A 2016 Review of the Past Year of Trust Cases

The Honourable Mr Justice David Hayton,
Judge of the Caribbean Court of Justice

Review of the 2016 Trust Cases by Mr Justice David Hayton at the Transcontinental Trust Conference in Geneva

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Reviews

By

The Honourable Mr Justice David Hayton, Judge of the Caribbean Court of Justice,

On the occasion of

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1) Sham trusts, illusory trusts, general powers of appointment

In *Clayton v Clayton* [2016] NZSC 29 the settlor was sole trustee and principal beneficiary of a discretionary trust for himself, his wife and issue and their spouses. As principal beneficiary he had power to appoint and remove trustees and he could remove persons from the class of Discretionary Beneficiaries, such term covering Final Beneficiaries. However, removing Final Beneficiaries from the class of Discretionary Beneficiaries did not mean that they ceased to be Final Beneficiaries who would take any property remaining in the trust fund on the vesting date. Thus he could not make himself sole beneficiary by removing all but himself from the class of Discretionary Beneficiaries as the Court of Appeal had thought.

On this basis the Court of Appeal had held this power was like a general power of appointment and so all the trust property within the power ranked as 'relationship property' as "any other right or interest" within s 2(e) of the Property Relationships Act ('PRA') in the settlor's divorce proceedings.

The Supreme Court rejected that basis but still found that all the trust property was 'relationship property' because, under express terms of the trust, the settlor as sole trustee could distribute capital and income to himself as one of the beneficiaries without considering the interests of the other beneficiaries and without being subject to any duty of impartiality or of avoiding a conflict of interest.

Whether the trust property was also within the PRA because the trust was a sham was then the subject of obiter dicta.

The Court of Appeal accepted that the settlor-trustee was subject to the irreducible core duty to act honestly and in good faith and to provide accounts to the beneficiaries who could enforce those obligations. It found that he intended to create a genuine trust for legitimate business activities separating the land that comprised the trust property from the operating assets of his corporate businesses. The trust acted as a banker borrowing funds on the security of the trust property and lending the money on to the settlor's businesses. Thus the trust was not a sham, but the judge had held it to be an illusory trust because the settlor could make himself sole legal beneficial owner of the trust property, this being incapable of amounting to a 'fraud on a power' since the trust deed envisaged the settlor so benefiting himself.

The Court of Appeal held that a trust was either a sham trust or not: there was no lesser concept of an illusory trust. The Supreme Court at [123] saw no value in using the word 'illusory' in respect of a trust: "if there is no valid trust that is all that needs to be said."

The Supreme Court considered that two lines of analysis of the trust were open in the particular circumstances but, not being unanimous, left the position open.

One could say at [124] that the settlor had reserved such very broad powers to himself as sole trustee that he could not be said to have disposed of his property in favour of another, so there was no valid trust, he remaining as sole legal beneficial owner. However, a valid trust would arise if he were replaced by an independent trustee.

Alternatively, at [125], although the trust was effectively defeasible whenever the settlor chose, it was to be regarded as a valid trust until such defeasance by the exercise of a power comparable to a general power of appointment or of revocation, so until then he must act honestly and in good faith and provide accounts to the beneficiaries. This was the Court of Appeal's view based upon the settlor's intent to owe enforceable obligations to beneficiaries. After all, a revocable trust is defeasible whenever the settlor wants but it is, nonetheless, unless intended to be a sham, a valid trust until prospectively revoked, as in the Privy Council case, *Tasarruf Mevduati Sigorta Fonu v Merrill Lynch Bank & Trust Co (Cayman) Ltd* [2011] UKPC 17. Here the court appointed a receiver by way of equitable execution over a judgment debtor's reserved power to revoke his trust which would have been unnecessary if the trust assets had belonged beneficially to the debtor because his trust was a sham.

Although the NZ Supreme Court at [113] referred to one of its decisions, *Ben Nevis Forestry Ventures Ltd v Commissioners of Inland Revenue [2008] NZSC 15, [2009] NZLR 289* at [33] as authority for "a sham is a pretence: a document that does not evidence the true common intention of the parties", it did not deal with a further sentence in that paragraph that had been cited approvingly by the Court of Appeal. "A document which originally records the true common intention of the parties may become a sham if the parties later agree to change their arrangement but leave the original document standing and continue to represent it as an accurate reflection of their agreement." This indicates that a true trust can become a sham trust. Surely this cannot be the case.

One can easily understand that there is no problem over a sham trust becoming a true trust from the date the settlor and trustees so decide or a new trustee replaces the old trustee on the understanding that he is undertaking the standard duty of loyalty to carrying out the terms of the trust. He cannot become an unknowing party to a sham as Munby J pointed out in *Av A [2007] EWHC 99 (Fam) at [47]*.

Once a true trust, however, always a true trust. Once the beneficiaries have rights under a true trust it becomes a breach of trust for the trustees to ignore this and treat the trust as a sham trust of property held to the settlor's order: see Rimer J (as he then was) in *Shalson v Russo [2003] EWHC 1637 (Ch), [2005] Ch 281 at [190]* and Munby j (as he then was) in *A v A [2007] EWHC 99 (Fam) at [42]-[43]*.

The scope of freezing orders in respect of defendants' interests under trusts

Where a claimant is suing a defendant who is more than a mere discretionary beneficiary under a trust, so that execution may be levied in respect of the defendant's interest in trust property to satisfy a judgment debt of the defendant, a freezing order may be made against the trustee to preserve the trust property if (i) there is a real risk that any judgment might go unsatisfied by reason of the disposal or dissipation of the property and (ii) it is just and convenient to make the order. These orders made against a third party, as opposed to a defendant who may well become a judgment debtor, are known as *Chabra* orders after *TSB Private Bank International v Chabra* [1992] 1 WLR 231.

To make such an order there has to be "good reason to suppose" or, in other words, "a good arguable case" that execution may be levied against the trust assets because the defendant has power, directly or indirectly, to dispose of them as if they were his own, as where the trustee will deal with the assets in accordance with his direct or indirect instructions e.g. via himself or a protector.

To help establish this under an inherent equitable jurisdiction or specific civil procedure rule (like the English CPR Part 25.1(g)) a court may make an order directing a party to provide information about relevant property or assets which are or *may be* the subject of an application for a freezing injunction. In *JSC Mezhdunarodniy Bank v Pugachev* [2015] EWCA Civ 139 the Court of Appeal held that to make such an order the court only needs to be satisfied that there are "credible grounds" for applying for such order. It was so satisfied and so made the order.

Using information obtained as a result of this order, an *ex parte* application for a freezing order against trustees of Mr Pugachev's New Zealand trusts failed before the Chancery judge but succeeded before a Court of Appeal (containing no ex-Chancery Division judges) in [2015] EWCA Civ 906. Counsel submitted, inter alia, (as indicated at [23]) that the trustees held "the trust assets subject to the control of Mr Pugachev and it is appropriate to infer from that fact that they may be available to satisfy a future judgment against him."

Bean LJ stated at [30], "There is a good arguable case that the assets held by the trusts are in reality assets of, or *under the control of*, Mr Pugachev" so as to grant the requested world-wide freezing order against his New Zealand trustees. The Lord Justice seems to have assumed that it was appropriate to infer that the controlled trust assets might be available to satisfy a future judgment debt against Mr Pugachev, much influenced by the large number of hearings against Mr Pugachev before and after he fled the English jurisdiction, showing that he had taken every possible step to keep his assets out of reach of the courts.

Subsequently, there was an *inter partes* application requiring the claimant to make good its case for continuing the freezing order or the order would be discharged.

There were five similar New Zealand discretionary family trusts settled by Mr P who was the Protector, with his son, Victor, having the powers of Protector if Mr P came under a disability which prevented him from exercising those powers. The Protector had power to appoint and remove trustees and a right of veto over distributions and investments, but could not direct distributions. He could, however, direct the sale of properties used as residences by beneficiaries, though the proceeds, of course, would be trust property.

