

3 HARE COURT

BRIEFING NOTE

Introduction

1. A Pauline action is a claim available in Jersey which enables a creditor to reverse a transfer of property by a debtor to a third party. It is often compared to a claim under s423 of the Insolvency Act 1986 (“IA 1986”), of which Jersey has no statutory equivalent. This note summarises the central features of both causes of action and identifies the key differences.

Pauline actions

2. The Pauline action originates in Roman law. Its existence in Jersey customary law is rooted in the work of commentators such as Poingdestre, Le Geyt, Pothier and Domat upon which, in the absence of more recent judicial authority, substantial weight is placed by the Jersey courts. The modern incarnation, which draws heavily upon the aforementioned sources, is primarily framed by two decisions of Birt, Deputy Bailiff (as he then was) in In re Esteem Settlement¹.
3. A creditor can set aside a disposition made by a debtor where (a) the creditor’s claim pre-dates the disposition in question, (b) the debtor was insolvent at the time of the disposition, or became insolvent as a result, (c) the disposition was made with an intention on the part of the debtor to prejudice his creditors, and (d) actual prejudice is caused to the creditor as a result². The limitation period is ten years and, for the purpose of (a) above, the underlying claim of the creditor is deemed to arise when the facts which give rise to it occur, not the date upon which it is upheld by a court³.

¹ 2002 JLR 53 and 2002 JLR 243

² 2002 JLR 53 at para 261

³ Ibid

4. Insolvency is assessed on a balance sheet basis⁴. The court will take a common sense view as to whether the debtor was insolvent at the time of disposition, or became so as a result. This approach acknowledges that the events in question are likely to have occurred several years before trial, the creditor is unlikely to have all of the debtor's financial information from that time, and that the debtor's asset position may have been extremely complex⁵. Where it is claimed that the disposition caused insolvency, the creditor need only establish a close connection in time and effect between the disposition and the subsequent insolvency⁶. To establish the requisite intention on the part of the debtor, recklessness will not suffice but the dishonest (bad faith) intention to defraud need not be the sole or dominant purpose behind the disposition⁷. If the creditor can prove insolvency on this basis, the burden of proof will shift to the debtor to prove that they were not insolvent at the time of the disposition⁸.

5. A distinction is drawn between dispositions to an innocent volunteer for no value (or less than full value) and those made for full value. The former are voidable when the debtor alone has the intention to defeat his creditors. In the latter case the transaction will only be voidable if the recipient was privy to the real nature of the transaction⁹. An innocent volunteer will have to return the original assets or their proceeds of sale, and the court has a discretion to order the disgorgement of profits made after the Pauline action was commenced¹⁰. The defence of change of position is available to an innocent recipient if it would be inequitable for an order for restitution to leave them worse off than if the disposition had not occurred¹¹. A recipient who understood the true nature of the disposition at the time (i.e. was not innocent) will have to account for any profits.

6. There is no judicial guidance as to how a Pauline action affects creditor priority. Article 10 of the Bankruptcy (Désastre) (Jersey) Law 1990 provides that no proceedings can be commenced (unless by the Viscount) where the debtor has been declared en désastre. If the Pauline action was already on foot at the time of the declaration, the permission

⁴ This was accepted by the Court in *Esteem* on the basis that it had not heard argument upon whether, in some circumstances, it would be appropriate to apply a cash flow test. See 2002 JLR 53 at para 206

⁵ 2002 JLR 53 at para 203

⁶ *Ibid* at para 204

⁷ *Ibid* at paras 222 to 227

⁸ *Ibid* at para 203

⁹ 2002 JLR 53 at para 213

¹⁰ 2002 JLR 243 at para 29

¹¹ 2002 JLR 53 at para 236

of the Viscount would be required to continue the proceedings¹². If *désastre* proceedings were commenced after the Pauline action but no declaration had been made before its conclusion the creditor would not need the consent of the Viscount, however the Viscount could seek to stay the proceedings pending the conclusion of the *désastre* proceedings¹³.

