

Resolution of family disputes and payments to non-beneficiaries - Y Trust [2015] JRC 059

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From time to time, trustees may find themselves caught up in family disputes relating wholly or partly to the assets that they administer. Of the militating family members, some may be beneficiaries, but some may not be. The prospect of an out-of-court settlement will usually be welcome news, but there may be complications if the settlement terms involve the trustee distributing assets in a way that confers a direct or indirect benefit on non-beneficiaries.

This is what happened in Y Trust [2015] JRC 059, where the Trustee sought to surrender its discretion to the Royal Court regarding the manner in which it should act in connection with hostile divorce proceedings. The case examines the right approach to be taken in such circumstances.

Background

The assets of the Trust principally comprised a family business. Historically, the Trustee had not interfered in the management of the business, leaving that up to the Husband. However, when it became apparent that the Husband and Wife's marriage was foundering the Trustee took steps to impose itself and ensure that it had proper control of the Trust assets. This involvement was not well received by the Husband.

The Trust Deed (which was somewhat unorthodox) provided for an "Appointer", with powers to appoint and remove the trustees. The Appointer was, according to the Trust Deed, to be rendered an excluded person. Whilst it had originally been intended that the Husband was to be a beneficiary, this was inadvertently compromised when he assumed the role of Appointer.

The other beneficiaries were the Wife, their children and their grandchildren (who were minors).

In the course of the hostilities, the Wife made applications to the Royal Court alleging that the Husband had been exerting too much influence over the Trust and its assets, such that he was benefitting personally to the prejudice of the beneficiaries. By contrast, the Husband alleged that the Trustee's actions in seeking to exert control over the Trust assets had caused him serious reputational damage.

Settlement

It was a complex and deeply acrimonious dispute, but one which the Husband and Wife eventually agreed to settle. The terms of the settlement included significant distributions for the benefit of the Wife and their children and also indirectly for the Husband. As mentioned above, the Husband was an excluded person because he was also the Appointer. Therefore, the Royal Court recognised a residual risk to the Trustee connected with distributions in favour of someone who was *prima facie* not entitled to benefit.

In order to remove this residual risk to the Trustee, the adult beneficiaries (the Wife and children) proposed that the Trust Deed be amended so that the class of beneficiaries became closed and limited only to them. Thus, the adult beneficiaries would represent the totality of the beneficial class and together be able to call for the termination of the Trust and associated distributions in accordance with the settlement agreement.

There were three areas for the Court to consider:

- Surrender of discretion;
- Fraud on a power;
- The position of the convened parties.

Surrender of Discretion

The Trustee had surrendered its discretion. The Royal Court confirmed it will only accept a surrender of discretion "*for good reason*", examples being where two trustees of the same trust are deadlocked or where the trustees are disabled by a conflict of interests [Re S Settlement [2001] JRC 154]. However, a trustee "*was not entitled to hand over performance of the trusteeship to the court*". A surrender of discretion was a "*last resort*" where "*no sensible alternative exists*". It operates to enable the Royal Court to act in a trustee's place by giving directions.

In this case, the Royal Court was satisfied that it was appropriate for the Trustee to surrender its

discretion. The main aim of the amendment to the Trust Deed was to remove the residual risk to the Trustee. Therefore, the Trustee had its own interest in the outcome of the matter, creating a conflict with its fiduciary obligation to act selflessly.

Although the Royal Court is often willing to assist a trustee faced with a difficult decision, careful consideration must always be given to the way in which the Royal Court's supervisory jurisdiction is called upon. If there is a conflict of interests then that conflict should be recognised, and discretion should be surrendered. However, a conflict façade should not be utilised as an excuse for a trustee to avoid taking potentially difficult and momentous decisions.

