ownership of

the assets to the Trustee, the Trust assets may be protected from claims being made against it by the Settlor’s future creditors.

- *Estate Planning*

A Trust enables a Settlor to provide for his spouse or dependents during his lifetime and after his death. It also enables the preservation of family wealth and continuity of family business.

In some countries, freedom of testamentary disposition is restricted by heirship laws. Such heirship rights are not recognized in the Cayman Islands as being enforceable against a Cayman Trust. Thus, a Settlor may avoid these restrictions by transferring assets to a Cayman Trust.

- *Avoidance of Probate*

On the death of the Settlor, Trust assets will remain vested in the Trustee and dealt with in accordance with the Trust

Deed. Therefore, there will be no need to obtain a grant of probate on the death of the Settlor.

- *Flexibility*

The trust structure enables a settlor to tailor the Trust to meet his needs. The Trust may provide a fixed interest for each beneficiary or it may confer wide discretionary powers on the Trustee to distribute the assets to the beneficiary. The Trust may also include a power of revocation or amendment which may be vested in the Settlor or Protector.

### **Types of Trusts**

- *Discretionary Trust*

A Discretionary Trust provides a flexible and efficient structure for the Settlor and the Beneficiaries. It gives the Trustees wide discretionary powers to decide when and which beneficiaries should receive benefits under the Trust. The Trustees may be guided by a letter of wishes prepared by the Settlor which sets out how the Settlor wants the Trustees to distribute the assets. The Settlor may also appoint a Protector, who is a trusted friend or adviser, whose role it is to monitor the activities of the Trustees.

- *Fixed Interest Trust*

In a Fixed Interest Trust, the Trust Deed would stipulate the beneficiaries and the share or asset that each beneficiary should receive upon an eventuality occurring.

- *Exempted Trust*

Exempted Trusts must be registered in Cayman with the Registrar of Trusts. The Governor in Cabinet may give an undertaking to the trustees of an exempted trust that no law may be enacted in Cayman imposing any estate duty or inheritance tax for a period not exceeding 50 years from the date of creating the exempted trust.

- *Charitable Trust*

A Charitable Trust is established for the benefit of a charitable institution or purpose pursuant to Cayman Laws.

### **Special Trusts Alternative Regime (STAR) Trust**

A STAR Trust provides an alternative to the traditional trust structure by providing a sophisticated framework for benefitting beneficiaries and/ or achieving a wide range of charitable and non-charitable purposes.

STAR Trusts are useful in both private and commercial contexts including where the Settlor wishes:

- The Trust to hold shares of an operating company or the family business;
- To establish a traditional trust with an indefinite trust period;
- To retain control over the Trust Fund;
- To exclude the beneficiaries right to enforce the Trust;
- To create a charitable trust, which may not be solely charitable;
- To hold shares in a special purpose vehicle. 📄



For more information, contact  
Country Managing Partner,  
Gina M. Berry  
[gberry@higgsjohnson.com](mailto:gberry@higgsjohnson.com)

## Bahamas Attorneys Promoted to Senior Associates



Alexandra T. Hall, Ocean Centre



Sandy J. Lightbourn, Lyford Cay



Lori C. Nelson, Lyford Cay



# Artificial Intelligence in the Law

*Delivered at the Higgs & Johnson 2017 Annual Client Seminar*

By Kendrick Knowles



**A**t the 2017 Firm seminar, *Weathering a Changing Climate*, we discussed the opportunity, myths and reality of Artificial Intelligence (“AI”) in the legal profession. We concluded that, far from being a threat to the replacement of lawyers with robots, AI presents a unique opportunity for legal professionals to not only improve the quality of their legal advice but also to boost overall efficiency to the benefit of both clients and professionals alike.

In a nutshell, AI can be appropriately viewed as advanced computing, merely leveraged as a tool that can enable lawyers to find the right answers even more quickly and apply those answers as necessary. For over 50 years, standard computing has always been focused on accuracy and calculation. However, AI

improves upon this by adding cognitive machine learning to language and text, thereby answering even the toughest questions before they are asked.

*Where does the Legal Professional fit in all of this?*

The lawyer, law student and law firm can all benefit from this technology in the same way we have benefited from other technological advancements like the use of email, increased cyber security and video conferencing. The key to taking advantage of new and emerging technology is to be aware of its existence and its benefits.

