

## Power struggles: challenges based on capacity and undue influence

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A recent judgment issued by Kawaley J provides a detailed and helpful analysis on claims seeking to set aside an exercise of powers on the basis of a lack of capacity and undue influence in the Cayman Islands.

The judgment in *In the Matter of Poulton Trust* [1] will be of assistance to individual power holders, and those assisting or advising such persons, in seeking to: (i) assess potential deficiencies prior to a purported exercise of powers; (ii) take steps to protect a purported exercise of powers from challenge; and (iii) minimise the risk of costly litigation associated with a challenge to a purported exercise of powers.

*Re Poulton Trust* will also be of assistance to beneficiaries and trustees in assessing their rights, liabilities and obligations where a purported exercise of powers by an individual power holder has taken place and may be open to challenge on the basis of incapacity and/or undue influence.

Trustees will, for example, need to consider whether any active steps are required by them consistent with their duties to act in the interests of the beneficiaries. The beneficiaries may seek to take active steps themselves, particularly where their interests may have been prejudiced by any such purported exercise of powers.

### | Summary of facts

*Re Poulton Trust* relates to a purported removal of beneficiaries by a settlor in respect of a family trust governed by the law of the Cayman Islands. The beneficial class, from time to time, included the settlor (**Alan**), his wife (**Deborah**), his five children (the **Children**) and the Children's descendants.

In October 2015, Alan received a terminal cancer diagnosis, having been in declining health from early that year. The Children complained to the trustee of the trust that they were being denied access to Alan, and raised concerns about his mental capacity and Deborah's undue influence. The last time Alan saw any of the Children was in early August 2015. On 2 March 2016, Alan removed the Children and their descendants from the beneficial class of the trust (the **Removal**). Alan died on 6 June 2016.

The Children brought proceedings seeking to set aside their purported removal as beneficiaries, primarily on the grounds of either: (i) Alan's lack of mental capacity; or (ii) Deborah's undue influence.

In the event, the Court found that the Children's claims succeeded on the grounds of undue influence and failed on the grounds of Alan lacking mental capacity.

The Court's judgment provides a helpful summary and restatement of the law applicable to claims brought on the basis of a want of capacity and/or undue influence.

## **Capacity: legal test**

The first issue was whether Alan lacked the requisite mental capacity when he exercised the power to effect the Removal. The test for capacity is as set out in *Banks v Goodfellow*. [2] For a person to have the requisite capacity, that person must understand:

- the nature of the act and its effects
- the extent of property being disposed of
- the claims to which they may give effect

This continuing application of the *Banks v Goodfellow* test was common ground between the parties in *Re Poulton Trust*.

Kawaley J confirmed however that he would not apply the test in a mechanistic way, and paid due regard to the dicta in *Re Key*, [3] which recognised that the *Banks v Goodfellow* test:

- must be applied so as to accommodate other factors capable of impairing testamentary capacity, in a way which the Court may have found difficult to recognise in the 19th century
- is primarily about the mental capacity to understand or comprehend

In *Re Key*, the evidence of the experts showed that an affective disorder such as depression, including that caused by bereavement, was more likely to affect powers of decision-making than comprehension. It was noted, in that case, that a person in that condition may have the capacity to understand what his property is, and even who his relatives and dependants are,

without having the "mental energy" to make any decisions of his own about whom to benefit.

Interestingly, the Court in *Re Key*, and by extension the Court in *Re Poulton Trust*, appear to be widening the scope of the *Banks v Goodfellow* test for capacity by considering, in the application of that test, additional factors outside of the strict confines of understanding and comprehension (including "mental energy" and other factors that might affect decision making).

The Court in *Re Poulton Trust* acknowledged an overlap between the issues of "mental energy" and "will" on both the raised issues of capacity and undue influence, and declined to comment further on those issues in the context of capacity. The authorities, however, suggest fertile ground for a restatement or refinement of the *Banks v Goodfellow* test in future judicial consideration.

## | Capacity: analysis

Power holders, or those advising or assisting them, should look to carefully document and evidence the power holder's comprehension and understanding of the nature and effect of the purported exercise of powers. Relevant evidence will include email communications, phone notes and other memoranda, audio and/or video recordings proximate in time to the purported exercise of power.

