

Thoughts on future trust law developments

Justice David Hayton*

Abstract

Many foreign trust laws provide ‘firewall’ protections for trust property and strengthen the settlor’s position at the beneficiaries’ expense. They also provide more flexible liberal parameters for a trust than permitted under traditional trust laws. Will there not be an increasing choice of foreign laws by settlors and even increasing changes from one governing trust law to another (under an express power in that behalf) so as to exploit the advantages of such laws? The future for arbitration of internal trust disputes and enforcement of awards is, however, very cloudy, due to Article 6(1) of the Human Rights Convention and Article V(2)(a) of the New York Arbitration Convention. Does English law on rectification not need clarification and development in light of foreign laws and can a foreign law be used to avoid limitations under English law?

When I started out in practice in Lincoln’s Inn in 1970, having first commenced teaching trusts at Sheffield University in 1966, we trust practitioners were focused on English trust law governing English trustees running trusts for English beneficiaries or English charitable purposes. A very few tax and trust practitioners, however, for tax minimization reasons helped to set up trusts with trustees resident in offshore British Dependencies or Overseas Territories with a trust law that was basically the same as English trust law. The Cayman Islands, however, had legislation in the 1960s (inspired by

Milton Grundy) providing for ‘exempted trusts’, registered with the Registrar of Trusts, where all the rights and remedies that the beneficiaries would otherwise have been vested in the Registrar, the beneficiaries having no rights or remedies against anyone.¹ This enabled English taxes to be avoided till blocked by the Finance Act 1969.

However, civil law notaries and civil law commercial lawyers were becoming increasingly aware of the use of English trusts to provide for a testator’s property situate in civilian jurisdictions after his death and to provide ring-fenced financial arrangements in such jurisdictions. Pressure from these notaries and lawyers led countries to have The Hague Conference on Private International Law take steps for the preparation of a convention on recognition of trusts in civil law and other countries.

Having developed Underhill on Trusts in its 13th edition in 1979, I was invited by the Lord Chancellor’s Department to attend the first meeting in June 1982 of a Special Commission to prepare a draft Hague Trusts Convention. Civilian lawyers then expressed a desire for the Convention only to apply to ‘good international trusts’ but not ‘bad’ ones! Of course, like the use of companies or knives, it all depends on whether the user is a good or bad person. Anyhow, the Convention came into effect in 1985 and was incorporated into UK law by the Recognition of Trust Act 1987.

It was then considered very peripheral by most English trust lawyers, who considered other jurisdictions’ trust laws inferior to, and more old fashioned than, English trust law. The Cayman Trusts (Foreign

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1. Now found in s 83 Cayman Trusts Law 2011 Revision.

Element) Act 1987 (inspired by Antony Duckworth, later responsible for Cayman STAR trusts in 1997), however, was a catalyst for dramatic developments in the trust laws of offshore and some mainland jurisdictions. Such trust laws have become much more flexible than English trust law and have strengthened not only the protection accorded to the ring-fenced trust property but also the settlor's position at the expense of beneficiaries' rights. Many trust lawyers have therefore become comparative lawyers and recognized significant possibilities within the cloak of the Recognition of Trusts Act.

Indeed, choice of a foreign governing law can be supported by exclusive trust jurisdiction clauses, whether to ensure that a court will have the necessary expertise if litigation arises or to make it more difficult or expensive to litigate in a distant country, particularly if it requires security for costs from non-local litigants. It is my belief that more use of a foreign governing law and of changes of governing law to a more flexible foreign governing law will be a feature of future developments in the practice of trust law for wealthy clients justifying bespoke trusts. A little knowledge, however, can be dangerous as there may be some pitfalls that should not be overlooked, as will be discussed below.

As it happens I have just learned of a 2015 empirical study by Professor Adam Hofri-Winogradow of the Hebrew University of Jerusalem and the University of Connecticut² that was based upon responses to questionnaires of 409 trust service providers, having emailed 26,605 addressees identified as such potential providers. Essentially, 76 per cent of respondents were based in onshore jurisdictions, 17 per cent in offshore jurisdictions, the rest based in both.

As to be expected, responses revealed that the availability under offshore trust systems of features unavailable at home is the primary reason for using

such systems, with tax advantages a subsidiary feature. It was also clear that the wealthier the client the more likely that there would be a choice of a foreign governing law, estimated to occur in about 36 per cent of trusts, while 70 per cent were estimated to include trust jurisdiction clauses.

It is not what you do but how you do it

Choosing a foreign governing law

Research into offshore jurisdictions' trust laws and those of some States in the USA reveals how, over the last twenty-five years or so, such laws have increasingly been liberalized so as increasingly to make them very different from English or other main traditional trust law jurisdictions.³ Thus, ends that cannot be achieved if English law governs a trust may well be achievable by an express choice of law of another jurisdiction to govern the trust as permitted by the Recognition of Trusts Act 1987.