Essentially, the four corporate sole trustees of the five trusts were managed by their directors, an experienced trusts lawyer, Mr Patterson, his wife, Ms Hopkins, and a close business associate of Mr Pugachev, Ms Dozortseva, who had been a party to placing misleading evidence before the English court when a 2014 freezing order had been made against Mr Pugachev alone, though notified to the trustees.

On 14 July 2015 Mr Patterson and Ms Hopkins exercised their powers as shareholders to remove Ms Dozortseva as a director because they considered she had ceased to act properly as a director, acting in the interests of Mr P to the potential detriment of the trust beneficiaries.

On 24 July 2015 four new NZ trust companies were hastily incorporated with three directors, Ms Dozortseva, Mr Lenihan, a lawyer specialising in sports law, and a Mr Willem Smit. That day Mr P and his son, Victor, appointed those companies to be trustees in place of the original trust companies because of a lack of confidence in Mr Patterson and Ms Hopkins who had not consulted Mr P before removing Ms Dozortseva as director. Mr Patterson and Ms Hopkins for the original trust companies then sought directions from the New Zealand HIgh Court as to whether the trust companies had been validly removed and the new trustees validly appointed.

It appears that the original trustees were merely concerned to protect their backs, in that they did not seek to make out a case of unfitness against the directors of the new trustees, being content to have matters determined on uncontested affidavit evidence of Mr P and Victor. As a result the NZ High Court held that there was no reason to suggest that the Protector's power to remove the original trustees was exercised improperly.

Having been appointed trustee on Friday 24 July 2015, on Monday 27 July and without taking independent advice, a trustee via its directors Ms Dozortseva and Mr Smit signed a lengthy complex agreement with Mr Pugachev whereby the latter assigned to the trustee a percentage of the net proceeds of an international arbitration against the Russian State up to a maximum $20million in return for the trustee making $800,000 available to fund this. This was paid to Mr Pugachev's lawyers but due to the terms of a 2014 freezing order made against Mr Pugachev alone but notified to the trustees of his New Zealand trusts, his lawyers repaid the money to the trustee after some proceedings. Ms Dozortseva ought to have been well aware of problems in respect of paying money over to assist Mr Pugachev since she had been much involved in proceedings relating to the 2014 freezing order before she and Mr Pugachev both left for France on the same day.

Mann J drew the inference that the new trustees were appointed because they would enter into the funding arrangement, so justifying the inference that they were prepared to do Mr Pugachev's's bidding, which was supported by their knowledge as to how quickly the original trustees had been removed when they had sacked Ms Dozortseva without Mr Pugachev's approval.

Mann J observed that the trigger for the claimants bringing proceedings against the trustees was the replacement of the original trustees by the new trustees. He accepted at [98] that until then "it could not be demonstrated that Mr Pugachev would seek to interfere in the affairs of the trusts so as to bring about dissipation which would be contrary to [the 2014 freezing order against him] *and achieve success*." Thus Mann J accepted that the original trustees were independent trustees running perfectly valid trusts.

The risk of dissipation manifested itself when the particular new trustees were appointed and the $800,000 was made available to Mr Pugachev's lawyers. Mann J held at [114] "…a combination of the structure (which gives him rights as Protector), the propensities that he is said to have demonstrated to conceal assets and, where possible, to have them applied for his purposes, the circumstances of the change of trustees and what the trustees then did all point towards de facto, not de iure control." He thus concluded at [116], "I find that there is a real risk of dissipation based on the real possibility that Mr Pugachev has put in place trustees whom he would seek to influence and in respect of whom there is a very serious risk that they will give effect to that influence."

BUT once it has been accepted that there is a valid trust it always remains a valid trust the terms of which must be strictly observed by whoever is the trustee. As Rimer J stated in *Shalson v Russo* [2003] EWHC 1637 (Ch)[2005] Ch 281 at [190], "Once the assets are vested in the trustee, they will be held on the declared trusts, and he is entitled to regard them as so held and to ignore any demands from the settlor as to how to deal with them. I cannot understand on what basis a third party could claim merely by reference to the unilateral intention of the settlor that the settlement was a sham and that the assets remained the settlor's property."

Moreover, as Munby J emphasised in *A v A* [2007] EWHC 99 (Fam) at [43], "Nor can it make any difference, where the trust has already been properly constituted that a trustee may have entered into office – may indeed have been appointed a trustee in place of an honest trustee – for the very purpose and with the intention of treating the trust for the future as a sham. If, having been appointed as trustee, he has the trust property under his control he cannot be heard to dispute either the fact that it is trust property, or the existence of his own fiduciary duty."

It follows that the new trustees had no right to commit a breach of trust by doing whatever Mr Pugachev told them, while his instigation of a breach of trust would make him liable for dishonest assistance in a breach of trust (as Munby J also pointed out in [43]). Surely any trust assets transferred to Mr Pugachev in breach of trust in these circumstances would not amount to his property liable to be taken in execution but would remain assets held on trust for the beneficiaries and not available for his judgment creditors. Surely, no freezing order should have been made at the potential judgment creditor's behest against the new trustees who are required by law properly to carry out their strict equitable duties in relation to the trust property.

Indeed, if the beneficiaries knew of a possible attempt by the trustees to distribute trust property in breach of trust it should be they who should be obtaining an injunction to prevent this. They should be able to resist any attempt by a judgment creditor of Mr Pugachev to claim trust property in order to satisfy Mr Pugachev's debt out of trust property to which he had no entitlement. Trust property can only have execution levied in respect of it by a judgment creditor of a debtor who is interested under the trust in the following five circumstances.

(i) Where the settlor-debtor is the beneficial owner of the trust property because his trust, purportedly created by a transfer of his property to trustees, is a sham, intended to create the appearance of a trust for others but, in reality, intended by the settlor and the trustees to be a case where the trustees hold the trust property to his order.

(ii) Where the settlor-debtor has a power of revocation or a power to appoint the trust property to himself or a power to remove all beneficiaries but himself so as to become sole beneficial owner, this will be presumed a valid trust where, until such power is exercised, the trustees must act bona fide in the best interests of the beneficiaries and must account to the beneficiaries for their stewardship of the trust property. *Exceptionally*, such a trust will be found to be a sham trust if from the outset, in the light of the settlor's pre-eminent powers, the trustees and the settlor understand that the trustees are to do what the settlor wants, essentially holding the property to his order.

(iii) Where the settlor-debtor has no powers to obtain the trust property for himself but is the protector with a power to appoint and remove trustees and whose consent is required to make changes of investments proposed by the trustees and to make distributions of income or capital proposed by the trustees, this, too, will be presumed a valid trust. This is on the basis that the powers of appointment and removal are fiduciary powers having to be exercised bona fide in the best interests of the beneficiaries, like the power to withhold consent to proposed investment decisions, though not the non-fiduciary power to withhold consent to distributions to beneficiaries. *Exceptionally,* such a trust will be found to be a sham trust if from the outset, in the light of the settlor's extensive powers, the trustees and the settlor understand that the trustees are to do whatever the settlor wants, essentially holding the property to his order.

(iv) Where the settlor-debtor is not the beneficial owner of the trust property under a sham trust but has a personal power under a valid trust to recover the trust property from the trustees for himself e.g. under a power of revocation or a power of appointment in his own favour or a power to exclude all but himself as beneficiaries, the trust property will be available to judgment creditors via the appointment of a receiver over the power by way of equitable execution. Thus a freezing order may be obtained against the trustees of the trust property. In due course equitable execution of a judgment debt may be obtained by the court appointing a receiver over the power, ordering the debtor to delegate his power to the receiver, and, in default, ordering the delegation to be exercised on his behalf.

