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Scope creep: deleting beneficiaries' interests in the name of cost-efficiency?

Aidan Briggs*

Abstract

The *Re Benjamin* jurisdiction has been given a new and unexpected lease of life by recent developments in the administration of insolvent financial institutions following Lehman Brothers. But are such developments based on sound principles, or does the practice of the court provide adequate protection for the interests of beneficiaries?

It is well established that the court may make an order authorising trustees to act on a particular set of assumed facts without actually determining them. Classic examples of such facts are that a person did not survive the testator, that a person is no longer of child-bearing age or that there are no further members of a class to be found. These are often referred to as 'Benjamin orders' after *Re Benjamin* [1902] 1 Ch 723. The basis for such orders was "evidence of the practical impossibility of proof of the fact or event sought to be established"; it was principally directed to issues of practicality, where full investigation of the facts would be disproportionately expensive or for other reasons impossible.

Such an order does not determine any facts or indeed bind any parties to the trust; it simply protects the trustees from acting in breach of trust—*Re Green's Will Trust* [1985] 3 All ER 455. The same is true of the statutory power to authorise trustees to act on counsel's opinion under s.48 of the Administration of Justice Act 1985. If a beneficiary whose demise had been presumed subsequently emerges, their rights are preserved and they are entitled to follow the trust property into the hands of the recipients in a *Re Diplock* action—*Re Evans* [1999] 2 All ER 777. These days, thanks to technology and the increasing effectiveness of tracing agents, genuinely 'missing' beneficiaries are a rare thing; in those cases, an application under the Presumption of Death Act 2013 may be more convenient and give more finality. For this reason, the courts have generally encouraged trustees to restrict applications under either the *Re Benjamin* or s.48 jurisdictions to cases in which there is no substantial dispute between the relevant parties—*Greenwold v Pike* [2007] EWHC 2202 Ch.

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Under the provisions of the Client Assets Sourcebook (CASS), regulated firms such as stockbrokers receive

* Barrister, New Square Chambers, London, WC2A 3SW, UK. Tel +44 (0)20 7419 8000; Fax +44 (0)20 7419 8050; Email: aidan.briggs@NewSquareChambers.co.uk

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and hold client money on trust. CASS 7.7.2 R provides (so far as relevant) as follows:

> A firm receives and holds client money as trustee . . . . on the following terms:
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> 1. for the purposes of and on the terms of the client money rules and the client money distribution rules;
> 2. subject to (4) for the clients . . . for whom that money is held, according to their respective interests in it;
> 3. . . . .
> 4. for the payment of the costs properly attributable to the distribution of the client money in accordance with (2) if such distribution takes place following the failure of the firm; and
> 5. after all valid claims and costs under (2) to (4) have been met, for the firm itself.

In the event of the failure of a firm (usually triggered by a supervisory notice from the Financial Services Authority), the client money distribution rules in CASS 7A are engaged. The practical consequence of this is that any remaining client money is treated as pooled, and clients' individual entitlements to their specific funds are replaced with a claim on the pooled fund. The firm immediately comes under fiduciary obligations to distribute the fund "so that each client receives a sum which is rateable to that client's money entitlement" as calculated in accordance with CASS 7 A.2.5R. In most cases, the directors of the firm promptly apply for an investment bank special administration order by which administrators are appointed to carry out this task.

To give some sense of the scale of this task, it is useful to look at the facts of some of the cases. As Briggs J put it in *Lehman Brother International (Europe) (In Administration)* [2009] EWHC 3228 (Ch): "In an ideal world, the flawless operation of the scheme created by the CASS 7 rules would ensure first, that the clients' money could not be used by the firm for its own account and secondly, that upon the firm's insolvency, the clients would receive back their money in full . . . In the imperfect and hugely complex real world occupied by [Lehman Brothers] and its numerous clients, there has . . . been a falling short in the achievement of both of those objectives on a truly spectacular scale." In that case, there were claims exceeding $3 billion on a fund of only $2.16 billion. In *Re Worldspreads Ltd* [2015] EWHC 1719 (Ch), the anticipated distribution from the pooled fund was in the region of 10.3 pence in the pound.

Aside from mere difficulties of scale, particular administrative difficulties with distributing client funds arise in such cases where there are either (a) clients whose claims are rejected in whole or in part, but have yet to issue any proceedings or (b) clients who simply fail to respond to an invitation to make a claim. Many of these clients' interests are such that it is wildly disproportionate to pursue them on an individual basis; in *Re Pritchard Stockbrokers* [2019] EWHC 137 (Ch), for example, there were considered to be 1839 clients entitled to a sum of £1 or less.