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Other jurisdictions have more liberal rules eg as to the perpetuity rule against remoteness of vesting of beneficial interests, the rules against non-charitable purpose trusts, the rule in *Saunders v Vautier*, the rule against self-settled spendthrift trusts, the extent to which dispositions can be set aside under the rule in *Hastings-Bass*,⁴ the extent to which documents can be rectified,⁵ the extent to which beneficiaries' rights may be limited directly or indirectly,⁶ the extent to which beneficial interests may be varied,⁷ the extent to which trustees will not be personally liable for

2. 'How Harmful is Trust Proliferation?' Available at SSRN via <<http://ssrn.com/abstract=262914> or <http://dx.doi.org/10.2139/ssrn.2629174>> last accessed 1 June 2016

3. See A Hofri-Winogradow, 'The Stripping of the Trust: From Evolutionary Scripts to Distributive Results' (2014) 75(3) Ohio State L J 529–70.

4. As in Jersey and Bermuda.

5. *Fairmont Hotels Inc v Att Gen of Canada* [2015] Ontario CA 441, *Juliari v Att Gen of Canada* (2000) 50 OR (3d) 728 Ont CA; USA Uniform Trust Code ss 415 and 416.

6. Non-assignable life interests, limited rights to information eg Bahamas Trustee Act 1998 s 83 as amended.

7. Bermuda's Trustee Act s 47.

external dealings as trustees with third parties,⁸ the extent to which internal trust disputes may be resolved by arbitration or mediation.⁹ Offshore jurisdictions also have extensive ‘firewall’ protections for trust assets against claims by creditors, heirs and divorcing spouses and against enforcement of foreign judgments, though the laws of such jurisdictions cannot have extraterritorial effect in respect of ‘attackable’ foreign property.

Nowadays, there normally ought not to be fears about choosing a foreign trust law to govern a trust with significant English elements, though in extreme cases English public policy could intervene eg in relation to English property in a trust of property settled on protective or spendthrift trusts for the settlor himself.

Apart from such extreme cases, if worried whether there might be a problem when all elements are English but for the choice of a foreign Trustopian trust law permitting provisions that are impermissible under English law, one can start out with a Trustopian trust that is wholly or substantially Trustopian, comprising Trustopian trustees and beneficiaries and some Trustopian and other property. It can then accumulate income except for the odd small distribution to a Trustopian charity under a power in that behalf. A year or so later powers to add and delete beneficiaries may be exercised so that new elements are grafted on to the trust so that the elements become wholly or substantially English, but the trust remains a valid Trustopian trust. Its validity cannot be affected by virtue of substituting English assets for its Trustopian assets or substituting English beneficiaries or trustees for Trustopian beneficiaries or trustees. This leads to the consideration that if you can achieve this end result indirectly, why should you be prevented from achieving this directly?

Once a valid Trustopian trust always a valid Trustopian trust until the governing law is replaced pursuant to power in that behalf, though under Article 18 of the Trusts Convention incorporated in

the Recognition of Trusts Act 1987, ‘The provisions of the Convention may be disregarded when their application would be manifestly incompatible with public policy’. This would require an extreme case, like that of self-settled spendthrift trusts or a case where the purposes of the Trustopian trust were legal in Trustopia but criminal in England or infringed fundamental human rights.

It is also sensible in the case of Cayman STAR trusts for beneficiaries who have no rights at all unless appointed an enforcer, to ensure that there is at least one beneficiary appointed as an enforcer, so as to oust any possibility of a resulting trust for the settlor, with the trustee authorized to make distributions to the beneficiaries until the settlor revokes this authority or dies. An alternative analysis ousting a resulting trust suggests that the trustee has legal beneficial ownership like the executor of a deceased testator, *but* the settlor is alive and so can retain beneficial ownership. Moreover, the executor owes equitable duties to the will beneficiaries who can enforce against him their right to what is due to them under the will, *but* a STAR trustee owes no duties to the beneficiaries who have no locus standi to enforce the trust unless appointed an enforcer.

VISTA trusts created under the BVI Special Trusts Act 2003 (as amended) are also very attractive. They avoid the possibility of trustees’ liability under *Bartlett v Barclays Bank Trust Co Ltd*¹⁰ for failure adequately to monitor the conduct of directors of companies owned by the trustees and so intervene where necessary. VISTA trusts are thus very useful in enabling the management of companies to be carried out by the directors free from interventions of the trustees except where permitted by the trust instrument eg where the company is a trading company or an investment company where the settlor wishes to run the company himself or via persons he considers more skilled and knowledgeable than the trustees (so making trustees’ insurance much cheaper than otherwise would be the case).

Thus I foresee more use being made by knowledgeable English trust lawyers of the choice of law

8. See Trusts (Jersey) Law Art 32, Trusts (Guernsey) Law s 42 and *Investec Trust (Guernsey) Ltd v Glenalla Properties Ltd* Guernsey CA Nos 28 & 41 of 2014.

