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In the Matter of the Representation of Rysaffe Fiduciares SARL [2021] JRC 230

Service area / Dispute Resolution and Litigation, Trusts and Private Wealth
Legal jurisdictions / Jersey
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Royal Court of Jersey (MacRae, Deputy Bailiff, and Jurats Crill and Dulake)

The Royal Court of Jersey has considered the so-called substratum rule and concluded that no such rule exists in Jersey law. The judgment concerned an application by a Trustee of two Jersey law trusts for the blessing of its decision to give effect to an agreement between beneficiaries regarding division of the trust assets.

A key aspect of the agreement was the addition of the late settlor's widow to the beneficial class of one of the trusts in order for her to receive benefit under it. The Court considered whether it was within the Trustee's powers to benefit the late settlor's widow from this trust, particularly whether the exercise by the Trustee of its power of addition was prohibited on the basis that it would *"destroy the substratum of the Trust"*.

Background

In 2015, the settlor of two Jersey law discretionary trusts died unexpectedly and intestate. An agreement was reached between the members of the settlor's family, which provided for a division of the assets held in the settlor's estate (the "**Estate**"), and in two Jersey law discretionary trusts settled in 2000 (the "**2000 Trust**") and 2008 (the "**2008 Settlement**") (together the "**Trusts**"). The financial affairs of the Estate and the Trusts were intertwined as the settlor had received significant loans from the 2008 Settlement, which were repayable by the Estate.

The Trustee sought approval of its decision "in principle" to give effect to the agreement that had been reached between the settlor's family.

The beneficial class of the 2000 Trust was defined in wide terms and included, not only, the settlor's widow, his step-child, a child from a previous relationship, two children and a grandchild from his first marriage, but also the settlor's ex-wife, his brother and his brother's former wife and issue.

Pursuant to a letter of wishes executed in 2009, the settlor expressed his wish that his widow should be treated as the principal beneficiary of the 2000 Trust during her lifetime, and thereafter his step-child and his issue should benefit.

The settlor was the only beneficiary of the 2008 Settlement during his lifetime, with two charities added as default beneficiaries upon the settlor's death as an interim measure. Pursuant to a memorandum of wishes made in 2008, the settlor expressed a wish that after his death *"my children"* be added to the class of beneficiaries, which the trustee interpreted to mean the settlor's three biological children.

A key aspect of the agreement reached between the family was for the settlor's widow to be added as a beneficiary of the 2008 Settlement so that the benefit of the loans repayable by the Estate could be appointed to her, with the settlor's widow thereafter being excluded.

Decision

There were two key points, which the Court considered:

1. that the proposed agreement departed from the settlor's letters of wishes in respect of the 2008 Settlement; and
2. whether it was within the Trustee's powers to add the settlor's widow as a beneficiary of the 2008 Settlement, if the effect of this was to *"destroy the substratum of the Trust"*.

Letter of wishes

The Court noted that, whilst letters of wishes are not binding on the Court or the Trustee, they *"are something that a Trustee ought to have regard to in relation to a decision such as this, particularly where the assets of the Trust were donated by the Settlor, and it is the Settlor and his family who were at all times principal beneficiaries of the Trust".*

The Court accepted the Trustee's evidence that, whilst it had given weight to the letters of wishes, they were executed at a different time (some years before the settlor's death) and were not updated to reflect the change in position as regards the assets of the Trusts, particularly to account for the outstanding loans. Further, based on subsequent conversations with the settlor, the Trustee considered that the settlor would have wished for his family to be provided for in a manner akin to that set out in the agreement, and for matters to be resolved in an amicable fashion.

The so-called substratum rule

The Royal Court rejected the proposition that there is an absolute rule that prohibits the exercise of the power of addition and exclusion of beneficiaries to alter the *"substratum"* of a trust (being the trust's basic or underlying purpose). The argument is that the use of powers in a trust deed to destroy the substratum amounts to the use of trust powers for purposes for which they were not conferred.

The Royal Court applied the decision of the Court of Appeal of Bermuda in *Grand View Private Trust Company Ltd v Wong, Wen Young & Ors* [Civil Appeal No. 5A of 2019]. In *Grand View* the Court of Appeal reversed the first instance decision of the Supreme Court of Bermuda which held that there was a legal prohibition on using general powers of amendment to change the underlying character or substratum of a trust.

The Court of Appeal in *Grand View* acknowledged the difficulty in applying such a substratum rule where it may be difficult to define the characteristics of the substratum especially when such a substratum may not necessarily exist. In rejecting the existence of a substratum rule, the Bermuda Court of Appeal held that there is no reason to suppose that settlors would wish to constrain trustees by reference to *"some wholly unexpressed "substratum""* rather than conferring on trustees the maximum flexibility to meet unforeseen changes whilst having regard to settlors' wishes expressed upon establishing trusts and from time to time during the existence of trusts.

In terms of the equitable constraints imposed on trustees in the exercise of their powers, the Bermuda Court of Appeal referred to the three questions identified by Lord Walker in *Pitt v Holt*; *Futter v Futter* [2013] UKSC 26:

- is the exercise of the power within the scope of the power
- has the trustee given adequate deliberation as to whether and how he should exercise the power; and
- is the power being used for an improper purpose (a purpose other than one for which it was conferred).

The Royal Court adopted the principles outlined by the Bermuda Court of Appeal and concluded that:

> *"There is no substratum rule. It is unnecessary for such a rule to be adopted, as the approach of Lord Walker in Pitt v Holt referred to at paragraph 42 above is sufficient. Powers of addition and exclusion are to be given their natural meaning when considered with the three questions posed by Lord Walker in mind".*

The Royal Court determined that the proposed exercise of the Trustee's power to add the settlor's widow was permitted, had been given adequate consideration and was for a proper purpose having regard to all of the circumstances of the case.

The Royal Court thereafter approved the Trustee's decision to give effect to the agreement between the family, which it considered was in the interests of all of the beneficiaries.

Conclusion

This decision provides welcome confirmation that the so-called substratum rule does not exist as a matter of Jersey law.

It provides reassurance to those settlors who seek to establish trusts with appropriate flexibility to deal with changing needs and circumstances. In particular, broad and unlimited powers of amendment will be able to be used by trustees in accordance with their terms, having due (but not slavish) regard to the settlors' wishes both when the trust was established and at the time the power is exercised.

Louise Woolrich presented the application on behalf of the Trustee, and was supported by Andreas Kistler and Dean Robson.

Continued

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