

**Jersey & Guernsey Law Review – February 2012****SOME THOUGHTS ON THE RELATIONSHIP  
BETWEEN THE PAULINE ACTION AND THE  
*DÉSASTRE* REGIME IN JERSEY****Sinéad Agnew**

1 Until the judgment of Birt DB (as he then was) in *In re Esteem Settlement*<sup>1</sup> ten years ago, the Pauline action was a little known and little used Jersey customary law action. The *Esteem* judgment clarified the nature and operation of the action in general terms but its relationship with Jersey's *désastre* regime remains unclear. The purpose of this note is briefly to compare the extent of the protection offered to creditors by the Pauline action and art 17 of the Bankruptcy (*Désastre*) (Jersey) Law 1990 ("the *Désastre* Law") and to consider how a Pauline action is likely to be affected by the fact that the plaintiff may not be the only creditor.

**The Pauline action and art 17 of the *Désastre* Law—a brief comparison**

2 The origins of the Pauline action may be found in Roman law: its purpose is to allow a creditor to revoke an alienation of assets by his debtor to a third party, which has been made in order to defeat the interests of creditors.<sup>2</sup> As Birt DB explained in *Esteem*, the Pauline action is personal, revocatory and restitutionary in nature.<sup>3</sup> The creditor may reverse a transfer by the debtor of the debtor's own property to a third party, as long as the creditor can show that (a) he is a creditor of the debtor; (b) the transfer of assets is made when the debtor is insolvent or the transfer renders him insolvent; (c) the debtor makes the transfer with the intention of defrauding his creditors; and (d) the transfer causes actual prejudice to the creditor himself.<sup>4</sup> If the transfer of assets is made for value, the creditor must also demonstrate that the recipient was "privy to the real nature of the transaction"

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<sup>1</sup> 2002 JLR 53.

<sup>2</sup> Justinian, Book IV, Title VI, para 679, no 6.

<sup>3</sup> *In re Esteem Settlement* 2002 JLR 53, 138.

<sup>4</sup> *Ibid*, 124, 126–127, 128–129, 132, 134.

before the transfer will be reversed.<sup>5</sup> If the elements of the cause of action are made out, the third party recipient will be ordered to give up the original assets or their proceeds of sale<sup>6</sup> and, possibly—if the transfer was for value and the recipient was privy to its real nature<sup>7</sup>—any profits made by the recipient from the assets after the Pauline action has been commenced.<sup>8</sup> The defence of change of position<sup>9</sup> is available to an innocent recipient who has changed his position in good faith in reliance on the receipt.<sup>10</sup> According to Birt DB in the *Esteem* case, the Pauline action is an *action personnelle réelle*, which attracts a prescription period of ten years.

3 The Pauline action stands alongside the statutory bankruptcy regime. The closest statutory equivalent is art 17 of the *Désastre* Law, which provides, amongst other things, as follows—

“(1) If a debtor has at a relevant time entered into a transaction with a person at an undervalue the court may, on the application of the Viscount, make such an order as the court thinks fit for restoring the position to what it would have been if the debtor had not entered into the transaction.

(2) The court shall not make an order under paragraph (1) if it is satisfied—

- (a) that the debtor entered into the transaction in good faith for the purpose of carrying on a business or, in the case of a company, its business; and
- (b) that, at the time the debtor entered into the transaction, there were reasonable grounds for believing that the transaction would be of benefit to the debtor.”

4 Article 17 has several features. For its purposes, good faith turns on whether the recipient was aware that the transfer was at an undervalue, was made at a time when the debtor was insolvent or would likely lead to his insolvency and whether the recipient was an associate of or

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<sup>5</sup> *Ibid*, 130.

<sup>6</sup> *Golder v Société des Magasins Concorde Ltd* 1967 JJ 721.

<sup>7</sup> Domat, *Les Lois Civiles dans leur Ordre Naturel*, livre II, section II, Nouvelle Edition, 194.

<sup>8</sup> *In re Esteem Settlement* 2002 JLR 243, 253–254.

<sup>9</sup> As to the meaning of good faith, see *Niru Battery Mfg Co v Milestone Trading Ltd* [2003] EWCA Civ 1446 and *Abou-Rahmah v Abacha* [2006] EWCA Civ 1492.

<sup>10</sup> *In re Esteem Settlement* 2002 JLR 53, 134–135.

connected to the debtor.<sup>11</sup> A transaction at an undervalue means a gift or a transaction by way of a marriage settlement or on terms for which there is no *cause* or where the value of the *cause* provided is significantly less than that provided by the debtor, *cause* having its usual meaning in Jersey customary law.<sup>12</sup> The statutory mechanism applies to transactions at an undervalue made within a period of five years immediately preceding the making of a declaration that the debtor was *en désastre*,<sup>13</sup> provided that the debtor became insolvent before or as a result of the transaction itself.<sup>14</sup> There is no limiting period in cases where the transaction is made with a person connected with a debtor or with an associate of the debtor.<sup>15</sup> Finally, a *bona fide* purchaser for value is not required to give up any benefit from the transaction unless he was a party to the transaction and the property interests of more remote recipients are protected.<sup>16</sup>