Unfortunately, there is no scope for schemes of arrangement in relation to proprietary claimants—see *In re Lehman Bros International (Europe) (No 2)* [2010] Bus LR 489—but in that case, Lord Neuberger MR gave strong judicial encouragement to a *Re Benjamin*-style solution: "I hope, indeed I would expect, that, if the administrators decide to make an application under the Trustee Acts or pursuant to the court's inherent equitable jurisdiction, in relation to dealing with beneficiaries' rights, the court will provide effective assistance, by arriving at a practical and fair outcome, while ensuring that delay and costs are kept to a minimum."

Welcome as such judicial encouragement might be for those faced with such difficulties, it sits uneasily with the role that Benjamin orders have traditionally played in the administration of trusts, as set out above. The court does not, in principle, "deal with beneficiaries' rights" at all. A Benjamin order will not usually be appropriate where there are intimated claims on the estate which remain outstanding. However, in the last 60 years, there has been a degree of "scope creep" in this area. In *Re Gess* [1942] Ch 37, the court authorised executors to distribute an estate known to have creditors overseas without advertising for claims in Poland, because of the impracticability of advertisement in Poland during German occupation. The likely claims of creditors deferred to the practical necessity of administration.

Neuberger's encouragement was taken up in *Re MF Global UK (No.3)* [2013] EWHC 1655 Ch. Of the 5345 claims on the pool, 3275 had been fully agreed, 268 had been rejected and the remainder had not yet been finally determined. The administrators of MF Global applied to the court for directions authorising interim and final distributions of funds held in the client pool on the basis that (a) the only persons with a claim to client money were those who had lodged a claim by the bar date and (b) any claimants whose claims were rejected and who did not issue proceedings to challenge the rejection by a set date had no claim. An intricate procedure was proposed for advertisement and handling of claims, closely adapted from the insolvency rules. David Richards J began by noting that, assuming the court had jurisdiction to make the order, it was clearly in the clients' best interests that it be made.

In considering whether the court had jurisdiction to make the order, David Richards J accepted that the proposal to distribute without providing for known, but disputed, claims was outside the existing scope of the *Re Benjamin* jurisdiction. However, he did not consider that this constituted a barrier: "If such orders can be made in the context of third party claims to the trust property, I can see no reason in principle why such orders cannot also be made in the context of rejected claims to a beneficial interest. There is no fundamental distinction between the two categories of claims in this context." The expansion of the jurisdiction was justified by the need for practical effect to be given to the trust, and clients' interests in receiving their money promptly.

The principal authority relied upon in pursuit of Neuberger's encouragement was the court of appeal decision in *Finers v Miro* [1991] 1 WLR 35. The plaintiff firm held client funds on trust for their client, but there was a potential proprietary claim by a third party, the liquidator of a company apparently defrauded by the client. Balcombe LJ felt bold enough to state without reference to authority "In my judgment the court undoubtedly has jurisdiction to authorise payment out by a trustee who, as in this case, *prima facie* holds his assets on trust for a named person absolutely, although with the possibility that there may be other persons interested in those assets."

However, it is important to note the extent to which that broad proposition was qualified in the actual case, and how the facts may be distinguished from the scenario in *MF Global*. First, the liquidator was not even aware that the fund existed and had made no direct claim to the trustees. Contrast that position with a known client having made a disputed claim, but failing to issue proceedings by the bar date. Second, the court only authorised the distribution of a relatively small sum (the report does not reveal the total value of the fund) to fund the beneficiary's legal representation, leaving the remainder intact for the benefit of the potential claimant, whereas *MF Global* authorised a final distribution of the fund. Third, the court not only required the balance of the fund to be held back, but also authorised the trustees positively to notify the potential claimant of the fund, notwithstanding client privilege. Looked at in the round, the judgment hardly supports trustees being authorised to distribute funds in the face of known claims. What little distribution was authorised appears to have been based more on practicality than principle.