9. As in Guernsey, Bahamas and Florida.

10. [1980] Ch 515.

permitted by the Trusts Convention so as to achieve results not permitted by the English law. The whole point of private international law is to recognize that nations have developed different laws that deserve a wide measure of respect and those laws should be given effect unless manifestly incompatible with public policy. Thus, as long ago as 1904, the English Court of Appeal held that the assignment to a London moneylender of a Scots non-assignable alimentary life interest under a trust as security for a loan provided no security to the lender, even though it would have done under an English trust because English life interests cannot be non-assignable.¹¹

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Thus there should be no difficulty in English or other courts accepting the validity of a non-charitable purpose trust under foreign legislation creating an enforceable obligation by virtue of an appointed enforcer. Indeed, the British Privy Council in its non-judicial role has assented to Crown Dependencies enacting such legislation while also liberalizing trust law eg as to very lengthy perpetuity periods or none at all as in Jersey. There should thus also be no difficulty in accepting foreign trusts with a longer duration than the longest duration permitted by the English law.

It is clear¹² that under the English Variation of Trusts Act 1958 the court can approve on behalf of minor, unborn and unascertained beneficiaries a proposal, agreed by all beneficiaries of full capacity, that a family discretionary trust for the settlor's issue and their spouses shall continue under a foreign governing law for a longer period than that provided by the

settlor's trust instrument, so affecting the rights of those who would otherwise have acquired the trust property at the end of the original perpetuity period. In such a case, it is all those between themselves absolutely beneficially entitled to the trust property who are essentially exercising their rights as beneficial owners of the property to do what they wish with their own property. Thus the old trust dies and a new one commences.

Query whether the courts would accept the validity of the exercise of an express power conferred upon trustees to change the governing trust law to a trust law that enables the trust to continue beyond the period provided under the original governing law. It seems they should when the settlor authorized this and it is he who determines the extent of his bounty, which may be defeasible. In essence, the trust that would have died at the end of its original perpetuity period is given a heart transplant upon exercise by the trustees of the power to extend the trust's life. If the settlor could have chosen a particular foreign law to have his trust last for 300 years but initially chose English law with a trust period of 125 years but conferred power on his trustees to extend the period up to 300 years by a change to that particular governing law, why should his wishes be frustrated? Must the settlor really have to play safe and initially choose the foreign trust law permitting a perpetuity period of 300 years but provide in the trust instrument for a trust period of 125 years but with power for the trustees to extend this to a period of up to 300 years?

Beware the law governing whether a trust has been effectively launched

Nevertheless, one must be aware of the critical distinction between the law governing a launched trust and the law determining whether or not a trust has been launched. This distinction was made clear in Article 4 of The Hague Trusts Convention which excludes from the Convention 'preliminary issues

11. *Re Fitzgerald* [1904] 1 Ch 573.

12. See *Allfrey v Allfrey* [2015] EWHC 1717 (Ch), [2015] WTLR 1117.

relating to the validity of wills or of other acts by virtue of which assets are transferred to the trustee'.¹³

One must be aware of the critical distinction between the law governing a launched trust and the law determining whether or not a trust has been launched

Under the Convention, the law governing a trust can be chosen by the settlor but the law governing whether property has been effectively vested in a trustee cannot be chosen, the relevant *lex situs* normally determining the validity and effect of a transfer of property, though an equitable in personam jurisdiction between the relevant parties may be invoked to undo or rectify the transfer.¹⁴

Thus, if an inter vivos gift of English property to trustees is to be set aside as made with intent to prejudice creditors within section 423 Insolvency Act 1986 or as one made by a bankrupt within five years of bankruptcy under sections 339–342 Insolvency Act or as made to evade a financial claim under the Matrimonial Causes Act 1973 or the Inheritance (Provision for Family and Dependents) Act 1975, it will normally be English law that governs the issue, not whatever law happens to be the governing trust law. If, however, equitable in personam relief is sought so as to set aside a transfer for mistake or to rectify a deed of transfer (as where property was omitted from a schedule) then the focus is upon the relationship between the parties to ascertain the system of law with which they were most closely connected.¹⁵

In the case of testamentary trusts, the law governing succession to the testator's estate or patrimony will determine the extent to which the testator's net estate or patrimony may be subjected to trusts after taking account of fixed or discretionary mandatory family protection rules that form part of the law governing succession.

Where, however, a testator made lifetime gifts of property to trustees or individuals that were valid under the English *lex situs*, such property falls outside the testator's estate and so is not subject to the law governing succession to his estate (unless, most exceptionally, the gifts were made within six years of death by an English-domiciled testator or testatrix with intent to evade financial claims under the discretionary Inheritance (Provision for Family and Dependents) Act 1975).

This status quo has been preserved by the UK (like Ireland) not opting in to the EU Succession Regulation No 650 of 2012. If it had opted in, then donees of English property would have been liable to monetary claims from civil law forced heirs seeking to make up the full amount of their forced indefeasible shares in the patrimony of the testator when insufficient property to satisfy their claims was owned by the deceased at death. For this purpose, the patrimony is notionally enlarged by adding back to the patrimony the value of earlier lifetime gifts made within periods varying in civil law jurisdictions from five to thirty years before the testator's death. Three children would normally be entitled to an amount corresponding to three quarters of such enlarged patrimony.

It is worthwhile noting that once a trust has been launched and the trustees exercise their internal distributive powers to benefit beneficiaries, it will be the governing trust law that determines whether the exercise of such powers can be set aside for mistake or under the *Hastings-Bass* principle, whether as restricted by the UK Supreme Court or in a retained statutory form as in Jersey and Bermuda, or whether the document exercising particular powers can be rectified. This is reflected in Article 8(i) of the Trusts Convention.

