

# Fighting firewalls

*An examination of two judgments on a conflict between the firewall provisions of Jersey and Cayman trust laws*

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## Abstract

- Where there is a conflict of rival firewall provisions applicable to a transaction, the applicant will need to consider carefully the forum in which they bring proceedings.
- The application of the firewall provisions of the *Trusts (Jersey) Law 1984* will be excluded by an express choice of law in the relevant instrument affecting the disposition of property to be held on the terms of a Jersey trust.
- When making cross-border dispositions into a Jersey trust, attention should be paid to what law should govern the relevant transfer.
- In the cases discussed, both the Grand Court of the Cayman Islands (applying Cayman law) and the Royal Court of Jersey (applying Jersey law) would have set the appointments aside on the grounds of mistake had they otherwise been valid.

**The Grand Court of the Cayman Islands** and the Royal Court of Jersey have recently had to consider the interaction between the firewalls established under sections 90 to 93 of the Cayman Islands *Trusts Law* (2011 revision) and article 9 of the *Trusts (Jersey) Law 1984* (the Jersey Trusts Law), to determine the validity of appointments of assets from a Cayman employee benefit trust (the Cayman trust) to three Jersey employer-financed retirement benefit schemes (the Jersey trusts).

Firewall provisions are a common and important feature of the trusts laws of many offshore jurisdictions. Firewall provisions are

aptly named as their purpose is to shield or protect trusts established in such offshore jurisdictions from foreign laws or judgments. The firewall provisions of the Jersey and Cayman trusts laws each require, in essence, that matters concerning trusts governed by the laws of those jurisdictions should generally be determined in accordance with the laws of the jurisdiction in question, without reference to foreign laws, and that any decision of a foreign court will not be enforced to the extent that it is not in accordance with the laws of the jurisdiction in question (subject to certain exceptions).

**“ The Royal Court’s judgment has cast doubt on the correctness of a number of recent Jersey cases which have applied Jersey law, notwithstanding an express choice of a foreign law, to transactions closely linked with the establishment of a Jersey trust**

In the course of its 9 March 2015 decision,<sup>1</sup> the Grand Court of the Cayman Islands noted what it considered to be a conflict between the Cayman and Jersey firewall legislation, in that each, if read literally, would require the law of the relevant territory to be applied to determine the validity of the appointment of assets from the Cayman trust or the disposition of property to the Jersey trusts. The Grand Court determined that Cayman law should apply.

The Royal Court agreed that Cayman law applied in view of the express choice of Cayman law in the instruments of appointment.<sup>2</sup> This was on the basis of the *Trusts (Amendment No.5) (Jersey) Law 2012* (the 2012 amendment) to the Jersey Trusts Law. The Royal Court’s judgment has cast doubt on the correctness of a number of recent Jersey cases which have applied Jersey law, notwithstanding an express choice of a foreign law, to transactions closely linked with the establishment of a Jersey trust.

Both the Grand Court and the Royal Court also considered the alternative basis on which the application was presented – an application to set aside the appointment of assets on the grounds of mistake.

**THE FACTS OF THE CASE**

The underlying issue was the validity of certain appointments out of the Cayman trust to the Jersey trusts. The Cayman trust, established irrevocably in 2000, conferred a power of appointment on its trustees by which they could transfer trust property to the trustee of a new

settlement, but only if the beneficial class of the new settlement consisted solely of persons who were beneficiaries of the Cayman trust (a qualifying settlement).

The Jersey trusts, however, to which the assets were appointed in 2011, included, within their beneficial classes, persons who were not eligible to benefit under the Cayman trust (being the dependants of the beneficiaries of the Cayman trust). Therefore, the Jersey trusts could not be qualifying settlements.

During a subsequent dispute with the UK tax authority, HMRC, which sought to enforce an inheritance tax (IHT) charge in respect of the appointments of the assets to the Jersey trusts, it became apparent that the appointments were, as Chief Justice Smellie put it in the Grand Court’s judgment, ‘fatally flawed’. The trustees had purported to benefit a class wider than that permitted under the Cayman trust. Further, they had made the appointment believing (mistakenly, but on advice) that no IHT charge would arise and they had purported to make a revocable appointment (so that the trustees could call back the trust assets if a tax liability they anticipated crystallised). In contrast, the power under the Cayman trust could only be exercised irrevocably so that the appointment, if it took effect at all, would be irrevocable.