A further development has taken such cases beyond the scope of the *Re Benjamin* jurisdiction. The Financial Conduct Authority has power under s.138A of the Financial Services and Markets Act 2000 to give a direction which effectively varies the statutory trusts on which client money is held. The result of such a variation is that if certain conditions are met, beneficiaries' interests are extinguished entirely. The trustees then apply to the court for approval of the decision to seek such a modification—this has become known as an *Alpari* order after the judgment of Newey J in *Re Alpari* (unrep) 29 September 2016, as explained in *Re Pritchard Stockbrokers* [2019] EWHC 137 (Ch). As noted above, *Re Pritchard Stockbrokers* was peculiar for the number of low-value claims, and part of the order made was to introduce a *de minimis* threshold of £6.10 below which clients would be treated as having no interest. Giving judgment in that case, Norris J was at pains to emphasise the meticulous and time-consuming steps gone through by the special administrators in order to reduce the unagreed claims to an "unresponsive rump" constituting 22% by numbers, but only 3% of total claims by value.

He concluded that "Many of the outstanding individual claims are so small that the view may properly be taken that the unpursued claims are abandoned. In relation to claims of more substance the view may properly be taken that the need for finality is much greater than the need to preserve hitherto unpursued claims. Those who now receive a final distribution are entitled to regard it as their own (and not exposed to some claim to follow or trace into it by a hitherto unresponsive client). It is undoubtedly time for the book to be closed."

Norris J also set out the factors which the court should consider in deciding whether to approve such applications:

a. the exact nature and scale of the problem facing the special administrators in relation to a final distribution by the trustee company of the client money it holds on trust;
b. the precise steps that the joint administrators have caused the company to take in order to identify clients and quantify individual claims, and what the results are;
c. that every reasonable step has been taken to effect a distribution to each of those entitled having regard to (i) the size of the claim, (ii) the cost and difficulty of investigation, (iii) where that cost burden falls and (iv) the need to ensure the return of client assets to all clients as soon as reasonably practicable (so that a distribution notwithstanding imperfect knowledge is the appropriate course);
d. the details of the proposed distribution mechanism and what steps are to be taken in relation to those who will not receive a distribution; and
e. if the statutory trusts are to be modified, then why the extinguishment of beneficial interests is to be preferred over a distribution on a particular footing which preserves those beneficial interests (i.e. why an *Alpari* order is to be preferred over an *MF Global* order).

The practical and utilitarian attractiveness of such orders is hard to dispute. However, this recent expansion of the court's jurisdiction raises some troubling questions and the potential for an unwelcome relaxation of the rules concerning beneficiaries' interests in the trust.

First, the justification relied upon in several of the *MF Global* style judgments was that the beneficiaries' interests would not be extinguished, and they retained the ability to follow into the hands of other recipients if necessary in a *Re Diplock* claim. Such a claim is both legally and practically questionable; where the whole basis of the order is the impracticability for the administrators of individually contacting and litigating with every client, it will *a fortiori* be impracticable and disproportionately expensive for an excluded beneficiary to pursue thousands of recipients, each for a minute share of the sums owed to them. Moreover, in *MF Global*, it was noted that each of the 'agreed' clients had entered into a proforma 'settlement agreement' before receiving their distribution. It would appear, therefore, that each of them was likely to be a purchaser for value, rather than a volunteer, and therefore insulated from any *Diplock* claim. Clients subject to the *Alpari* and *Pritchard Stockbrokers* orders were directed to the Financial Services Compensation Scheme, which is likely to be liable to compensate at least some of the affected beneficial class, but compensation would not be available to non-natural persons or those outside the jurisdiction.

Second, in none of *MF Global*, *Alpari* or *Pritchard Stockbrokers* were any of the affected beneficial class represented, despite the seismic effect of the orders on their interests. In the ordinary course, an application for *Public Trustee v Cooper* relief would require all affected parties to be joined or represented. Even in the more limited *Benjamin* jurisdiction, one would expect affected beneficiaries at least to be served with the application. No explanation appears from the judgments as to why this was considered unnecessary. In *MF Global*, the total value of the claims of missing or disputed clients was £340 million, so it could hardly be said that it would be disproportionate for their interests to be represented.

Given the immense cost savings and practical utility of the orders made in these cases, it might be suggested that the ends justified the means, but the author would question whether such a radical departure from the basic principles of trust litigation has opened a worrying crack in the court's supervisory jurisdiction into which unscrupulous litigants may yet attempt to apply a lever to their own ends.

Aidan Briggs *is a barrister and mediator at New Square Chambers specialising in contentious trusts, probate and real property disputes. He is a contributor to Williams Mortimer & Sunnucks on Executors, Administrators and Probate (21st edn) and an Associate Editor of Lewin on Trusts (20th edn). E-mail: aidan.briggs@NewSquareChambers.co.uk.*