Once a trust has been launched and the trustees exercise their internal distributive powers

13. See *Akers v Samba Financial Group* [2014] EWCA Civ 1516, [2015] Ch 451 (awaiting appeal heard by UKSC) as to art 4 not covering a settlor's declaration of himself as sole trustee as the trust assets are already vested in him.

14. *Ewing v Orr-Ewing* (1883) LR 9 HL 34; *Webb v Webb* [1994] QB 696; *R Griggs Group Ltd v Evans* [2005] Ch 153.

15. *Martin v Secretary of State for Work and Pensions* [2009] EWCA Civ 1289, [2010] WTLR 671; *Lightning v Lightning Electrical Contractors Ltd* (2009) 23 Trust LI 35.

to benefit beneficiaries, it will be the governing trust law that determines whether the exercise of such powers can be set aside

Siren calls from sexy jurisdictions to encourage exercising powers to change the law governing a trust

A strong siren call emanates from jurisdictions which have wide-ranging legislation similar to section 90 of the Cayman Trusts Law (2011) Revision.

All questions arising in regard to a trust which is for *the time being [emphasis added]* governed by the laws of the islands or in regard to any disposition of property upon the trusts thereof including questions as to –

- the capacity of any settlor;
- any aspect of the validity of the trust or disposition or the interpretation or effect thereof;
- the administration of the trust, whether the administration be conducted in the Islands or elsewhere, including questions as to the powers, obligations, liabilities and rights of trustees and their appointment and removal; or
- the existence and extent of powers conferred or retained, including powers of variation or revocation of the trust and powers of appointment, and the validity of any exercise thereof,
- are to be determined according to the laws of the Islands, *without reference to the laws of any other jurisdictions with which the trust or disposition may be connected [emphasis added]*.

There are, however, some obvious pragmatic exceptions in a proviso, so that eg section 90 does not validate a trust or disposition of immovable property that is invalid by its *lex situs* nor a testamentary trust or disposition invalid according to the testator's domicile. Otherwise, a change to such law or similar

governing laws (eg Bermuda, Gibraltar, Guernsey, Jersey) will enable advantage to be taken of their 'fire-wall' protections.

Section 90 was relied upon by Smellie CJ in a Cayman case¹⁶ where in March 1994 property had been mistakenly omitted from being listed in a schedule of property transferred to a Liechtenstein trustee of a Liechtenstein trust. Many years later this was discovered but the remedy of rectification of the document was not one available under Liechtenstein law. Thus the governing trust law was changed to Cayman law. The Chief Justice held that section 90 enabled the trust deed for the time being governed by Cayman law to be rectified to treat the omitted property as having been included and disposed to the trustees in March 1994 before the settlor became deemed domiciled in the UK in April 1994.¹⁷

It so happened, however, that the omitted assets were choses in action located in Cayman as debts of Cayman companies. A problem is likely to arise, however, for assets outside the jurisdiction of the new governing trust law due to the likelihood of courts of the *lex situs* not recognizing the effect of a judgment of the courts of such new trust law eg if Liechtenstein property had been omitted from the Liechtenstein trust. It is possible, however, that this problem could be avoided if such Liechtenstein property had been sold and its traced proceeds of sale invested in Cayman property. Thus it could be possible to exercise a power to change the proper law to enable ends to be achieved that could not otherwise be achieved.

Another example arises because under most trust laws the beneficial provisions in a trust cannot be varied except pursuant to an express power in that behalf in the trust instrument or under a Variation of Trusts Act with the consent of all beneficiaries of full capacity together with a court approval supplying the consent of all beneficiaries without full capacity or as yet unascertained, but only if the court is satisfied that this is for the benefit of those beneficiaries. These

16. *Re Goldentrust, Megerisi v Protec Management Establishment*, Cayman Grand Court No FSD 79 of 2012, 10 Dec 2012.

17. No mention was, however, made of s 89(5) stating 'A change in governing law shall not affect the legality or validity of, or render any person liable for anything done before the change'. The relationship between this and s 90 remains to be resolved.

difficulties, however, can be circumvented once a trust is governed by Bermudian law so that reliance can be placed upon section 47 of its Trustee Act.

Fortuitously, this section, derived from sections 57 and 64 of the English Trustee Act,¹⁸ has been held by Bermudian courts¹⁹ to enable the court to confer upon trustees the power needed to enter into any expedient transactions whether or not involving variation of beneficiaries' interests. This could be involved if the court conferred on trustees the power to ratify acts or omissions of invalidly appointed trustees unless they would have been breaches of trust if the conduct of validly appointed trustees. The court's authorization involves no consents by beneficiaries and so, for example, avoids leading the American IRS to consider those giving consents as taxable parties to a disposition, while extensions to a perpetuity or accumulation period can be made against opposition by beneficiaries.

There should be no problems where a variation under section 47 is prospective, but what if a change of governing law was made so as to enable some retrospective effects to be achieved?. One use of section 47 might be to confer on a validly appointed trustee a power to validate the acts of invalidly appointed trustees (and so trustees de son tort) and to release them from liability for such acts if they would not have amounted to breaches of trust if carried out by validly appointed trustees. Validation of formerly invalid acts will vary the beneficial rights of those who could have benefited from their claims that the acts were invalid but now cannot, yet section 47 authorizes such impact.