*How can AI be used today practically?*

AI has already been in use for some time in the business of law. Law firms that have taken a proactive step toward cyber security have already used AI to predict and prevent computer virus patterns by using advanced AI algorithms in antivirus software. AI has also been used to prevent threats among computer networks between offices that communicate together. We expect that in The Bahamas AI will take a more central role in the operational side of law by answering search queries about case law and court decisions in a minute rather than through hours or days of manual searching.

*What does this mean for billing?*

Central to the discussion of AI is the issue of client billing and whether the

hourly rate would increase due to the machine learning advantage of the legal task or whatever the overall cost would decrease due to less time being used by humans to find the correct answer. All of this has yet to be determined as the variables involved with billing and attorney client work are considerable and extend beyond the mere answering of questions.

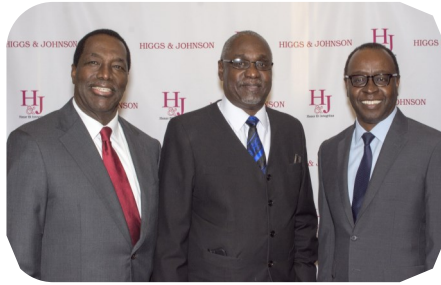
*Will the future eventually move toward machine lawyers?*

The truth is that technology has always proved challenging to any industry. In some cases, it has replaced human work force, for instance, in auto and product manufacturing. However, the Legal Profession as an industry is unique and built by and for – people - real individuals who need to use empathy, compassion, love, drive, commitment and measured generosity – qualities that machines despite their processing speed, cannot replace. No one can predict the future for sure, but we can state for certain that the only way that technology has ever helped humanity is when we commit to learning and growing with it. AI as a technological advancement is like a wave - we cannot stop, it so we must first observe it, then resign to ride it toward the shores of our passions and goals. 🍷

## Firm Celebrates 70th Anniversary



Minister Jeffrey Lloyd with partners, Tara Archer-Glasgow, Christel Sands-Feaste and Senior Partner, Philip C. Dunkley, QC.



Partner, Earl Cash; President of the Court of Appeal, Sir Hartman Longley; and Global Managing Director, Oscar N. Johnson, Jr.



Philip C. Dunkley, QC with Minister Brent Symonette, Attorney General Carl Bethel and Oscar N. Johnson, Jr.



Dr. Earl Cash, Kasynti Bodie, Ansbacher, Partner Sterling H. Cooke, Sherland Ritchie, RBC and Oscar N. Johnson, Jr.



Partners, Stephen J. Melvin and Christel Sands-Feaste with Justice Rhonda Bain and Oscar N. Johnson, Jr.



Partner, Zarina Fitzgerald; Christina Rolle, Securities Commission, Dr. Earl Cash and Gregory Cleare of Holowesko Partners.



Senior Associate, Audley D. Hanna, Jr. with RBC representatives Ericka Rolle and Dwayne Kemp.



Christel Sands-Feaste with fellow BCCEC officials—President & CEO, Edison Sumner and Director, Viana Gardiner.

In honour of its anniversary year, the firm hosted a reception on February 1 to say ‘thank you’ to clients and friends of the firm who contributed to its legacy. “After 70 years, Higgs & Johnson is very much a part of the fabric of The Bahamas,” said Managing Partner Oscar N. Johnson.

The firm was established in 1948 when pre-eminent Bahamian attorney the Hon. Godfrey Higgs joined longtime friend and former Registrar-General of The Bahamas, Mervyn Johnson in the formation of The Bahamas’ first non-family law partnership. In 70 years the firm has grown alongside the needs of its clients from a single office to a leading corporate and commercial law firm with a cadre of 40 attorneys, advising institutional and individual clients around the world from five offices in The Bahamas and the Cayman Islands.

Partners of the firm have contributed to the legal jurisprudence of the country by advocating landmark cases in The Bahamas and at the Privy Council in England, acting for the developers in some of the country’s key multi-million-dollar real estate developments, and have been instrumental to the drafting and implementation of several important pieces of legislation in The Bahamas.

This milestone also marks the expansion of the firm’s corporate social responsibility programme, focused for years on rewarding excellence in education, and now formalised into the Higgs & Johnson Charitable Trust. A key award of this programme is the Sir Geoffrey Johnstone Memorial Scholarship, tenable at the Eugene Dupuch Law School and named for the firm’s late Senior Partner.