However, as noted, the Courts are beginning to pay attention to factors outside of the strict confines of comprehension and understanding. Power holders and those advising or assisting them will want to be mindful of any pre-existing conditions and/or those arising from specific circumstances that may impact on decision-making such as bereavement or depression. In addition to the evidence listed above, contemporaneous medical or psychological evidence (and in special circumstances, two independent assessments) may assist to document the power holder's lucidity, comprehension and decision-making so as to safeguard exercises of power from challenge.

## | Undue influence: legal test

The second issue was whether the Removal should be set aside on the basis of Deborah's undue influence. For a claim based on undue influence to succeed:

- a presumption of undue influence must be established and
- that presumption must not be rebutted

A finding of misconduct is not required for a claim based on undue influence to succeed (on the part of the person said to be exercising undue influence).

## Presumption of undue influence

The Court, in *Re Poulton Trust*, referred to *Backlin v Dowsett* [4] for a summary of the applicable principles for triggering the presumption of undue influence. It must be shown that:

- the person entering into a transaction had reposed trust and confidence in another or they had acquired some ascendancy over the person entering into a transaction
- the transaction was not otherwise readily explicable by the relationship between those persons

## Rebuttal of presumption of undue influence

In order to rebut the presumption, the person seeking to do so must show that the transaction was not procured by an abuse of their position of influence but was rather the free exercise of the will of the other party as a result of full, free and informed thought. [5]

It is not sufficient for there to be a reasonable explanation for the transaction or that it was not manifestly to the donor's advantage. It must be proved that the donor had entered into the transaction of his or her own free will, independently of, and not in any way as a result of, the influence the other party was in a position to exercise over the donor.

## Undue influence: analysis

Persons seeking to exercise a trust power, or those advising or assisting them, are likely to have limited control over persons that may be deemed to have their trust and confidence, or are in "a position of ascendancy over them" (ie a position of influence, domination or control). However, in looking to protect an exercise of power, any such person may seek to protect that exercise by providing a robust and full explanation for that exercise, particularly where any such exercise could represent a departure from previous wishes. Contemporaneous documents (as referred to above) will be relevant to the Court's assessment on any such challenge and medical and psychological contemporaneous evidence could assist in assessing whether or not decisions were being made as a result of full, free and informed thought on the part of the decision maker.

## Conclusion

It seems likely that the role of individual power holders (whether a trustee, protector and/or settlor or some other power holder) will continue. Particularly in the context of family discretionary trusts, it is not uncommon for a settlor to seek to retain some element or control or influence over family wealth.

Succession provisions for individual power holders will often take effect on that person's death

(absent retirement or confirmation of incapacity). Prior to that, elderly, and potentially otherwise vulnerable, persons exercising trust powers are at risk of such powers being challenged, especially from a disenfranchised beneficiary, where beneficial interests are purportedly altered.

It falls upon the power holder, or those advising or assisting them, to pay attention to potential challenges and to properly document and evidence: i) the rationale for a particular exercise of powers ii) the comprehension and understanding of the power holder and iii) the circumstances leading up to and impacting upon the decision that was made. Alternatively, it falls upon those advising or assisting, (or associated persons, such as trustees or beneficiaries), to identify potential deficiencies in capacity and/or risks of undue influence arising at an early stage with a view to avoiding financial and emotional turmoil associated with costly litigation at a later stage.

While associated persons can (and should) grapple with these issues at the earliest possible juncture, we anticipate seeing an continuing trend of claims of the kind described in *Re Poulton Trust* passing through the courts. We are seeing an increasing industry focus on issues pertaining to mental health and are similarly conscious of an increasing level of technical competency on the part of trust beneficiaries, and a readiness of those persons to seek further advice on rights, duties and obligations within a trust context.

With established precedents such as in *Re Poulton Trust* and the common law, those advising or assisting the power holder or the person seeking to challenge the power holder, are adeptly placed to assist. However, the complexities and potential permutations of mental health conditions means that no two situations are the same, thus the role of the advisor and Court may be called upon often.

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[1] FSD 121 of 2016.

[2] (1869-70) LR 5 QB 549.

[3] [2010] EWHC 408 (Ch).

[4] [2004] EWCA 904.

[5] In *re Poulton* at 453, referring to *Gouldbourne v Gouldbourne*, Civil G0207 of 2014 at 114-115.

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