A REVIEW OF RECENT TRUST CASES

Hon Mr Justice David Hayton LLD, TEP (Hon), ACTAPS (Hon)

Caribbean Court of Justice

Transcontinental Trust Conference, Geneva, June 19 2013[1]

1. Inadequate deliberation of trustees under the so-called *Hastings-Bass* rule and rescission of mistaken gifts

In the joined appeals in *Futter v Commissioners for HM Revenue and Customs* and *Pitt v Commissioners for HM Revenue and Customs* [2013] UKSC 26 the Supreme Court (in a judgment of Lord Walker with which the other six Justices agreed) firmly endorsed the Court of Appeal's drastic restriction of the so-called rule in *Re Hastings-Bass* [1975] Ch 25 and so dismissed the appeals in *Futter v Futter* and *Pitt v Holt* [2011] EWCA Civ 197, [2012] Ch 132 that relied upon a broad *Hastings-Bass* rule.

The Court, however, allowed the appeal in *Pitt* where the Court of Appeal had refused to set aside a gift on discretionary trusts made due to a serious mistake because the mistake had not been as to the legal *effect* of the transaction, only as to the disastrous tax *consequences* of the transaction. The Supreme Court repudiated the *Gibbon v Mitchell* [1990] 1 WLR 1304 distinction between "effect" and "consequences", holding at [122] that a gratuitous disposition can be set aside when caused by "a mistake either as to the legal character or nature of a transaction or as to some matter of fact or law which is basic to the transaction", or, in short, where there has been "a causative mistake of

[1] The usual caveat applies that my views are merely provisional in the absence of any argument. Without the assistance of counsel's submissions I am like a ship's captain sailing in misty dangerous waters without the benefit of a skilled experienced pilot to warn of hazardous rocks and shoals. If such assistance is provided in the future I may well need to steer a different course.

sufficient gravity" as indicated in *Ogilvie v Littleboy* (1897) 13 TLR 399 at 400 per Lindley LJ.

"*Inadequate deliberations*" *distinct from excessive execution of powers*

Lord Walker at [60] distinguished "excessive execution" cases of trustees going beyond the scope of their powers from "inadequate deliberation" cases of trustees acting within the scope of a relevant power but failing to give proper consideration to relevant matters in making their decision. An excessive execution of a power is void e.g. an advancement that is not "for the benefit of" a beneficiary as was the case in *Re Abrahams* [1969] 1 Ch 463, but not in *Re Hastings-Bass.*

If a discretionary distributive power (eg of advancement, appointment, or allocation) is exercised within the terms of the power but with inadequate deliberation, though without any breach of the trustees' duties in respect of that exercise (e.g. because they obtained and acted upon apparently competent professional advice), then the exercise is valid even though having unintended unsatisfactory consequences, unless as in *Pitt* it can be set aside for mistake: see [41]. Otherwise, a remedy may only lie by way of a claim against the professional advisers for negligence. Both *Futter* and *Pitt* fell into this category because the trustees and the receiver respectively had not been in breach of their duties, having taken professional advice on tax matters which happened to be bad advice. Once they have carried out their duties, why should they or their beneficiaries be any better off than an individual or a company who had received bad advice and who can only sue negligent advisers and not rescind their decisions so as to try to do better next time.

Where, however, a discretionary distributive power is exercised within the terms of the power but with inadequate deliberation because the trustees in some way have breached their duties in respect of that exercise, then the trustees' act may be voidable at the instance of a beneficiary who is adversely affected: at [93]. After all, the trustees have badly let down the beneficiaries in not performing their key duty to be as fully informed as reasonably possible on relevant matters before exercising their distributive discretions. The exercise of the court's discretion will be subject to the usual equitable bars e.g. if the claimant was complicit or guilty of acquiescence or laches or if third party rights intervened: see [8], [43] & [70]. It is also possible that the court could appoint new trustees or authorise or direct representative persons of the classes of beneficiaries to prepare a scheme of distribution or even, should a proper basis for distribution appear, it could itself direct the trustees to distribute on such basis: see [63].

Duties in exercising fiduciary distributive powers as opposed to personal powers

Trustees must inform themselves, before making a decision, of factual, fiscal and other considerations which are relevant to that decision and must use proper care and diligence in obtaining the relevant information and advice relating to those considerations: see [10], [40] & [41]. If trustees do so they cannot be in breach of duty so as to have their decision impugned if that information or advice actually turns out to have been incorrect.

The effect of the breach of duty that led to relevant considerations being overlooked

In order for the court to intervene, is it necessary to show that the trustees "would not" have exercised their powers as they did but for the overlooked relevant consideration or only that they "might not"? Lord Walker at [91] pointed out that the Court of Appeal had deliberately ignored this question and, at [92], he himself refused to lay down when "would not" or "might not" ought to be the proper test. His reason was that there needed to be "a high degree of flexibility in the range of the court's possible responses" to the failure of trustees duly to perform their decision-making function, especially when "relief can be granted on terms." He pointed out: "In some cases the court may wish to know what further disposition the trustees would be minded to make if relief is granted, and to require an undertaking to that effect."

