SOUTHERN FEDERAL TAX INSTITUTE

IT'S ENGLISH TO ME: NON-U.S. TRUST LAW FOR U.S. LAWYERS

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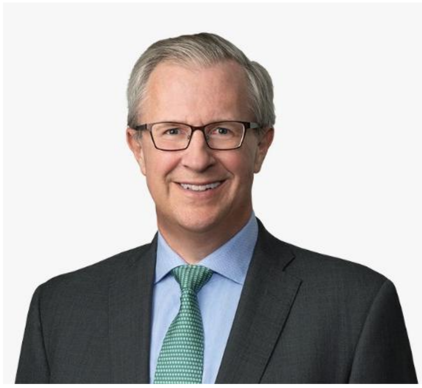

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Bernadette is the head of our Cayman Islands trusts and private wealth team and has a broad private client practice advising on wealth structuring and estate planning matters including the creation of dynastic structures; the administration, restructuring, and termination of trusts; and probate and testamentary issues. She is also an experienced litigator in the private client space, regularly appearing before the Grand Court of the Cayman Islands on multi-party non-contentious applications and contentious trust disputes, as well as in respect of estate litigation and other cross-border private client disputes.

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Bernadette is an elected member of the International Academy of Estate and Trust Law (TIAETL), where membership to the global body is by invitation only. She is also an International Fellow of the American College of Trusts and Estates Counsel (ACTEC), and a long-standing Council Member of the Cayman Islands branch of the Society of Trusts and Estates Practitioners (STEP). She is a director of the Cayman Islands Family Office Association, launched in 2022. Bernadette is the author of the Cayman Islands chapters of numerous private client text books, including "International Estate Planning: A Reference Guide" and "Trusts in Prime Jurisdictions". Bernadette was listed as a Global Elite Thought Leader in *Who's Who Legal* for Private Client. She is also ranked by both Legal 500 and Chambers and Partners High Net Worth, and features in the 2024 Private Client Global Elite Directory.

IT'S ENGLISH TO ME:
UNDERSTANDING FOREIGN TRUST LAW

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I. Introduction

When a U.S. lawyer advises a U.S. citizen or resident client who is a beneficiary of a foreign trust, the lawyer will often focus on how the government will tax the distribution and how the beneficiary must report the distribution. While the relevant tax and reporting rules are complicated, a lawyer can easily find these rules, regulations related to the rules, court decisions related to these rules, and instructions on how to fill out the relevant forms. But advising clients on tax issues related to foreign trusts is usually only part of the advice.

Lawyers in the United States must also help clients understand the terms of a foreign trust, the nature of the beneficiary's interest in the trust, the scope of the trustee's powers, and the beneficiary's right to information related to the trust. In some instances a client will be asked to consent to a decision made or proposed by the trustee of a foreign trust. Because trusts are so commonly used in the United States and U.S. trust law is so well developed, you might think it is easy enough to advise the client on trust law issues of this kind. After all, almost all trust instruments, trust legislation, and court decisions related to trusts are in English. It is tempting to think that U.S. lawyers are well equipped to advice on foreign trust law and administration issues because they see issues of this kind in the domestic context.

Although all trust law comes from the same place – England – trust law and trust administration differs considerably among the trust law countries, and it is not safe to assume that the law of another trust law jurisdiction is the same as the trust law of a U.S. state. Similarly, it is not safe to assume that trust administration practices in other trust law jurisdictions are the same as they are in the United States, nor is it safe to assume that trust beneficiaries of foreign trusts have the same rights as they would with respect to a U.S. trust. To properly advise a U.S. client who is a beneficiary of a foreign trust or who is otherwise involved with a foreign trust, a U.S. lawyer must understand that foreign trust law and practice is not the same as it is in the United States.

