

UPDATE

Schroder Cayman Bank and Trust Co Ltd v Schroder Trust AG

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The Cayman Islands court held that three separate appointments of capital from an employee benefit trust, established in the Cayman Islands to three employee financed retirement benefit schemes in Jersey, were void as a result of an excessive execution of powers contained in the relevant Trust deed by the trustees and on the grounds of mistake. In separate proceedings in Jersey, the Jersey court granted recognition of the decision of the Cayman Islands court. This update provides further details of the decision.

Background

Our client, Schroder Cayman Bank and Trust Company Ltd, and the defendant, Schroder Trust AG, were appointed as original trustees (the **Trustees**) of an employee benefit trust irrevocably established in the Cayman Islands on 28 January 2000 (the **Trust**) by a UK company as settlor. The Trust was established for the benefit of a class of beneficiaries defined in the Trust deed as 'the Employees and the wives, husbands, widows, widowers and children or stepchildren and remoter issue, of the Employees'.

The Trust deed contains a prohibition on the Trustees transferring Trust property to the trustee of a new settlement unless the beneficial class of the new settlement is identical to the beneficial class as defined in the Trust deed.

In early 2011, the Trustees sought legal advice regarding the potential implications which the UK draft Finance Bill 2011 might have upon the Trust. The Trustees were advised it would be tax efficient to make various appointments of capital from the Trust to employee financed retirement benefit schemes (**EFRBSs**). In reliance upon this advice, the Trustees made three transfers of capital out of the Trust to three separate EFRBSs in Jersey (the **Appointments**).

The Trustees subsequently became embroiled in a dispute with HMRC about whether the Appointments triggered a liability to UK inheritance tax. During the course of this dispute, it became apparent that the Appointments were made incorrectly. Principally, the Appointments purported to benefit a class of beneficiaries wider than was permissible pursuant to the provisions of the Trust deed. The Appointments were also executed in the mistaken belief that the classes of beneficiaries in the EFRBSs and the Trust were identical, and that no tax liability would arise from the Appointments.

The Trustees sought legal advice from new counsel, who advised that it was clear that a charge to tax would, in fact, arise upon the transfer of property out of the Trust.

Upon realising the Appointments were erroneously made and in the mistaken belief that they were fiscally prudent, Schroder Cayman Bank and Trust Company Ltd (the **Plaintiff**), represented by Mourant Ozannes, applied to the Cayman Islands court pursuant to section 48 of the Trusts Law (2011 Revision) for directions as to how it should proceed. The Plaintiff sought a declaration of the Court that the three Appointments were void and of no effect, or alternatively, sought an order setting aside the Appointments on the grounds of mistake.

Jurisdiction

Before the Court could address the substantive legal arguments arising from the Plaintiff's application, it had to settle the question of whether the matter should be determined by the law of the Cayman Islands or the law of Jersey, as the Trust was established in the Cayman Islands and the EFRBSs were established in Jersey. Ostensibly, conflicting provisions in the Cayman Islands and Jersey trusts laws each provided that questions relating to trusts established in that jurisdiction should be governed by the laws of that jurisdiction, regardless of any other jurisdictions with which such trusts might be connected (Firewall Provisions). Counsel appearing on behalf of the Plaintiff explained that given the apparent legislative conflict, the Plaintiff was left with no option but to fall back on the general principles of private international law. These principles require the identification of the jurisdiction most closely connected with the transactions in question in deciding which set of laws should apply. In this case, it was argued, the transactions were most closely associated with the Cayman Islands, and so the Plaintiff commenced the action in the Cayman Islands court.

The Chief Justice approved of this reasoning, adding that it was possible that the issue of conflicts of laws did not arise at all, because if the Appointments were invalid from inception, the assets were never actually transferred out of the Trust and the question of jurisdiction would not arise. Further, the shares transferred out of the Trust and into the EFRBSs were considered *choses in action*, and under the applicable common law principles, the governing law of the transaction would be the law of domicile, which, in this case, was the law of the Cayman Islands. The Chief Justice also confirmed that, based upon expert evidence submitted by the Plaintiff, applying the law of Jersey in this matter would result in the same conclusions and orders, because the common law principles underpinning Jersey trust law are much the same as those applied in the Cayman Islands.