Faced with a significant IHT liability, the trustees applied to the Grand Court for a declaration that the appointments were void for excessive execution and, alternatively, that they ought to be set aside on grounds of mistake.

**TWIN FIREWALLS**

The Grand Court’s consideration of the case was complicated by the existence of the respective firewall provisions in the Cayman Islands and Jersey, broadly designed to insulate trusts governed by Cayman and Jersey law from foreign judicial decisions not made in accordance with the laws of these respective jurisdictions that impact materially on the trusts in a proscribed way.

Section 90 of the *Trusts Law* (2011 revision) of the Cayman Islands requires all questions relating to a trust governed by Cayman Islands law, or any disposition of property held by such a trust, to be determined according to the law of the Cayman Islands without reference to

1. *Schroder Cayman Bank and Trust Company Ltd v Schroder Trust AG*, FSD 122/2014

2. *Representation of Schroder Cayman Bank Trust Company Ltd Schroder Trust AG* [2015] JRC 125, 10 June 2015

the law of any other jurisdiction.<sup>3</sup> In Jersey, article 9 of the Jersey Trusts Law contains equivalent provisions with respect to Jersey trusts and dispositions of property into them.

The Grand Court, having identified the potential for a clash between the firewall provisions, noted that, in these circumstances, the applicant was obliged to choose one of the competing fora in which to bring proceedings. It also found that, in making that choice, the applicant was correct to resort to general principles of private international law, in this case requiring the identification of the system of law most closely connected with the transactions under challenge. The Grand Court determined that to be the law of the Cayman Islands, being the law that governed the Cayman trust and, therefore, the discretionary power to make the dispositive appointments at issue in the application. Smellie CJ accordingly proceeded to determine the validity of the appointments under Cayman law.

However, in accordance with an invitation from counsel and on the basis of expert evidence, the Chief Justice indicated that he was satisfied that the principles applicable to the setting aside of erroneous or invalid exercises of discretion were broadly the same in Jersey and the Cayman Islands and he would have come to the same conclusion had he applied Jersey law.

While the primary application was for the appointments to be declared void for excessive execution (which the Grand Court upheld), the Grand Court was also invited to consider an alternative basis to set aside the dispositions, namely that they had been entered into by mistake, in that:

- The trustees of the Cayman trust had been advised (incorrectly) that there would be no IHT charges arising from the disposition of property to the Jersey trusts.
- The trustees had believed that the beneficiaries of the Jersey trusts were exactly the same as

under the Cayman trust, but in fact the Jersey trusts had a wider class of beneficiaries (in that they included dependants).

- The dispositions, if they took effect at all, took effect as irrevocable appointments (there being no power to make revocable appointments under the Cayman trust). However, the trustees had believed they were making revocable appointments such that they could call for the return of the trust property to meet tax charges (not the IHT charges) that they anticipated might arise.

The Grand Court noted that no application was made to set the dispositions aside under the *Hastings-Bass* principle, so it did not need to decide whether the decision of the Supreme Court in *Pitt v Holt; Futter v Futter*<sup>4</sup> would be followed as a matter of Cayman law. However, with respect to the application to set aside the appointments for mistake, the Grand Court did follow and apply the principles enunciated by the Supreme Court and found that it would have granted relief on that basis. The Grand Court came to the conclusion that, irrespective of whether the trustees might have a claim against their tax advisor for negligence, it is a requirement of any negligence action that the plaintiffs seek to mitigate their losses, so it is appropriate that an application be made and considered before such a claim is pursued.<sup>5</sup>

## THE JERSEY SEQUEL

Given the potential conflict between the firewall provisions in each jurisdiction, an application was made to the Royal Court of Jersey in June 2015 asking the court to ‘give effect’ to the Cayman decision.

