Seaton v Morgan

Jurisdiction:	Jersey
Judge:	J.A. Clyde-Smith, Jurats Le Brocq, Le Cornu
Judgment Date:	08 November 2007
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Text

[2007] JRC 206

ROYAL COURT

(Samedi Division)

Before:

J.A. Clyde-Smith, **Esq., Commissioner, and** Jurats Le Brocq **and** Le Cornu.

In the Matter of the Winton Investment Trust made on 29th November 2005.

And in the Matter of Article 51 of the Trusts (Jersey) Law 1984

Between
Seaton Trustees Limited
First Representor
and
Benedict John Morgan
Second Representor

Advocate A. J. N. Dessain **for the First Representor and the Second Representor**.

Authorities

Hastings-Bass and Others v Inland Revenue Commissioners [1975] 1 Ch 25.

Trusts (Jersey) Law 1984.

Dicey, Morris and Collins, The Conflict of Laws (19 th Ed'n).

In the matter of the Green GLG Trust [2002] JLR 571.

Sieff and Ors v Fox and Ors [2005] 1 WLR 3811.

In re Duxbury's Settlement Trusts [1995] 1 WLR 425.

Trustee Act 1925.

Barclays Private Bank & Trust (Cayman) Limited v Chamberlain and Ors [2004] 9 ITELR 302.

Friedman v Asiatrust Limited [2006] JRC 187.

Abacus Trust Co (Isle of Man) Limited v Barr and others [2003] Ch 409.

In Mettoy Pension Trustees Limited v Evans [1991] WLR 1587.

THE COMMISSIONER:

1 This is an application by Seaton Trustees Limited (the Trustee) to set aside certain agreements it had entered into in its capacity as trustee of the Winton Investment Trust (the "WI Trust") under the principle in the case of *Hastings-Bass and Others v Inland Revenue Commissioners* [1975] 1 Ch 25. A second application by Benedict John Morgan ("Mr Morgan"), who was the settlor of the WI Trust, to rescind the same agreements on the grounds of mistake, was left over.

2 The WI Trust is a discretionary trust governed by Jersey law. The beneficiaries comprise Mr Morgan (who was divorced) and his two named minor children whom he supports. In the particular circumstances of this case the Court was persuaded to dispense with an order appointing an advocate to represent the interests of the two minor children.

Background

3 Mr Morgan is an investment banker domiciled in the United Kingdom but during the

material time resident for UK tax purposes in Russia.

4 Mr Morgan was employed by an investment banking business based in Moscow which offered its employees a deferred compensation package providing "points" which could be surrendered for cash payments upon the occurrence of certain events. These rights were contained within certain agreements which we will refer to as the "Deferred Compensation Agreements", and which were subject to Isle of Man law.

5 In anticipation of the sale of the investment banking business, Mr Morgan took advice from the London office of PricewaterhouseCoopers ("the accountants") on the UK tax implications of his points. That advice focused on the income tax issues. In subsequent discussions with the accountants, it was proposed that Mr Morgan should transfer the points to a Jersey trust. On the 17 th November 2005, the Jersey Office of the accountants noted that no specific UK tax advice had been sought regarding the offshore structure and therefore sought confirmation from the London office that the proposed transfer would not result in any adverse tax consequences in the United Kingdom. The London office confirmed that the advice they had given to Mr Morgan in regard to "the UK tax implications of his points" would not change if the funds were directed to a trust. In so advising, the accountants failed to take into account the inheritance tax implications both to Mr Morgan and to the Trustee.

6 Under some pressure of time resulting from the impending sale, the WI Trust was created on 29 th November 2005 with an initial sum of £3,200 and on the same day the Trustee resolved to accept the points as an addition to the trust fund. That addition was effected by the Trustee resolving to execute two Novation and Assignment Agreements ("the Novation and Assignment Agreements") governed by Isle of Man Law under which "for good and valuable consideration" Mr Morgan with the consent of the relevant employer company assigned by way of novation to the Trustee his rights and obligations under the Deferred Compensation Agreements. The employer company released and discharged Mr Morgan from all claims and demands under the Deferred Compensation Agreements and accepted the Trustee in lieu of the liability of Mr Morgan.