(v) Where the settlor-debtor has a power to remove trustees and appoint anyone (but himself) to be a trustee that is expressed to be a personal, non-fiduciary power, the exercise of which is to be unchallengeable in the courts, and the trustees can appoint capital and income to the settlor as a discretionary beneficiary without considering the interests of any other beneficiaries, a freezing order should be available against the trustees. This is either because the understanding of the settlor and trustees is that the property is held to the settlor's order or because by way of equitable execution the court can order the debtor to appoint a receiver to be trustee in place of the current trustee and to appoint enough trust property to the settlor to satisfy the judgment debt, the receiver receiving such property on the debtor's behalf. In default of compliance a court officer can make the relevant appointments.

Jurisdiction and applicable law

Succession matters and lifetime matters

C alleges that D's conduct in D's lifetime amounted to D declaring himself trustee of particular property for C. To ascertain which State's courts have jurisdiction to determine the issue, one has to ask the question, "Is this a matter of "succession" excluded from "civil and commercial" matters governed by the Brussels Convention on Jurisdiction and the Recognition and Enforcement of

Judgments, replaced by Brussels Regulation 44/2001, itself replaced by the recast Brussels Regulation 1215/2012?" "Wills and succession" are now covered by the Succession Regulation 650/2012 "on jurisdiction, applicable law, recognition and enforcement of decisions and acceptance and enforcement of authentic instruments in matters of succession and on the creation of a European Certificate of Inheritance."

While a defendant's residence is a good starting point for jurisdiction against him, other connecting factors may be more appropriate. Thus, in the succession sphere courts of a deceased's nationality law chosen by him to be his *lex successionis* may be more appropriate to take jurisdiction than the courts of his habitual residence, as recognised in the Succession Regulation. In the case of civil and commercial matters persons resident in one Member State may be more appropriately sued in another Member State: in contract matters in the courts of the State of the place of performance of the obligation; in tort or delict matters in the court of the State where the harmful effect occurred; or in disputes brought against a settlor, trustee or beneficiary, the courts of the State in which the trust is domiciled. The reason for this is that courts in these latter States are likely to be better placed to judge matters than the courts in the former States.

Because of the complexities involving the differing connecting factors to determine the law governing succession to a deceased person's estate, such factors covering residence, nationality, domicile in the technical common law sense, and situs of immovable property, "succession" was excluded from the Brussels Convention and Regulation to await a Succession Regulation dealing with the applicable law for succession matters and the courts having jurisdiction over such matters. The Jenard Report (Official Journal European Community 1979 C 59/1 at 10-11) indicated that the exclusion of "succession" related to matters regarded in private international law as "succession".

In *Winkler v Shamoon* [2016] EWHC 217 (Ch) W claimed that D, a deceased Israeli citizen and resident, had made a lifetime gift to W of a 12.5% shareholding in a BVI company, holding it on trust for W. The Israeli administrator, who in Israel managed and controlled the shares remaining in D's name, could not be sued in England. W, therefore, brought English proceedings against A and B, entitled to receive the shares under D's will, on the basis of alleging them to be resident or "domiciled" in England, so falling within the jurisdiction of the English courts under the Brussels Regulation. W claimed an order that A and B were to take all necessary steps to ensure that W was registered as owner of the shares or to ensure that the proceeds of sale of the shares were to be transferred to him at the earliest opportunity.

Carr J held that W's claim against A and B involving his entitlement under a trust to the BVI shares was a matter of succession and so was excluded from the Brussels Regulation, finding support from regarding the Succession Regulation as applying if then in force. The test was, as indicated by Rattee J in *Re Hayward* [1997] Ch 45 at 53H to ask "what was the principal subject-matter of the proceedings?" Carr J held at [72] that the "principal subject-matter of the claim is 'succession'." He considered at [69] that the estate was being administered as part of the process of "the sharing out of the estate" within Art 23(2)(j) of the Succession Regulation. The claimant, W, at [68] was "in reality, claiming to be entitled to succeed to the estate of a deceased person" and "to frustrate the claims of [A and B] to succeed to the shares under the terms of the will."
But, with respect, surely W's claim was to a proprietary interest created by a lifetime gift: he was not claiming to succeed to part of D's estate. He was claiming that from the date of the lifetime gift the gifted property was part of *his* estate not D's, and this preliminary issue had to be resolved before one reached "the sharing out" of whatever was in D's estate. Succession law determines who succeeds to whatever happens to fall within D's estate, but does not determine what are those

assets remaining to be inherited when there are claims by outsiders that D's assets have been diminished by property, contractual, tortious or trust claims.

Indeed, in *Re Hayward* [1997] Ch 45 shortly before D died, D's trustee in bankruptcy became entitled to D's half share in a villa owned by D and H. The trustee claimed to be entitled to this share rather than W who inherited that share in the villa on D's intestacy, but this issue was held not to be a matter of succession. As it happened, though H was allegedly aware of D's bankruptcy, W transferred her inherited half share to H to settle debts due from D to H respecting work on the villa. H was then registered as sole owner of the villa which was in Minorca. Because the trustee claimed rectification of the Minorcan land register and title to Minorcan land was involved, the Spanish court had exclusive jurisdiction under the Brussels Convention.

Carr J surprisingly did not cite Article 1.2(g) of the Succession Regulation which excludes from the Regulation, "property rights, interests and assets created or transferred *otherwise than by succession, for instance by way of gift* …. without prejudice to point (i) in Article 23(2)." He did, however at [72] cite in support of his approach Article 23(2)(i) as including within succession matters "any obligation to restore or account for gifts, advancements or legacies when determining the shares of the different beneficiaries."

This provision, however, has nothing to do with the validity of D's alleged gift to W. It just covers the vitiation of gifts by common law rules, like the presumption against double portions, and by the major civil law add-back rules whose operation led the UK and Ireland not to opt in to the Succession Regulation. Under these rules D's patrimony is notionally enlarged to include the value of lifetime gifts made within a specified period before D's death. If D left three children they are entitled to reserved or forced shares of three quarters of the notional estate and only one quarter forms D's freely disposable part of his patrimony. If the actual value of the patrimony at death is insufficient to make up the value of the reserved shares, the forced heirs have money claims against recipients of D's lifetime gifts to ensure that they receive the full value of their shares.

In any event, Carr J went on to reject W's claim that he had an equitable interest in the 12.5% shareholding held by D. This claim was a *Rose v IRC* [1952] Ch 499 claim based on D having done everything necessary for him to do to transfer the shares to W so that this was an exception to the principle that Equity will not perfect an imperfect gift. D had orally told his Swiss lawyer to take care of all formalities required to register W as owner of the shareholding. Carr J rejected W's claim because an earlier written instruction of D to his lawyer prohibited him engaging him in any activity in respect of shares registered in D's name without the written consent of D and a subsequent oral confirmation from D. This requirement had not been satisfied by D. Moreover, D had intended to make an outright gift so that he could not be regarded as having retained the shares and declared himself trustee thereof for W.

Developing a broad scope for the tracing process

In *The Federal Republic of Brazil and another v Durant International Ltd and another*

[2015] UKPC 35, [2015] 3 WLR 599 the Privy Council dismissed the appeal from the Jersey Court of Appeal (considered last June at this conference) and endorsed the broad scope for the tracing process developed in Jersey.

(a) Tracing is relevant to proprietary and monetary claims.

Assume that a trustee, T, sold trust property for $1 million so that he could use the money to buy X Ltd shares for himself or for his wife. Two years later the X Ltd shares are sold for $2 million and these proceeds of sale are used to purchase Y Ltd shares. A year later this is discovered when the Y Ltd shares are worth $3 million. Is T or his wife simply liable to a mere monetary claim for $1 million with interest? No. The beneficiaries can successfully claim to have had a continuing equitable proprietary interest in the traced Y Ltd shares worth $3 million, so that these shares have always comprised part of the trust fund held for the beneficiaries. The beneficiaries' proprietary interest affords them priority over unsecured creditors of the defendant and secures rises in value of traced property.

