

Trusts and Wealth Management Conference, Singapore

Asian Wealth and the Global Context 2019

Family Trusts Today

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Introduction

1. There is an old Chinese saying about family wealth- 富不过三代 (“*Wealth does not pass three generations*”). I have taken this saying as the theme for this keynote speech on family trusts. The paradigm trust for my purposes is the family trust set up by a successful business person, who, perhaps starting from humble beginnings, made their fortune and then wanted to keep their wealth in the family for many generations to come.
2. As the saying indicates, by the time that the business reaches the third generation, the children may be much less interested in the business. There may also be a cultural layer here: it may be that the settlor never really discussed what he wanted because of cultural attitudes which view with disfavour discussions about what it to happen after the most senior family passes on. In some cultures, there is a reluctance to make a letter of wishes or a formal will since it may be thought to be unlucky.
3. The members of the second generation who enter the business may be perfectly content with the trust arrangements but, by the third generation, the attitudes and values may have changed. The economic situation may have changed. The family may no longer find it as congenial as it was in the past to continue to be based where the business is located and so on. It is not every third generation beneficiary who is unhappy with the family trust; there are many family trusts that have survived many generations. However, the saying that *Wealth does not pass three generations* is valuable because it illustrates how over time disputes may arise within family trusts. If there is a dispute between different branches of the family, then, as a way of dividing the trust assets in the third generation, the assets may, with the consent of all concerned, be put into a number of separate trust companies, marking a shift away from the original trust structure.

4. There can, of course, be many reasons for wanting to restructure a trust. For instance, the minimisation of tax may be an objective. It may, for that reason, be desired to put the assets forming part of the trust in a jurisdiction with a low tax rate. That may lead to further complications. If, for example, that jurisdiction is not a common law jurisdiction but one which applies, say, Sharia law, it may be found that that system of law does not favour or allow an absolute disposition by a person during his lifetime. The reorganisation of a trust in a different jurisdiction may be referred to as *transitioning*.
5. When, however, the third generation takes a different view about the purpose of the trust from the original settlor, there can be tension also between the trustees and the beneficiaries. There may be considerable difficulty for the trustees in deciding how a discretion should be exercised.
6. I propose to consider four problems affecting family trusts. I believe these to be some of the problems which are uppermost in people's minds in practice today. The four problems are:
 - i. **Privacy in court proceedings:** Issues of privacy may arise when seeking directions from the court, as it may be desirable to keep the details of the trust and the names of the beneficiaries out of the public domain.
 - ii. **The over-dominant settlor and sham trusts:** Under this head, I am going to look at the landmark case of *JSC Mezhdunarodniy Promyshlenniy Bank v Pugachev* [2017] EWHC 2426 (Ch) ("*Pugachev*"), in which professionally-drafted discretionary trusts established in New Zealand were set aside by the High Court of Justice of England and Wales. The general issue is what happens when the settlor of a family trust, which he endows with business assets, turns out to be a person who dominates the trust and someone then contends that the trust is not a valid trust.
 - iii. **Insolvency:** This may be an issue because the businesses which form part of the assets of the family trust become insolvent in circumstances where there are not enough assets to meet the liabilities incurred by the trustees. So the question arises: can the creditors sue the trustees personally?

- iv. **Climate change and handling disputes:** I will say a little about disputes between beneficiaries and trustees in the particular context of climate change between trustees and beneficiaries.

(1) Privacy in court proceedings

- 7. Court proceedings can provide important guidance and protection to trustees. The courts in various jurisdictions have provided considerable assistance to trustees to enable them to operate in an efficient fashion. One of the latest of these decisions was the decision in the matter of the *C Trust* [2019] SC (Bda) 44 App by Chief Justice Hargun of Bermuda. The trust in that case made provision for a protector, but the corporate entity that had been acting as a protector for some years had not been properly appointed. The Chief Justice made an order under the inherent jurisdiction of the court to intervene in the administration of the trust to approve certain acts which were in fact an effective departure from the trust. Chief Justice Hargun relied on *re New* [1901] 2 Ch 534, *In the matter of the Z settlement* [2016] JRC 048 and *Schmidt v Rosewood Trust Ltd* [2003] 2 AC 709. Chief Justice Hargun concluded that the court may under its inherent jurisdiction order that the current trustees leave undisturbed the acts or omissions of the previous trustees while there was an issue about the validity of the previous trustees' appointment. In short, the trust could be administered on the same footing as if those acts had been validly done with the authority of the duly constituted trustees. In other cases, the courts have varied the terms of the trust deeds so as to substitute or add a valid provision relating to the perpetuity period.
- 8. In connection with court proceedings, however, there is often a desire for anonymity. Can there be hearings in private?
- 9. Originally trust proceedings were always heard in private but this is less so today. In England and Wales, the applicant for a hearing in private has to show that it is necessary to hold the hearing in private. But there are circumstances where applications may have to be heard in private in order to protect beneficiaries, including children who might be kidnapped if it was widely known how wealthy they or their families were. If in these circumstances

there is a request for privacy, it may be necessary for the family to disclose their social media history.