Rescission for mistake

Lord Walker considered the case law on the basis used by Lloyd LJ below that there must be (1) a mistake (2) of the relevant type and (3) sufficiently serious to satisfy the *Ogilvie v Littleboy* test.

(1) As to the need for a mistake, neither disappointed expectations nor mispredictions as to future events are mistakes: mistakes relate to some past or present matter of fact or law: see [104] & [109].Forgetfulness or ignorance is not, as such, a mistake but it can (see [105]) lead to a false belief or assumption recognised by the law as a mistake as in *Lady Hood of Avalon v Mackinnon* [1909] 1 Ch 476. Lady Hood, after appointing £8,600 to her younger daughter on her marriage, appointed the same amount to her elder daughter to bring about equality between them, overlooking that 16 years earlier an appointment had already been made in favour of the elder daughter on her marriage and re-settled by her. Similarly, in *Re Griffiths* [2009] Ch. 162, Griffiths, aged 73, settled property as a potentially exempt transfer if he survived long enough, when he believed himself healthy enough for such survival so as to ignore the advice that he should take out term assurance to cover the eventuality of his death before expiry of the requisite period. His ignorance of the terminal cancer he had when settling his property led to his tacit assumption that he was of good health at the time. But for that assumption he would not have settled his property. The judge, not having any adversarial argument set aside the settlement. Lord Walker, at [113] endorsing Lloyd LJ below, however, pointed out that the judge had overlooked that Griffiths had ignored advice and taken the risk of his premature death, so that it was strongly arguable that his settlement should not have been set aside.

(2) The relevant type of mistake at [114] covers careless mistakes of a donor/settlor "unless the circumstances are such as to show that he deliberately ran the risk, or must be taken to have run the risk, of being wrong." The Court of Appeal was, however, wrong to reject the appellant's case by making use of the distinction made by Millett J as he then was in *Gibbon v Mitchell* [1990] 1 WLR 1304 between a mistake as to the legal effect of a transaction, in the sense of the legal character or nature of a transaction, which was a relevant mistake, and a mistake as to the legal consequences of a transaction, like its fiscal consequences, which was not a relevant mistake. The Court of Appeal was right to recognise that, as in the *Lady Hood* case, a mistake as to an existing fact which was basic to the

transaction would suffice, but the Court should have gone on to include a mistake of law which was basic to the transaction. Due to such broadening of the relevant types of mistake Lord Walker concluded "that the true requirement is simply for there to be a causative mistake of sufficient gravity" as under the *Ogilvie v Littleboy* test, but at [122] "as additional guidance to judges… the test will normally be satisfied only when there is a mistake either as to the legal character or nature of a transaction, or as to some matter of fact or law which is basic to the transaction."

(3) The *Ogilvie v Littleboy* test requires that the donor/settlor was "under some mistake of so serious a character as to render it unjust on the part of the donee to retain the property given to him." The gravity of the mistake must be assessed by a close examination of the circumstances of the mistake and its consequences for the person who made the vitiated disposition, while other findings of fact may need to be made in relation to change of position and other matters relevant to the exercise of the court's equitable discretion: see [126]. Lord Walker also pointed out at [126] that "the injustice (or unfairness or unconscionableness) of leaving a mistaken disposition uncorrected must be evaluated objectively with "an intense focus on the facts of the particular case."

In summary at [128] "The court cannot decide the issue of what is unconscionable by an elaborate set of rules. It must consider in the round the existence of a distinct mistake (as compared with total ignorance or disappointed expectations), its degree of centrality to the transaction in question and the seriousness of its consequences, and make an evaluative judgment whether it would be unconscionable, or unjust, to leave the mistake uncorrected." Thus the court must form a judgment about the justice of the case. There was no doubt that Mrs Pitt as receiver, duly sought tax advice to minimise tax before settling her husband's £800,000 damages. Much tax would have been saved if she had settled the damages on the disabled trusts favoured under s 89 IHTA 1984 designed to help people in her husband's position. Instead, due to bad advice she settled the damages on discretionary trusts under a basic mistake as to this having good tax consequences instead of the disastrous tax consequences that it actually had. In these circumstances it would be unconscionable if she was not entitled to have the trust set aside for mistake.

Miscellaneous comment on mistakes about tax

At [135] "In some cases of artificial tax avoidance the court might think it right 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 would prove ineffective, or on the ground that discretionary relief should be refused on grounds of public policy…artificial tax avoidance is a social evil which puts an unfair burden on the shoulders of those who do not adopt such measures." Contrast the Jersey Royal Court in *Re R and the S Settlement* [2011] JRC 117 at [39] most unsympathetic to the Leviathan tax authority.