There should be no problems where a variation under section 47 is prospective, but what if a change of governing law was made so as to enable some retrospective effects to be achieved?

In the absence of statutory authority for variation of beneficial interests, more complex orders are required from the court. Thus, if a distribution of \$100,000 was made to B by trustees de son tort, the order will be that the new valid trustee executes a deed to the effect that the earlier \$100,000 and all rights to recover it are held on trust for B absolutely, as also is all the income arising from such \$100,000.²⁰ Under the *Schmidt v Rosewood Trust Co*²¹ inherent power of the court to supervise and, if appropriate, intervene in the administration of the trusts in the best interests of the beneficiaries as a whole, it appears that the court can go on to order that the new trustee administer the trust on the same footing as if the acts and omissions specified in a schedule had been done or omitted by the authority of duly constituted trustees acting within their powers.

A change of governing law might also be sought to take advantage of a jurisdiction like Jersey that, by virtue of section 47H of the Trusts (Jersey) Law as amended, has retained the old *Hastings-Bass* rule so as apparently to enable an earlier exercise of the trustees' powers made before the change to Jersey law to be set aside where no breach of trust had occurred but negligent professional advice had very adverse consequences. After all, once there is a trust governed by Jersey law and a Jersey court has jurisdiction, by section 9(1):

any question concerning ... (d) the administration of the trust ... (e) the existence and extent of powers...and the validity of any exercise of such powers ... shall be determined in accordance with the law of Jersey and no rule of foreign law shall affect such question.

By section 9(3A) it is made clear that 'the law of jersey' is its domestic law, not its conflict of laws.

Is there not a difficulty, however, because once the problematical act occurred under the then governing

18. See *Hambro v Duke of Marlborough* [1994] Ch 158.

19. *GH and IJ v KL* [2010] Bda LR 86, *Re ABC Trusts* [2012] Bda LR 89.

20. See *Re Z Trust Ltd* [2016] JRC 048 not following the broad approach in *In the Matter of the D Retirement Benefit Trust* [2011] JRC 148.

21. [2003] UKPC 26, [2003] 2 AC 709.

law it would have given rise to rights and obligations crystallized under that law so as to fix beneficiaries' rights under the trust at that date? Surely, a subsequent change of governing law cannot change that crystallization of beneficial rights with territorial effect outside the country of the governing law. Moreover, in respect of English and EU courts' recognition of foreign courts' judgments and in the context of the European Convention on Human Rights featuring in the English Human Rights Act 1998 and of English public policy considerations, one needs to consider Article 1 of the First Protocol whereby a person is 'entitled to the peaceful enjoyment of his possessions' and 'no-one shall be deprived of his possessions except in the public interest and subject to the conditions provided for by law'.

Is there not a difficulty, however, because once the problematical act occurred under the then governing law it would have given rise to rights and obligations crystallized under that law so as to fix beneficiaries' rights under the trust at that date?

The remedy of rectification is unique in having retrospective effect, so what if a power to change the governing law were exercised to change the governing law to that of a country which allows rectification in broader circumstances than those allowed under the original governing law eg in many USA States and Canada and perhaps, even, in Jersey if the voidable exercise of a power by a trustee 'has such effect as the court may determine' under section 47G(2) or section 47H(2) and the court very boldly decides that this is broad enough to enable it declare that the power retrospectively had a different effect from the outset than the effect it apparently had.²²

Rectification might thus be sought of the exercise of a trustee's power of appointment to distribute trust assets to someone absolutely or on new trusts or sub-trusts when the position will be governed by the law

applicable to the trust under Article 8 of The Hague Trusts Convention or the general law.

Take the case where at the date of the written appointment rectification was not possible under the restrictive approach of the governing English law so the governing law is changed to a new governing law. Such new law would normally only have prospective effect but query whether when a remedy's inherent nature is retrospective it will have retrospective effect, especially if it can then be argued that no persons have been deprived of their possessions because they never had them in the first place. But does not this beg the question whether unrectifiable matters have become rectifiable? It thus seems that, unless the assets in question were situated in the country whose trust law is the new governing law, rectification could not be recognized as retrospectively effective.

Arbitration of trust disputes and differences

Earlier mention of the Convention on Human Rights, implemented by the Human Rights Act 1998, leads on to the surprising problems it creates for arbitration of trust disputes and differences, a process proving to be very successful for commercial disputes between persons of full capacity who can waive their Convention rights. Arbitration is also readily available for disputes between trustees and third parties. The problem, however, with family trusts is that internal disputes will normally involve minors and unborn or unascertained persons, who cannot waive their human rights and who have special protection in court disputes entitling them to proper representation and to have compromises approved if they are to be valid.

The English Trust Law Committee considered Article 6(1) of the Convention to create real difficulties.