The purpose of this outline is to give U.S. lawyers a guide to key areas in which foreign trust law and practice differs from U.S. trust law and practice. The outline focuses both on English law, from which all trust law is derived and which influences the trust law of other countries more than it influences the trust law of the United States, and the trust law of offshore financial centers. In the outline, we address several areas of U.S. trust law and practice and then compare them to the equivalent law and practices in England and other trust law countries. Just as the trust law of U.S. states, the trust law of other English-speaking countries differs. However, there are many shared laws and practices in the non-U.S. trust law countries that a U.S. lawyer should know in order to advise U.S. clients and we hope this outline is a helpful resource.

II. Understanding Foreign Trust Law

A. What are the Sources of Non-U.S. Trust Law?

All English-speaking countries have trust law, a common inheritance from England. In the United States lawyers are accustomed to evaluating trust law questions based on extensive trust legislation in all the states as well as decades' worth of court decisions on trust-related matters. English trust law, by contrast, is less legislation-driven and more common law-driven and often evolves at a considerably slower rate as a result.[1] English trust law statutes have always provided in a limited sense for the "traditional" purposes of a trust which were, broadly speaking, to hold property, to secure assets for families, and to ensure tax efficiencies. Twentieth century English trust legislation, outside the specialist application of trusts as vehicles for commercial investment and pension provision, saw a spate of legislation clarifying the scope of or setting a base line for trustee powers and duties, principally focusing on administrative matters. However, in more recent times, and particularly offshore, trust law has evolved via case law later enshrined into legislation to allow for more flexible relationships with broad powers, new roles and offices, and purpose-designed protection.

Other English-speaking jurisdictions tend to follow the English model, with legislation supplementing the common law of trusts. Trust law in Australia and Canada, like the United States, varies by state, province, and territory, with each political subdivision having its own legislation and court decisions, though like in the United States, courts in the various political subdivisions follow court decisions from others. Other countries such as New Zealand, Singapore, Switzerland, France and Brazil apply national, rather than state or provincial, trusts law some of which is relatively new by comparison. In all these countries, however, trust legislation is much less extensive than it is in the U.S. states.

Moving further offshore, trust legislation has tended to evolve in a progressive manner in order to suit the modern needs of an internationally connected private client. The major offshore jurisdictions (including Jersey, Guernsey, the Cayman Islands, and the British Virgin Islands (the "BVI")) have proven to be more agile in terms of their legislative developments and have attracted an open-minded and highly skilled judiciary. The result is modern legislation and wealth structuring options that are flexible and easy to understand and, designed to meet the developing needs of an increasingly varied and international client base.

Even within the "offshore" English-speaking jurisdictions, there are nonetheless marked differences in approach to the evolution of trust law. The Cayman Islands and Bermuda follow the English model but tend to have more extensive legislation and less case law. In the Crown Dependencies (Jersey, Guernsey and the Isle of Man) English law principles are followed but the influence of French law can still be felt in some aspects of trust law.

The greater reliance on legislation in some of those jurisdictions reflects the importance of the trust business, as is the case in some U.S. states. For example, some of the offshore jurisdictions have been leaders in developing "firewall" legislation that shields or protects trusts established in offshore jurisdictions from foreign laws or judgments. All of the Crown Dependencies have enacted "firewall" provisions in their respective laws, as have the Cayman Islands, Bermuda, and the BVI. These provisions require in essence, that a court should generally determine matters concerning trusts governed by the laws

[1] *See generally* T. Gallanis, "The Dark Side of Codifying U.S. Trust Law," 49 ACTEC L. J. 283 (2024); L. Clover-Alcolea, "Policy Over Doctrine: A Brief History of U.S. Trust Law," 49 ACTEC L. J. 127 (2024).

of those jurisdictions in accordance with local law without any reference to foreign laws. Firewall provisions also require that a local court not enforce any decision of a foreign court to the extent that the decision is not in accordance with local law, subject to certain exceptions, often including the important question of whether or not the transfer of property outside the relevant jurisdiction into the trust was valid in the first place. The breadth of the offshore jurisdictions which have enacted firewall legislation indicates the importance of security and certainty for families seeking to structure their wealth and the focus of the offshore jurisdictions on offering up viable solutions in a dynamic global environment.