The legislation that fell to be interpreted in Jersey was article 9 of the Jersey Trusts Law, in particular paragraph (1), which, insofar as it is relevant, states that:

‘Any question concerning... (b) the validity or effect of any transfer or other disposition of property to a trust... shall be determined in accordance with the law of Jersey and no rule of foreign law shall affect such questions.’

Article 9(4), as amended, provides that no judgment of a foreign court, or other foreign

3. Section 91 *Trusts Law* (2011 revision) goes on to provide that trusts governed by Cayman law are not void, voidable or liable to be set aside or defective, nor is the capacity of the settlor to be questioned, nor is the trustee, any beneficiary or any other person to be subjected to any liability or deprived of any right, by reason that the laws of a foreign jurisdiction prohibit or do not recognise the concept of a trust, or that the trust avoids or defeats rights, claims or interests conferred by foreign law upon any person by reason of a personal relationship (as defined) to the settlor or by way of heirship rights (as defined), or otherwise contravenes any rule of foreign law or any court orders intended to recognise, protect, enforce or give effect to any such rights, claims or interests. Section 93 provides that foreign judgments, to the extent they are inconsistent with s91, will not be recognised or enforced by the Cayman court

4. [2013] 2 AC 108

5. As the Chief Justice had previously held in *Re Golden Trust, Megeris v Protec Trust Management* 2012 (2) CILR 355

“ **The *Trusts (Amendment No.5) (Jersey) Law 2012* opened up a number of instances where the firewall would not apply and reduced the likelihood of conflicts between firewalls and other incongruous results** ”

tribunal with respect to a trust, shall be enforceable, or given effect, to the extent that it is inconsistent with article 9 (i.e. decided in accordance with a law other than the law of Jersey), irrespective of any applicable law relating to conflict of laws. This provision has been interpreted to mean that, even if the trustee has submitted to the jurisdiction of a foreign court, the resulting decision will not be enforceable if it is not decided in accordance with Jersey law.<sup>6</sup>

Article 9 has been amended on a number of occasions, notably by the 2012 amendment. The Royal Court said the pre-amendment position was ‘clear and unambiguous’ in the case of *CC Ltd v Apex Trust*.<sup>7</sup> where the validity of a transfer or other disposition to a trust governed by Jersey law is disputed, Jersey law is the proper law for determining that dispute, regardless of any other conflict-of-laws principles and regardless even of any express choice of law by the parties.

As the Royal Court identified in *Schroder*, this is problematic where the disposition of property originates from a trust governed by the law of a jurisdiction that has its own firewall provisions. Since Jersey conflict-of-laws principles are expressly excluded by article 9(3), an alleged defect in the disposition would require determination both in Jersey under Jersey law, and in the Cayman Islands under Cayman law, with all the risks of inconsistent judgments and legal costs that simultaneous proceedings in two jurisdictions would entail.

After *CC Ltd v Apex Trust* was decided, the 2012 amendment was enacted by the States of Jersey. This amendment inserted a new paragraph (2A) into article 9, opened up a number of instances where the firewall would not apply and reduced the likelihood of conflicts between firewalls and other incongruous results.

Article (2A) provides (emphasis added):

- ‘(2A) Subject to paragraph (2), paragraph (1) –
- (a) does not validate any disposition of property which is neither owned by the settlor nor the subject of a power of disposition vested in the settlor;
  - (b) does not affect the recognition of the law of any other jurisdiction in determining whether the settlor is the owner of any property or the holder of any such power;
  - (c) is subject to any express provision to the contrary in the terms of the trust or disposition;**
  - (d) does not, in determining the capacity of a corporation, affect the recognition of the law of its place of incorporation;
  - (e) does not affect the recognition of the law of any other jurisdiction prescribing the formalities for the disposition of property;
  - (f) does not validate any trust or disposition of immovable property situate in a jurisdiction other than Jersey which is invalid under the law of that jurisdiction; and
  - (g) does not validate any testamentary disposition which is invalid under the law of the testator’s domicile at the time of his death.’