In the determination of his civil rights and obligations or of any criminal charge against him, everyone is

22. See R Stewart Smith, 'Rectification of Trustee Errors' STEP Journal March 2014 at p 18.

entitled to a fair and *public hearing* within a reasonable time by an independent and impartial *tribunal established by law*. Judgment shall be pronounced publicly but the press and the public may be excluded from all or any part of the trial in the interests of morals, public order or national security in a democratic society, where the interests of juveniles or the protection of the private life of the parties so require, or to the extent strictly necessary in the opinion of the court in special circumstances where publicity would prejudice the interests of justice.

Article 14(1) of the International Covenant on Civil and Political Rights, ratified by many countries outside the EU, is worded in very similar terms, though the USA's reservations 'essentially render ineffective all Convention rights which would require any change in national law to ensure compliance with Covenant obligations'.²³

Much will depend upon how far the court is prepared to allow liberal 'wriggle-room' in the exceptions from the need for a public hearing. If little wriggle-room is allowed then, for arbitration to become possible, court proceedings will need to be instituted so that persons may represent minor, unborn and as yet unascertained beneficiaries, and these representatives can then waive their beneficiaries' rights. The court can then stay proceedings to enable arbitrators to resolve the trust dispute and make an award which the court can then approve. Better still, legislation could confer on arbitrators of trust disputes all the powers of a judge if hearing such disputes—as in *The Bahamas*.²⁴

Much will depend upon how far the court is prepared to allow liberal 'wriggle-room' in the exceptions from the need for a public hearing

However, I do not see this happening in England for a considerable period. Perhaps this period would

be shortened if lawyers had their settlors create trusts governed by a foreign law under which internal trust disputes could easily be resolved by arbitration, though this could lead to English lawyers losing potential business to foreign lawyers so why should such lawyers choose a foreign governing law? If, however, foreign lawyers were creating foreign trusts with the advantage of arbitration for trust disputes so that English lawyers lost business from settlors, then there would be stimulus for changing English law. Nevertheless, the main stimulus ought to be pride in maintaining the law of England, the founder of trust law, at the fore of proper developments in the trusts sphere.

There is, however, a problem as to enforcement of arbitration awards under the New York Convention which applies to arbitrations based on agreements signed by the parties under Article II(2). Nevertheless, UNCITRAL has recommended that this should be a 'non-exhaustive' definition so that there is scope for beneficiaries who attempt to enforce their rights under the trust to be regarded as manifesting their agreement to an arbitration clause in the trust instrument²⁵ and also scope for regarding beneficiaries as having received the benefit of a conditional transfer of property so as to be bound by the burden of the conditions. Article V (2)(a) of the Convention, however, empowers the courts, in a country where enforcement is sought, to refuse enforcement if the subject matter of the dispute is not capable of settlement by arbitration under the law of that country, quite apart from the fact that English public policy as to the fundamental human right to a public hearing might possibly also prevent enforcement.

Rectification of settlors' or trustees' donative documents

Moving back to technical law after that Human Rights Act-inspired excursus on arbitration,

23. See UN Human Rights Committee, General Comment No 24 (52) para 12.

24. Trustee Act 1998 s 91B, inserted by Trustee (Amendment) Act 2013.

25. *Rachal v Reitz* 403 SW3d 840 (Tex 2013), Texas Sup Ct overruling the full CA Bench; also see *Diaz v Bukey* 282 P3d 1217 (Cal 2012), California Sup Ct vacating CA decision.

clarification is needed as to the parameters of the discretionary equitable remedy of rectification especially when the Supreme Court relatively recently clarified the scope of the equitable discretionary remedy of rescinding a disposition for mistake—and rectification is a response to a mistake. Thus Lewison LJ in *Day v Day*²⁶ opined that in the case of voluntary dispositions rectification and rescission for mistake should be governed by the same principles.

Clarification is needed as to the parameters of the discretionary equitable remedy of rectification

This, however, was before Lord Walker gave the judgment of the Supreme Court in *Pitt v Holt*.²⁷ Referring to a rectification case, *Racal Group Services Ltd v Ashmore*,²⁸ cited by counsel, Lord Walker stated:²⁹

Rectification is a closely guarded remedy, strictly limited to some clearly established disparity between the words of a legal document and the intention of the parties to it. *It is not concerned with consequences* [emphasis added]. So far as anything in *Racal* is relevant to the different equitable remedy of rescission for mistake it is relevant not to establishing the existence of a mistake but to the court's discretion to withhold relief where it would be inappropriate for the court to grant it.

Lord Walker was concerned with a case to rescind a disposition for a mistake as to consequences and rejected the view that while a disposition could be rescinded for a mistake as to its effect, it could not also be rescinded for a mistake as to its consequences, like tax consequences.

It would appear from Lord Walker's above dicta that he considered rectification to be a more restricted remedy than rescission. Rescission for mistaken consequences allows a fresh start to be made so as

prospectively to achieve the desired consequences by means not contemplated at the time of the mistake, but rectification for mistake retrospectively gives effect to what was originally intended at the time of the mistake. Thus rectification is not available where the mistake was as to the consequences of executing the document (as made clear in *Racal*), only being available for a clear disparity between the words of a document and the intention of the parties or a party in a unilateral document.