5 In two respects the Pauline action offers more extensive protection to creditors than that available under art 17. First, the ability of a creditor to reverse a transaction under art 17 is limited to transactions occurring in the five years before the debtor's *désastre*, whereas the prescription period for the Pauline action is a more generous ten year period. Secondly, if a creditor can raise a Pauline action, he is not limited to reversing transactions at an under-value; as long as he can demonstrate that the recipient knew what the debtor was up to, he may also reverse transactions at full value. It is right to point out, however, that it may be more difficult to get a Pauline action claim off the ground because the creditor must show that the debtor entered into the transaction with the intention to prejudice his creditors, whereas art 17 is neutral as to the debtor's intention. That said, the test for intention established in *Esteem* is fairly creditor-friendly. A creditor must show that the debtor was dishonest, but the fact that the defeat of creditors is the natural result of a transaction is a material factor in assessing whether the necessary state of mind is established and the creditor need only show that the intention to defeat creditors was a substantial purpose of the debtor—it need not have been his only or dominant purpose.<sup>17</sup> In *Esteem* itself the court found that Sheikh Fahad (the debtor) had the capacity to arrange his affairs to defraud his creditors, failed to attend the hearing of the Pauline action and gave no

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<sup>11</sup> Article 17(6).

<sup>12</sup> Article 17(7).

<sup>13</sup> Article 17(8).

<sup>14</sup> Article 17(9).

<sup>15</sup> Article 17(10).

<sup>16</sup> Article 17(5).

<sup>17</sup> *In re Esteem Settlement* 2002 JLR 53, 134.

explanation for the transfers of assets to Abacus (the third party recipient). These factors, together with its (not altogether favourable) view of Sheikh Fahad's character, caused it to infer the requisite intention to defraud on his part. This shows that the court will not always require the creditor to identify an explicit, fully articulated intention to defraud on the part of the debtor. Intention may be inferred from the circumstances surrounding the transaction and in practical terms the evidential burden may not be too difficult to surmount, thus making the Pauline action a useful and potentially more potent alternative to an art 17 application.

### A coterie of creditors

6 There is a paucity of authority as to when, if ever, a Pauline action plaintiff must share the spoils of a successful Pauline action with other creditors. The *Esteem* judgment is silent on this question and in the *Golder* case,<sup>18</sup> the only other significant Pauline action judgment given in the last fifty years in Jersey, the Pauline action plaintiff was the only creditor. Either GT was Sheikh Fahad's only creditor in *Esteem* or none of his other creditors was aware of or wished to be involved in the Pauline action. In any case, if there are no other creditors there is no reason why the Pauline action plaintiff should not keep the spoils of his successful claim to himself.

7 If other creditors do exist, the impact of their existence on the conduct and outcome of the Pauline action depends on whether *désastre* proceedings are commenced by them or the debtor himself and if so, when. Three potential scenarios arise in which art 10(1) of the *Désastre* Law may play a role. Article 10(1) provides as follows—

“(1) With effect from the date of the declaration a creditor to whom the debtor is indebted in respect of a debt provable in the ‘*désastre*’ shall not—

- (a) have any other remedy against the property or person of the debtor in respect of the debt;
- (b) commence any action or legal proceedings to recover the debt; or
- (c) except with the consent of the Viscount or by order of the court, continue any action or legal proceedings to recover the debt.”

8 If the debtor himself or another creditor were to start *désastre* proceedings and obtain a declaration of *désastre* before the

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<sup>18</sup> *Golder v Société des Magasins Concorde Ltd* 1967 JJ 721.

commencement of the Pauline action, the effect of art 10(1) would be that the *désastre* procedure would take precedence and the Pauline action plaintiff could not commence his action at all. He could only invite the Viscount to commence the action on his behalf and, perhaps, that of other creditors too.

9 Alternatively, if *désastre* proceedings were commenced after the Pauline action were commenced and a declaration of *désastre* were granted before judgment was delivered, as a result of art 10(1) the plaintiff would require the Viscount's consent for the continuance of the Pauline action. The Viscount might well allow the Pauline action to continue unless he thought that art 17 provided a better route to recovery of the debtor's assets. If he thought that the Pauline action was to be preferred and was aware of other creditors who were or might have been prejudiced by the transfer of the debtor's assets to the recipient he would probably seek to be joined to the action on their behalf or, indeed, be substituted as plaintiff on behalf of all prejudiced creditors. Finally, if *désastre* proceedings were commenced after the Pauline action had been started but no declaration had been made before the conclusion of the Pauline action, the plaintiff would not need the Viscount's consent for the continuance of the action. However, the Viscount might again intervene in the Pauline action and ask the court to stay the proceedings pending the grant of a declaration in the *désastre* proceedings. Again, if a declaration were granted and the Viscount thought it appropriate, he could seek to take on the mantle of plaintiff in the Pauline action on behalf of all prejudiced creditors. In either case, the Pauline action plaintiff could well end up having to share the fruits of the action with other creditors and it is likely that appropriate costs orders would be made to reflect the changes to the conduct of the action.

10 In light of the above, it may be said that the Pauline action represents a potentially more powerful weapon in creditors' hands than art 17 of the *Désastre* Law, as long as the hurdle of establishing the requisite intention can be cleared. However, its utility against a debtor who has multiple creditors may be of limited value if those other creditors seek to stymie the action by commencing *désastre* proceedings in a strategic fashion. Further clarification from the Royal Court on the relationship between the customary law action and the statutory procedure would be welcome.

*Sinéad Agnew, LLB (Dub), MJuris (Oxon), MPhil (Cantab), of Gray's Inn, Barrister, is a PhD candidate in law at the London School of Economics.*