The relevant limb for the *Schroder* case was the emphasised sub-paragraph (c). The Royal Court found that, provided the transaction by which property is disposed to a Jersey trust includes an express provision stating that the disposition is to be governed by the law of a foreign jurisdiction, paragraph 1 and the Jersey firewall will not apply. Further, the law chosen to govern the disposition governs not only its interpretation but also its material validity.

However, as per the language of article 9(2A)(c), the choice of law must be express; it is not sufficient that a foreign law may have a closer connection with the transaction so that, in the absence of the firewall, that law would apply under general conflict-of-laws principles.

The application made to the Royal Court sought that the decision of the Cayman court be ‘given

6. *In the matter of the IMK Family Trust* [2008] JLR 250; [2008] JLR 430

7. [2012] (1) JLR 314



effect'. The court asked for clarification as to exactly what was meant by this – in particular whether it was sought to enforce the decision or merely recognise it. The court noted that rule 42 of *Dicey, Morris & Collins on the Conflict of Laws* allows enforcement of a money judgment which is final and conclusive; that the Cayman decision was not a money judgment; but that there was Jersey authority which would go further than the *Dicey* rule and allow a non-money judgment to be enforced.<sup>8</sup>

However, the Royal Court determined that it was in fact being asked to recognise the judgment of the Cayman court and there was no restriction on what judgments can be recognised as determinative of a matter. The court, therefore, recognised the findings of the Cayman court that the appointments were void as being *res judicata* between the trustees of the Cayman trust and the Jersey trust, both trustees having been parties to the proceedings in the Grand Court. Accordingly, the trustees of the Jersey trust could safely return the assets transferred to them by the trustees of the Cayman trust.

As a footnote, the Royal Court held that, had it been required to apply Jersey law to determine whether the disposition of property to the Jersey trust should be set aside on the grounds of mistake, it would have reached the same result as the Cayman Court for essentially the same reasons.

**COMMENT**

The Royal Court's decision, as the first under the amended article 9, has potentially important implications for future disputes involving foreign trusts with Jersey connections. The scope of article 9(1) is broad, encompassing questions concerning not only the validity of transfers but the validity and interpretation of trusts themselves; the capacity of settlors; the administration of trusts and powers of trustees; the nature and extent of any beneficial interests; and the exercise of powers (statutory or otherwise) by foreign courts to vary trusts. Until the 2012 amendment, and

subsequently in a number of cases where the implications of article 9(2A) may not have been recognised,<sup>9</sup> the Jersey law of mistake was applied to documents closely connected with the establishment of a Jersey trust in cases where the documents contained an express choice of English and Welsh law to govern those documents. It is doubtful that the Royal Court will continue to follow the same approach if its attention is drawn to the 2012 amendment in future cases.

**IMPLICATIONS FOR OTHER JURISDICTIONS**

The implications for similar firewall provisions in other jurisdictions remain to be seen. Offshore jurisdictions, by their nature, cannot isolate themselves entirely from foreign laws and the 2012 amendment to the Jersey firewall seeks to achieve a realistic and workable balance between protecting Jersey trusts from adverse decisions in foreign courts and recognising foreign laws where considered appropriate.

Given the similarity between the firewalls existing in the various offshore jurisdictions, it may be that other jurisdictions will, in time, update and amend their firewalls in a similar way to Jersey. This could avoid the reputational damage and consequent competitive disadvantage created by incongruous and inconsistent judicial decisions concerning trusts established in those jurisdictions. In the meantime, trust lawyers and trust professionals should take note of the Jersey changes and bear them in mind when planning and executing cross-border transactions.

The success of the alternative claim to set aside the appointments on the grounds of mistake, being a mistake made by the trustees of the Cayman trust in the exercise of a dispositive power, further demonstrates that the relief for mistake has almost entirely supplanted the principle in *Hastings-Bass* for setting aside dispositive decisions of trustees.

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8. *Brunei Investment Agency v Fidelis Nominees* [2008] JRC 152

9. See *Representation of Wilkes and Wilkes* [2015] JRC 200