

‘Momentous’ decisions in dividing trust assets

24/08/2016

Private Client analysis: In the matter of the LKM Discretionary Trust, the court considered the definition of a ‘momentous’ decision regarding the distribution of trust assets. Karen Le Cras, partner and head of the litigation and dispute resolution group at Carey Olsen, along with Richard Field, counsel, and Paula Fry, associate, examine the background to the case and its potential impact.

What is the background to the case?

The trustee of the LKM Discretionary Trust was asked to make a substantial distribution from trust assets to enable a beneficiary to satisfy the terms of a deferred prosecution agreement (DPA) and a settlement agreement. The beneficiary had negotiated these agreements with foreign authorities in order to resolve proceedings and investigations brought against him.

The claims against the beneficiary involved alleged fraudulent misrepresentations and omissions in respect of certain investments, leading investors to claim damages against the beneficiary and others. Further, the authorities in the relevant jurisdiction investigated and brought criminal proceedings against the beneficiary and others, which meant that the beneficiary was subject to an arrest warrant and faced costly on-going litigation and defence costs. The DPA and the settlement agreement were signed with a view to bringing those proceedings to an end, without the need for significant further costs being incurred.

The beneficiary asked the trustee to make the distribution on the basis that the beneficiary did not have independent means to satisfy the payment due under the DPA.

The LKM Discretionary Trust was established under Guernsey law as a conventional discretionary trust. The original class of beneficiaries included the beneficiary, the beneficiary’s wife, their daughters and any other person added to the class. By a subsequent appointment, a sub-fund was created for the principal benefit of the beneficiary and the daughters (the Main Fund).

The terms of the trust conferred broad powers upon the trustee. These included the power to raise any assets out of the main fund and to apply them for the benefit of any main fund beneficiary. Moreover, the trustee was entitled to exercise its powers in an unfettered manner (save for its inherent fiduciary obligations) and could ignore entirely the interest of any other beneficiary of the fund.

The assets of the main fund included cash and the share capital of companies owning real estate (one of the properties was the family’s main residence). While the distribution did not represent the majority of the overall assets of the main fund, it would, if paid, represent a significant part of the liquid assets, thereby affecting the liquidity of the main fund.

The trustee was satisfied that it had the requisite powers to make the distribution for the benefit of the beneficiary under the terms of the trust—however, the trustee recognised that its decision to proceed with the payment was one that might be considered as ‘particularly momentous’ in the circumstances.

As part of its deliberations, the trustee identified that real benefit could accrue not only to the beneficiary but also to the remaining beneficiaries of the trust. For instance, the trustee highlighted the direct benefit to the beneficiary of being permitted to travel, no longer facing on-going litigation with its ensuing costs and resuming a regular home-life. The trustee also considered the collateral benefits to the family in that the daughters would be able to see their father on a more regular basis and the family’s domestic circumstances would be improved. Moreover, the trustee was mindful that the making of the distribution was likely to benefit the trust more widely, as it would enable the trustee to access funds to manage and maintain the real estate within the trust.

In considering whether to make the distribution, the trustee noted that the distribution represented a significant sum and a substantial proportion of the liquid assets of the main fund. It also had to consider the beneficiary’s need to satisfy the terms of the DPA. The trustee therefore made an in-principle decision to make the distribution, subject to an application to the court for its blessing in order to protect the trust from future claims.

The trustee's decision was set out in very full and considered minutes, which charted in detail the trustee's thought process and the factors it took into consideration in reaching its decision. The court noted the detail provided by the trustee, which undoubtedly assisted in terms of persuading the court that the trustee had given the matter due consideration.

What was the outcome?

The court was satisfied that the trustee's application fell squarely into 'category two' of the categories set out in *Public Trustee v Cooper* [1999] All ER (D) 1524 and that its jurisdiction to entertain such claims was well established. The court was also satisfied that the trustee had not surrendered its discretion to the court and that the decision to make the distribution could be properly regarded as 'momentous'.

When assessing the 'momentous' nature of the decision, the court was referred to various authorities including *Kan v HSBC International Trustee Limited* [2015] JCA 109 (registration required), a Jersey case in which Bompas JA referred to a momentous decision as being 'a decision of real importance for the trust' and the *Re F Guernsey* judgment 32/2013 (registration required), a Guernsey case in which Martin JA effectively inverted the test and stated that if 'the court considers that the trustees' decision is of insufficient moment, it may refuse to entertain the application'.