“Our commitment to giving back to the community will continue to grow with our firm,” said Johnson. “I am confident that our founders would be pleased to know that their successors continue to build on their foundation of commitment to clients and dedication to the community.”




## H&J News

### Firm Continues to Receive ‘Top Tier’ Accolades



For the 15th year running, Higgs & Johnson’s leading law firm status has been confirmed by Chambers and Partners in its annual publication *Chambers Global: The World’s Leading Lawyers for Business*. The firm has held its top spot (Band 1) on the list since 2003 when Chambers, a leading legal directory since 1990, first started researching The Bahamas. The 2018 edition, which coincides with the firm’s 70th anniversary, ranks eight Higgs & Johnson lawyers, and commends the high performance of a number of practice groups within the full-service corporate and commercial law firm.

“This firm remains at the forefront of the market, with its deep bench enabling it to provide clients with a wide variety of legal services,” says Chambers. “It is regularly mandated on significant cross-border transactions, including M&A and loan financing. It also regularly advises on major corporate restructuring and high-value insolvency mandates for clients in sectors as varied as shipping, healthcare and banking. The dispute resolution practice is experienced in trust litigation, as well as contentious tax and employment cases. It also advises on the regulatory aspects of real estate matters. Market commentators acknowledge the firm’s strong reputation and agree that the team continues to be ‘a standout’.”

(Photos of Ranked Attorneys L - R: Philip C. Dunkley, QC; Oscar N. Johnson, Jr.; Dr. Earl A. Cash; Surinder Deal; Stephen J. Melvin; Tara A. Archer-Glasgow; Christel Sands-Feaste; Heather L. Thompson) 

### TerraLex North American Insolvency & Bankruptcy Practice Group Meeting



Higgs & Johnson is pleased to have hosted the annual meeting of the North American Insolvency & Bankruptcy Practice Group of TerraLex, a leading global network of more than 155 independent law firms. The working meeting for insolvency and bankruptcy lawyers from across the United States highlights the collaborative efforts of member firms to meet client needs in a global marketplace.

“Our attorneys have a high regard for the expertise and cooperation available within the TerraLex network,” said Surinder Deal, Partner at Higgs & Johnson and TerraLex Lawyer of the Year (2014). “We have worked together over the years or turned to one another for assistance in executing coordinated cross-border solutions with speed and efficiency. Higgs & Johnson continues to value our membership in TerraLex and to benefit from connections made around the world. Similarly, our clients accrue added value from our access to unparalleled global legal resources.” 

## Power Women's Breakfast



Exposure and information are key to ensuring that women have fair and equitable opportunities for engagement and advancement in the workplace, says Audrey Oswell, President & Managing Director of Atlantis, Paradise Island. Oswell, who in 2017 became the first woman to head the iconic resort and largest private employer in The Bahamas, delivered the keynote address at the first Power Women's Breakfast hosted by the firm. The event, which is part of the firm's focus on diversity, brought together leading female executives from financial services, law, energy, shipping and the public sector to examine the challenges facing women in the workplace and discuss the conditions necessary to overcome them.

## Board of Directors Appointment



Country Managing Partner, Gina M. Berry, has been appointed to the Board of Directors of the Civil Aviation Authority in the Cayman Islands.

## Firm Expands with New Hires



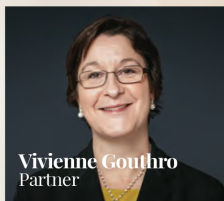
Ximena Thompson joins the firm's Abaco office as Of Counsel.



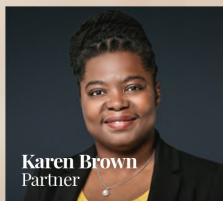
Godfrey V. Perpall joins the litigation practice group in the Nassau office.

## Women in Leadership

HIGGS & JOHNSON continues its support for the mission of the International Federation of Women Lawyers (FIDA) and congratulates our partners **Vivienne Gouthro** (Director) and **Karen Brown** (Assistant Secretary) on being appointed to the FIDA Executive Board for the 2018-2020 term.



**Vivienne Gouthro**  
Partner



**Karen Brown**  
Partner

*We salute these exemplary professionals and all women in leadership.*