What if T or his wife had sold the Y Ltd shares for $3 million and used the proceeds to pay their son's creditors in order to save him from bankruptcy? No proprietary claim is possible against T or his wife. T, however, will be liable for a monetary claim for $3 million with interest. Such a claim will also lie against T's wife if she had knowingly or unconscionably dealt with property subject to a trust in a manner inconsistent with such duty.

(b) Problems with money passing through bank accounts: "lowest intermediate balance" restriction and "backwards tracing"

Take $1 million trust money paid into T's account containing $1 million of T's own money; T pays out $1,990,000 to discharge various debts so only $10,000 left. T pays in $90,000 proceeds of sale of property which is presumed to belong to him unless there is clear evidence that it represents the proceeds of sale of traced trust property. The $100,000 is then used to purchase an asset. Trust beneficiaries can only claim $10,000 of the purchase price to obtain 10% of the purchased asset. If the whole $2 million had been dissipated in paying debts then trust beneficiaries could have no claim at all on T's asset purchased for $90,000. Their claim is restricted to the lowest intermediate balance in the bank account: *Roscoe v Winder* [1915] 1 Ch *62*.

So far as concerns backwards tracing, take T who placed an order to buy a vintage Ferrari for himself, expecting to sell a trust painting so that he can wrongfully use the proceeds to buy the car once delivered. An unexpected delay over selling the painting and receiving its proceeds forces T to obtain bridging finance for himself for a fortnight until the source of the bridging finance can be repaid out of the painting's proceeds of sale. Can the beneficiaries claim the vintage car, or is it T's own car bought out of his own creditworthiness so that the car is T's own property available to satisfy claims of his unsecured creditors? More commonly, "backwards tracing" will involve tracing through bank accounts where a bank account is credited and a payment made thereout before relevant funds have been received from a correspondent bank.

Should a sophisticate fraudster be able to defeat a tracing claim by manipulating the sequence in which credits and debits were made to his account? "No" is the court's answer as made clear in *The Federal Republic of Brazil and another v Durant International Corporation and another* [2015] UKPC 35, [2015] 3 WLR 599.

In this case the courts at all levels were prepared to adapt a broad approach to tracing principles where there had been no question of the defendant's insolvency and prejudice to his unsecured creditors. On a strict view, however, it would seem that the extent to which the claimant should be able to trace the substituted value of his property into the hands of the defendant ought not to depend upon whether the defendant is solvent or insolvent.

Nevertheless, in practical reality, in assessing the evidence and drawing inferences a judge may well be more easily satisfied that property could be traced into the defendant's hands where the defendant is solvent enough to satisfy the claimant's personal claim and when any gains clearly should enure for the benefit of the claimant rather than the disloyal defendant. Indeed, it is arguable that the task of a judge determining the extent of a personal claim against a defendant fiduciary involves the performance of a discretionary exercise, while the task of determining whether the claimant has an equitable proprietary interest with multilateral priority over creditors of the defendant and gratuitous transferees of the relevant property or subsequent equitable chargees of such property is determined by fixed settled rules.

The Jersey Royal Court decision [2012] JRC 211 that was endorsed by the Court of Appeal [2013] JCA 71 has now found favour with the Privy Council. The Royal Court found that, as a result of a wide-scale fraud, monies of the Municipality of Sao Paulo that should have been used in major construction projects were diverted in breach of fiduciary duty into the hands of Paulo Maluf (mayor of Sao Paulo) and his son, Flavio, as bribes, commissions or 'kick-backs'. Expert evidence of Brazilian law indicated that the Municipality retained a proprietary claim, no title to the stolen money having passed to the Malufs.

Via coded bank accounts and unidentified black-market currency dealers ("*doleiros*") dealing with the stolen Brazilian money, US$10,500,000 ended up held for the Malufs in a New York bank account controlled by them. The Court held that the claimant had made out a case, which in the absence any other explanation, more than justified the conclusion that the US$10,500,000 represented the Municipality's money even though there was a "black hole" or "maelstrom" created by the Malufs so that the exact route by which the funds reached their destination could not be determined. The defendants had not been able to discharge the evidential burden of displacing such conclusion by showing where the New York bank money had come from and why. The US$10,500,000 or, at least, $7,700,000 thereout were transferred to a Jersey Bank account of Durant International and then the majority of the monies were paid into the Jersey Bank account of Kildare Finance, the wholly owned subsidiary of Durant. These companies were indirectly owned and controlled by the Malufs. Thus, the knowledge of the Malufs was attributed to those companies so as to establish both personal and proprietary liability of the two companies if the monies could be traced into the Jersey Bank accounts that had earlier been frozen to await the outcome of the trial.

The Court held that the monies could be traced into the Jersey Bank accounts. The fraudulent theft of the Municipality's money in breach of fiduciary duty sufficed to enable tracing principles to be applied. Indeed, fraud usually involves a breach of a fiduciary relationship sufficient to enable tracing principles to be applied. The Royal Court, however, strongly considered that tracing principles should be generally available as an evidential process (as suggested by Lords Steyn and Millett in *Foskett v McKeown* [2001] 1 AC 102) even where the claimant had a legal beneficial interest in the relevant property but no equitable interest separate from the legal interest e.g. where a robber stole a person's gold bars or a painting or where, as here, no equitable proprietary interest could exist under Brazilian law. The Court of Appeal endorsed this at [51] stating that the law of Jersey "does recognise tracing as a unitary concept" with no separate rules of equitable and common law tracing.

The defendants claimed that only US$7,700,000 could be traced into the Jersey Bank accounts as a result of either (a) the last three payments into the New York Bank having been made after the final payment to Durant's Jersey Bank, "backwards tracing" not being possible or (b) a claimant not being able to claim beyond the lowest intermediate credit balance in the New York Bank under the principle in *Roscoe v Winder* [1915] 1 Ch 62.

The Jersey Court at [219] was not prepared to enable a sophisticated fraudster to defeat an otherwise effective tracing claim simply by manipulating the sequence in which credits and debits were made to his bank accounts, particularly where "there is no question of possible insolvency and prejudice to unsecured creditors." "The question is simply whether there is sufficient evidence to establish a clear link between credits and debits to an account, irrespective (within a reasonable timeframe) of the order in which they occur or the state of balance in the account. It is unnecessary to posit any limitation on how, as a matter of evidence, the necessary link might be proved: it might be by means of bank documentation or by reference to the account-holder's intentions or in some other way. Nor is there any cause to diminish the effect of such a link, once recognised, by introducing the concept of a 'lowest intermediate balance rule'."

The Court of Appeal at [61] cited the Royal Court as above, having itself at [58] emphasised that "the fundamental question in any given case is whether the plaintiff can establish a sufficient link between the property of which he was originally deprived and the property into which he is seeking to trace". Like the Royal Court it found sufficient links - see [66]-[69.

Thus the claimants had a proprietary claim to the US$10,500,000 in the defendants' Jersey Bank accounts, as well as the two defendants being personally liable [as constructive trustees] for such amount. The Court of Appeal upheld the award of interest at US Prime Rate plus 1% compounded with monthly rests.

The Privy Council dismissed the appeal, stating as follows at [38]. "The development of increasingly sophisticated and elaborate methods of money-laundering, often involving a web of credits and debits between intermediaries, makes it particularly important that a court should not allow a camouflage of interconnected transactions to obscure its vision of their true overall purpose and effect. If a court is satisfied that the various steps are part of a coordinated scheme, it should not matter that, either as a deliberate part of the choreography or possibly because of the incidents of a banking system, a debit appears in the bank account of an intermediary before a reciprocal credit entry."