7 Under the arrangements between the vendor and purchaser of the investment banking business, the latter did not take on any liability to pay former employees. The vendor therefore transferred into escrow funds sufficient to meet the sums due to the employees in relation to their points. A number of agreements were entered into by the vendor, the purchaser, the Trustee and the employees (and others) to reflect these arrangements namely an Escrow Agreement governed by English law and a Framework Agreement, a Contribution Agreement, Assignment and Assumption Agreements, a Contribution Agreement and a Release Agreement governed by New York law. We will refer to these agreements as the "Post Novation and Assignment Agreements".

8 In May 2006 Mr Morgan met with the accountants in London to seek advice as to how the WI Trust should be recorded in his UK Tax Return. During this meeting it became apparent

that a substantial inheritance tax liability had been triggered on the execution of the Novation and Assignment Agreements. Mr Morgan made it clear, not unreasonably, that had he been advised about the inheritance tax liabilities he would never have executed these agreements.

9 The advice of English counsel filed with the Court confirms that the transfer of the points to a discretionary trust was a transfer of value for inheritance tax purposes chargeable to tax at the rate of 20% to the extent that it exceeded the nil rate band (at the time of £275,000) and any otherwise unutilised annual exemptions. Because of grossing up the effective rate of tax will be 25%. The primary liability is on Mr Morgan but there is a secondary liability on the Trustee. If Mr Morgan were to die within 7 years then additional tax would fall on the Trustee. $4.5 million has been paid to the Trustee with a further approximately $1.2 million due to be received in 2008. The liability therefore to inheritance tax is substantial.

10 Whilst independent of the accountants, the Trustee had delegated to the Jersey office of the accountants the collation of the information relating to prospective new clients to ensure compliance with the Jersey Financial Services Commission codes, the relevant Jersey law and the Trustees' Client Acceptance Procedures. The documentation provided would include relevant due diligence, copies of tax advice, draft documents and a checklist for review. In this case the Trustee satisfied itself that tax advice had been obtained and that it was not adverse. The Trustee, through an affidavit filed by the director responsible for the WI Trust, has made it clear that if it had known of the inheritance tax liability it would never have resolved to execute the Novation and Assignment Agreements. In practical terms if such a liability was known to apply the Trustee would not have been invited to act as a trustee of a discretionary trust to receive the points although it was possible that an interest in possession trust might have been used instead.

Applicable law

11 The parties to the Novation and Assignment Agreements have agreed to the Royal Court dealing with this application and have consented to the relief being sought by the Trustee. However this leaves open the issue as to which law the Court should apply bearing in mind that the Novation and Assignment Agreements are expressed to be governed by Isle of Man law. Mr Dessain submitted that we should apply Jersey law for the following reasons:

(i) The WI Trust is governed by Jersey law and is therefore a Jersey trust for the purpose of the Trusts (Jersey) Law 1984 ("the Law"). The Court therefore has jurisdiction over the WI Trust pursuant to the provisions of Article 5 of the Law.

(ii) The relevant part of Article 9 (1) of the Law provides:

"Subject to paragraph (3), any question concerning ..... .

(b) the validity or effect of any transfer or other disposition of

property to a trust;

(d) The administration of the trust ... including questions as to the powers, obligations, liabilities and rights of trustees;

(e) the existence and extent of powers ... including powers of appointment and the validity of any exercise of such powers

shall be determined in accordance with the laws of Jersey and no rule of foreign law shall affect such question" .

