A 2015 Review of Trust Law Developments

Hon Mr Justice David Hayton, Caribbean Court of Justice

Update on appeals in cases mentioned in the 2014 Review

FHR European Ventures LLP v Cedar Capital Partners LLC [2014] UKSC 45

Profits obtained by use of fiduciary position as well as use of fiduciary property are held on trust

Lord Neuberger, giving the unanimous judgment of a Bench of seven Justices, overruled himself in *Sinclair Investments Ltd v Versailles Trade Finance Ltd* [2012] Ch 453 where he and his brother Lord Justices had applied the Court of Appeal decision in *Lister v Stubbs* (1890) 45 Ch D 1 and happily refused to follow the Privy Council in *Att-Gen for Hong Kong v Reid* [1994] 1 AC 324. Equity will not permit an agent to rely on his breach of fiduciary duty to justify retaining a benefit for himself on the ground that it was a bribe or secret commission for his personal benefit. Instead, Equity will treat him as having acted in accordance with his duty to act in his principal's interests, so that the benefit must be held on trust for his principal: see [11] and [46]. English law thus provides a proprietary remedy against trustees or fiduciary agents who receive bribes or secret commissions and is no longer out of step with other common law jurisdictions.

AIB Group (UK) plc v Mark Redler & Co [2014] UKSC 58

The measure of equitable accountability for misapplying trust property

The Supreme Court examined in depth the House of Lords judgment in *Target Holdings v Redferns Ltd* [1996] AC 421 and clarified the law as to remedies for breach of trust. The Court supported the general thrust of Lord Browne-Wilkinson's judgment in *Target* but indicated some deficiencies in it. The case concerned a breach of a trustee's strict absolute duties not to apply trust assets except as prescribed in the trust instrument (requiring substitutive compensation) but Lord Browne-Wilkinson did not distinguish this from a trustee's breach of management duties to act with due care and skill (requiring reparation compensation). Moreover, he relied upon dicta in the Canadian Supreme Court in *Canson Enterprises Ltd v Boughton & Co* (1991) 85 DLR 4th 128 which were concerned with a fiduciary at fault in not making disclosure of information that he ought to have disclosed.

Mr & Mrs S (the mortgagors) re-mortgaged their house so as to borrow £3.3 million from AIB on the basis that two mortgages to Barclays Bank for £1.2 million and £273,000 would be discharged so that AIB would have a first legal charge. The £3.3million was received by Mark Redler & Co, solicitors, on trust for AIB until completion of the re-mortgage by discharging the two Barclays' mortgages and ensuring a first legal charge in favour of AIB. The solicitor's negligence led to it discharging only Barclays' £1.2 million mortgage and paying the balance to the mortgagors. Thus Barclays retained a first charge for £273,000 and AIB could only acquire a second charge for £3.3 million.

Subsequently, the mortgagors defaulted and their house was sold by Barclays for £1,140,000. It paid itself £273,000 out of the £1,140,000 proceeds of sale and transmitted the remaining £867,000 to AIB. AIB claimed from the solicitors the entire £3.3 million paid to the solicitors less the £867,000, amounting to £2,433,000.

The basis for this was that if the trustee of a family trust misapplies £3.3 million, by paying it to a stranger or investing it in an unauthorised investment, equity does not permit him to allege he acted in breach of duty but treats him as if he had duly performed his obligations. Therefore, the payment in the trustee's accounts is falsified to leave £3.3 million in the accounts as part of the trust fund. Taking account, however, of the fact that AIB had already received £867,000 of the £3.3 million it was entitled to £2,433,000.

On the other hand, if the solicitors had fulfilled their instructions AIB would have had a first charge for £3.3 million over the mortgaged house sold for £1,140,000 and so would have received the whole £1,140,000, not just £867,000. Thus, failure to carry out AIB's instruction led to AIB receiving £273,000 less than it would have done if its instructions had been carried out. Therefore the solicitors were only liable for £273,000.

The trial judge held the breach of trust was only the misapplication of £273,000, not of £3.3 million, but the Court of Appeal held it was a misapplication of the £3.3 million to dispose of any of it without an undertaking from Barclays enabling the solicitors to be sure of a first charge for AIB over the house, and its reasoning was not challenged in the Supreme Court (though Lord Reed was not happy with this at [140]). The Court of Appeal, however, held that one looked at the position at the date of the hearing, not the date of the misapplication so that the solicitors were only liable for the £273,000 which would have been AIB's loss even if the solicitors had properly performed their trust instructions.

Lords Toulson & Reed (with whom the other three Justices agreed) endorsed this. They took account of the fact that the trust was part of the machinery for performance of a contract, so that it would be artificial and unreal to look at the trust in isolation from the obligations for which it was brought into being: see [48], [71] and [137]). Clearly, at [62], Equity could not give redress to a beneficiary for a loss which would have been suffered if the trustee had properly performed his duties as here - and as in *Target* where the finance company was seeking to be put into a better position on the facts (as agreed or assumed for the purposes of summary judgment) than if the solicitors had done as they ought to have done. The equitable compensation to restore what AIB had lost as a result of the trustee's breach of trust came to the same as the loss caused by the solicitor-trustee's negligent breach of contract.

The purpose of a strict liability remedy for unauthorised or misapplied disposals of trust property is to put the beneficiary in the same position as if the trustee had performed his obligation so that the breach had not occurred. This arose here with the award of £273,000, although to put the beneficiary in the same position as if a breach had not occurred will normally require the trustee to restore the misapplied property or its monetary value: [64]-[67], [70], [134]. While a preliminary taking of accounts might indicate that the entry of the unauthorised payment of £3.3 million should be falsified and struck out so that £3.3million would need to be restored, this could not be permitted because it would put the beneficiary in a much better position than if the trustee had performed his obligation. AIB only needed £273,000 to be put in the position in which it would have been if the trustee had performed its obligation. AIB had to accept the consequences of the hopeless inadequacy of the security it had accepted.

The purpose of a remedy for negligent management of trust property is also to put the beneficiary in the same position as if the trustee had performed his obligation so that the breach had not occurred: [66], [73], [94].