10. Different courts adopt different approaches to the question whether trust disputes should be heard in public. I have been told that in India, for instance, all documents filed in courts can be inspected by the public. In *In the matter of G Trusts* [2017] SC (Bda) 98 Civ, the court held that a directions application should be held in private because it was essentially a matter about internal trust administration in which there was no public interest.
11. Contrast *MN v OP* [2019] EWCA Civ 679 22 ITEL 61, where the Court of Appeal of England and Wales confirmed in a case involving a substantial family trust that there was no presumption that an anonymity order would be made in a variation of trusts application. The Court of Appeal concluded that the judge was entitled to come to the conclusion that a good case for anonymity had not been made. However, it further concluded that there was possible prejudice to minor children so it made orders under section 39(1) of the Children and Young Persons Act 1933 preventing any identification of them in any publication. Information about the assets within the family trust was already in the public domain and the judge had refused anonymity about the adult beneficiaries' interests even though the allocation of their beneficial interests had not previously been made public. These cases demonstrate very different approaches.
12. So the practical point here for trustees and those advising them is that trustees need to be sure about the practice of the jurisdiction before making their application for directions or other relief.
13. Next there is a question about whether investigative journalists or other members of the public can get copies of the documents filed in court. Here the decision of the Supreme Court of the United Kingdom in *Dring (on behalf of the Asbestos Victims Support Group) v Cape Intermediate Holdings Ltd (Media Lawyers Association intervening)* [2019] UKSC 38; [2019] 3 WLR 429 is of some interest. The Supreme Court held that the principle of open justice extended even to documents which were not part of the records of the court and to documents for whose disclosure there was no rule in the Civil Procedure Rules. The courts had inherent jurisdiction to provide access to any person, and for this purpose they had to carry out a weighing exercise balancing the open justice principle against other

considerations which, depending on the case, would include privacy interests and proportionality. The purpose of the open justice principle was to bring individual judicial officeholders to account and to enable the public to understand what evidence had been before the court and why decisions were made. So a member of the public could apply to see any document placed before the court, including the trial bundle. Subject to questions of, for example, proportionality, a person could apply to inspect documents which had been produced at a trial he had not attended, or which had taken place many months earlier.

14. People sometimes want information about a trust which is not contained in documents lodged for the purposes of litigation. More and more jurisdictions are deciding that trusts have to be registered and in some cases this involves revealing the name of the ultimate beneficial owner on a website. Beneficiaries may be able to use the data protection legislation to obtain copies of information about themselves (see *Damson-Damer v Taylor Wessing LLP (Information Commissioner intervening)* [2017] EWCA Civ 74 [2017] 1 WLR 3255).
15. As to the use of trust funds to defend hostile claims, see, for example, *AG v. Trustee L* [2016] SC (Bda) 50 Com and *Airways Pension Scheme Trustee Ltd. v. Fielder* [2019] EWHC 29 (Ch).

(2) Sham Trusts

16. Now for the landmark case of *Pugachev*. The settlor was a man known as Putin's banker or more precisely ex-banker. The claimant was a bank from which he was said to have misappropriated substantial funds. He went to New Zealand where a solicitor established discretionary trusts for Mr Pugachev and his family. Mr Pugachev was the first protector. If he came under a "disability", which was said to have happened because an order had been made against him in England and Wales freezing all his assets, he could not continue to act as protector and his son became protector in his place.
17. The claimant bank claimed that these trusts should be set aside as illusory trusts or shams, alternatively as transactions to defeat creditors within section 423 of the Insolvency Act 1986. The trial was heard by Birss J, who gave a long and detailed judgment (456 paragraphs). He held that the claimant had established that the trusts were illusory. In short, the judge held that Mr Pugachev had retained beneficial ownership of the assets put into the

trust as a matter of the interpretation of the trust deeds. It followed that they were shams (paragraph [455]). The trusts should not be enforced either on the basis that they were illusory or on the basis that they were a sham (paragraphs [441] to [442]). He also held that the section 423 claim succeeded. But it is the first holding with which I am here concerned and which I believe means that it is rightly to be called the landmark case of recent times. The judge's core holding on illusory trust was:

“The true effect of all the trust deeds in this case, properly construed, is to leave Mr Pugachev in control of the trust assets. Mr Pugachev is the beneficial owner. They amount to a bare trust for Mr Pugachev.” (paragraph [455])

18. At the start of the passage directing himself on the law on illusory trusts, Birss J at paragraph [155] cited the following passage from the judgment of the Chief Justice Richard Ground in Bermuda in *Re AQ Revocable Trusts* (6 April 2010) at paragraph [29]:

‘the concatenation of rights and powers in the settlor, when coupled with the fact that he was the sole trustee at the time of the constitution of the trusts, *rendered this trust illusory during his lifetime* ... the cumulative effect of the trust documents, when taken with the de facto situation, means that the settlor as trustee could not effectively be called to account in his lifetime.’ (Words italicised by the judge)

19. Before I venture further, I want to examine the decision of the Chief Justice on which Birss J relied. It is common in the case of lifetime trusts for settlors to reserve powers to themselves, or to appoint themselves as protector of the trust, which gives them power to intervene in the management of the trust. There are also cases where a settlor sets up a trust but appoints himself as trustee, which may lead to him not properly distinguishing between the trust assets and his personal assets.

20. *AQ Revocable Trusts* is relied on in *Pugachev* so it is important to be clear about the *ratio* in that case. The issue which Ground CJ there had to decide was whether the trusts set up by the settlor in his lifetime were valid or whether they were invalid because of the way the trust was operated. If they were invalid, the trust assets fell into testamentary trusts of the settlor and that led to major tax savings by the beneficiaries.

21. We only have a glimpse into the evidence but it is apparent that the problem was the settlor's behaviour. The judge found that the over-dominant settlor's conduct showed that he had no intention of abiding by the terms of the trust. At least one of the trustees had no real knowledge of what was happening in relation to the trust assets.
22. To cap it all, there was a clause in the trust deed that enabled the settlor to give his approval to any transaction and for the trustees to be relieved of their liability if that happened. The trust had been drafted in the United States and was possibly based on an American precedent adapted for use in Bermuda. The Chief Justice found that the settlor had effective sole dominion over the trust assets in this lifetime. Not surprisingly the Chief Justice held that the trusts were ineffective and void.
23. In reaching his conclusion, the Chief Justice relied on "the de facto situation", which can only be read as a reference to the evidence he had heard but (perhaps for privacy reasons) was not set out in his judgment. He was influenced by that evidence and by the terms set out in the trust deed, including the one to which I have referred. The judge recalled the beneficiary principle, i.e. the principle for a trust to be valid a beneficiary had to be able to enforce the trust. I note in passing that that principle has to work both ways of course. If a beneficiary can enforce the terms of a trust, it can hardly be said to be illusory. In short, in this case, it is clear that the Chief Justice took account of both the evidence and the terms of the trust, thus it may be that we have to read the conclusion of Birss J on illusory trust in that light.
24. The judge went on to consider whether the *Pugachev* trusts were sham trusts. There was in fact no need for the judge to have recourse to the concept of a sham trust. The judge was able to set the trusts aside simply because the settlor had not respected the fact that when he set up the trust, he transferred control of the assets so transferred to the trustees. A sham, on the other hand, is a transaction into which parties enter with a view to the transaction having a different effect from that that appears to be the effect of the transaction. The test of what is a sham was laid down by Diplock LJ in a case called *Snook v London and West Riding Investments Ltd* [1967] 2 QB 786, 802. He held:

‘... it is, I think, necessary to consider what, if any, legal concept is

involved in the use of this popular and pejorative word. I apprehend that, if it has any meaning in law, it means acts done or documents executed by the parties to the “sham” which are intended by them to give to third parties or to the court the appearance of creating between the parties legal rights and obligations different from the actual legal rights and obligations (if any) which the parties intend to create. One thing I think, however, is clear in legal principle, morality and the authorities ... that for acts or documents to be a “sham”, with whatever legal consequences follow from this, all the parties thereto must have a common intention that the acts or documents are not to create the legal rights and obligations which they give the appearance of creating. No unexpressed intentions of a “shammer” affect the rights of a party whom he deceived.’

25. There are a number of cases where this has been applied in the context of trusts. For example, in *Midland Bank v Wyatt* [1995] 1 FLR 697, the settlor made a written declaration of trust in favour of his wife and children and then put the relevant instrument away in his safe. The court held that the settlor did not intend to benefit his wife and children. He simply wished to bring the trust into existence in case he should need it to avoid paying his creditors. It was held that the trust deed was a sham, but it is to be noted that the only relevant intention was that of the settlor.