He submitted that under Article 9 (1) (b) the Novation and Assignment Agreements undoubtedly constitute transfers of property to the WI Trust and the issue of their validity would appear to fall within the express wording of that Article. Whilst he did not think Article 9 was intended by the legislature to deal with this type of validity (rather to deal with issues such as forced heirship and anti-trust creation legislation), the words of the statute appeared clear and unambiguous.

Under Article 9 (1) (d) and (e) the actions of the Trustee in exercising its discretion to enter into the Novation and Assignment Agreements is part of the administration of the WI Trust and we are concerned with the validity of the exercise of its powers. Accordingly, he submitted that whether the Trustee's actions can be impugned is a question governed by Jersey law.

(iii) Whilst under Rules 203 and 206 of Dicey, Morris and Collins, The Conflict of Laws (19th Ed'n) the existence and validity of the contract, or of any term of a contract, are determined by the governing law chosen by the parties, the defect for which *Hastings-Bass* relief will be granted is a defect relating to the exercise of its discretion by the Trustee in resolving to enter into the contracts: the Court will interfere if it is clear the Trustee would not have acted as it did had it not failed to take into account considerations which it ought to have taken into account or had it taken into account considerations that it ought not to have taken into account. He argues that since the nature of the defects sought to be addressed in this application relates to failures arising out of the exercise of discretion by the Trustee, the issue is governed by the proper law of the WI Trust rather than the governing law of the contract which the Trustee seeks to set aside as a result of the exercise of its discretion. In effect the reason for setting aside the contract is as a result of some defect preceding the execution of contracts rather than defects in the contracts themselves.

(iv) The Trustee filed an opinion from an Isle of Man solicitor from which it is clear that Isle of Man law recognises the *Hastings-Bass* principle and would be likely to grant the relief sought so that in practice it made little difference if the *Hastings-Bass* principle was applied either under Jersey or Isle of Man law - it would produce the same result on the evidence available.

12 We agree that in applying the *Hasting-Bass* principle to a Jersey trust we should apply Jersey law. The principle operates within the domestic confines, so to speak, of the trust examining the processes by which the trustee arrives at its decision. What is not clear from

the authorities is the extent to which the principle could be applied where bona fide third party purchasers for value are affected. It would lead to uncertainty in our view in contractual dealings between third parties and trustees if agreements with trustees could be set aside, not on the grounds to which all contracting parties are subject such as say (in this jurisdiction) fraud, duress or mistake but on the ground of deficiencies in the internal decision making process of the trustee. We doubt therefore whether the *Hastings-Bass* principle could be invoked to the prejudice of such third parties. We doubt further whether this court, applying the Hastings-Bass principle under Jersey law, could set aside an agreement with third parties which is governed by foreign law. The issue does not arise in this case because the other parties to the Novation and Assignment Agreements have agreed to the remedy being sought by the Trustee.

Application of the Hastings-Bass Principle

13 The principle in Hastings-Bass as known under English law is equally a principle of Jersey law as was made clear in the case of *In the matter of the Green GLG Trust* [2002] JLR 571. A summary of the principle under English law can be found in the recent decision of *Sieff and Ors v Fox and Ors* [2005] WLR 3811, in which Lloyd LJ said:

> ***"119. I will however summarise the*** *Re Hastings-Bass* ***principle as I see it, as follows:***
>
> ***(i) The best formulation of the principle seems to me to be this.*** Where trustees act under a discretion given to them by the terms of the trust, in circumstances in which they are free to decide whether or not to exercise that discretion, but the effect of the exercise is different from that which they intended, the court will interfere with their action if it is clear that they would not have acted as they did had they not failed to take into account considerations which they ought to have taken into account, or taken into account considerations which they ought not to have taken into account .
>
> ***(ii) I have expanded the formula from that set out at paragraph 49 above to include expressly the proposition that the trustees are not acting under an obligation, so as to distinguish cases such as*** *Kerr v British Leyland (Staff) Trustees Ltd* ***and*** *Stannard v Fisons Ltd.* ***It is only in cases, such as those, where the trustees are obliged to act, that the "might" test applies.*** Stannard should not be treated as applying or endorsing the *Re Hastings-Bass* ***principle, but as being in the same line as cases such as*** *Kerr*.
>
> ***(iii) It does not seem to me that the principle only applies in cases where there has been a breach of duty by the trustees, or by their advisers or agents, despite what Lightman J said in*** *Abacus Trust Co (Isle of Man) v Barr*.
>
> ***(iv) His conclusion that, if the principle is satisfied, the act in question is voidable rather than void is attractive, but seems to me to require further consideration, in the light of earlier authority*** .