Lord Reed in dealing with misapplication of trust property stated at [135] that the measure of compensation should normally be assessed at the date of trial, with the benefit of hindsight. The foreseeability of loss is generally irrelevant, but the loss must be caused by the breach of trust in the sense that it must flow directly from it and not from the action of a third party unrelated to the breach of trust (as in *Canson*). Losses resulting from unreasonable behaviour on the part of the claimant will be adjudged to flow from that behaviour and not from the breach.

Earlier Lord Reed had noted judicial dicta indicating that for negligent mismanagement of trust property there was no reason why common law rules of causation, remoteness of damage and measure of damages should not apply, so loss resulting from an unforeseen general economic downturn should be irrecoverable. On the other hand such a loss could be recovered as flowing from a fiduciary's failure to disclose a conflict of interest or as in the case of damages for deceit. He pointed out, however, that there is no single set of common law rules so that it is necessary to consider the specific characteristics of the obligation in question and the respects in which it resembles or differs from obligations arising in other areas of the law in order for the law governing liability to be coherent. He thus left open the position on negligent mismanagement.

Investec Trust (Guernsey) Ltd v Glenalla Properties Ltd (CA Judgments 28 & 41)

Contractual liability of trustees dealing with third parties

Under traditional trust law, because a trust is not a legal person, when a third party contracts with a trustee he is not contracting with the trustee as agent of the trust but with the trustee as a principal who alone can sue or be sued to the extent of his personal patrimony unless providing in the contract for limitation of his liability e.g. not to exceed the value of the trust property at the time of being sued. In such a case, the third party will usually require the trustee to guarantee or warrant that the value of the trust fund will not fall below a particular amount while the contract is on foot.

Nevertheless, a trustee liable in debt or for damages for his actions as trustee has a right of indemnity enabling him to pay the relevant amount of money out of the trust fund unless his entering into the relevant contract was a breach of trust or he is indebted to the trust fund e.g. due to a liability for some other breach of trust. A creditor has no direct right against the trust fund but has a right of subrogation to the trustee's right of indemnity. He stands in the shoes of the trustee and so has no better right than the defaulting trustee who must make good his default before having a right of access to the trust fund.

To deal with this problem Art 32 Trusts (Jersey) Law in providing for trusts governed by Jersey law states -

(1) Where a trustee is a party to any transaction or matter affecting the trust-
   (a) if the other party *knows* that the trustee is acting as trustee, any claim by the other party shall be against the trustee as trustee and shall extend only to the trust property;
   (b) if the other party does *not know* that the trustee is acting as trustee, any claim by the other party may be made against the trustee personally (though, without prejudice to his or her personal liability, the trustee shall have a right of recourse to the trust property by way of indemnity).

(2) Paragraph (1) shall not affect any liability the trustee may have for breach of trust."

The Guernsey CA (see [44]-[46] of 29 Oct 2014 judgment No 41 of 2014) has held that this has significantly changed the traditional English law position.

Under (1)(a) any personal liability of a trustee is excluded, and the claim against him in his capacity as trustee must be satisfied so far as possible out of the trust fund, irrespective of the state of account between the trustee and the trust fund, because under (2) any liability of the trustee for a breach of trust is a separate issue.

Under (1)(b) the trustee is personally liable but the trustee still has a right of indemnity out of the trust fund, irrespective of the state of account between the trustee and the trust fund because under (2) any liability of the trustee for a breach of trust is a separate issue. The Court at [50] considered Article 32 as “unambiguous” but there does seem to be some ambiguity in the relationship between para (1)(b) and para (2). Why should not the trustee’s right of recourse be subject under the general law to a set-off to the extent of his liability for a breach of trust or in respect of any other sum owed to the trust?

As matters stand, the beneficiaries are disadvantaged in that access to their trust fund is not prevented by breaches of trust making the trustee indebted to the fund. They are, however, unaffected by whether the trustee is or is not personally liable to third parties due to his right of indemnity against the trust fund in both cases.

Correspondingly, creditors are advantaged by having greater access to the trust fund than under traditional trust principles, though if the trust fund is inadequate to satisfy their claims they are disadvantaged if they cannot sue the trustee personally.

Investec, the Guernsey Trustee of a trust governed by Jersey law, incurred liability as trustee for loans of £183 million. It applied to the Guernsey Royal Court for a declaration that it had no personal liability for the loans, that any liability only extended to the value of the trust fund and that as a former trustee it had a non-possessory lien over the trust fund owned by the current trustee.

The retired Chadwick LJ, sitting at first instance as Lieutenant Bailiff, held that since the governing law of the loans was not Jersey law (but Guernsey or, perhaps, English law) Art 32 did not apply. The Court of Appeal, however, on 27 June 2014 (Judgment No 28 of 2014) held that Art 32 did apply, but also found that the loan documents properly construed on traditional principles excluded the trustee’s personal liability.

The reasoning for holding that Art 32 applied was an analogy with the private international law position of corporations which have legal personality. Here the law of the place of incorporation determines, inter alia, the extent of an individual member’s liability for the debts and liabilities of the company. Where a person knows he is contracting with an individual as agent of a foreign company he knows he is not dealing with an individual but with a foreign company and so needs to look into the legal position of such a company under the law of its incorporation to avoid risks of any limitations of liability. By analogy a person who knows he is dealing with a trustee acting as a trustee and not as an ordinary individual similarly needs to look into the position of the trustee under the law governing the trust.

On the other hand, in the former case a party is dealing with the agent of a legal person, but in the latter case is dealing with the individual in front of him who is not acting as agent of any person.

Is any guidance provided by considering that a trust has an internal aspect and an external aspect as made clear in Professor Schlosser's Explanatory Report on the 1968 Brussels Convention as amended by the UK, Irish and Danish Accession Convention in [1979] Official Journal of the Communities 59 paras 109 -120 . No amendments to the 1968 Convention were necessary for the external relationships of trustees dealing like other persons with third parties since this fell within well-understood civil law contractual and delictual principles covered by the Convention. Amendments, however, were very necessary for the internal non-contractual relationships between trustees and beneficiaries or between the trustees themselves that were alien to civil lawyers. Similarly, the Hague Trust Convention was concerned with determining the trust law applicable to the internal relationships alien to civil lawyers, while recognising that other mandatory laws could affect the operation of trusts.