Subsequently, the Chancellor, Sir Terence Etherton, also took this view in *Kennedy v Kennedy*.³⁰

Rectification cannot be granted unless the wording or legal effect of clause 2(1)(c) did not represent their true intention. Intention must be distinguished from motive. Mr Sturrock's intention was that clause 2(1)(c) should have the legal effect which it had, namely to vest the whole of the trust fund in Mr Kennedy absolutely. His mistake was in thinking that, for purely factual reasons extraneous to the document, clause 2 (1)(c) would not [as a consequence] give rise to a CGT charge. That mistake is not a mistake which can found a claim for rectification.

The Chancellor held that it founded a claim to rescind the clause.

There appear to be two types of mistake.³¹ There is a 'meaning mistake' where there is a clear disparity between the properly construed terms of a document and what a person clearly intended to put his signature to. There is a 'motivational mistake' where there is no such disparity, the signatory intending to sign up to the document but the signatory was motivated to sign by virtue of incorrect data which would have led him not to sign if he had known this at the date of signature.

A motivational mistake enables the document or a clause thereof to be set aside, even though the signatory had no specific alternative document or clause in

26. [2013] EWCA 280, [2014] Ch 114.

27. [2013] UKSC 26, [2013] 2 AC 108.

28. [1995] STC 1151.

29. At [131].

30. [2014] EWHC 4129 (Ch), [2015] WTLR 837 at [43]. Also see *Giles v RNIB* [2014] EWHC 1373 (Ch), [2014] STC 1631.

31. See B Häcker, 'Mistaken Gifts after Pitt v Holt' (2014) 67 CLP 333.

mind at the time of signature.³² After the setting aside a fresh start can be made in the light of correct data. A meaning mistake, however, requires that at the time of signature the signatory intended to sign up to particular terms different from the correctly construed terms that misrecorded or did not record his intentions, as where a rock-star settlor mistakenly believed his Bahamian trust for his children included non-marital children.³³ The law ensures that the signatory's true intentions at the date of signature are carried out by retrospectively inserting in the document terms bearing the meaning intended at the date of signature.

Thus the two remedies have different objectives and the retrospective remedy of rectification is granted more restrictively than the remedy of rescission. It thus seems that *rectification* for mistake, unlike *rescission* for mistake, should be restricted to rectifying the effect of a mistake as opposed to the consequences of a mistake in a broad sense.

A major difficulty is the ambiguity of the terms 'effect' and 'consequence'. After all, words are used to have the effect or consequence of producing a meaning. Nevertheless, can one not consider that after words have been used to produce such a meaning, there is a separate issue as to the legal or tax consequences flowing from such meaning?

The doctrine of rescission for mistake then enables such mistaken consequences to be rescinded for a fresh start to be made, while the doctrine of rectification enables wording to be rectified from the outset so as to produce the effect or meaning then intended by the signatory. Thus mistaken consequences can only be rescinded, not rectified.

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The case law, however, reveals cases where words were deliberately signed up to but there was a mistake as to the legal consequence of those words yet rectification was permitted. Thus covenants to pay a specific regular sum 'free of tax' have been rectified so as to pay 'such a sum as after the standard rate will amount to' the covenanted sum;³⁴ a deed of variation of a will has been rectified to refer expressly to section 142(1) of the Inheritance Act 1984 and section 62(6) of the Taxation of Chargeable Gains Act 1992 so as to be effective as intended for IHT and CGT purposes³⁵ and, in another case, to make one clause 'subject to inheritance tax';³⁶ a standard form accumulation and maintenance settlement has been rectified for qualification at the age of 25 years so as to attract intended favourable IHT treatment;³⁷ and section 31(2)(ii) of the Trustee Act 1925 has been excluded from a settlement so that it qualified as intended as an interest in possession trust.³⁸

In all these cases it is clear that the client intended by simple means to achieve a well-known tax avoidance outcome that his lawyer could, and should, have achieved at the outset. Thus, the straightforward wording that should have been used at the outset can be pleaded and proved as the wording to replace and rectify the original wording from the outset. Indeed, Graham J stated in *Re Sloccock's WT*,³⁹ 'If a mistake is made and a document is legitimately designed to avoid the payment of tax, there is no reason why it should not be corrected'. This seems eminently fair and sensible, though it does alter the legal consequences of the original language.

32. *Ogden v Trustees of the RHS Griffiths 2003 Settlement* [2008] EWHC 118 (Ch), [2009] Ch 162 at [27], endorsed in *Bhatt v Bhatt* [2009] EWHC 734 (Ch) at [29].

33. *Frey v Royal Bank of Scotland (Nassau) Ltd* (2001) 3 ITEL 775.

34. *Burroughes v Abbott* [1922] 1 Ch 86, *Jervis v Howle & Talke Colliery Co Ltd* [1937] Ch 67.

35. *Wills v Gibbs* [2007] EWHC 3361, [2008] STC 808.

36. *Oun v Ahmed* [2008] EWHC 545 (Ch).

37. *Bartlam v Coutts & Co* [2006] EWHC 1502 (Ch), [2006] WTLR 1165.

38. *Fine v Fine* [2012] EWHC 1811 (Ch); *Price v Williams-Wynn* [2006] WTLR 1633, [2006] All ER (D) 43 Jan.