Section 423 of the IA 1986

7. A claim under s423 enables a transaction at an undervalue to be set aside where it has been entered into with the intention of putting assets beyond the reach of a person who is making (or may at some point make) a claim against the transferor, or otherwise prejudicing such a person in relation to their present or potential claim. It is not necessary for the debtor to be insolvent and the claimant is not required to prove dishonesty. The proscribed intention must be a purpose of the transaction, but need not be the sole or dominant one¹⁴.
8. A transaction at an undervalue is defined in s423(1) as (a) gifts or transactions at no consideration, (b) transactions entered into in consideration of marriage or the formation of a civil partnership, or (c) transactions for a consideration the value of which is significantly less than the value of the consideration provided by the transferor. The term transaction is widely defined in s436 as a gift, agreement or arrangement.
9. If the debtor has been made bankrupt, or is a body corporate which is being wound up or is in administration, a claim can be brought by the official receiver, the trustee of the bankrupt's estate or the liquidator or administrator of the body corporate. In these circumstances a victim of the transaction can still commence a claim but only with the leave of the court¹⁵. Where a victim of the transaction is bound by a voluntary arrangement, proceedings can be commenced by the supervisor of that arrangement and in all other cases the claimant need only be a victim of the transaction¹⁶. A victim is defined as someone who is, or is capable of being, prejudiced by the transaction in

¹² Articles 10(1)(c) and 10(2) of the Bankruptcy (*Désastre*) (Jersey) Law 1990

¹³ For a more detailed discussion of the interaction between the Pauline action and the *désastre* regime see S. Agnew, *Some Thoughts On The Relationship Between The Pauline Action And The Désastre Regime In Jersey*, Jersey & Guernsey Law Review, February 2012.

¹⁴ JSC BTA Bank v Ablyazov [2018] EWCA Civ 1176

¹⁵ s424(1)(a)

¹⁶ ss424(1)(b) and (c)

question¹⁷. Importantly, s424(2) provides that any application shall be treated as made on behalf of every victim of the transaction. It follows that even where a claim is brought against a solvent debtor the proceeds may have to be shared with victims who did not participate in the litigation.

10. The Limitation Act 1980 (“LA 1980”) applies to s423 claims. Where the underlying transaction is a specialty, a 12 year limitation period will apply however if the claim is for a sum of money recoverable by virtue of any enactment the applicable period will be six years. Limitation runs from the point at which the claimant becomes a victim¹⁸ but can be postponed under s32 of the LA 1980. Although s423 provides a collective remedy, the identity of the claimant forms an ingredient of the cause of action¹⁹. Accordingly, an office holder has no cause of action before the relevant event of insolvency. It follows that where a claim is brought by an office holder a victim may benefit in circumstances where a claim brought in their own name would have been time barred.
11. The existence of a change of position defence has been a contentious issue²⁰. It has been referred to as available²¹, however more recent authorities have framed it as a factor relevant to the court’s discretion in determining the appropriate relief, rather than a defence in itself²². A specific defence for third parties who acquired property from a person other than the debtor in good faith, for value and without notice of the relevant circumstances and those who received a benefit from the transaction in good faith, for value and without notice is provided by s425(2).

Conclusion

12. The principal differences between the causes of action are summarised below. While some are significant, in many cases the outcome in both jurisdictions would be the same.

¹⁷ s423(5)

¹⁸ Hill v Spread Trustee Co Ltd [2006] EWCA Civ 542 at para 12

¹⁹ Ibid at paras 148 to 150

²⁰ In re Fowlds (A Bankrupt) [2021] EWHC 2149 (Ch) at para 44 *et seq*

²¹ 4Eng v Harper [2009] EWHC 2633 (Ch)

²² BTI 2014 LLC v Sequana SA [2017] Bus. L.R. 82 at para 523, Akhmedova v Akhmedov [2021] 4 WLR 88 at para 86.

13. A Pauline action requires proof of insolvency, but can apply to a transaction at full value. There is no insolvency requirement for a s423 claim but the transaction must be at an undervalue. A s423 claim is pursued on behalf of every victim of the transaction. That is not the case in a Pauline action but it only operates to return property to the transferor, thus making it available for enforcement. It does not give rise to the breadth of remedies available under s425(2). The impact of a successful Pauline action on creditor priority is unclear. In practice the underlying claim against the assets is usually brought in the same action. A creditor wishing to assert a competing claim, or preserve the assets for the purpose of insolvency proceedings, would be well served to act quickly.
14. On one view the need to establish bad faith sets a higher threshold for intention, but it is hard to think of a circumstance in which a plaintiff who can establish the necessary intention for a s423 claim would be unlikely to prove the bad faith required by Jersey law. The position is similar in respect of actual prejudice, which will ordinarily follow the fact that the plaintiff's claim pre-dates the disposition in question and remains unpaid.
15. Lastly, while the actions attract different limitation periods, the Jersey customary law doctrine of empêchement de fait has a similar effect to s32 of the LA 1980. Both can come to the aid of a victim who, due to the fraudulent conduct of the debtor, was unaware of their cause of action.

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