Is Art 32 concerned with the internal trustee- beneficiary relationship? It appears so, now that we have the benefit of the 29 Oct 2014 Judgment, because Art 32 limits the extent of the beneficiaries' rights in the trust fund. It ousts the protection accorded to them in traditional English trust law by the rule that the trustee's right to reimbursement out of the fund cannot be exercised if he is indebted to the fund for breaches of trust.

However, in providing that a contracting party who knows he is contracting with a trustee cannot sue the trustee personally, Art 32(1) (a) does not affect the extent of the rights of the beneficiaries in the trust fund, because recourse to the trust fund is available whether or not the trustee can be personally liable. It appears to be the external relationship between the trustee and third parties that is involved and this should be governed by the law governing the contract.

On this basis, when the appeal against the 27 June 2014 judgment pending before the Privy Council is heard it may be that a third party signing up to a contract governed by English or Dutch law with Tony Trustworthy, whom he knows is acting as trustee of a Jersey trust, should be entitled to sue Tony to the limit of Tony's personal patrimony in the absence of limitations in the contract. The arguments are finely balanced.

In practice each party to a contract needs to look after its own protection by clarifying the position in the terms of the contract.

Crociani v Crociani [2014] UKPC 40

Exclusive jurisdiction clauses in trust instruments

The Privy Council upheld the Court of Appeal [2014] JCA 089. Clause 12 empowered trustees of a trust governed by Jersey law to appoint new trustees in another jurisdiction and declare that the trusts should be read and take effect according to the laws of the country of the residence or incorporation of the new trustees. On such power being exercised, "thereafter the rights of all persons and the construction of each and every provision hereof shall be subject to the *exclusive jurisdiction* of and construed only according to the law of the said country which shall become the *forum for administration* of the trusts hereunder."

On the exercise of the power, so as to have a Mauritius trustee, the PC held that this clause was not concerned with conferring exclusive jurisdiction on the courts of Mauritius. Rather it ensured that the trust became exclusively governed by the laws of the country of Mauritius as the new governing law. Moreover, in providing for the law of Mauritius to become the forum for administration the clause simply meant that Mauritius was to be the country for day-to-day administration of the trust. Thus breach of trust disputes concerning matters when Jersey law was the governing law were not subject to the exclusive jurisdiction of the Mauritius courts.

Even if clause 12 had conferred exclusive jurisdiction the Privy Council, like the courts below, would have allowed the Jersey proceedings to continue and would not have stayed them. Three of the four main claims involved Jersey law and Jersey trustees, while Jersey courts had extensive experience of trust litigation and were clearly more familiar with Jersey trust law than the Mauritius courts which had no trust law before 1989 and very few cases on such law.

In deciding whether or not to insist on observance of an exclusive jurisdiction clause, the PC held that less weight should be given to such a clause in a trust instrument than in a contract. After all, in a contract the parties had actually agreed upon the clause, while the beneficiaries had no input into such a clause and the court had the *Schmidt v Rosewood* inherent role to supervise trusts and, if necessary, intervene in their administration at the instigation of a beneficiary.

While accepting that such reasons justify affording less weight to exclusive jurisdiction clauses in contracts than in trusts, the difference in weights ought, in my opinion, to be slight. The justification is that a settlor's gratuitous trust is a gift of his property to be made by trustees over a lengthy period of time. It is up to the settlor how bountiful is his gift when laying down the parameters of his trust within mandatory non-derogable trust laws.

Thus the transferred trust property may contain some burdensome or troublesome assets, the trustees may have powers not just to invest but to speculate as if they were billionaires who could afford to lose £50 million without it affecting their standard of living one iota, the trustees may be exempt from liability for their action or inaction so long as not dishonest, the trustees may have much larger remuneration than normal if a clause expressly authorises high remuneration as a percentage of the trust fund's value, and the trustees may have particular conflicts of interest authorised even if likely to disadvantage some beneficiaries. Nevertheless, unless beneficiaries disclaim their interests they have to accept as a whole the extent of the benefits and burdens that the settlor has chosen to give them. This extends to exclusive jurisdiction clauses.

Akers v Samba Financial Group [2014] EWCA Civ 1516

Self-settled declarations of trust and the Trusts Convention

The Court of Appeal in a judgment delivered by Vos LJ considered the effect of the Hague Trusts Convention on trusts declared by a settlor over a designated part of his own property as opposed to trusts declared by a settlor upon transferring his property to trustees. A common lawyer would naturally expect the governing trust law to determine the validity of the trusts declared by the settlor and the lex situs to govern the transfer of property to the trustee.

If an English settlor declared himself trustee of English assets for beneficiaries and later sold some to buy assets in a civilian State, courts in the latter State should accept the beneficiaries as having some rights so far as capable of being fitted in to a system of law having no equitable proprietary rights under trusts. What, however, if a Saudi declared himself trustee of designated Saudi shares for a Cayman company with Saudi law or Cayman law as the governing law – or if any person in a State not having the common law trust concept declared himself trustee of designated assets situated in such a State?

How does the Trusts Convention deal with this important issue?

It has to be remembered that this is a private international law Convention designed to harmonise PIL rules and not to change States' domestic laws except so far as absolutely essential to achieve the PIL purposes of the Convention. At the outset civilian delegates made it clear that they were opposed to common law imperialism. The Convention would have been stillborn if it had required full proprietary effect to be given to the common law trust. The most it could do in civilian States would be to provide for an "obligational trust" conferring on beneficiaries preferred personal rights in a ring-fenced fund such that those rights bound not just the trustee but his private creditors, heirs and spouse, though not third parties. The Convention thus had to concern itself with recognition of foreign trusts and not enable civilian settlors to create trusts of civilian property for civilians. Moreover "bad" trusts could not be allowed, like trusts enabling creditors to be defrauded or enabling forced heirship rights or community of marital property rights to be avoided.