Earlier at [34]-[37] the PC held that that there may be cases where there is a close causal and transactional link between the incurring of a debt and the use of trust funds to discharge it, as where interim financing had been obtained with a view to repaying it from trust funds, citing *Agricultural Credit Corporation of Saskatchewan v Pettyjohn* (1991) 79 DLR 4th 22 (Sask CA). Indeed, it would not matter if the account providing bridging finance was in credit or overdrawn; it can still be used as a conduit for funds: (see [39]). "The claimant has to establish a coordination between the depletion of the trust fund and the acquisition of the asset which is the subject of the tracing claim, looking at the whole transaction such as to warrant the court attributing the value of the interest acquired to the misuse of the trust fund": (see [40]).

One has to accept that this is inherently Imprecise as in several other areas of the law where the court has to make an evaluative judgment having regard to all the circumstances and the assistance provided by decisions on the facts of other cases e.g. setting aside for mistake because it would be unjust not to do so (below) and whether an employee's tort is so closely connected with his employment that it would be just to make his employer vicariously liable: *Mohamud v W M Morrison Supermarkets plc [2016] UKSC 11.*

Setting aside for mistake as to legal or factual effects or consequences

England

In *Van der Merwe v Goldman and HMRC* [2016] EWHC 790 (Ch) the Claimant, M, and 1st Defendant, G, were a husband and wife whose tax-planning arrangements finalised on 27 March 2006 were caught out by drastic tax changes to interest in possession settlements announced in the 22 March 2006 Budget as having effect from 23 March 2006. To make matters worse, HMRC was added as defendant to argue the arrangements were not gratuitous but contractual so that the very strict common law requirements applied in which case it was common ground that the arrangements could not be set aside. Moreover, even if the arrangements were gratuitous, HMRC suggested reasons why the requirements for setting aside the arrangements in equity might not be satisfied.

On Friday 24 March M and G, who were co-owners of a house, executed a transfer of the house to M for no stated consideration. On Monday 27 March M executed a deed of trust, settling the house on interest in possession terms therein and appointing himself and G as trustees, and executed a transfer of the house to himself and G as trustees. Before 23 March no IHT would have been payable and, because the settlor would not become domiciled in the UK till 6 April 2006, the house could before then have been charged up to the hilt to enable the borrowed money be invested outside the UK as excluded property outside the IHT net. Instead, in August 2012 it was discovered that 20% IHT charge on the house worth £1.4 million had become payable in 2006 and a 6% IHT charge would fall due on every tenth anniversary. Moreover, interest had built up to over £60,000 and penalties could possibly be imposed.

The terms of the family trust were for M and G to be the Principal Beneficiaries to whom income was to be paid during their joint lifetimes and the lifetime of the survivor, remainder on discretionary trusts for their children and remoter issue. Significantly, the Trustees had power to apply the whole or part of the Trust Fund to or for the advancement of a Principal Beneficiary. In exercising the power the Trustees were entitled to have regard solely to the interests of the Principal Beneficiaries and to disregard all other interests or potential interests under the trust. M claimed that the 27th March deed of trust and the transfer should be set aside in equity, but, upon HMRC claiming that those related documents were not gratuitous, all parties were content for the court to consider an alternative claim by both M and G that both the 24th March transfer and the 27th March arrangements be set aside.

HMRC argued that M and G had contracted to make the 27th March arrangements benefiting G in return for G on 24 March transferring her half share in the house to M so he became sole legal beneficial owner. M and G argued that the 24 March transfer was an outright gift leaving him free to deal with the house as he pleased, there being no intent to create legal contractual relations.

Morgan J took a different view. He held G did not intend to give the house to M to do as he pleased but in order to carry out their common intention to create the intended family trust. The house held on trust for M and C equally was transferred to M to hold upon trusts to be shortly declared, so giving rise to a resulting trust for M and C equally until the trusts were declared. The 24th and 27th March arrangements were always intended to be effected by two steps and so must be considered as a whole.

By those arrangements M and G settled their house on themselves and their issue and did not provide consideration for the family trust. The absence of consideration meant that the liberal equitable rules applied to setting aside their arrangements, not the very strict common law rules. Morgan J then set out at [26] the detailed equitable rules and applied them so as to order that the 24 March transfer and the settlement and transfer of 27 March be set aside. He rejected HMRC's attempts to show he had no grounds to make such an order, reasoning as follows.

The ignorance of M and G as to the budget announcements had led them to a mistaken belief that there would be no adverse tax consequences in carrying out their arrangements. They would not have entered into their arrangements but for this grave mistake as to the consequences of those arrangements, and the mistake was of so serious a character as to render it unjust or unconscionable for M and G's trust beneficiaries (their issue) to resist rescission of the arrangements, applying the requirements laid down by the UK Supreme Court in *Pitt v Holt* [2013] UKSC 26, [2013] 2 AC 108.

HMRC made the point that the position of M and G had not really changed as a result of their arrangements because they could exercise their powers as trustees to transfer the house back to themselves, so why set their arrangements aside. The judge's response was that the trust was not a sham and the court would not be acting in vain if it ordered rescission, because without such rescission there would be a major IHT liability.

HMRC then relied upon Lord Walker's statements in *Pitt v Holt* [2013] UKSC 26, [2013] 2 AC 108 at [135] where Lord Walker had stated, "In some cases of artificial tax avoidance the court might think it fit to refuse relief, either on the ground that such claimants, acting on supposedly expert advice, must be taken to have accepted the risk that the scheme might prove to be ineffective or on the ground that discretionary relief should be refused on grounds of public policy." HMRC argued that M and G had run the risk of a possible liability to IHT and had to suffer the consequences of the risk having materialised. Morgan J rejected this at [41] on the ground "they believed there was no question of a charge to tax by reason of the creation of the settlement." At [47] he explained that he did not consider this to be a case where the parties accepted a risk that their scheme might not have its intended results. It thus is clear that if you are advised that carrying out your scheme is a straightforward case where no tax becomes payable and this would actually have been the case but for an overlooked budget announcement, you are not regarded as accepting a risk of any tax being charged. This is a very narrow ratio.

It seems likely that there is a broader ratio that if you are advised that carrying out your scheme is a clear case where no tax is payable, but the advice is mistaken, since you did not consciously run any risk as to having to pay tax, you are not regarded as having run any risk. Thus the court can set aside your mistaken disposition. This latter view can find support from Lord Walker at [113] endorsing the view of Lloyd LJ commenting upon *Re Griffiths* [2009] Ch 162 where the mistaken settlor had rejected advice to take out term assurance in case he died before his potentially exempt transfer became exempt and so could be regarded as consciously having taken a risk. In practice, one can expect tax advisors to warn their clients of risks the client is accepting by proceeding with a scheme so as to protect the advisors from negligence claims.

Finally, though HMRC had originally indicated it would rely on Lord Walker's dicta at [135] to contend as a matter of public policy that the tax-avoiding settlement ought not to be set aside, at [42] it "accepted at this level of decision, in the light of recent decisions of the Supreme Court on the principle of *ex turpe causa* and public policy, in particular, *Les Laboratoires Servier v Apotex Inc* [2015] AC 430, the court could not be expected to withhold relief on this ground in this case." The UKSC had diminished the scope for invoking *ex turpe causa* and public policy.

Subsequently, at [2016] EWHC 926 (Ch), HMRC applied to the judge for leave to appeal, which he refused on the basis an appeal had no realistic possibility of success, and also for leave to make a leapfrog appeal to the Supreme Court to deal with the public policy ground for refusing relief. The judge refused such leave on the basis this was not the appropriate case for the Supreme Court fully to adjudicate upon the public policy issue.

It is worth noting that in *Bainbridge v Bainbridge* [2016] EWHC 898 (Ch) it was made clear that the courts' powers to grant relief extend beyond the original property mistakenly transferred to cover traceable property subsequently purchased with the proceeds of sale of the original property.