Judges in England and in offshore jurisdictions refer extensively to trust law decisions from other English-speaking jurisdictions. It is not uncommon for a judgment in one jurisdiction to refer to English precedents as well as precedents from other jurisdictions. This is similar to the way that the U.S. states with little trust law rely on decisions from other states. But the borrowing in the offshore jurisdictions is much more common and accepted and often, but not always, leads to a level of uniformity on trust law principles on those jurisdictions. However, as would be expected, in areas of comparative legal novelty – such as the proper extent of a protector's duties, or the right of beneficiaries to see trust documents other than accounts and the trust deed – there are sharp distinctions between the jurisdictions.

B. Choice of Law Principles

An important preliminary issue in evaluating legal questions related to all trusts, foreign and domestic, is to determine which law applies to a trust. Most trust instruments specify a choice of law in one way or another, though the form of these kind of clauses varies widely. If a trust does have a choice of law clause, it typically raises several questions:

- What is the scope of the choice of law clause? Does it cover validity, construction, and administration of the trust?
- Is the settlor's choice of law for a particular question a valid choice of law under applicable conflicts of law rules under the law of the chosen jurisdiction?
- If the choice of law clause has gaps, what law applies?
- How do you interpret a choice of law clause?

If a trust instrument does not have a choice of law clause, or if the trust instrument's choice of law clause does not address a particular legal question that arises, then the analysis turns to what law should apply to that question. The answer may be found in choice of law legislation or in choice of law common law that a court chooses to apply.

1. U.S. Choice of Law Principles

In the United States trust choice of law rules have traditionally focused on three separate issues: formal and substantive validity of a trust, the construction and interpretation of a trust instrument, and the administration of the trust. The U.S. states have also long distinguished inter vivos trusts and testamentary trusts and trusts that hold real property and trusts that hold moveable property in their choice of law rules.[2]

[2] There is an emerging professional consensus that as a matter of public policy the distinction between immovable property and movable property in conflict of laws related to trusts and estates is no longer helpful or useful. Both the American Law Institute in a forthcoming Restatement of the Law on Conflicts as well as the Uniform Law Commission in a forthcoming Uniform Act on Choice of Law for Trusts and Estates will eliminate the distinction.

If a settlor has chosen the applicable law in a trust instrument, U.S. courts would traditionally evaluate whether to respect or not respect the choice of law with respect to the validity of a trust based on the following principles:

- For a trust that holds real property a court will apply the law of the state in which the real property is located with respect to validity matters. If the settlor chose the law of another state, a court would typically not respect that choice of law with respect to validity of the trust.[3]

- For a trust that holds movable property, a court will typically respect a choice of law to govern the validity of the trust if:

    - There is some substantial relationship to the trust to the state selected; and

    - The application of the chosen law does not violate a "strong public policy" of the state with the most significant relationship to the trust.[4]

For purposes of this rule, a state will have a "substantial relationship" to a trust if:

- The trust is administered in the state.

- The trustee's place of business or residence is in the state.

- One or more beneficiaries reside in the state.

- The settlor or testator resides in the state.[5]

A U.S. court will usually respect a settlor's choice of law with respect to matters of interpretation and construction of a trust instrument; the settlor need not be connected to the particular state. In contrast with the common law on matters of trust validity, U.S. courts will also respect a settlor's choice of law on matters of construction for trusts that own real property even if the selected law differs from the law of the situs of the property.

A court will generally respect a settlor's designation of the law of a particular state to govern the administration of a trust that owns movable property.[6] As is the case with matters of interpretation and construction, the settlor or testator can choose the law of a jurisdiction that has no connection to the trust.[7] In the absence of a designation of governing law, the law of the jurisdiction in which the trust is actually administered will generally govern matters of administration.[8] On the other hand, a court may not respect a forum selection clause in a trust deed when pursuing a trust-related action in that forum would be difficult