Difficulties in restricting the scope of the Convention to foreign trusts led to postponement of providing restrictions on the impact of the Convention to Chapter III on “Recognition”, having dealt with “Applicable Law” in Chapter II. Chapter I on “Scope” defined “trusts” and restricted the Convention to trusts created voluntarily and evidenced in writing, while stating in Art 4 “This Convention does not apply to preliminary issues relating to the validity of wills or of other acts by virtue of which assets are transferred to the trustee."

Art 11 provided for recognition of an obligational trust but ended, “However, the rights and obligations of any third party holder of the assets shall remain subject to the law determined by the choice of law rules of the forum.”

Art 13 provided “No State shall be bound to recognise a trust the significant elements of which, except for the choice of the applicable law, the place of administration and the habitual residence of the trustee, are more closely connected with States which do not have the institution of the trust or the category of trust involved.” Thus if a Civilopian purported to create a trust of Civilopian assets for Civilopians by expressly choosing English law to be the applicable law of the trust and an English trustee to administer the trust in England, the Civilopian Court had the option of refusing to recognise this trust. The UK omitted this article from the Recognition of Trusts Act 1987 on the basis that the UK did not need such protection.

Art 15 then dealt with non-derogable mandatory rules of the law designated by the PIL rules of the forum relating e.g. to the effects of marriage, indefeasible shares of heirs and “the transfer of title to property.” These rules had priority over the applicable law of the trust. Art 16 dealt with overriding international mandatory rules e.g. on exchange control or export of arms or heritage objects. Art 18 enabled the Convention provisions to be disregarded when their application would be manifestly incompatible with public policy.

Against this background, in six transactions, one expressly governed by Saudi law, one by Bahraini law (between which it was common ground that there were no material differences) and four, which represented 72% by value, without any choice of law, a Saudi had declared himself to be trustee of shares in Saudi companies on trust for a Cayman company that had apparently purchased the shares. This company was the Saudi’s family investment vehicle. After commencement of the winding up of the vastly insolvent Cayman company, the Saudi transferred the shares worth $318 million to Samba, a Saudi bank with a registered branch office in London, so as to discharge his debts to the bank of which he had been a director. Akers, as liquidator of the Cayman company, claimed that the transfer to Samba was a disposition of the Cayman company’s “property” that was void under s 127 Insolvency Act 1986.

Samba then sought a stay of the proceedings on the basis that the Saudi courts were clearly and distinctly more appropriate to hear the case (in which eventuality it was alleged the liquidator's claim would fail because the Saudi lex situs would not treat the Cayman company as having any property interest in the Saudi shares). While the Chancellor had granted a stay, the Court of Appeal disagreed and an appeal is pending to the Supreme Court.

The Court of Appeal focused on Art 4 of the Trusts Convention not considered by the court below: "The Convention does not apply to preliminary issues relating to the validity of wills or other acts by virtue of which assets are transferred to the trustee."

The purpose of this article was to exclude "rocket-launching" or "trust-launching" matters from the Convention which was to focus upon the rocket or trust: see Von Overbeck Explanatory Report para 53.

Para 57 then states as follows.

> "The words 'assets are transferred to the trustee' are completely clear when the settlor and the trustee are distinct persons. In contrast, one may doubt whether they cover the case of the declaration of trust in which these two persons are mingled: the owner of assets declares that henceforth he will hold these assets as a trustee. The Commission *unanimously* accepted that the acts by which this change in the capacity in which the assets were held was effectuated must also be envisaged by article 4 and *therefore excluded from the Convention's scope*. A proposal was offered to express this by the words "acts by which assets are placed under the control of a trustee for trust purposes" (Working Document No 2). The Fifteenth Session, after having accepted this proposal, returned however in the end to the terms used in article 2 of the preliminary draft. It was thought on the one hand that this *expressed rather clearly the idea that article 4 also applied to the declaration of trust*, and on the other hand it was not desired to take up here the allusion to control which appears in a different perspective in article 2, first paragraph. A proposal to make express allusion to the declaration of trust (Working Document No 60) was offered on the second reading, but did not receive the absolute majority required in order that the discussion be reopened."

In the context of a Convention covering both civilian and common law systems it would seem inappropriate to take a strict approach to the interpretation of Art 4 when it appears from the above paragraph that civilians understood Art 4 as if it read "acts by virtue of which [economic benefits of] assets are transferred to the trustee", so covering acts by virtue of which a person declares that a designated part of his assets has been transferred from his full beneficial or economic ownership to be held by himself as trustee. One can, however, understand Vos LJ not being prepared to stretch matters so far and on a literal interpretation of Art 4 construing it as only covering transfer of assets to another person as trustee.

The significance is that if, contrary to the view of Vos LJ, self-declared trusts were excluded from the Convention by Art 4, it was assumed that it would be the English forum's private international law rules that would apply the Saudi lex situs of the Saudi shares to determine whether or not there had been a valid declaration of trust, just as the lex situs determines whether or not a document has validly transferred assets to a person. On this basis the Saudi declaration of trust could not have resulted in creating any proprietary interest in favour of the Cayman company, so Samba had acquired a good title free from attack under the Insolvency Act.

Since Vos LJ had held that self-declared trusts were not excluded from the Convention, the Convention had to be applied. As, however, it would make no sense for a person to be able to declare a trust over property inalienable by the lex situs, there was a preliminary issue as to whether or not the relevant property was alienable at all under the Saudi lex situs. Nevertheless, once the lex situs permits alienation of the assets, questions as to a settlor's capacity to alienate an interest in Saudi shares by way of declaration of trust and the transfer of the beneficial interest effected by the declaration were to be determined by the governing law of the trust, which arguably was Cayman law for 72% of the shares by value (see [82]).

While declarations of trust cannot divide the legal and equitable interests in Saudi shares under Saudi law, they may give the Cayman company rights under the trust that have to be determined by the Cayman governing law of the trust, taking into account the impossibility of a division of legal and equitable interests (see [55]).