Fraud on a Power

A “*fraud on a power*” may occur where a trustee exercises its powers ostensibly in favour of a beneficiary. However, the trustee's real aim is actually to benefit a non-beneficiary or excluded person. In effect, the trustee uses the beneficiary as a conduit to give its actions the impression of legitimacy, knowing that the benefit will subsequently pass through to someone not-so-entitled. It is a unlawful device, the aim of which is to circumvent the restrictions on the way in which the trustee discharges its duties and powers.

The Royal Court in this case confirmed that in the right circumstances a trustee could make a legitimate distribution to a beneficiary, knowing that it will also indirectly benefit others. That much seems obvious, as the benefit of a distribution will rarely be felt in isolation, and will usually have a knock-on effect on others. For example, a distribution to a beneficiary will not automatically be impugned just because, in reality, the advantage might be felt indirectly by the beneficiary's spouse and children as well.

The test is the primary purpose of the trustee's actions. In this case there was indirect financial benefit to the Husband. However, the Royal Court held that the settlement would allow the Wife a “*clean break*” from the Husband, and to switch her focus from hostile litigation to spending time with her children and grandchildren. The Royal Court also noted that the underlying litigation had been a huge burden on her health, and that burden would now be lifted. The settlement was also for the benefit of the children, not only because they would receive significant distributions from the Trust, but also because it would lead to an end of “*the extraordinary haemorrhaging of the trust fund in litigation in various jurisdictions*”. It was these factors that comprised the primary purpose of the trustee's actions in making the distributions.

It is a reminder that often non-financial considerations will be just as important (if not more important) than pure financial ones. It also indicates that the Royal Court is likely to look favourably on, and will facilitate as far as possible, proposals that seek to bring to an end to long-running and attritional family disputes.

Convened Parties

It was clearly important to the Court that the positions of the convened parties were properly understood. It underlines the critical importance of ensuring that all parties who are required for the proper determination of any matter are given due notice. As mentioned above, there was a proposal to close the beneficial class so that it was limited only to the adult beneficiaries. This had the effect in practice of excluding minor beneficiaries (all of whom were issue of the adult beneficiaries). The Court was satisfied in this case that there were “*strong family bonds*”, such that “*the future of the grandchildren*” was secure. It was not a case where “*arrangements are intended to defeat the interests of those who cannot yet speak for themselves*”.

Fortunately, the position between the children and grandchildren in this case appears to have been sufficiently secure to allow the Royal Court to be satisfied that the former would look after the latter. Such security does not, however, always exist in this way throughout families.

In addition, the Trustee was able to bring its application urgently, presumably because the Wife had already made applications to the Royal Court (as mentioned above) and so the relevant parties had already been convened, were aware of the action and were armed with local legal support. Whether the Trustee could have mobilised so quickly without that head-start is questionable. Settlements in litigation can be reached suddenly and unexpectedly, requiring urgent action before impending trial or hearing dates. If a trustee wishes to seek directions from the Royal Court, and the Royal Court is not already seized of the matter, then there may be timing issues. A trustee will need to convene all relevant parties, some of whom may be out of the jurisdiction. There may be significant paperwork to review, and the need to appoint a *guardian ad litem* for the minors and unborns. All of this is expected by the Royal Court to ensure that the decision is properly considered. However it takes time, and perhaps more time than is available. In such circumstances, the trustee may be left having to take the decision without the benefit of judicial support, or perhaps only with the protection of a QC’s opinion.

Conclusion

This case provides useful guidance to trustees who find themselves caught up in family disputes, which ultimately settle on terms requiring them to exercise their discretion in ways which may benefit more than just the beneficiaries. It is clear that the Royal Court will aim to provide as much help as it can. However, the manner in which a trustee petitions the Court in such circumstances must be carefully considered.

Whether the primary purpose of the trustee’s proposed actions is the benefit of the beneficiaries will depend on the facts of each case. However, in general, the Royal Court has demonstrated that there may very well be significant benefit in the cessation of expensive, hostile and time-consuming family disputes – even if that means a non-beneficiary walking away with some of

the trust bounty.

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