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[3] *See generally* Restatement (Second) of Conflicts of Law § 278.
[4] *See* Restatement (Second) of Conflicts of Laws §§ 269(b) (testamentary trusts) and 270 (inter vivos trusts).
[5] Restatement (Second) of Conflicts § 269, comment f; Restatement (Second) of Conflicts of Laws § 270, comment b. Comment (b) to section 270 provides that "other contacts or grouping of contacts" may satisfy the substantial relationship test. *See, e.g.*, *In re Rensin*, 600 B.R. 870 (S.D. Fla. Bankr. 2019) (court ignored Belize choice of law clause in trust instrument and instead applied Florida law in evaluating trust-related matters on public policy grounds); *Dahl v. Dahl*, 459 P.3d 276 (Utah 2015) (in a trust matter related to a divorce proceeding of residents of Utah, court refused to recognize Nevada choice of law in a trust agreement and instead applied Utah law).
[6] *See* Restatement (Second) of Conflicts of Law § 271(a).
[7] Restatement (Second) of Conflicts of Law § 271, comment (c) (the settlor "can freely regulate most matters of administration" and "may provide that different matters of administration shall be governed by different laws").
[8] *Id*., comment (d).

or inconvenient.[9] For trusts that own real property, the applicable law with respect to trust administration is the law that a court in the situs state would apply, which would ordinarily be that state's own law.[10]

Despite these familiar common law rules, U.S. states have engaged in a lot of considerable legislative activity related to trust choice of law questions over the years with the result that many choice of law questions are now answered by statute rather than by court decisions. In particular, the U.S. Uniform Trust Code or "U.T.C." has a broad choice of law provision that simplifies trust choice of law rules. Under section 107 of the U.T.C., the law of the jurisdiction designated in the trust instrument will govern legal questions related to the trust unless the designation of that particular jurisdiction's law "is contrary to a strong public policy of the jurisdiction having the most significant relationship to the matter at issue." The drafters of the U.T.C. based this provision in part on a provision in the Hague Convention on the Law Applicable to Trusts that gives a settlor wide discretion to specify the law that governs a trust instrument, a rule that this outline discusses in more detail below.[11]

The U.T.C. also address choice of law issues with respect to trust administration, providing that a court will respect a settlor's choice of a particular state as the "principal place of administration" of the trust as long "the trustee's principal place of business is located in or a trustee is a resident of the designated jurisdiction" or "all or part of the administration occurs in the designated jurisdiction." This rule, however, is not exclusive; section 108(a) notes that this particular rule does not preclude other means for "establishing a sufficient connection with the designated jurisdiction." The drafters of the U.T.C. did not attempt to meaningfully define "principal place of administration" for this purpose, though the notes to section 108 point out that the principal place of administration will typically be where the trustee resides. The implication of section 108 is that a choice of law related to matters of administration of a trust must have some relationship to where the trust is in fact being administered.

Despite its name, however, many states that adopted the Uniform Trust Code tinkered with the language in sections 107 and 108, undermining its uniformity. For example, Illinois changed section 107 to provide a general rule that unless otherwise expressly provided by the trust instrument or by court order, Illinois law governs the administration of a trust while the trust's principal place of administration is in Illinois.[12] Pennsylvania rewrote section 107 to provide that "meaning and effect" of the provisions of a trust instrument are determined under the law specified in the trust instrument unless that law has a provision that differs from Pennsylvania's mandatory (i.e. nonchangeable) rules in its version of the U.T.C.[13] Pennsylvania also rewrote section 108 to change "principal place of administration" of a trust to the "situs" of a trust and added a rule that a choice of law related to the situs of a trust would also be valid if a beneficiary resided in the chosen jurisdiction.[14] The list goes on and on: Florida, Ohio, and Minnesota made various changes to sections 107 and 108, and Massachusetts adopted section 108 but not section 107.

States that have not adopted the U.T.C. have also enacted legislation addressing choice of law issues, sometimes with an eye towards attracting trust business in their states. In South Dakota, for example,

[9] *See, e.g., Beaubien v. Cambridge Consolidated, Ltd*., 652 So. 2d 936 (Fla. App. 1995) (Florida court refuses to give effect to clause in trust deed declaring that the forum for legal proceedings related to a Cayman trust would be the Cayman Islands in light of various factors, including current lack of connections to the Cayman Islands).