Nevertheless, Art 15 circumscribes the application of the trust law so that it cannot oust mandatory rules of a law applicable under the forum's private international law rules. Thus, by virtue of Art 15(1)(d) the application of trust law is ousted by mandatory rules of the lex situs that relate to "the transfer of title to property"; and Lord Hodge in *Joint Administrators of Rangers Football Club* 2012 SLT 599 had stated, :In the context of a Convention which covered both civilian and common law systems it would not be appropriate to take a technical view of the concept of property in art 15 (d)."

Moreover, this paragraph cannot be concerned solely with transfer of title to property in a narrow sense since such is a rocket-launching matter covered by Art 4. While various mandatory rules of Saudi law were alleged to apply there was, however, insufficient evidence of foreign law to assist the court at this stage.

Furthermore, at this stage of proceedings it was not possible to determine the governing law of the trust in respect of 72% by value of the transactions, where it was arguable that Cayman law was the governing law.

Thus the stay was lifted so that after a full evidential hearing in the light of all the circumstances of the case all questions as to Art 15 and the governing law under Arts 5, 6, 7 & 8 could be determined.

Notably, the court did not have to deal with Art 13 but a civilian court applying Art 13 might well find that the colossal significance of a Civilopian purportedly declaring himself trustee of an allegedly segregated part of his Civilopian assets and choosing this to be governed by Trustopian law was such that the trust need not be recognised. Courts in States suspicious of the trust will take full advantage of all the restrictive provisions in the Convention, while others, like Italy, have taken the opportunity to develop internal or domestic obligational trusts that are perfectly valid where all the factors are Italian except for the choice of a foreign governing trust law.

An appeal is pending before the Supreme Court. Query, whether it will decide the appeal on narrow grounds, leaving much to be dealt with after a full evidential hearing. It is to be hoped, however, that it will take advantage of this first case on the Convention to look at the Convention in the round.

As things stand, it seems to matter little whether or not self-declarations of trust are within Art 4 and so outside the Convention. If outside the Convention it appears that the *lex situs* should determine the validity and effects of such a trust. If inside the Convention, then, if the property is alienable under the *lex situs*, the law governing the trust under Art 6,7 & 8 governs the validity and effects of the trust subject to Art 11(3)(d) and to being overridden by mandatory rules of the *lex situs*, inter alia, under para (1)(d) of Art 15.

The latter position is preferable because it would be odd for the Convention to apply to the settlor's declaration of trust as to the property he has transferred to the trustee but not as to his declaration of trust over property vested in himself.

A final query on the case relates to the meaning of "property" in s 127 of the Insolvency Act. On a traditional interpretation the Cayman company had no property interest in the Saudi shares capable of binding third parties other than bona fide purchasers, but what if it had a strong in personam ad rem claim against the Saudi settlor (holding as "trustee" or "nominee" for the company) such that under Saudi law the court would, at the request of the company, order the Saudi settlor-nominee to transfer the specific Saudi shares to the company? Does this not mean that the company had a chose in action relating to the Saudi shares against the settlor that the settlor had disposed of by extinguishing it by virtue of his transfer of the legal-beneficial ownership of the shares to Samba, and under s 436 of the Insolvency Act 'property' includes "things in action"? The in personam ad rem claim had been extinguished or disposed of, leaving only a bare in personam claim.

Some significant new cases

Freedman v Freedman and HMRC [2015] EWHC 1457 (Ch)

The scope for setting gratuitous dispositions aside for mistake

In a settlor's claim to have her settlement set aside for mistake all parties supported it except the Revenue. The Revenue were trying to restrict the scope of setting aside gratuitous dispositions for mistake by relying on limits applicable to the courts' equitable jurisdiction that were set out in Lord Walker's judgment in *Futter and Pitt v HMRC [2013] UKSC 26, [2013] 2 AC 108* and referred to by Etherton C in *Kennedy v Kennedy [2014] EWHC 4129 at [36].*

The background to Melanie in 2013 settling two houses on the advice of her wealthy father and his solicitor, was that in 2001 he had lent her £280,000, secured by a charge, to buy Property A to live in with her child, the result of an unsatisfactory relationship with a married man. When the relationship ended in 2005 he forgave the debt and the charge was removed. In 2010 Melanie rented out Property A so that she could move with her child to rented accommodation near the school attended by her child and where she worked as a dinner lady. She then found a nearby Property B to buy, and her father again provided the full purchase price, £530,000.

He wanted to maintain equality between Melanie and her two siblings so that Melanie would not have the exclusive benefit of both Properties and so that Melanie would have to repay the £530,000 loan using the proceeds of sale of Property A towards such repayment. Delays in finding a purchaser of property A and a desire to protect Melanie from the pressures of her child's father and other possible exploitative males, led Melanie's father and his solicitor to advise Melanie to put both properties into a trust, and the trustees would be expected in due course to appoint the proceeds of sale of Property A to Melanie to help her repay the loan. "Melanie was very close to her father to the extent that if he recommended a course of action to her she would follow it without question": at [15]

On the advice of her father and his solicitor, who believed that the full value of the settled property would remain part of Melanie's estate if she were life tenant, Melanie in February 2013 became life tenant with remainder to her child, while the trustees had extensive powers of appointment of capital in favour of a class of discretionary beneficiaries comprising the children of Melanie's parents and their issue. Sadly, from 22nd March 2006 IHT had been reformed so that the transfer of the Properties into the trust created an immediate entry charge of £156,000 (bearing interest) while exit charges and a 10-yearly periodic charge would also apply, thereby creating a problem if an appointment was made to enable Melanie to pay off her father's loan. Her father died in June 2013 and her debt to him appeared in his estate's IHT account.

Melanie argued that she had made two interdependent mistakes: that she would have no tax worries on making her settlement and that the settlement would not be an impediment preventing her being able to repay the £530,000 loan for acquiring Property B. The trustees had now sold property A for £82,000 less than that loan, while Melanie was liable for £156,000 IHT bearing interest and would be liable to an exit charge on appointments of capital to her.