2. Constructive trusts of secret commissions

In *FHR European Ventures LLP v Mankarious and Cedar Capital Partners LLC* [2013] EWCA Civ 17 the English Court of Appeal had the opportunity to consider the "highly controversial" judgment of Lord Neuberger MR, delivering the English Court of Appeal judgment, in *Sinclair Investments (UK) Ltd v Versailles Trade Finance Ltd* [2011) EWCA Civ 347, [2012] Ch 453. He was happy to consider himself bound by the Court of Appeal in *Lister v Stubbs* (1890) 45 Ch D 1 and held that bribes received by a fiduciary from a third party are not held on constructive trust. He did not apply the contrary decision of the Privy Council in *Att-Gen of Hong Kong* v *Reid* [1994] 1 AC 324 which had expressly disapproved *Lister*. His basis for this [at 88] was that English case law established that "a beneficiary of a fiduciary's duties cannot claim a proprietary interest, but is entitled to an equitable account, in respect of any money or asset acquired by a fiduciary in breach of his duties to the beneficiary, unless the asset or money is or has been beneficially the property of the beneficiary or the trustee acquired the asset or money by *taking advantage of an opportunity or right which was properly that of the beneficiary*."

In *FHR European Ventures* the Court of Appeal distinguished *Sinclair.* Etherton C at [102] pointed out that there the fraudster was the principal shareholder of Co A which had a subsidiary Co B. The fraudster then set up Co X to receive money for investment which was diverted to Co B and enabled Co A shares to appreciate very significantly, so the fraudster sold some of them and used the proceeds to buy a London house for £9million. In respect of this house, Lord Neuberger had rejected the proprietary tracing claim of the assignee of the victims' rights after examining the bribe and secret commission cases. However, the Co A shares had belonged to the fraudster before he perpetrated his fraudulent scheme, so was it not inevitable that he could not be regarded as having received them as a secret commission?

The Court of Appeal thus focused upon Lord Neuberger's phraseology that permitted a proprietary interest to be claimed where a fiduciary took advantage of "an opportunity which was properly that of the beneficiary" or of "opportunities beneficially owned by the claimant". The Court was then able to expand upon this phraseology so as to hold at [59] (Lewison LJ), [74] (Pill LJ) and [111] (Etherton C) that a contractual right to a €10 million secret commission and then the money paid pursuant to that contract was held by the defendants on a proprietary constructive trust for the claimant. The Court made clear that it was time the position was fully reviewed by the Supreme Court since *Sinclair* is out of line with courts in Australia, Canada, Singapore and the USA which have, like the Privy Council, held bribes to be subject to a proprietary constructive trust.

The Court was very critical at [57] per Lewison LJ and at [84] per Etherton C of Lord Neuberger's phrases "an opportunity which was properly that of the beneficiary" at [88] and "opportunities beneficially owned by the claimant" at [89]. The judges pointed out that these dicta had been uttered in ignorance of *Bhullar v Bhullar* [2003] EWCA Civ 424 in which the Court of Appeal had decisively rejected the notion that it was necessary to identify some form of beneficial ownership of the opportunity itself. As Etherton C stated at [84] "Opportunities are not a species of property capable of being held on trust." Nevertheless, a contract, a species of property, coming into existence as the result of an exploitation of an opportunity in breach of the fundamental fiduciary "no profit, no conflict'' rule can be held on trust such that the traceable product of the contract will be held on constructive trust.

Cedar Capital LLC was owned by Mankarious. While Cedar was advising the claimants in relation to the possible purchase by them of the Monte Carlo Grand Hotel, it entered for a limited period into an exclusive brokerage agreement with the hotel owners. Under the agreement Cedar was to receive a €10 million fee from the owners for introducing prospective purchasers who then entered into negotiations with the hotel owners and purchased the hotel. This fee was to be paid within five days of the hotel owners receiving the purchase price. In the agreement Cedar also agreed "it shall disclose its appointment hereunder" to the prospective purchasers.

These prospective purchasers, however, were not made aware of Cedar's commission entitlement when Cedar on their behalf negotiated with the hotel owners to obtain the lowest possible purchase price. Simon J thus held there had been insufficient disclosure for Cedar to succeed in its defence that the claimants had given their fully informed consent to Cedar's contractual right to €10 million after the claimants had bought the hotel for €211.5 million.

Applying *Sinclair,* Simon J held that there was no constructive trust of the €10 million, only a personal liability to account to the claimants for such sum. On appeal, the claimants succeeded in their claim that there was a proprietary constructive trust.