Guernsey

In *Gresh v RBC Trust Company (Guernsey) Ltd and HMRC* No 6 of 2016 Gresh received £1,462,280 paid to him at his request by RBC as trustee of a pension fund. The request had been made based upon tax advice that this distribution of a lump sum would be taxfree if not remitted to the UK. Gresh and RBC (to whom Gresh showed the advice) believed the advice to be correct and acted upon it. The advice was wrong, as it was correct only in respect of periodic pension payments, so Gresh was assessed to tax at 40%. Naturally, Gresh applied to have the distribution set aside on the ground of a mistake which had caused the distribution to be made.

RBC adopted a neutral stance, but HMRC had itself joined as a party to oppose the application. In favour of the application was that he had made a grave causative mistake by requesting the payment in straightforward circumstances where he had accepted no risk that a taxavoiding scheme might not work.

Did the Court just have to look broadly at "whether it would be unconscionable or unjust to leave the mistake uncorrected", per Lord Walker in *Pitt v Holt* [2013] UKSC 26, [2013] 2 AC 108 at [128], in which case it was submitted that Gresh's application would succeed?
Did the Court, instead, have to consider whether it would be unconscionable for the donee to retain the property given to him, given Lord Walker's reliance on *Ogilvie v Littleboy* (1897) 13 TLR 399 at 400 requiring a donor to show "that he was under a mistake of such serious character as to render it unjust on the part of the donee to retain the property given to him"? The Bailiff, Sir Richard Collas, accepted that this was the right question to ask. He concluded at [57], "It is not unconscionable (unjust or unfair) that he
[Gresh] should have to retain the distribution made by the Trustee to him."

He pointed out that one had to look at the consequences of setting aside or not setting aside the disposition. Gresh was the only person affected in that he had to pay out 40% tax though retaining the balance, while in the decided cases where the court had been persuaded to set aside a disposition there had been other persons whose interests would have been detrimentally affected if the disposition had not been set aside, citing *Pitt v Holt* (supra), *Freedman v Freedman* [2015] EWHC 1457 (Ch), *Re Strathmullen Trust* [2014] JLR 309. In addition, Gresh had a contractual relationship with his tax adviser which might well assist him for his direct loss, there being no "black-hole" problems resulting from who the claimant should be and who had suffered relevant loss.

<u>*Note that in Jersey*</u> by Art 47E3 (c) and s 47G(3)(c) the court may set aside for mistake the disposition of property to a trust or the exercise of a power under a trust where "the mistake is of so serious a character as to render it just for the court" to do so. It may be that this will afford Jersey courts the scope to assist persons like Gresch above.

Setting aside under restricted Hastings-Bass principle or similar statutory rule because fiduciary would not have done what s/he did but for overlooking a relevant consideration

Now that, after *Pitt v Holt,* a court can set aside as voidable dispositions those that would not have been made but for a mistake as to legal or factual effects *or consequences,* such as tax consequences, reliance is likely to be placed upon the mistake jurisdiction in equity rather than the restricted *Hastings-Bass* principle. The mistake jurisdiction, however, can, as just seen, give rise to problems as to whether it would be unjust not to exercise the jurisdiction. This does not arise under *Hastings-Bass.*

In the Matter of the F Trust and the A Settlement [2015] SC (Bda) 77 Civ was the first case to be considered by the Bermudian Courts after the Trustee Amendment Act 2014 had enacted a new s 47A to oust the UK Supreme Court's restriction of the *Hastings-Bass* principle to matters that arose from a breach of trust by the trustees, not from negligent advice of advisers properly engaged by trustees in carrying out their trusteeship duties.

S 47A applies to the exercise of a "fiduciary power" where, but for his failure to take into account relevant considerations or his having taken into account irrelevant considerations, a power holder would not have done what he did. Critically it provides in s 47A(4) that those requirements "may be satisfied without it being alleged or proved that, in the exercise of the power, the person who holds the power, or any adviser to such person, acted in breach of trust or in breach of duty."

"Fiduciary power" is defined in s 47A(8) as meaning "any power that, when, exercised, must be exercised for the benefit of or taking into account the interests of at least one person other than the person who holds the power."

In the *F Trust* on the death of a trustee the surviving trustees in 2005 appointed a new trustee, D, to maintain there being three trustees. In the related *A Settlement* it was the settlor who had power to appoint new trustees and in 2008 he appointed D as new trustee.

It was held that the power to appoint new trustees was a fiduciary power as much in the case of the settlor of the *A Settlement* as in the case of the trustees of the *F Trust.* These fiduciary power holders had taken no advice on appointing D as new trustee despite his UK residence, and if advice had been taken as to the actual or potential tax consequences they would not have made the appointment. Thus the appointment could be set aside. There had been clear breaches of fiduciary duty in not seeking advice so that there was no need to rely upon the s 47A(4) ouster of the *Pitt v Holt* restriction.

Would the case, therefore, have been decided the same way if it had been an English court deciding the case applying *Pitt v Holt*? It seems so.

The English Court, however, would have had to consider *Re Duxbury's Settlement Trusts* [1995] 3 All ER 145 at 147 where the Court of Appeal judgment makes clear that the High Court judge had held that the power to appoint a new trustee cannot be attacked under the *Hastings-Bass* principle and the parties had accepted this. The basis seems to be that the *Hastings-Bass* principle only applies to the gratuitous exercise of distributive discretions in favour of beneficiaries and not managerial or administrative powers, as appears from *Donaldson v Smith* [2006] EWHC B9 (Ch), [2007] WTLR 421 at [54].

It seems that these views were taken in view of the danger that if the appointment of T3 and T4 to replace T1 and T2 could be void ab initio there would be grave problems for third parties who had dealt with T3 and T4 but who could not plead they were purchasers of a legal estate. *Pitt v Holt*, however, makes it clear that application of the restricted *Hastings-Bass* principle only makes a transaction voidable, thereby protecting any purchaser before the transaction was avoided, as held below in *Re Z Trust* [2016] JRC 048 at [47].

It is also notable that in *Green v Cobham* [2000] WTLR 1101, an appointment by trustees of some trust assets to new trustees of accumulation and maintenance trusts for minor beneficiaries was set aside under the *Hastings-Bass* principle because it had led to the composite body of trustees to become UK resident and liable to much UK tax. The judge appears to have had no worries over the position of purchasers who might have dealt with the new trustees.

In view of the protection now afforded to purchaser of legal interests in the face of an earlier voidable transaction, coupled with the general equitable bars to discretionary equitable remedies, there is scope in England to expand the restricted *Hastings-Bass* principle beyond the mere exercise of distributive discretions under powers of advancement or appointment or allocation or appropriation. It may be, however, that advantage can be taken of the *Pitt v Holt* enlarged jurisdiction of setting aside for mistake as to overlooked consequences.

Setting aside appointment of trustees for mistake and statutory HastingsBass/sorting out resultant mess

In *Re Z Trust Ltd* [2016] JRC 048 the Jersey Royal Court (Commissioner Clyde-Smith with 2 Jurats) set aside the settlor's exercise of a fiduciary power to appoint new trustees of her discretionary family trust who were UK resident, unlike the retired trustee, such UK residence causing tax liabilities to arise to the extent of 40% of the value of the trust property. This included a foreign company that owned, inter alia, an English flat and house. The settlor was in seriously bad health and had a poor command of English.

The settlor's exercise of the power was impeached on many grounds. In particular, she had not exercised it in a rational manner in the best interests of all the beneficiaries but had been focused upon the interests of her son. However, it was expressly set aside (i) for mistake under Art 47G Jersey Trust Law due to a mistake of so serious a character as to render it just to set it aside and (ii) for overlooking a relevant consideration under Art 47H that if taken into account would have led her to have exercised the power in a different manner.

The retired trustee's acts in ensuring control of the underlying foreign company passed to the purported trustees was so closely related that not only was the appointment of the purported trustees without effect but also, as a necessary consequence, the retirement of the old trustee, who thus remained the trustee, while the transfer of company shares was of no effect and the appointment of a purported director in place of the retired trustee (and its employees fulfilling particular company offices) was of no effect. At [47] it was pointed out that the appointments were voidable so that bona fide purchasers of legal interests before the appointments were avoided were protected.