26. As Birss J makes clear, the Court of Appeal of England and Wales (to which I was party) decided in an earlier tax case, *Hitch v Stone (Inspector of Taxes)* [2001] EWCA Civ 63 [2001] STC 214, that to find a sham the court had to look at subjective intention. In the same case I also observed that the court was able to look at the surrounding circumstances and the same one might imagine may be true for illusory trusts. It is then open to argument that the judge in *Pugachev* did not go further than look at the trust deeds. But more fundamentally, in *Pugachev*, there was no finding that the irreducible core of the trust, that is the presence of some minimum obligations enforceable required by the law which is fundamental to the concept of a trust (see *Armitage v Nurse* [1998] Ch 241, 253), was not present. If that is so, we must ask whether an illusory trust is an exception to the irreducible core principle so that a trust can be illusory even if the irreducible core is present.

27. There is authority that this is not so. For instance, in *Citibank NA v MBIA Assurance SA* [2007] EWCA Civ 11, Citibank was trustee for the holders of debt notes issued to securitise Eurotunnel debt. Under the notes, MBIA guaranteed repayment of the sums due on their notes. Under the trust deed, MBIA had power, in order to protect its position as guarantor, to give Citibank instructions concerning the exercise of most of its powers as trustee. Those instructions were binding on Citibank and the trust deed specifically provided that Citibank “need not have regard to the interests of the Noteholders” when following MBIA’s instructions. The trust deed also exempted Citibank from all liability to the noteholders when acting on MBIA’s instructions. The Court of Appeal of England and Wales, in a decision to which I was party, held that the trust was valid because Citibank continued to have an obligation of good faith and had real discretions to exercise in terms of other powers. Accordingly, the trust created by the notes was valid.
28. An issue on which opinions differ is the extent, if any, to which the powers of the protector in *Pugachev* went beyond those giving powers of control to protectors and which are commonly met.
29. Other issues arise out of this case, such as whether the law of shams in relation to trusts where the trust as created in created by a document to which the first trustees are party should require the necessary shamming intent to be shown on the part of trustees as well as the settlor. Where professional trustees are involved this is likely to be extremely difficult to show. I shall leave those matters there.

(3) Insolvency

30. By using a trust, assets are insulated from creditors of the settlor but this may expose a weakness in the structure – insolvency law of course contains several provisions designed to bring assets back into the pot for the settlor’s creditors and one of these is an old statutory provision avoiding transactions designed to defeat creditors. In England and Wales, that is currently section 423 of the Insolvency Act 1986.
31. There are several issues which have arisen in recent years concerning family trusts. One of them concerns trusts holding businesses in various companies. The trustees may have got

into the position of raising substantial loans in their capacity as trustees. It has recently been established in the Privy Council that, unless there is special legislation, the trustees will end up as liable to the creditors, with a right of indemnity over against the trust fund. The case in which this was established is *Investec Trust (Guernsey) Ltd v Glenalla Properties Ltd* [2018] UKPC 7 [2019] AC 271. The decision establishes the following legal principles:

- i. Trust is not a legal entity with a distinct legal personality separate from the trustee: it is a relationship between the trustee and the beneficiaries in relation to specific property. The trust assets are vested in the trustee, and only the trustee is capable of assuming legal rights and liabilities to third parties on behalf of the trust.
 - ii. The trustee has the relevant rights and liabilities. The trustee acts a principal and not as agent for the beneficiaries or the other legal entities within the trust. He is not an agent of the trust.
 - iii. On orthodox trust law principles, the legal personality of a trustee is said to be unitary: there is no distinction between a trustee's personal and fiduciary personality and is without limit, thus putting at risk not only the trust assets but also the trustee's personal assets.
 - iv. An unsecured creditor of the trustee has no direct recourse to the trust assets to enforce his debt. He can only sue the trustee. His only way of accessing the trust assets is through subrogation to the trustee's right of indemnity from the trust fund for liabilities reasonably incurred.
32. All this means that there are limits on the ability of the trust creditor to obtain recourse from the trust assets. If the loan has been improperly incurred, they will have no right of subrogation to the trustee's right of indemnity against the trust assets because the trustee will not be entitled to any such indemnity.
33. A trustee can by contract limit his liability for obligations which he undertakes as trustee to the trust assets. There are jurisdictions where by statute the liability of the trustee for liabilities incurred on behalf of the trust is limited to the trust assets. In *Investec*, the Privy

Council held (by a majority) that the common law would recognise such statutory limits on the liability of a trustee arising under the law pursuant to which the trust was set up.