Sir Terence Etherton, the new Chancellor of the High Court, pointed out that the effect of *Sinclair* is that there are three categories of benefits received by a fiduciary in breach of the fiduciary 'no profit, no conflict' duty, only the first two giving rise to a constructive trust:

(1) where the benefit is or was an asset belonging beneficially to the principal e.g. any benefit obtained by misappropriating or misapplying the principal's property;

(2) where the benefit was obtained by the fiduciary taking advantage of an opportunity which was properly that of the principal;

(3) all other cases where a benefit was obtained, covering situations like those in *Sinclair* and also in *Att-Gen of Hong Kong v Reid* if the facts had occurred in England.

The Court of Appeal held that Cedar's contractual right to receive the secret commission (and thus the actual receipt thereof) was not a category 1 benefit, even though the fact that, under the agreement, the commission was to be paid by the hotel owners to Cedar within five working days of the receipt of the purchase price from the purchasers raised a strong inference that Cedar's commission was in a practical sense paid out of moneys received from the purchasers. Nevertheless, on payment of the purchase price to the hotel owners in return for the hotel, the full legal beneficial title to the money passed to the owners and the purchasers were divested of all interest in the money paid over. Thus, it could only be the hotel owners' moneys, not the purchasers' that had passed to Cedar by way of the €10 million commission payment: see [30] and [33] (and [67] and [105]).

The Court, however, found that Cedar held the benefit of the commission contract on a constructive trust for the claimants as a category 2 benefit as refined, the benefit having been obtained by the fiduciary, in breach of the 'no profit, no conflict' rule, taking advantage of an opportunity in which his principal was interested. Thus it could be traced into the €10 million receipt. This was the result of examining three classes of cases where a benefit, wrongly obtained by a fiduciary by misusing the opportunity presented by his relationship with his principal, had been found to be held on constructive trust, even though the benefit had been acquired by the fiduciary's own assets or efforts and had come from a third party – and whether or not, if there had been no breach of fiduciary duty, the benefit could have or would have been obtained by the principal.

The three classes of cases giving rise to a category 2 proprietary constructive trust are as follows, the Court of Appeal relying in particular on the third class.

(1) Cases where the principal had actually instructed the agent to acquire or to negotiate the acquisition of property for him, but the agent purported to acquire

the targeted property on his own behalf – or joint venture cases where one stole a march on the other by acquiring property exclusively for himself.

(2) Cases where the fiduciary was not specifically charged with acquiring particular property for his principal, but the fiduciary acquired property which would have been of interest to the principal if the fiduciary had disclosed, as he ought, the possibility to his principal. *Bhullar* was this type of case, where two directors discovered that property adjoining their company's property was available to be purchased by them in a company that they incorporated for this purpose. Jonathan Parker LJ stated, "Where a fiduciary has exploited a commercial opportunity for his own benefit, the relevant question is not whether the party to whom the duty is owed had some kind of beneficial interest in the opportunity; in my judgment that would be too formalistic and restrictive in approach. Rather the question is simply whether the fiduciary's exploitation of the opportunity is such as to attract the application of the rule." The rule is that "no fiduciary shall be allowed to enter into any engagements in which he has, or can have, a personal interest conflicting, or which may possibly conflict, with the interests of those whom he is bound to protect." The Court of Appeal endorsed asking the question whether the fiduciary's exploitation of the opportunity was such as to attract the rule and answered it in the affirmative in the circumstances before it.

Phipps v Boardman [1967] 2 AC 46 was a similar type of case where the trust fund comprised a minority shareholding in a private company. No more shares could be acquired unless, upon application under s 57 of the Trustee Act 1925, the court authorised this. The solicitor to the trust, with the help of a beneficiary who attended company meetings with him, thought that a majority holding should be acquired and the company business reorganised. With what they thought was informed consent from trustees, who did not want to be involved in any such business dealings, they proceeded to acquire the remaining shares and reorganise the company's business to the advantage of the trust fund and of themselves by increasing the value of the shares in the company.

A beneficiary with a five eighteenths interest in the trust's minority shareholding claimed a declaration that he was entitled to five eighteenths of the shares acquired by the defendants. As the Chancellor stated at [91], Wilberforce J made the claimed declaration that five eighteenths of the shares owned by the defendants were held on constructive trust for the claimant beneficiary and ordered an account of the profits made by the defendants so that the defendants, as desired by the claimant, could simply account to the claimant for such profits rather than convey the shares to the claimant in return for being reimbursed the cost of the shares. The House of Lords upheld the orders of Wilberforce J making plain that there had been a proprietary constructive trust, though Lord Neuberger without the benefit of a detailed examination had considered that the question of a proprietary constructive trust had not arisen.