HMRC first argued that Melanie had made no distinct mistake but was merely guilty of ignorance or inadvertence in simply doing what her father advised her to do. Lord Walker had stated at [108] that "mere ignorance, even if causative, is insufficient" to invoke the court's assistance. Melanie, however, relied upon Lord Walker going on to state that "Inadvertence or ignorance can lead to a false belief or assumption which the court will recognise as a legally relevant mistake" and (at [108]) that "the court in carrying out the task of finding the facts should not shrink from drawing the inference of conscious belief or tacit assumption when there is evidence to support it." What then is the distinction between ignorance and a tacit assumption?

Proudman J stated at [26] "Ignorance meant that the person simply did not think about the consequences of an action. However, a tacit assumption does not involve a thought process involving a series of steps culminating in the thought, "I believe I will be able to comply with the loan agreement." That would be a conscious belief and there are some things that are simply taken for granted. Melanie's assumption is to be inferred because she proceeded on the basis of legal advice coupled with a belief her father would not advise her to do something dangerous. Accordingly, there was at the least a tacit assumption that entering into the settlement did not involve any impediment to compliance with her agreement to repay the loan."

The case had proceeded on witness statements without any cross-examination. Melanie's evidence was that "I broadly understood the letter [containing the solicitor's advice] to mean that the Settlement would not have any tax consequences I needed to worry about." "It did not occur to me at all that creating a Settlement could affect my ability to repay my father as we had agreed." This evidence sufficed to reveal a clear mistake based on a tacit assumption.

The Revenue's first line of attack having failed, it then claimed that Melanie's mistake was not sufficiently grave as it did not go to the heart of the transaction which was designed for the purpose of asset protection of Melanie's assets and this fundamental purpose had been achieved. It was significant that Melanie's Letter of Wishes as settlor did not mention her loan agreement with her father. The purpose had not been tax planning when relief could be given for a mistake as to serious tax consequences because the mistake would have the requisite degree of centrality to the transaction, though counsel stated "this would be limited to cases of unexceptionable tax avoidance as in *Pitt v Holt* [2013] 2 AC 108 or *Kennedy v Kennedy*" [2014] EWHC 4129", where statute provided a perfectly legitimate way of avoiding tax.: see [39]. Otherwise, as Lord Walker had made clear in *Pitt v Holt*, no relief would be afforded where a taxpayer had run the risk or must be taken to have run the risk of his tax avoidance arrangements being unsuccessful.

Proudman J rejected the Revenue's submissions. "In each case the issue is whether or not the mistake is sufficiently serious. A mistake about the effect of a transaction can meet the test, and although it is true that a matter of fact or law basic to the transaction is required in most cases, it is strongly arguable in any event that the test is met in the present case since the tax consequences have the effect that the loan from Melanie's father cannot be repaid….. The Settlement was so affected by the tax consequences that its effect was entirely different from that which Melanie believed it to be."

Proudman J then held that it would be unjust and unconscionable not to set aside the Settlement and allow other beneficiaries to insist on their rights under it, taking account of evidence that otherwise Melanie and her child would not be able to retain Property B as their home if the requisite IHT and interest had to be paid.

JSC Mezhdunarodniy Promyshlenniy Bank v Pugachev [2015] EWCA Civ 139

Obtaining disclosure as to possibly dominant defendant's position as discretionary beneficiary and location and value of trust assets

The Court of Appeal in a judgment delivered by Lewison LJ dealt with whether, in connection with the grant of a freezing order, the court has jurisdiction to order a member of a class of discretionary trust beneficiaries who had disclosed the bare existence of his interest in five named New Zealand discretionary trusts to make further full disclosure of details of the trusts' terms and the location and value of the trust assets. The assets themselves might then be considered for bringing within the scope of the order. Lewison LJ held the court did have jurisdiction if there were "credible grounds" for believing that such disclosure could reveal that the Respondent was not an ordinary mere discretionary beneficiary because the trustees would deal with trust assets according to his direct or indirect instructions. It was not necessary to reach the threshold of showing "good reason to suppose" this to be the case, the threshold for the grant of a freezing order.

A preliminary issue related to the scope of the freezing order. The prohibition in the order extended in para 7(c) to "any interest under a trust or similar entity including any interest which may arise by virtue of the exercise of any power of appointment, discretion *or otherwise howsoever*", para 6 having already generally referred to "all the Respondent's assets…whether the Respondent is interested in them legally, beneficially *or otherwise*." Para 6 also treated the Respondent's asserts as including any asset which he had the power, directly or indirectly, to dispose of or deal with as if it were his own and regarded him as having such power if a third party (like a trustee) helds or controlled the asset in accordance with his direct or indirect instructions.The CA held that both paragraphs extended to the interests of a potential beneficiary under powers contained in a discretionary trust and that such interests fell under para 9 requiring the Respondent to "inform the Applicants' solicitors of his assets worldwide, whether in his own name or not and whether solely or jointly owned, giving the value, location and details of all assets."

It thus mattered nought that such a beneficiary has at [13] a "right that is not a proprietary interest in the assets held by the trustees, although it can be described as an interest of sorts: *Gartside v IRC [1968] AC 553, 617-618".* However, his hope of receiving trust assets is more than a "mere hope" since he has a right to insist that the trustees must apply some objective criteria in deciding whether or not to exercise their discretion in favour of a particular beneficiary. Lewison LJ could also have mentioned that a discretionary beneficiary has a *Schmidt v Rosewood[2003] UKPC 26* right to invoke the supervisory jurisdiction of the court and can, on behalf of the trust fund, trace and recover trust assets (*Re Diplock [1948] Ch 465*) though he cannot make a gift of his hope because it is not existing property.

The established justification for a freezing order is to preserve assets which would be amenable to execution in aid of any judgment against the defendant, though it does not give the claimant a security interest. Assets held by trustees on discretionary trusts for beneficiaries are not amenable to execution if judgment is entered against one of the class of potential beneficiaries unless the trustees apply the trust assets in accordance with the beneficiary's direct or indirect instructions as reflected in para 6 of the Order.