(v) I am in no doubt that, as a general proposition, fiscal consequences are among the matters which may be relevant for the purposes of the principle .

(vi) There are limits to what trustees have to consider in such a situation."

14 We note also his comments on the limits of the principle in paragraph 82:-

"82. I do not need to decide between "void" and "voidable" in order to decide this case: all Counsel agreed that nothing turned on that distinction in this instance. It seems to me, however, that on authority, the main ways at present open to the court to control the application of the principle are: (a) to insist on a stringent application of the tests as they have been laid down, (b) to take a reasonable and not over-exigent view of what it is the trustees ought to have taken into account, and (c) to adopt a critical approach to contentions that the trustees would have acted differently if they had realised the true position, perhaps especially so in cases (unlike the present) where it is in the interests of all who are before the court that the appointment should be set aside. As Park J said in *Breadner*, [2001] Ch at 543, ***in paragraph 61:***

"It cannot be right that whenever trustees do something which they later regret and think that they ought not to have done, they can say that they never did it in the first place.""

15 The first preliminary question that arises is whether the *Hastings-Bass* principle applies at all on the ground that the Trustee was accepting an addition to the WI Trust as opposed to acting under a discretion given to it under the terms of the WI Trust. English Counsel advised that under English law equity would not allow a trust to fail for the want of a trustee and if the trustee refuses to accept an addition to the trust equity will save the trust by appointing a new trustee. On that footing, there would be no scope under English law for any trustee discretion. If the addition to the WI Trust had been of cash or other freely transferable property or securities that might have been the case as the only legally operative act would be that of Mr Morgan as settlor rather than the Trustee as trustee. But as English Counsel pointed out in the present case the Trustee had to and did take the positive step of agreeing to be bound by the terms of the Deferred Compensation Agreements by entering into the Novation and Assignment Agreements under which for good and valuable consideration the Trustee took on certain obligations. We agree with English Counsel that the Trustee in this case did in fact act under a discretion and was not merely accepting an addition to the WI Trust.

16 The second preliminary question which arises is whether the principle applies to administrative as opposed to dispositive discretions. The cases under which the *Hastings-Bass* principle has been developed and expounded have been concerned, in the main, with the exercise of dispositive as opposed to administrative decisions and there is a hint in the English case law of some reluctance by the English courts to apply the *Hastings-Bass*

principle to administrative discretions. *In Re Duxbury's Settlement Trusts* [1995] 1 WLR 425, Rattee J declined to apply the doctrine to the appointment of a trustee under the Trustee Act 1925 Section 36. The first instance decision of Rattee J is apparently not reported separately and the Court of Appeal decision at page 427G records only that the judge " ***declined to extend [the rule in Hastings-Bass] to an appointment made under section 36 of the Trustee Act 1925***". The Court of Appeal did not have to consider the point and did not comment on the judge's conclusion or reasoning. No doubts were expressed on this point in the more recent cases of *Barclays Private Bank & Trust (Cayman) Limited v Chamberlain and Ors* [2004] 9 ITELR 302 (the Cayman court considering BVI law) under which the trustee's decision to accept a loan was declared voidable and *Friedman v Asiatrust Limited* [2006] JRC 187 (the Jersey court considering Cook Island Law) under which the sales of interests in certain companies were set aside. In the view of English Counsel he would not expect the English courts to limit the principle to dispositive discretions if the point were raised and argued fully before the English courts. The issue has not been argued before us but we cannot see any reason in principle to distinguish between dispositive and administrative discretions. The application of the principle is dependent on whether the trustee is acting under a discretion in circumstances in which it is free to decide whether or not to exercise that discretion and not upon an analysis of the nature of that discretion.