(3) Cases where the fiduciary was held to be a trustee of a profit made in breach of fiduciary duty, even though the principal did, in fact, obtain the target property. In *Tyrell v Bank of London* (1862) 10 HLC 26. Tyrell was the Bank's solicitor and secretary. The Bank was offered the opportunity to buy certain property on part of which stood the Hall of Commerce, in which it was interested, though it was not then in a position to buy it. Tyrell subsequently entered into a contractual arrangement with Read who had a contract to buy the property from the mortgagee. The arrangement was for Tyrell and Read to be jointly interested in Read's contract. The Bank then agreed with Read to buy the Hall of Commerce part from him and paid him the purchase money. The House of Lords held that Tyrell held the benefit of his contract with Read on trust for the Bank so far as concerned the Hall of Commerce part of the land, so that Tyrell held the traceable profit on trust for the Bank. Similarly, see *Fawcett v Whitehouse* (1829) 1 Russ & M 132 where Fawcett, on behalf of himself and two partners, acquired an underlease of ironworks from a lessee who was finding it an unprofitable business and so paid Fawcett £12,000 to clinch the deal: Lord Lyndhurst LC held that Fawcett held two thirds of the £12,000 on trust for his two partners.

Thus Cedar's exploitation of the opportunity to make a large commission for itself in breach of the "no profit, no conflict" rule in helping the claimants acquire the Grand Hotel was such as to require it to hold the benefit of its commission contract and then the commission itself on constructive trust for the claimants.

3. Cases on powers

Aiding a defective execution of a power in a trust deed

In *Re the Shinorvic Trust* [2012] JRC 081, [2013] WTLR 337 the settlor, who had created a discretionary trust for himself and his sister and her issue, had in 1990 purported by deed to exercise his power to add persons to the class of discretionary beneficiaries so as to add as a beneficiary, B, his paramour of almost 40 years. He had provided for her not only in his lifetime but also by his will after his death in 2005, while his Shinorvic Trust letter of wishes described her as his "paramount concern". He had signed the 1990 deed to add B as a beneficiary but it had not been witnessed as required by the Trust Deed.

Old case law showed that Equity would treat a formally defective execution of a power by a donee as a proper one where the donee in executing the document intended to benefit a creditor or someone to whom he owed a natural or moral obligation like a wife or child of his. The Jersey Royal Court extended this to B, so as to "develop the principle to take account of modern standards and *mores*", and uphold payments made to her since 1990.

Treating a person's exercise of a power as extending to exercising another power where that person's intention could only be achieved if it did so extend

It so happened in *Shinorvic* that the settlor by a duly witnessed deed in 1998 had properly added his brothers and their issue to the class of beneficiaries. The recitals recited the power to add beneficiaries and stated that the deed was supplemental to the 1990 Deed "in terms of which [B] was added to the class of Beneficiaries". The Royal Court held that if it had not been able to aid the defective execution in 1990 it would have been able to impute an intention to the settlor to add B in 1998 as a beneficiary, since he clearly had such power and, presumably, would have wanted to exercise it then if his earlier deed had not been effective, there being no positive evidence to the contrary. The courts have always been prepared to hold that a particular power has been exercised by implication on the exercise of another power by the donee of the power where the donee had an intention to bring about a particular result or effect which could only be achieved by means of the exercise of the particular power.

Another recent example is *Entrust Pension Ltd v Prospect Hospice Ltd* [2012] EWHC 3640 (Ch), Henderson J at [42]-[43] and [110]-[111] treating pension trustees as having exercised a power enabling them to do what they had done, citing dicta of Scott J in *Davis v Richards & Wallington Ltd* [1990] 1 WLR 1511 at 1530. "The [purported] disposition [of A] cannot be effective unless associated with the exercise of a power vested in A and that A could properly have exercised in order to make the disposition. The disposition makes no mention of the power and does not purport to be an exercise of it. The effect of the principle and cases is that A's intention to make the disposition justifies imputing to him an intention to exercise the power, providing always that an intention not to exercise the power cannot be inferred. If the requisite intention can be imputed the court will treat the disposition as an exercise of the power." At 1531 Scott J went on to accept that on the facts it was impossible to infer a positive intention but stated "The intention will, however, be imputed to [A] unless the facts of the case justify the inference that [A] had the positive intention not to exercise the power."

Exclusion of beneficiaries and addition of beneficiaries

In the Matter of the C Trust [2012] JRC 086B and 098 there had previously been acrimonious divorce proceedings between the settlor's son and the son's wife, the mother of the settlor's two grandchildren. The ex-wife approached the trustees asking them to help her ex-husband satisfy his maintenance obligations. The antagonistic settlor's widow, the primary discretionary beneficiary, persuaded the trustee irrevocably to exercise its power to remove her son and his two children as beneficiaries during her lifetime.