39. [1979] 1 All ER 358, 363.

Thus, in these situations rectification can remedy legal consequences, just like setting aside a disposition for mistake, though the remedy is retrospective. Nevertheless, when at the outset there was merely an intent to avoid tax but no specific intention to use a specific form of wording that would have worked to avoid tax, no rectification can occur.⁴⁰ Instead, rescission for mistake can occur if the signatory would not have executed the document but for his mistake in believing it avoided tax, even though he might not know what otherwise he might have done. The court cannot rewrite the document to make it one that its maker might have signed if he were better informed.

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But, as Frances Dawson has pointed out,⁴¹ is this not what happens in the earlier examples where the signatory signed up to the very words in a document intended to avoid tax in an acceptable way but that was not drafted so as actually to avoid tax? There are cases indicating that if the document contains the particular form of words intended by the signatory no rectification is possible.⁴² The purpose of rectification is to ensure that the document contains the wording which it was intended to contain, not those which it would have contained had the signatory been better informed. Thus a mistake in the interpretation of a document or the legal consequences of signing it should be insufficient to justify rectification as opposed to rescission for mistake.

Clearly the cases are ripe for consideration by the Supreme Court which could take a hard line or, perhaps, be prepared to be as liberal as the Canadian courts. In *Attorney General of Canada v Juliar*,⁴³ transfers of shares were designed to divide a family

business between two families in a tax-neutral fashion, but the advising accountant was provided with erroneous data by the families leading him to advise that there would be no adverse tax consequences arising from the transfers being in exchange for promissory notes. This would have been correct if the data had been correct. Instead, there was an immediate liability to tax which would easily have been avoided if the transaction had proceeded by way of exchange of shares. The Ontario Court of Appeal rectified the transaction by changing the exchange of shares for promissory notes into an exchange of shares for shares. The court stated as follows.

Parties are entitled to enter into any transaction which is legal and, in particular, are entitled to arrange their affairs to avoid payment of tax if they legitimately can If a mistake is made in a document legitimately designed to avoid the payment of tax, there is no reason why it should not be corrected.

Subsequently, the Ontario Court of Appeal in *Fairmont Hotels Inc v AG of Canada*⁴⁴ applied *Juliar* when rectifying a corporate resolution that mistakenly had authorized share redemptions having adverse tax consequences when a tax-neutral outcome was intended. The Court stated as follows.

Juliar is a binding decision. It does not require that the party seeking rectification must have determined the precise mechanics or means by which the party's settled intention to achieve a specific tax outcome should be realized. *Juliar* holds in effect that the critical requirement is proof of a continuing specific intention to undertake a transaction on a particular tax basis . . . the respondent had a specific unwavering intention from the outset to ensure that the Legacy-related transactions were tax neutral and, to that end, that no redemptions of the relevant preference shares

40. *Allnutt v Wilding* [2007] EWCA Civ 412, [2007] WTLR 941; *In the Matter of the R E Sesemann WT* [2005] JLR 421.

41. (2014) 130 LQR 356 in his case-note on *Day v Day* [2013] EWCA Civ 280.

42. *Barrow v Barrow* (1854) 18 Beav 529, *Frederick Rose (London) Ltd v William Pim Junior & Co Ltd* [1953] 2 QB 450, *Allnutt v Wilding* [2007] EWCA Civ 412, [2007] WTLR 941, *Racal Group Services Ltd v Ashmore* [1995] STC 1151.

43. [2000] CanLII 16883 (ON CA), 50 OR 3(d) 728.

44. 2015 ONCA 441 (CANLII).

should occur. Nonetheless, by mistake the redemptions were authorised by corporate resolutions It was unnecessary that the respondent prove that it had determined to use a specific transactional device - loans - to achieve the intended tax result.

O Brave New World. Who fancies their chances of arguing this before the Supreme Court? Should such a liberal change be reserved for the Legislature? Intriguingly, in the restricted area of trusts, section 416 of the Uniform Trust Code states as follows.

To achieve the settlor's tax objectives the court may modify the terms of a trust in a manner that is not contrary to the settlor's probable intention. The court may provide that the modification has retroactive effect.

How about choosing as the governing law of a trust that of an American State that has adopted the Uniform Trust Code?⁴⁵ Would the English court really regard this as manifestly contrary to English public policy (under Article 18 of the Trusts Convention) or would it accept it, leaving the Legislature to deal with this in a Finance Act if it thought appropriate?

Prior to becoming a Judge of the Caribbean Court of Justice in July 2005, The Honourable Mr Justice David Hayton was Professor of Law, King's College London, Barrister and Benchers of Lincoln's Inn, and a part-time judge in London and The Bahamas. He has written or edited fifteen books in the areas of trusts, property, succession, and tax, including the standard practitioner's text, Underhill and Hayton, Law of Trusts and Trustees, now in its 19th Edition: see www.caribbeancourtofjustice.org/about-the-ccj/judges/hayton. E-mail: dhayton@ccj.org

45. Thirty-two States have enacted it with slight amendments: <<http://uniformlaws.org/Act.aspx?title=TrustCode>> last accessed 6 June 2016