

Substratum – what is it and do I need to worry about it?

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There has been debate between legal academics and trust practitioners about whether a power holder is prohibited from exercising powers of addition or exclusion of beneficiaries, or other analogous powers, when the proposed change is so significant that it has the effect of changing the basic purpose, or '*substratum*' of the trust. That is to say, the exercise of trust powers would result in an outcome closer to a fundamental change to the purpose of the trust itself than a simple variation, or addition or exclusion of beneficiaries.

This article considers recent authority on the so-called '*substratum*' principle, and in particular how those authorities might impact similar proceedings before the Grand Court of the Cayman Islands.

The '*substratum*' principle

The origins of the principle can be found in jurisprudence from the Courts of Equity, however the dicta of Megarry J in *Re Ball's Settlement Trusts* [1968] 2 All ER is often cited [at 442-443] "*if an arrangement changes the whole substratum of the trust, then it may well be said that it cannot be regarded merely as varying that trust*". Indeed, case law indicates that a valid variation to the trust's substratum would be better characterised as a revocation and restatement of the trust.

The substratum principle is inexorably linked with the doctrine of fraud on a power - that a power cannot be used for a purpose other than that for which it is given. For instance a power of amendment can only be exercised if the amendments (including changes to the beneficial class) could "*reasonably be considered to have been within the contemplation of the parties when the trust instrument was made, having regard to its nature and circumstances*" [1].

Bermuda

In *Grand View Private Trust Company Limited v Wong & Ors* (Civil Appeal No. 5A of 2019) the Court of Appeal for Bermuda considered a decision on an application for summary judgment on

a point of law given by Kawaley AJ as to the validity of a trustee's exercise of powers. While the facts of the dispute are complex (the Court of Appeal judgment extends to 144 pages) the core of the dispute was whether the trustee of an irrevocable discretionary family trust (the **Global Resource Trust** or **GRT**) could change the beneficial objects from natural person family members of the settlor to a Bermuda law Purpose Trust (the **Wang Family Trust**) which had no natural person beneficiaries, before appointing all of the assets to the latter trust.

The court at first instance found that the proposed variation and appointment of trust assets *"would prima facie constitute resettling the Trust assets on entirely new trusts and effectively revoking the original trusts altogether rather than merely amending or varying them"* [at ¶113]. The trustee of the GRT had no power under that trust to revoke it and resettle it on new terms for the benefit of the Wang Family Trust.

The trustee of the GRT appealed the decision. The Bermuda Court of Appeal heard the appeal over three days and Sir Christopher Clarke, President of the Bermuda Court of Appeal gave the leading judgment which found that there was no *"absolute rule which, whatever the terms of the power or the circumstances of the trust, prohibits the exercise of specific powers of addition and exclusion of beneficiaries from altering the substratum of the trust"* [at ¶85].

Grand View is subject to an appeal to the Judicial Committee of the Privy Council which was heard between 8 and 10 March 2022.

Jersey

In *Re Rysaffe Fiduciaries SARL* [2021] JRC230 (considered in depth in the [linked Ogier briefing](#)) a trustee administered two Jersey law discretionary trusts, and pursuant to their terms and letters or memoranda of wishes made around the time of their settlement:

1. the first trust (**G 2000**) provided residual benefit after the settlor's death to his wife and on the event of her death to "our children", construed as the settlor's biological children from previous relationships and his wife's biological children from a previous relationship; and
2. the second trust (**G 2008** - a discretionary trust historically governed by Cayman Islands law but changed to Jersey law in anticipation of the application) provided residual benefit after the settlor's death to "my children", construed as the settlor's biological children.

The settlor died unexpectedly, intestate, resulting in residual benefit passing to the respective individuals set out above. The trustees of the two trusts decided to agree a global settlement with the various groups of beneficiaries to settle outstanding indebtedness between the trusts as well as outstanding loans owed to the trusts by the settlor's estate. As a consequence of how loans were structured across both trusts, as part of a settlement the trustee considered it important that the settlor's widow be added as a beneficiary to the second trust (G 2008) for a limited time so that she could receive the benefit of the waiver of various loans owed by the

settlor's estate to that trust.

As adding the settlor's widow to the second trust was directly contrary to the settlor's intention for that trust at the time of its settlement, recorded in the letter of wishes, the trustee applied for a Court blessing before doing so notwithstanding that, importantly, all of the beneficiaries consented to the trustee's proposed course of action.

In light of the decision in *Grand View* the Royal Court considered the law relevant to the substratum rule, particularly as the trustee's proposed course of action would fundamentally alter the purpose of the 2008 Trust. The Deputy Bailiff ultimately determined that "*There is no substratum rule. It is unnecessary for such a rule to be adopted*" [at ¶49], and confirmed that the Royal Court would consider any limitations to the exercise of trustee powers under the relevant trust instrument and against the yardstick of proper purpose.

The position in Cayman

Although the Cayman Courts have considered the proper purpose principle in the context of fraud on a power^[2], there is limited jurisprudence to date in the Cayman Islands directly on the substratum principle. .

Some indication of the Grand Court's approach since the Bermuda Court of Appeal decision in *Grand View* emerged in the 18 February 2022 ruling of Mr Justice Kawaley (who now sits as a Cayman Islands judge), in the *Matter of the Poulton Family Trust*. In that case Kawaley J accepted that no reliance could be placed on his first instance decision that one cannot exercise a (similar) power in a way which is inconsistent with the substratum of the Trust^[3]. In the context of the Poulton case the matter was obiter^[4] and otherwise, the Grand Court has not had reason to consider the 'substratum' principle directly since the above authorities were handed down.

Conclusion

Until the Judicial Committee of the Privy Council delivers its judgment on *Grand View* it remains uncertain whether the substratum principle will become a more regular feature of trust law or be confined to the judgments explored in this article.

In either case, a trust power must be exercised for a proper purpose. It remains the case that, even if there is no distinct freestanding rule of law prohibiting powers of amendment, addition or exclusion of beneficiaries from being exercised in a manner which alters the substratum of a trust the key questions remain:

- (a) Whether the exercise of the power is within the terms of the trust instrument
- (b) Whether the trustee has given adequate deliberation to the exercise of the power; and

(c) Whether the power has been used for an improper purpose

Trust practitioners should bear in mind that even if the substratum rule is conclusively rejected, the parallels between considering the effect of the exercise of the power on the trust's substratum and analysing the true nature and construction of trust powers when considering the doctrine of *fraud on a power* are so similar it might make little practical difference.

[1] Lewin on Trusts 20th Ed. at 33-079.

[2] *Q Trusts* 2001 CILR 481, the court held that fraud by a trustee on a trust power or by the donee of a special power could be committed in three ways, namely (a) to benefit someone who was not an object of the power or on the understanding that a non-object would be benefitted thereby; (b) for a corrupt purpose; or (c) for a purpose outside the scope of the power.

[3] *In the Matter of the Poulton Family Trust* (unreported 18 February 2022) [592]

[4] *Kawaley J* stating that if he had been required to consider the wrongful exercise of power of exclusion/fraud on a power claim he would have dismissed it [para 593]

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