17 On the question whether it is sufficient that trustees "might" have acted differently or whether it must be shown that they "would" have done, so the view as expounded above by Lloyd LJ is consistent with that expressed by Birt, Deputy Bailiff, in *Green GLG* case at paragraph 28:

> ***"It is clear that the limits of the principle are still to be developed.*** As you have observed earlier, it is certainly not every decision by trustees which they later come to regret that can be declared void. In particular, there was some discussion in the English cases as to whether, before declaring a decision void, the court has to be satisfied that the trustees would not have taken the decision if they had known the correct facts or whether it is sufficient that the trustees might have come to the same decision. It is not necessary for us to resolve this difference in the present case because of our decision that, on the facts of this case, the higher test is met; but we incline to the view that "would" is the correct test rather than "might" and we note that that was the word used by Buckley LJ in *Hastings-Bass* itself".

18 This is similarly not an issue that this Court has to resolve because it is satisfied that the "would" test has been met. In our view it is clear that the Trustee would not have executed the Novation and Assignment Agreements if it had appreciated the true tax position.

19 As mentioned above it is not clear that the Hastings-Bass principle could easily be applied where a *bona fide* third party purchaser for value is affected. In this case the Trustee, having acquired the points under the Novation and Assignment Agreements, then entered into the Post Novation and Assignment Agreements to which, *inter alia*, numerous

employees were party. The Court requested and the Trustee provided opinions from both English and New York counsel both of whom have confirmed that, under the laws of their respective jurisdictions to which these agreements are subject, the rights of the other parties to the Post Novation and Assignment Agreements would not be adversely affected if the Novation and Assignment Agreements were set aside. In essence they advise that the obligations under the Post Novation and Assignment Agreements are purely contractual and as the WI Trust does not have legal personality, must have been entered into by the Trustee against whom the other parties retain their rights. The fact that the agreements indicated that the Trustee was acting as trustee would not be sufficient to limit the Trustee's liability to the assets of the WI Trust and to preclude the other parties from having recourse against its own assets. To the extent that the other parties rely on the assets of the WI Trust to back the obligations of the Trustee, they will still be available for that purpose. The Trustee will continue to hold as trustee albeit as bare trustee for Mr Morgan as opposed to trustee of the WI Trust and will have the same lien over the underlying assets as it would have had in the later capacity. Neither could either counsel see that setting aside the Novation and Assignment Agreements could affect in any way the validity and effectiveness of the Post Novation and Assignment Agreements. In the view of New York counsel the situation might be less clear if the Post Novation and Assignment Agreements were to be rendered void *ab initio*. In that eventuality the Trustee would not have been the legal owner of the points on the date of the agreements and would have lacked valid agency authority from Mr Morgan and its statement to the contrary might constitute a misrepresentation providing a basis for a claim for rescission. Even so in his view a claim in rescission would fail. Following the approach of Lloyd LJ in *Sieff v Fox* we are able to avoid the issue of whether the decision of the Trustee is rendered void or voidable by setting aside the decision and declaring it to be of no effect. We are satisfied therefore that the rights of the other parties to and the validity of the Post Novation and Assignment Agreements will not be affected if the Novation and Assignment Agreements are set aside.