The Respondent argued that no further disclosure could be ordered unless there was "good reason to suppose" that the trustees would do what the Respondent wanted so that the Respondent could be compelled to cause the trust assets to be applied by the trustees to satisfy a judgment against him: the evidence did not establish such a good reason. This was the threshold condition for granting a freezing order in the first place and should also cover the issue of further disclosure.

Lewison LJ rejected this because the jurisdiction to grant a freezing order carries with it the power to make ancillary orders that are necessary to make the freezing order effective. To this end CPR Part 25.1(1)(g) enables a court to make "an order directing a party to provide information about relevant property or assets or to provide information about relevant property or assets which *are or may be* the subject of an application for a freezing injunction."

Lewison LJ endorsed Henderson J in *Lichter v Rubin* [2008] EWHC 450 (Ch). "25.1(1)(g) is intended to provide machinery for the provision of information in advance of an application for a freezing injunction. Plainly a provision of that nature would lose its utility if it were necessary to demonstrate at that stage that a freezing order would in due course be granted. It is only necessary to show that a freezing order may be applied for, and whether or not the application would be successful is not a matter on which the court can form a view at this stage; it need only be satisfied that there are *credible grounds* for making an application if so advised."

Thus the Court was not powerless where the threshold test for including an asset within the scope of a freezing order was not met. There only needed to be credible grounds for investigating whether or not the Respondent was the effective owner of relevant trust assets.

Schroder Cayman Bank and Trust Company Ltd v Schroder Trust AG Cayman FSD No 122 of 2014, 9 March 2015

Applicability of "firewall" provisions, excessive execution of powers and setting aside mistakenly exercised powers

A Cayman Trustee of a Cayman Employment Benefit Trust for a UK company sought relief for mistakes it had made in appointing valuable shares in a Cayman company to Jersey Employee Retirement Benefit Fund Scheme Trusts. The Trustee had purported to benefit a class of beneficiaries wider than that permitted under the Cayman Trust, mistakenly believing the classes of beneficiaries under the Cayman Trust and the Retirement Scheme Trusts were identical. This was the "excessive execution" issue. The Trustee had also acted under two mistakes. First, that to escape forthcoming UK income tax and national insurance on distributions out of the fund the fund could be transferred to the Jersey trustees without occasioning adverse UK IHT consequences. Second,that the transfer was a revocable transfer so that the Trustee could recover assets to pay tax if necessary. The UK Revenue was fully informed of the application but decided not to intervene in the proceedings, perhaps because the "excessive execution" point was decisive as will be seen.

Counsel submitted that there was a conflict in the "firewall" provisions of Cayman and Jersey law that needed to be resolved. Cayman law in ss 89 and 90 of its Trust Law (2011 Revision) seemed to make Cayman law apply, without reference to the laws of any other jurisdictions, to any aspect of the validity of a disposition and the existence and extent of powers conferred or retained and the validity of any exercise of such powers. Jersey law had similar provisions.

Smellie CJ accepted the Cayman Trustee's submission that, assuming a conflict in firewall provisions, one had to fall back on ordinary private international law provisions, under which Cayman was the system of law most closely connected with the transactions under challenge. The judge also made the point that the Cayman lex situs governed title to Cayman shares and if the appointments were never validly made the Jersey Trustee never acquired the shares free from the Cayman beneficiaries' rights.

Under Cayman law the judge held that the appointment of shares was void as an excessive execution of the power as outside the scope of the powers conferred by the Cayman Trust, following the views of Lord Walker in *Pitt and Futter v HMRC [2013] 2 AC 108* on excessive execution of powers. The judge also held that this would have been the position if Jersey law were applicable.

Counsel did not draw the judge's attention to provisions in the "firewall" legislation of both Jersey and Cayman (see Art 9(2A)(a) Trusts Jersey Law and s 90 Cayman Trust law 2011 Revision) that provide that the protective provisions validating dispositions do not validate any disposition of property which is not owned by the settlor nor the subject of a power of disposition. Could not the Cayman Trustee as the provider of the shares transferred to the Jersey Trustee be regarded as a settlor who did not have power to settle property on the wide class of beneficiaries, in which case the exercise of the power would be outside the Jersey "firewall"?

Although the "excessive execution" point was decisive the judge, on the invitation of counsel, went on to consider the position as to mistake under Cayman and Jersey law in case there was a need to seek an order of the Jersey Royal Court confirming the order of the Cayman Court. Under Cayman law he applied *Futter and Pitt v HMRC* and held there had been distinct mistakes as to tax consequences and as to revocability of the appointment, such that the Trustee would not have made the appointments but for these mistakes. They were of sufficient gravity to invoke the equitable jurisdiction and it would be unconscionable or unjust to leave the mistakes uncorrected. It does not seem that counsel raised the point made by Lord Walker in *Futter and Pitt* that the court should not intervene if the taxpayer had run the risk, or must be taken to have run the risk, of being wrong about the success of his tax-avoidance arrangements.

Jersey law is governed by the Trusts (Amendment No 6) (Jersey Law) 2013 inserting Art 47G into the Trusts Jersey Law empowering the court to set aside a disposition that would not have occurred but for a mistake of "so serious a character as to render it just for the court to intervene" (rather than of so serious a character "as to render it unjust for the court not to intervene" as in England under *Futter and Pitt*). The judge simply accepted expert evidence that the Jersey court would set aside the appointments for mistake, without going into any details.

It seems that the Jersey formulation may be a little easier to establish than the English formulation, while the Jersey courts in dealing with what is "just" have ignored Lord

Walker's point that the courts should not intervene where a taxpayer must be taken to have run the risk of his tax-avoidance arrangements being unsuccessful, so that he cannot be allowed to try and try again till he succeeds. English tax is not their concern: "Leviathan must look after it itself." It may well be that Cayman courts will take a similar approach when the issue is directly raised before it.

V v T [2014] EWHC 3432 (Ch)

Variation of Trust Act 1958 applications and the principle of open justice

An application for a VTA claim to be in private was rejected. Morgan J was unimpressed by submissions that evidence of the level of profit made by a private company owned by the trust could have negative effects on the company, and thus the trust, and that knowledge of the high value of the trust fund could lead to security problems for the beneficiaries. He was however influenced by the effect that publicity could have on five minors and future children when their parents wanted them to have an ordinary non-ostentatious lifestyle concentrating on their studies and not finding themselves with false friends.