How could the resultant mess be sorted out, including a distribution by the purported trustees of a sum amounting to 3% of the capital to the son, when the retired trustee had honestly believed it had retired and was no longer trustee, and the purported trustees honestly believed they were entitled to run the trust as duly appointed trustees, instead of being trustees de son tort?

Under Article 45 of the Trusts Law the court relieved the retired trustee from liability for all its acts and omissions in respect of the trust and the company since the date of the mistaken appointment and retirement. The court then relieved the purported trustees from liability for all their acts and omissions in respect of the trust and the company during their supposed trusteeship, other than acts or omissions which would have been breaches of trust for which they would have been liable if they had been validly appointed.

The court then gave its sanction to the retired trustee to retire on appointing a new trustee which had been nominated by the primary beneficiary, the settlor having died.

What, however, could be done about actions of the purported trustees which could be impugned even if the trustees were protected from liability?

The court ordered that the trustees for the time being be authorised and directed to administer the trust and procure or allow the company to be administered on the same footing as though those acts or omissions specified in a schedule had been done or omitted by the authority of duly constituted trustees. The justification was that it would be contrary to the welfare of the beneficiaries and to the competent administration of the trust to spend time and money trying to unscramble acts or omissions of the purported trustees.

It further ordered that, in order to confirm the distribution paid by the purported trustees to the son, the new trustee, as soon as reasonably practicable after its appointment, be authorised and directed (i) to execute an appointment authorising and directing under its powers under the trust deed that the amount of the earlier distribution made to the son and all rights of recovery in respect of it be held on trust for the son absolutely, and (ii) to resolve under its powers that the income arising in respect of such earlier distribution be held on trust for the son absolutely.

The above approach was taken by Commissioner Clyde-Brown after adjourning the matter in order to enable the Jersey advocates to obtain opinion of English counsel and make further written submissions in the light of such opinion. Relying upon the illuminating advice received from Lynton Tucker, the Commissioner changed tack from the course he had taken in his earlier decision in the somewhat controversial *Re BB* [2011] JLR 672. There, without full consideration of the factors now before him, he had simply ratified the conduct of trustees de son tort, to the extent that such conduct would not have amounted to a breach of trust if the conduct of duly appointed trustees, relying upon Art 51 Jersey Trusts Law or its inherent jurisdiction. Art 51 permits the court to make orders concerning, inter alia, "the exercise of any power, discretion or duty of a trustee" and "the conduct of the trustee."

A particular problem, not considered in *Re BB [2011] JLR 672*, was the extent to which the court by its order was varying beneficial interests outside the restricted statutory power to approve the variation of a trust. Indeed, if a court inserts into a trust instrument a power for trustees retrospectively to validate the conduct of invalidly appointed trustees, thereby being trustees de son tort, this will be affecting vested beneficial rights to sue for breach of trust, not just in making distributions of income or capital but in exercising investment powers. It is only in Bermuda under s 47 of its Trustee Act that the court can confer powers to enter into expedient transactions whether or not involving variation of beneficiaries' rights.

Thus, the Commissioner preferred to rely upon confirming the position by directing nonintervention and by directing replacement of a vitiated transaction by an effective one. This can be regarded as the court exercising the court power to supervise and, if appropriate, to interfere in the administration of a trust to ensure that it is competently managed in the best interests of the beneficiaries as referred to in *Schmidt v Rosewood Trust Ltd* [2003] 2 AC 709.

Attacking appointments of trustees or protectors

In the Representation of Jasmine Trustees Limited [2015] JRC 196 useful guidance was provided if alleging that the appointment of trustees or protectors was invalid. The power to appoint trustees or protectors is presumed a fiduciary power to be exercised in good faith in the best interests of the beneficiaries as a whole whether the power is vested in trustees, a protector, a settlor or a beneficiary. As an exception, however, it seems that *express* provision can be made in a trust instrument for such a power of appointment vested in a protector, a settlor or a beneficiary, to be a purely non-fiduciary personal power the exercise of which is to be unchallengeable in the courts unless amounting to a fraud on the power. What can be done expressly may also be done by necessary implication in some particularly exceptional set of circumstances.

The Court stated that the duties of a person exercising a fiduciary power are:

(1) To exercise it in good faith in the best interests of the beneficiaries as a whole;

(2) To reach a decision open to a rational appointor (viz not reach a decision that no appointor acting in a reasoned fashion could reach);

(3) To take into account relevant matters and only those matters (as under the *Hastings-Bass* principle discussed above);

(4) Not to act for an ulterior purpose.

A protector, P, who was a beneficiary and father of the three adult beneficiaries, and whose consent was required for distributions to beneficiaries, by deed removed Jersey trustees and appointed a New Zealand corporate trustee, K, in respect of two related discretionary family trusts benefiting grandchildren as well as children. The trustees sought pertinent information but did not get satisfactory replies from K or P, so the trustees sought directions from the court in the absence of consensus from the beneficiaries as to P's acts.

The court held that P had failed to take account of material matters and had reached a decision not open to a rational appointor, so the deed was invalid, the old trustees remaining as trustees.

Material matters covered:-

(a) a considerable delay by K in supplying standard due diligence information;

(b) lack of information about the financial position of K, which appeared to be owned by an individual director and which did not appear to have any presence on the internet;

(c) lack of information as to the trust experience of K's directors and K's insurance cover;

(d) K was based in New Zealand, while the beneficiaries were primarily in the USA, the time difference creating difficulties.

After P resigned as protector his two sons became the new protectors of both trusts by virtue of an appointment by P in respect of one trust and by virtue of an appointment by a majority of the three adult beneficiaries, two sons prevailing over the one daughter, in respect of the other trust. The Court's directions as to the validity of the appointments was sought due to bitter acrimony between (1) the father and sons and (2) the daughter.

The court applied to these two appointments of protectors the above duties of powerholders as to their fiduciary powers of removing and appointing trustees to the above two appointments of protectors, but also considered whether the appointments were vitiated by a conflict of interest.

The court accepted that some conflict of interest was envisaged so the mere fact that the sons' interests conflicted with the daughter's interests was not sufficient to invalidate the appointments. Nevertheless, the appointments were invalid because they fell "outside the band within which a reasonable disagreement is possible", the decision to make each appointment being "a decision to which no reasonable appointor could come (i.e. irrational)".

The bases for this conclusion were as follows.

- There was a very significant conflict of interest existing between the sons and the daughter due to proceedings brought by the daughter against the sons and the father in the USA involving the running of family companies with allegations of fraud and forgery and breaches of fiduciary obligations. This had led to a complete breakdown of relations between the sons and the daughter.
- The sons lacked independence from their father, the USA proceedings revealing they had done whatever he wanted them to do e.g. signing whatever he put before them.

- The sons' appointment as protectors if not invalidated would be detrimental to the administration of the trusts because likely to lead to the court becoming regularly involved in resolving challenges brought by the daughter in respect of her brothers' decisions as protector.

Locus standi of a protector

Davidson v Seelig [2016] EWHC 549 (Ch) involved a claim by the married co-settlors' two children that apparent protectors were not such because the protectorship regime (requiring the protector's consent to distributions) had been introduced under deeds of appointment that were void or voidable. This was alleged to result from the exercise of a fraud on the power by the capricious exercise of a power not in the best interests of the beneficiaries but slavishly following what the settlors wanted in order to help them control distributions via a close relationship with the protector. There was an alternative claim for the removal of the protectors under the inherent equitable jurisdiction.

The two joint protectors were P1 and P2. Just three months before the impending trial P1 made a late claim to amend his defence and make a counterclaim for relief.