The Jersey Royal Court set aside the instrument of exclusion as no reasonable trustee would have executed such an instrument, the trustee's conduct being perverse. The court further denied the trustee's request that the case be not published, though requiring the grandchildren to be anonymised. It also denied the trustee any indemnity for costs out of the trust fund and required the trustee to pay the costs of the son and the grandchildren on an indemnity basis.

In the Matter of the A Trust [2012] JRC 066 the trustee sought the Jersey Court's confirmation that it would be acting properly within the parameters afforded for the exercise of a discretion to add persons as beneficiaries if it widened the class of beneficiaries to include remoter issue of the settlor. The trustee did this because all four existing beneficiaries objected and had, indeed, brought proceedings to remove the trustee. They argued that the trustee ought to await the outcome of the removal proceedings. The Court was initially most impressed by this argument but, in the end, confirmed that the trustee could widen the class as proposed. It was influenced by the absence of a letter of wishes and the fact that any new trustee would not have the current trustee's knowledge of the settlor's intentions and purposes.

4. Private International law

Exclusive jurisdiction clauses for administration of trusts and breaches of trust

What is the effect of a clause stating that "the forum for the administration of this Trust shall be the courts of State X"? Does it confer exclusive jurisdiction and does it extend to breach of trust claims? To avoid these problems the clause ought to have been drafted on the following lines. "The forum for all internal matters concerning the Trustee's administration of the trust, including breach of trust claims, shall exclusively be the courts of State X."

In the Matter of A Trust [2012] S C Bda 72 Civ , 12 December 2012 Kawaley CJ had occasion to consider issues that had also arisen in *Helmsman Ltd v Bank of New York Trust Co (Cayman) Ltd* [2013] WTLR 79 and *Re The Representation of AA* (2011) 13 ITELR 690. He held at [66] that the clause "the forum for the administration of this Trust shall be the courts of Bermuda" in context conferred exclusive jurisdiction on the

Bermudian courts as the forum for the administration of the Bermudian trust and at [68] rejected the submission that "administration" matters did not extend to claims for breach of trust.

He acknowledged Professor Matthews' view (in [2003] Jersey Law Review 232 criticising *Koonmen v Bender* (2003) 6 ITELR 568) that a breach of trust action was not an aspect of trust administration, especially in historical context, but considered at [69] that the better view is that "a modern draftsman" using the term "administration" did not have in mind the administration action within Order 85 of the Rules of the Supreme Court but administration in a general sense. The Chief Justice's view can be supported when one considers that a breach of trust action is an action for substitutive performance of due administration of the trust or a claim for reparation for maladministration of the trust. He gratefully adopted at [60] Commissioner Clyde-Smith's dictum at [30] in *Re the Representation of AA:*

> "it is at the end of the day a question of the court construing the particular deed before it in order to derive from it the presumed intention of the parties. That exercise has to be conducted against the background of the surrounding circumstances or matrix of facts existing at the time when the document was executed."

The significance of the lex situs

(i) Future property

Under English law X Co can raise money straightaway by selling to a purchaser its rights to future receipts of property, but on the basis that when it receives such property in the future it will immediately hold the property on trust for the purchaser. Such received property has, after all, been paid for. Thus an English football club can sell future receipts from season ticket sales for the next three seasons to a purchaser for whom the club will hold receipts on trust in due course. Thus a Scots Football Club, Rangers, in arrangements expressly governed by English law, received £20 million from a purchaser of its season ticket receipts for the next three seasons. Despite this, the Club went into administration and its administrators claimed that they could break the contract and would not hold receipts when received upon trust for the purchaser.

In *Re Clark and Whitehouse (Joint Administrators of Rangers FC)* [2012] Scot CS CSOH 55 he Court of Session upheld this claim. Under the Scots *lex situs* persons cannot alienate Scots property not yet in existence and so cannot create proprietary rights in respect of such future property. The position would be the same if a settlor or a beneficiary of a marriage settlement governed by English law covenanted to transfer to trustees of an English trust any Scots property he or she happened to acquire and then did acquire it: it would not automatically on receipt become trust property and so avoid limitation period problems for suing for breach of covenant (cp. *Pullan v Koe* [1913] 1 Ch 9).

(ii) Setting aside transfers of property

Where a settlor seeks to set aside a transfer of property to trustees on the basis of mistake, this matter is an antecedent preliminary matter outside the scope of The Hague Trust Convention so that it is the *lex situs* of the transferred property that determines the matter, not the law governing the trust: Dicey, Morris & Collins, *Private International Law,* 15th ed Rules 132 and 133, *Dervan and MD Events* v *Concept Fiduciaries Ltd,* Guernsey Royal Court, 7 Dec 2012.