Excessive execution and mistake

The Chief Justice noted there were at least two ways in which the Appointments affected the validity of the transfers to the EFRBSs. He referred to the first as the 'excessive execution' issue. The class of beneficiaries as defined in the EFRBSs included any individual dependent upon the relevant employee 'for the ordinary necessities of life at the date of the Member's death'. However, the power of appointment in the Trust deed could only be exercised for the beneficiaries as defined therein, and did not include this wider class of dependants featured in the EFRBSs. Similarly, the power to transfer Trust property contained in the Trust deed only permitted assets to be transferred to a 'qualifying settlement', defined as a settlement under which every beneficiary was also a beneficiary of the Trust.

In contravention of the relevant provisions in the Trust deed, the EFRBSs and the Appointments did not adhere to these requirements; rather, they appointed assets into the trusts of the EFRBSs which included the additional, impermissible class of 'dependent' beneficiaries.

The Chief Justice adopted the following dictum from the case of *Harvey v Stacey*:¹

'When an appointment is to a class, some of whom are within and others are not within the proper limits of the power, if the class of persons is ascertained, so that you can point to A, who is within the limits, and say, so much is to go to him, though the others are not within the limits, yet the appointment to A shall take effect; but if the appointment is to a class, some of whom may, and others may not, be objects of the power, and there is nothing to point out what portion is to go to those who are within the power, and what to those who are not, the whole fails.'

He found that the Appointments fell into the latter category, because the Trust and the EFRBSs were intended to be fully discretionary trusts, making it impossible to determine the precise entitlement of each of the beneficiaries.

The Judge also held that because the Appointments purported to benefit a class of beneficiaries wider than the class defined by the Trust, the Appointments were a wholly excessive execution of the power contained in the Trust deed. If the impermissible execution of the power cannot be properly severed from the

¹ (1 Drewry 73) (1852) 5.C.22, LJ Ch. 23.

permissible execution of the power, the entire exercise will be deemed a misuse of the power for an improper purpose and declared void ab initio.

As to the alternative argument, that the Appointments should be set aside on the ground of mistake, the Chief Justice noted that there had in fact been three mistakes in making the Appointments: a mistake as to the extent of the class of beneficiaries; a mistake regarding the tax consequences of the exercise and a mistake about the revocability of the Appointments. He accepted the Trustees' evidence that, had they been aware of any of these mistakes, they would not have exercised their powers to transfer assets out of the Trust and would not have executed the Appointments.

Ultimately, the Chief Justice was satisfied that the reliance by the Trustees on the erroneous advice and drafting caused severe consequences to the Trust which were never intended, and that the Appointments would never have been made but for those mistakes. The mistakes were of sufficient gravity so as to engage the Court's jurisdiction to set them aside, and it would be 'unconscionable' to leave them uncorrected.

Jersey proceedings

The terms of the Jersey Firewall Provisions meant that the Trustees faced the uncertainty of whether the Jersey court would recognise the Cayman Islands judgment. In particular, the Trustees were concerned that, absent express recognition of the Cayman Islands judgment in Jersey, they might ultimately be required to account to the beneficiaries of the Jersey Trusts on the basis that the assets in question were held on the trusts of EFRBSs in Jersey. They therefore sought orders granting recognition of the Cayman Islands judgment from the Jersey court.

The Jersey court ruled that the Cayman Islands judgment was capable of recognition at common law pursuant to Rule 42(2) in *Dicey, Morris and Collins*.²

In accordance with this Rule, the Trustee was required to demonstrate that Cayman Islands court had the jurisdiction to give the judgment in question; the Cayman Islands judgment was not obtained by fraud; the enforcement or recognition of the Cayman Islands judgment would not be contrary to public policy; and the proceedings in which the Cayman Islands judgment was obtained were not opposed to natural justice. On the facts of the case, the Jersey court was satisfied that each of these requirements had been met. Accordingly, it ruled that the Cayman Islands judgment would be recognised in Jersey and that the Trustees could act in accordance with the terms of that judgment in the knowledge that they would be able to rely on the judgment in any proceedings brought in future in Jersey.

The Jersey court also stated, on an obiter basis that, had it become necessary to determine the excessive execution issue and the mistake issue applying only domestic Jersey law, it would have reached the same decision as the Cayman Islands court for essentially the same reasons.

² 'A foreign judgment given by the court of a foreign country with jurisdiction to give that judgment in accordance with the principles set out in Rules 43 to 46, which is not impeachable under any of Rules 49 to 54 and which is final and conclusive on the merits, is entitled to recognition at common law and may be relied on in proceedings in England.' *Dicey, Morris and Collins, The Conflict of Laws* (15th Ed).

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