34. Under English trust law, there is no such statutory provision. No distinction is drawn between the trustee's personal and fiduciary capacities when determining the extent of the trustee's liability for obligations incurred on behalf of the trust. The trustee is (in the absence of some limitation in the contract) liable to the full extent of his personal assets for all liabilities incurred to a third party on behalf of the trust if the trust assets have been exhausted. On that basis, the question of the strength of the covenant of the trust is the same as the question as the strength of the covenant of the trustee.

(4) Climate change and disputes between beneficiaries and trustees

35. One of the issues of the day is undoubtedly climate change. This can affect trustees too. I recall that in 1999 I had a case about contaminated land (*X (claimant) v A, B and C (defendants)*), Chancery Division, 30 July 1999). There was a landfill site which had belonged to the deceased testator who had left his property on trust. The trustees discovered that they had enormous liabilities to deal with the methane gas which was being emitted from this land. There was an issue as to whether the trustees had a lien over the land in respect of their future liabilities to put the property right. I held that there was. There was also a question whether the trustee had power to invest funds that it held pursuant to its lien. I held that there was a wide power of investment.
36. There was a further interesting question about consultation with the beneficiaries. Counsel had advised that the trustee had to keep the beneficiaries informed and ascertain their wishes. I held that there was no such obligation, but I repeated what Wilberforce J had said at the end of his judgment in *re Pauling's Settlement Trust (No.2)* [1963] Ch 576. He expressed the hope and understanding that the trustee would give an undertaking that he would confer with the plaintiffs as to the investments held in the trust fund and give consideration to every suggestion made by them with regard to its investment and will not object to any suggestion made on reasonable terms.

37. I am sure that there will be many such problems in the future and that the wisdom of Wilberforce J will continue to be applicable and provide useful guidance to those who advise trustees of family trusts.

Conclusions

38. The world used to be a smaller place. A landowner would often make a settlement in his lifetime, and he would normally appoint as trustees his closest friends or his solicitor or his accountant. They would have been people he knew and often he would continue to live on the trust estate and he would want to express views on decisions the trustees were about to take or had taken. Now the trust has evolved. It is used in many cases where families have built up trusts as a result of successfully founding a business. It is a feature of a modern trust that its place of administration may be in one jurisdiction and the beneficiaries in another and this gives rise to legal issues in private international law. Moreover, the settlor may not have a personal relationship with the trustees, and the assets may no longer be physical assets or assets whose management he can monitor. So what has tended to happen is that, as in *Pugachev*, the settlor has become the protector, and there are clauses saying what trustees can or cannot do without his consent. They may be many other clauses not found in trusts of previous generations such as proper law clauses and “flee” clauses and all the rest.

39. I have three concluding thoughts.

40. First, it is remarkable how trust law has developed. Originally, in England and Wales, trusts were ways of avoiding the law against making a will. You transferred your property to another to the use of the beneficiaries and equity was prepared to enforce those trusts because they were not inconsistent with the law. Another reason in the thirteenth century was that landowners went off to the Holy Land to fight in the Crusades safe in the knowledge that their property would be properly looked after while they were away and if they did not return. Over the centuries, the law of trusts has spread to many countries and been used for a number of purposes, principally for conserving family wealth but also in commercial situations as well.

41. Second, it is striking how homogenous trust law is. That is why I have been able to cite cases from many different jurisdictions. Many countries recognise trusts. There may, of

course, be local differences due to legislation but, by and large, the principles are understood and held in common. There is also a network of practicing lawyers who keep in touch with each other and practice in one or more jurisdictions. This is helpful because trusts are often administered in one place when the proper law of the trust is that of another place. There has to be local learning in the place of administration and the judges there have to be familiar with the problems of trust law.

42. Third, it is apparent to me that practitioners in this field have to be very skilled at keeping all the balls in the air. For example, when all of a sudden a particular place becomes a popular home for substantial trusts (and this may happen in a very short space of time), the practitioners and judiciary in a jurisdiction may need rapidly to build up expertise to deal with the issues to which trusts give rise.
43. With those thoughts in mind, I welcome this event as providing an excellent opportunity for trust lawyers to get together and compare their views and get up to date. I thank you all for accompanying me on this short *tour d'horizon* of some of the problems that today are commonly met in this field.¹

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¹ The views which I express in this paper do not preclude me from considering the matter afresh should the matter come before me judicially.