(iii) Rectification

Where rectification is sought of provisions in a trust instrument this will be determined according to the law governing the validity and construction of the trust: see Art 8 of The Hague Trust Convention which reflects the common law position. However, if rectification is granted to cure the accidental omission of particular property from a schedule of property intended by the settlor to be

> transferred to the trust instrument (as granted by the Guernsey Royal Court in *Re the Colour Trusts* discussed in (2013) 19 Trusts *&* Trustees 152), it seems that it will be the *lex situs* of the property that will determine whether the relevant property has effectively been transferred by the settlor to the trustee or whether some further formalities are required to be satisfied, this appearing to be a preliminary issue falling outside the Trusts Convention.

The utility of changing the governing law

A Liechtenstein governing law was advantageously changed to the law of the Cayman Islands in 2011 so that rectification proceedings could be brought in *Re Goldentrust, Abubakar Megerisi v Protec* [sic] *Trust Management Establishment and Paget-Brown Trust Company Ltd* Cayman Grand Court No FSD 79 of 2012, 10 December 2012. Liechtenstein law does not provide a remedy of rectification, yet the settlor desperately needed rectification when on 31 March 1994 he had executed his trust instrument in circumstances where the schedule of property transferred omitted to include loans of £7,950,000 and US$5,434,607 that he had made to a Cayman company.

He needed retroactive rectification because on 6 April 1994 he had become deemed domiciled in the UK so that settlements of property after that date would not have been excluded property free from UK Inheritance Tax. Much later, after he had realised his mistake in 1999, he had effectively transferred the debts due to him from the Cayman company to the trustee: see [31].

The question arose whether once a trust is an “unrectifiable” trust it always remains an “unrectifiable” trust or whether it can retrospectively become a rectifiable trust by changing the governing law to a law that permits rectification. Fortunately, the Cayman Islands had “firewall” legislation. Once the original governing law (as here testified to by a Liechtenstein expert) recognises a change to Cayman law as the governing law (Trusts 2011 Revision s 89(4)), then by s 90, “All questions arising in regard to a trust which is for the time being governed by the laws of the Islands or in regard to any disposition of property upon the trusts thereof including questions as to… (b) any aspect of the validity of the trust or disposition or the interpretation or effect thereof…. are to be determined according to the laws of the Islands, without reference to the laws of any other jurisdiction with which the trust or disposition may be connected." Without such a provision there might have been an issue as to whether rectification could affect matters before the date of the change of governing law.

Anyhow, Smellie CJ ordered rectification so that the trustee had been entitled to the loan monies since 31 March 1994 rather than the much later date when the settlor had transferred to it the right to repayment of the loans. The settlor had clearly made a mistake as to the legal effect of his trust instrument. It did not matter that there was no contested issue as to the settlor's genuine intentions at the time he executed his trust instrument, so that the proceedings were purely designed to obtain a tax advantage. As the English Court of Appeal made clear in *Racal Group Services Ltd v Ashmore* [1995] STC 1151 at 1157, so long as there is an issue capable of being contested, it is irrelevant that rectification is sought or consented to by all involved on the basis of its tax advantages. The date that the trustee became entitled to the settlor's right to repayment of his loans was an issue capable of being contested, though this would have been a pointless contest in the light of the evidence available to all involved. Lord Walker in *Pitt v Commissioners of HM Revenue and Customs* [2013] UKSC 26 at [140] has since stated, "It is sufficient … that there is a genuine issue *capable* of being contested, even if the parties decide that they will not in fact contest it."

5. Developing a broad scope for tracing principles

It is worth noting at the outset that tracing principles are relevant to the extent not just of a proprietary claim but also a personal claim against a defendant who, knowingly or unconscionably, dealt with property subject to a trust or other fiduciary duty in a manner inconsistent with such duty. Thus if such property received by D when worth $1 million had become traceable property worth $4 million when knowingly dissipated by D, D will be *personally* liable for $4 million. If D still had such traceable property, then the claimant, C, would have a continuing equitable *proprietary* interest in such property affording him priority over D's creditors because D had never had beneficial ownership of the property.

There are two recent cases where the courts have been prepared to adapt a broad approach to tracing principles where there has been no question of the defendant's insolvency and prejudice to his unsecured creditors. On a strict view 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. In practical reality, however, 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 in *Federal Republic of Brazil and Municipality of Sao Paulo v Durant International Corporation and Kildare Finance Ltd* [2012] JRC 211 has been endorsed by the Court of Appeal [2013] JCA 071, 11 April 2013. 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 eg 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 of nil in the New York Bank under the principle in *Roscoe v Winder* [1915] 1 Ch 62 (treating subsequent payments in as not being replacement trust funds but private funds).

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.