Henderson J in the English High Court refused to allow such amendments at such late stage, but he did make some comments about the position of a protector who seeks relief from the court.

He indicated at [55]-[56] that protectors may only apply to the court for relief which relates to the exercise of their powers. Here they had power to give or refuse consent to the trustees' exercise of distributive beneficial powers; power to remove trustees with or without cause so long as a minimum of two individuals or a corporate trustee remained; power to appoint new trustees contingent on the death or incapacity of the co-settlors; power to appoint new protectors. These were all fiduciary powers.

A fundamental problem pointed out by Henderson J was that P1 and P2 were at loggerheads and the office of protector is a joint office like that of trustee, so that P1 could not act without the approval of P2.

P1's late claims for relief were treated as follows.

(1) P1 could not seek removal of all the trustees and their replacement by the court with an offshore trust company because P2 did not consent, though, in any event, only a trustee or beneficiary can apply for the court to replace trustees because the court's statutory power in s 41 Trustee Act 1925 is restricted by Trustee Act 1925 s 58(1). This states "An order under this Act for the appointment of a new trustee... may be made on the application of any person beneficially interested …or of any person duly appointed trustee." He stated at [57] "it is implicit in thus subsection that nobody other than a beneficiary or a trustee has standing to seek the appointment of new trustees under the 1925 Act." This, however, overlooks the inherent equitable jurisdiction outside the 1925 Act that can be invoked for removal and appointment of trustees as referred to in Lewin on Trusts 19th ed 13-062, and Underhill & Hayton on Trusts 19th ed 71.46. Indeed, in offshore jurisdictions the courts have developed inherent principles for the removal of protectors with fiduciary powers that reflect the centuries old grounds for removal of trustees: *In the Matter of the R and RA Trusts Guernsey 20 May 2014, In the Matter of the A Trust [2012] JRC 169A, In the Matter of the K Trust Guernsey14*

July 2015. In reserve *Schmidt v Rosewood Trust Co Ltd [2003] UKPC 26, [2003]*

(2) *AC 709* also makes clear that a Court of Equity has an inherent power to supervise and, if appropriate, to intervene in the administration of a trust.

(2) P1 could not seek removal of the settlors' powers of appointment of new trustees at [64] because P2 did not approve, though, in any event, this area fell outside the scope of the limited powers of the protector here. Moreover, s 57(1) Trustee Act 1925 enabling the court where expedient in the management or administration of a trust to make orders was unavailable because s 57(3) is restricted, like s 58(1) above, to applications made by trustees or beneficiaries.

(3) P1 could not seek removal of P2 and the appointment of two new individuals as protector because at [61] "He has no standing as a single protector to seek the removal of his co-protector. By contrast the beneficiaries clearly do have standing to seek [P2's} removal." Moreover, P1 "cannot unilaterally seek directions or surrender his jointly held discretion without the approval of" [P2].

One accepts that if two protectors are at loggerheads, so undermining the due administration of a trust, the trustees or a beneficiary will normally apply to the court to have the situation resolved. There may, however, be exceptional circumstances where there are, as yet, no ascertained adult beneficiaries and the trustee is content to have ineffective protectors at odds with each other and unable to bother the trustee. Surely, one protector ought then to have locus standi to approach the court, invoking its *Schmidt v Rosewood Trust* inherent jurisdiction to supervise and, if appropriate, intervene in the administration of a trust.

(4) P1 could not obtain information and documents from the trustees since he did not have the concurrence of P2, though, in any event, it was premature when it could well be that the protectorship regime was invalid.

NB Other jurisdictions may have wider statutory provisions than those in England, so enabling a protector to have locus standi to instigate legal proceedings himself as in Trusts (Guernsey) Law 2007 s 69(2)(e) or with leave of the court as in Trusts (Jersey) Law 1984 as amended Art 51(5), taking account of Art s 51(2)(a)(iii). However, even if a protector technically has locus standi the court may well not consider granting the requested relief because it falls outside the limited scope of the protector's powers, so that he should not be interfering in a matter that is none of his business.

10. Can there be distributions of unrealised capital gains?

In *Fischer v Nemeske Pty Ltd* [2015] NSWCA 6, [2016] HCA 11 on 24 June 1974 a discretionary family trust had been set up with A$200 and a parcel of ten B class shares in Aladdin Ltd (valued at A$1,000). Aladdin owned shares in other companies owning real estate. In July 1994 T revalued the Trust Fund, taking account of an "asset revaluation reserve" of A$3,904,300, so that the Aladdin shares were valued at A$3,905,300. Such an accretion in value of shareholdings is capable of being income according to *Clarke v Inglis* [2010] NSWCA 144 (at [18], [37], [38], [47] & [52]), though in *Fischer* the distributive power covered both income and capital, so this did not matter.

On 23 September 1994 T by corporate resolution resolved "That a final distribution be and is hereby made out of the asset revaluation reserve for the period ending 30 September 1994 and that it be paid or credited to the beneficiaries in the following manner: [*an amount equal to*] the entire reserve to be distributed to [A and B] as joint tenants." The italicised words were read into the resolution by the trial judge and the Court of Appeal, this not being challenged in the High Court of Australia.

The balance sheet as of 30 September 1994 recorded assets as the Aladdin shares at A$3,905,300 and liabilities as "Loan secured" A and B A$3,904,300. Security, however, was not actually provided until execution on 30 August 1995 of a mortgage deed between T and A & B creating a first charge over the Aladdin shares to secure T's A$3,904,300 indebtedness to A & B, T covenanting to pay the money to A & B on demand.

T claimed to have acted pursuant to its powers under cl 4(b) of the Trust Deed conferring power "to *advance or raise* any part or parts of the whole of the *capital or income* of the Trust Funds and to *pay or apply* the same as the Trustee shall think fit for the maintenance education advancement in life or *benefit of* any of" the beneficiaries.

Could a mere accounting entry recording an unrealised accretion in the value of shares within the Trust Fund fall within cl 4(b)?

A narrow view was that cl 4(b) only covered capital or income in the form of assets actually comprised within the Trust Fund and a mere accounting entry was neither. It was accepted there had been no exercise of a power to raise funds and no payment of any money. It was submitted that no advance was made because an 'advance' required specific property to be advanced for a specific person so that the beneficial ownership changed, and this had not occurred. Moreover, nothing had been applied for the benefit of beneficiaries because this, too, required a change in the ownership of particular trust assets. Thus, no equitable obligation to account to the beneficiaries could arise. Furthermore, no debtor-creditor obligation could arise at common law because the Trust Fund remained held on the continuing trusts for beneficiaries, a debt only being capable of arising where a specific amount was allocated to be held on a bare trust for a particular beneficiary.

All courts rejected this, taking a broad view (though only on a 3:2 margin in the High Court), holding that crediting the amount of the revaluation reserve was an advance of part of the income or capital that had been applied for the benefit of A and B. This gave rise not just to an equitable obligation to account for the relevant amount but also at law to create an immediate personal indebtedness of T to A and B, citing *Re Vestey's Settlement* [1951] Ch 209 and *Chianti Pty Ltd v Leume Pty Ltd* [2007] WASCA 270.

The High Court did not deal with the other issues where there had been no appeal from the Court of Appeal. The Court of Appeal had held that T had no power to mortgage the trust property under s 38 Trustee Act to secure the loan of A and B, though it had power to covenant to repay the loan. Nevertheless, the action on the covenant became statute barred in 2007 after twelve years unless in that period there had been some subsequent acknowledgment of the indebtedness and 12 years had not expired from such acknowledgment.

There was a Directors' Declaration of 26 May 2004 in respect of T's financial statements for the preceding year recording the indebtedness of T to A and B, and signed by C and D as in accordance with a resolution of the Board of Directors (A, B, C & D). This acknowledgment meant that the claim of A's estate was not barred, B having died in 2010 and A in 2011. T's admission that a debt was owed meant that a common law action for money had and received lay against T.