20 The decision of Lightman J in *Abacus Trust Co (Isle of Man) Limited and another v Barr* [2003] Ch 409, not mentioned in previous cases, that it is necessary to find some fault or breach of duty on the part of the trustee has, we understand, been much criticised and, as can be seen above, was doubted by Lloyd LJ in *Sieff v Fox*. We have not heard argument on the matter but if it is a prerequisite then it is clear from the judgment of Lightman J that a breach of duty can be attributed to the trustee even if the fault is that of the trustee's professional advisors or agents. In giving the confirmation as to the tax position the London office of the accountants were acting as professional advisers to the trustee through the trustee's agent, the Jersey office of the accountants. We are satisfied therefore that the professional advisors to the Trustee were at fault and that the higher test is therefore met.

21 In *Mettoy Pension Trustees Limited v Evans* [1991] WLR 1587 Warner J set up three questions that the court should ask itself when considering the principle in *Hastings-Bass*:

(i) What were the trustees under a duty to consider?

(ii) Did they fail to consider it?

(iii) If so what would they have done if they had considered it?

22 Taking each of these questions in turn and on the basis of the evidence before us:

(i) As Lloyd LJ made it clear in *Sieff v Fox* (supra) the tax consequences of trustees decisions are in general relevant. In this case and bearing in mind the UK domicile of Mr Morgan, it must have been relevant for the Trustee to consider the UK tax implications of the transfer of the points both to Mr Morgan and to the Trustee as evidenced by the Jersey office of the accountants seeking confirmation from the London office of the accountants.

(ii) The Trustee did not take into account the inheritance tax implications both to Mr Morgan and to the Trustee because the advice received from the London office of the accountants was deficient in that respect.

(iii) The Trustee would not have resolved to enter into the Novation and Assignment Agreements if it had appreciated the true tax position. Indeed if the true position had been appreciated the Trustee would not have been invited to act as trustee.

23 Consistent with the approach of the English court in *Sieff v Fox* and the Jersey Court in *Friedman v Asiatrust Limited* we will avoid the issue of whether the decision of the Trustee should be regarded as void *ab initio* or simply voidable by setting aside the decision and declaring it to be of no effect

24 It is in the interests of those before the court that the decision of the Trustee be set aside and we have heard no argument to the contrary. Consistent with his duty Mr Dessain has considered arguments he could think of for saying that the principle should not be applied. An alternative to applying the principle would be for the matter to be settled by litigation between Mr Morgan, the Trustee and the accountants, a suggestion that did not as a matter of policy attract the court in the case of *Green GLG*.

25 Mr Dessain did draw to our attention HM Revenue & Customs Tax Bulletin article (TB 83 June 2006) which had been provided by HM Revenue & Customs ("HMRC") which had been informed of the application. In that article, HMRC argue that any positive formulation of the principle should state that the court "may" interfere with the trustee's decision not that it "will" do so and that the effect of the principle, if applied, should be to render decisions voidable not void. They tentatively suggest that the principle as it develops should be assimilated with the general principles of law by which decisions of trustees may be impugned and the voluntary decisions of trustees to be set aside for mistake. They agree with Lloyd LJ in *Sieff v Fox* that the relevant test is whether the trustees "would" have acted differently not "might" have done so and that breach of duty is not a requirement. Thus far none of these arguments impact upon our approach to the matter save that they do go on to argue that, whilst accepting that fiscal consequences are generally matters trustees should take into account, there should be a distinction between cases where the trustees fail to

take into account fiscal considerations at all and cases where they take steps to obtain advice and that advice turns out to be to be wrong. In the latter case they feel that the principle should not apply. We decline to make such a distinction which is based presumably upon the policy that where there are tax advisors who have advised incorrectly, the Trustee should suffer the tax consequences and pursue its remedies against the tax advisors. This is the same suggested policy which the court rejected in *Green GLG* and we see no reason to depart from that.

26 We therefore set aside the Novation and Assignment Agreements and declare them to be of no effect. We further declare that the funds received by the Trustee under the Novation and Assignment Agreements, any investments made with the proceeds thereof and any income arising thereon and any funds which the Trustee may receive in the future under the Post Novation and Assignment Agreements are and shall be held by the Trustee as bare trustee for Mr Morgan.