Reporting restrictions were thus imposed so the minor beneficiaries could not be identified. Non-parties were not to be entitled to obtain a copy of the transcript of the hearing or of the statement of case or any judgment or order without obtaining the court's permission after giving notice to the parties. In future such cases should be listed by random initials where the parties intended to apply for reporting restrictions.

Bailey v Bailey [2014] EWHC 4411 (Ch)

Reminder of utility of VTA

The High Court approved variations of a family trust in three respects. First, to defer a vesting date so as to defer the occasions for CGT and IHT charges, Second, to extend the powers of the trustees so that they could farm in partnership with some of the beneficiaries thereby being able to obtain business relief (rather than just having agricultural relief for IHT). Third, to introduce a power of accumulation of income to help build a fund for paying tax so as to avoid selling land to pay such tax.

Crédit Agricole Corporation and Investment bank v Papadimitriou]2015] UKPC 13

Liability of recipients of trust property; money laundering

Robin Symes, as apparent owner of an art deco collection of furniture, wrongfully sold it. US$10.3milliion proceeds of his crime were paid to the Liechtenstein bank account of the Pataco Foundation, recently acquired by Symes before being paid into the CACI

Gibraltar account of Lombardi Corporation, a BVI company recently created with Symes as beneficial owner. Symes appeared a reputable, wealthy well-connected antique dealer introduced to CACI by a director of its Swiss company.The Lombardi money was used as guarantee of repayment of a five year loan made to Robin Symes Ltd by CACI's London branch to repay an existing loan from Citibank. The Lombardi money was wholly drawn down to pay the London CACI's loan. The arrangement for opening accounts with CACI in London and Gibraltar was expensive, requiring an annual fee of $51,500 over the five year term (envisaged to last for a shorter period due to sales of antiques by Robin Symes Ltd) and a $20,000 arrangement fee charged to Robin Symes Ltd, while the difference between the interest earned on the Gibraltar deposit and the interest payable by Robin Symes Ltd was calculated at around £180,000.

The Respondent, having established she was the real owner of the collection brought a proprietary claim against CACI for the proceeds of sale of the collection traced to the bank, while also claiming personal liability for dishonest assistance in a breach of trust and unconscionable receipt of trust property.

The Gibraltar chief Justice rejected all claims, taking account that the events took place in 2000. He focused upon whether, if the bank had made further reasonable inquiry into the source of the funds, it would have discovered that the transaction was probably improper – and found it would not. The Respondent appealed only on the proprietary claim, claiming that CACI had not proved it was a bona fide purchaser without notice.

The Court of Appeal allowed the appeal, finding there was ample evidence at the time that a bank contemplating entering into such a transaction should inquire into the commercial purpose of the transaction. Moreover, the purpose was not simply to repay an existing loan from Citibank. "The use of a web of legal entities and the cost would have alerted a reasonable bank to the improper motive, namely, to launder the money."

Lord Clarke on behalf of the Privy Council endorsed the Court of Appeal's view. He usefully pointed out the need to distinguish three circumstances; see [14]-[15].

1. Where the bank in fact appreciates that another person probably has a proprietary right in the relevant property and so has *actual notice*.
2. Where a reasonable person with the attributes of the bank should have appreciated on the basis of facts already available to it that a proprietary right probably existed and so has *constructive notice.*
3. Where the bank should have made inquiries or sought advice which would have revealed the probable existence of the proprietary right and so has *constructive notice.*

As to 3, "The bank must make inquiries if there is a serious possibility of a third party having such a right, or, put another way, if the facts known to the bank would give a reasonable banker in the position of the particular banker serious cause to question the propriety of the transaction": see [20].

Lord Sumption, in a one paragraph concurrence with Lord Clarke's reasons, stated at [33], "There must be something which the defendant actually knows (or would actually know if he had a reasonable appreciation of the meaning of the information in his hands) which calls for inquiry. The rule is that the defendant in this position cannot say that there might well have been an honest explanation if he has not made the inquiries suggested by the facts at his disposal with a view to ascertaining whether there really is…. If there are features of the transaction such that if left unexplained they are indicative of wrongdoing, then an explanation must be sought before it can be assumed that there is none. "

From these views of Lord Clarke and Lord Sumption it seems that appeals against the absence of personal accountability of the bank for unconscionable receipt of trust property or dishonest assistance in a breach of trust would have succeeded. The turning of a blind-eye to the need to make further inquiries or "commercially unacceptable conduct in a particular context (as pointed out by Lord Neuberger in *Vestergaard Frandsen A/S v Bestnet Europe Limited [2013] UKSC 37 at [26]*) would affect the bank's conscience to justify personal accountability.

Lord Sumption controversially concluded, "Whether a person claims to be a bona fide purchaser of assets without notice of a prior interest in them, or disputes a claim to make him accountable as a constructive trustee on the footing of knowing receipt, the question what constitutes notice or knowledge is the same." While this seems correct for facts like those in this case where the bank was reckless as to serious indications of wrongdoing and as to its reputation and its blind-eye knowledge amounted to notice, it does not fit cases where constructive notice arises from mere negligent failure to make such inquiries and inspections as ought reasonably to have been made.

As Megarry V-C stated in *Re Montagu's ST [1987} Ch 264 at 272-273,* "the doctrines of purchaser without notice and [personal accountability under] constructive trusts are concerned with matters which differ in important respects. The former is concerned with whether or not a person takes property subject to or free from some equity. The latter is concerned with whether or not a person is to have imposed upon him the personal burdens and obligations of trusteeship. I do not see why one of the touchstones for determining the burdens on property should be the same as that for deciding whether to impose a personal obligation on a man. The cold calculus of constructive and imputed notice does not seem to me to be an appropriate instrument for deciding whether a man's conscience is sufficiently affected for it to be right to bind him to the obligations [of personal accountability as] a constructive trustee."