After considering a number of Guernsey authorities (including the very recent case of *A (as Trustee of the Trust) and R1, R2, R3, R4 and R5 Guernsey* Judgment 25/2016 (registration required) in which the Royal Court approved the distribution of assets which was opposed by one beneficiary), the court set out the applicable test that it was required to address before approving a momentous decision:

- (a) Did the trustee have the power under the terms of the trust instrument, the instrument of appointment and the Trusts (Guernsey) Law, 2007 to make the 'momentous decision' of making the distribution?
- (b) Was the court satisfied that the trustee had formed the opinion to do so in good faith and that it was desirable and proper for it to make the decision?
- (c) Was the court satisfied that the opinion formed by the trustee was one which a reasonable trustee in its position properly instructed and informed could have arrived at?
- (d) Was the court satisfied that the opinion arrived at by the trustee had not been vitiated by any actual or potential conflict of interests which either had or might have affected its decision?

In considering questions (b), (c) and (d) the court noted that it should exercise caution, it should not act as a rubber stamp, and it should not take a lax approach.

Taking each point of the test in turn, the court was satisfied that:

- the trustee had sufficient powers under the terms of the trust to make the distribution
- taking a cautious approach and being satisfied on the 'thorough and extensive' factual evidence placed before it, the trustee had formed the opinion to make the distribution in good faith and that it was desirable and proper for it to make the decision to do so
- after taking a cautious approach and being satisfied on the evidence, the opinion formed by the trustee was one which a reasonable trustee could have arrived at—the court was especially satisfied on the evidence that the present state of affairs was having an adverse impact on the family of the beneficiary and that not making the distribution could have a potentially ruinous impact on the trust assets and the beneficiaries
- there was no evidence that the decision of the trustee to make the distribution had been vitiated by any actual or potential conflict of interests which had or might have affected its decision

Accordingly, the court decided to approve the trustee's decision to make the distribution.

Why is it important?

The court considered and helpfully summarised the most recent authorities from Guernsey, Jersey and England and Wales, making *LKM Trust* the most recent exposition of the law in this area.

The case gives clarity as to the approach to be taken by trustees and guidance as to the factors that trustees should consider when considering making an application to court for the blessing of a 'momentous' decision. It also sets out the scope of the court's role and its powers and is a useful reminder of the fact that the court will not substitute its own view for that of the trustee.

The court was careful not to prescribe a rigid set of requirements that would be necessary to illustrate that a decision was of sufficient moment. It underlined that all 'category two' applications are largely fact-sensitive. The refusal of the court to set out any form of prescriptive formula is to be welcomed. While some guidance can be elicited from the authorities in terms of the broad circumstances in which a trustee has ascribed the label 'momentous' to a decision, the context will be very different in each individual case.

What implications does this have for trustees?

It is important that trustees put sufficient and detailed evidence before the court to demonstrate that they have considered the pertinent matters in detail and made evidence-based decisions.

The importance of full and rational minutes of trustee meetings (or written resolutions made at the time the relevant momentous decision was made) cannot be overemphasised. The trustee's decision and reasons for it should be documented comprehensively and clearly, in a manner which demonstrates that the trustee has noted the background, has set out its deliberations and has resolved to make the 'momentous' decision.

Furthermore, and depending on the circumstances of the case, the court may well take into account other relevant factors, such as the collateral benefit to the beneficiaries and the trust assets, the pecuniary position of the beneficiaries or any of them and the composition of the assets of the trust. The trustee should therefore give consideration to such factors in its own deliberations.

Is there anything else that practitioners can take from this?

The judgment provides a welcome summary of the relevant law, helpful guidance as to how to approach such applications and sheds light on the likely approach of the court when dealing with 'momentous' decisions. While trustees will on occasion still need to think carefully as to how to approach particular decisions, the guidance set out here will doubtless assist them in that process. It is also a welcome reminder that the court will take a pragmatic approach when recognising the dilemmas that trustees face in their daily role.

Interviewed by Alex Heshmaty.

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