In *Relfo Ltd v Varsani* [2012] EWHC 2168 (Ch) Sales J had also taken a broad approach to tracing the payment of funds where there was a lack of evidence. On 4 May 2004 Mr Gorecia, controlling director of Relfo, an English company, in breach of his duties to the company, caused it to pay US$890,050 to a Latvian bank account of Mirren Ltd, a BVI company, in relation to a venture with a Ukrainian businessman. On 5 May 2004 Intertrade Group LLC, a Wisconsin company, used by Ukrainian businessmen, paid $878,479.35 from its Lithuanian Bank account to Mr Varani's Singaporean bank account. After deduction of a $10 banking fee $878,469.35 was credited to the Singaporean account. It just so happened that $878,479.35 was 1.3% less than $890,050,000. The judge found it probable that this percentage represented a handling fee for Mr Gorecia's dubious Ukrainian business associates who were used to preparing corrupt and fraudulent accounting books and records and to effecting payments which obscured the true source of monies and the purposes for which they were paid: see [59], [66] and [77]. At [77] the judge stated, "Mr Goracia caused the Relfo/Mirren payment to be made, intending to produce the result that the funds so paid should, by means to be devised by his Ukrainian contacts, be paid on to Bimji Varsani, and it is likely that they acted so as to bring about the result which Mr Goracia asked them to produce."

No proprietary tracing claim could lie since Relfo's liquidator had produced no evidence to show that money remained in Mr Varsani's Singaporean bank account or that payments had been made thereout to acquire particular assets. Nevertheless, a personal liability [as constructive trustee] for the traced $890,050 arose since the judge found that Mr Varsani was aware that he had received it in breach of Mr Gorecia's duty.

6. The key supervisory jurisdiction of the court

In *In the Matter of an Application for Information about a Trust* [2013] SC Bda 16 Civ , 12 March 2013 there was a clause "except to the extent that the Trustees (with the prior written consent of the Protector) in their discretion otherwise determine no person or persons shall be provided with or have any right claim or entitlement during the Trust Period to or in respect of accounts (whether audited or otherwise) or any information of any nature in relation to the Trust Fund or the income thereof or otherwise in relation to the Trust or the trusts powers or provisions thereof (and whether from the Trustees or otherwise)." The Protector, who was the Principal Beneficiary, had the right to demand information and accounts from the Trustees, who were under a duty to keep proper accounts and records and to have them audited annually (or as often as the Protector might otherwise direct) by accountants of high standing and international repute.

"The Protector shall not owe any fiduciary duty towards and shall not be accountable to any person or persons from time to time interested hereunder or to the Trustees for any act of omission or commission in relation to the powers given to the Protector by this deed to the intent that the Protector (in the absence of fraud or dishonesty) shall be free from any liability whatsoever in relation to such powers."

Wow! It was, however, clear to Kawaley CJ that the settlor had intended to create a meaningful trust obligation. Thus, effect should not be given to the non-disclosure clause to the extent that the Court considered it would substantially impair the core requirement of trustee accountability: "the beneficiaries must be in a position to hold trustees accountable in respect of the trustee's fundamental duty to duly administer a trust" (at [49]). The plaintiff beneficiary's position was that as the result of an irrevocable deed of appointment he potentially had an absolute interest in 35% of the Trust Fund and the clauses in the trust deed could not oust the court's inherent jurisdiction to supervise and, if necessary, intervene at his behest in the administration of the trust, Lord Walker having emphasised the significance of this jurisdiction in *Schmidt v Rosewood Trust Ltd* [2003] UKPC 26, [2003] 2 AC 309 at [36]. It is noteworthy that a similar approach had earlier been taken by the Hong Kong Final Court of Appeal in *Tam Mei Kam v HSBC International Trustee Ltd* [2011] HKFCA 34 at [41]-[46] endorsing the Court of Appeal [2010] HKCA 197 at [61] et seq.

In *In the Matter of The A Trust* [2012] JRC 169A at the behest of concerned beneficiaries the Jersey Royal Court removed S from his fiduciary office of protector of two Jersey trusts, applying the same guidelines as for the removal of a trustee. The guides for exercise of this jurisdiction, a jurisdiction not to be exercised lightly, are the welfare of the beneficiaries and whether continuance in office would be detrimental to the execution of the trusts. There was a breakdown of relations between the beneficiaries and S which was having a hugely detrimental effect which was likely to continue if S was not removed. S had cast himself in a role which went well beyond what was proper for someone in his position. He had over-zealously regarded himself as the living guardian and enforcer of the deceased settlor's wishes. There were significant tensions between S and personnel of the trust company. It was not S's role "to ensure that a settlor's wishes are carried out any more than it is open to a settlor himself to insist on them being carried out. A trustee's duty as regards a letter of wishes is no more than to have due regard to such matters without any obligation to follow them. A protector's duty can, correspondingly, be no higher than to do his best to see that trustees have due regard to the settlor's wishes (in whatever form they may have been imparted): from the moment of acceptance of the office of protector his paramount duty is to the beneficiaries of the trusts."