[10] Restatement (Second) of Conflicts of Law § 279. Comment (b) to section 279, however, notes that a court could respect a settlor's choice of the law of another state to govern the administration of the trust or at least some issues of administration.

[11] *See* Comment to U.T.C. § 107.

[12] *See* 760 ILCS 3/107(b).

[13] 20 Pa. Consol. Stat. § 7707(1).

[14] 20 Pa. Consol. Stat. § 7708(a)(3).

a South Dakota court will respect a choice of South Dakota law in a trust instrument in the following circumstances:

- The trustee is a "qualified person" and as trustee holds assets in South Dakota, including in a bank or other financial account in South Dakota;

- The trustee is a "qualified person;" or

- The administration of the trust takes place in South Dakota on an exclusive or nonexclusive basis.[15]

A "qualified person" is an individual who has a "true and permanent home" in South Dakota, a trust company organized under South Dakota law, a trust company organized under federal law that has its principal place of business in South Dakota, or a bank or savings association that has its principal place of business in South Dakota provided its deposits are insured by the Federal Deposit Insurance Corporation.[16]

Delaware has an interesting approach to its choice of law rules that focuses on the place of administration of the trust in addition to a choice of law in a trust instrument. Under Delaware law, if a trust is in fact administered in Delaware then a Delaware court will apply Delaware law to questions of the administration of the trust "notwithstanding a general choice of law provision in the governing instrument of a trust, such as a provision to the effect that the laws of a jurisdiction other than [Delaware] shall govern the trust or the administration of the trust."[17] This rule will not apply if the trust instrument in question provides that the law of another jurisdiction governs the administration of a trust and further provides that that law will not change if the place of administration is changed.[18]

2. Choice of Law Principles in Non-U.S. Trust Law Jurisdictions

From an English perspective the central issue around choice of law principles is the same as in the United States: is the purported trust arrangement one which English law will respect on its own terms where the trust itself is not governed by English law? This could be expected to arise within the context of non-English law trusts being established by English resident settlors, trusts providing benefits to English resident beneficiaries, and trusts owning real property located in England. This central proposition contains myriad subsidiary issues, such as the capacity of the settlor to create the trust, the precise extent of the administrative powers of the trustee over property located in England, the ability of English law to override an otherwise valid trust in whole or in part, but is one English law has historically sought to address by favoring the settlor's freedom of choice.

It should also be kept in mind that England does not have "firewall" legislation codifying the matters to be governed by English law, such that the broader English conflicts of law principles are often in play when determining the precise effect of a trust relationship. For example, simply because a trustee is the purported owned of an asset will not mean that English law will – ultimately – respect that ownership if the transfer to the trustee was defective for the purposes of another applicable foreign legal regime which English conflicts of laws rules also give effect to. Full discussion of these rules is beyond the scope of this outline, but the following principles can be observed:

[15] S.D.C.L. § 55-3-39.
[16] *See* S.D.C.L. § 55-3-41.
[17] 12 Del. Code § 3332(b).
[18] *Id*.

- Transfers of moveable property into trust by virtue of a formally valid testamentary document will be, under English law, subject to the forced heirship rights of the decedent's domicile.

- Transfers of immoveable property into trust by virtue of a formally valid testamentary will be, under English law, subject to the forced heirship rights of the law of the jurisdiction where the property is situated.

- Lifetime transfers of immoveable property into trust will, under English law, be subject to any local law applicable mandatory rights, potentially including forced heirship rights, and require a determination that the trust is itself valid under the applicable law (as identified below).

- Lifetime transfers of moveable property into trust will not be subject to forced heirship rights unless it can be established those rights are of a proprietary nature or the applicable law of the trust contains mandatory forced heirship rights and the trust into which it is transferred must be found valid under the applicable law (as identified below).

- Lifetime transfers of property subject to a matrimonial community property regime will likely be valid unless the specific regime confers proprietary rights to the other spouse or merely a personal claim against the transferring spouse.

In the English context regarding the law of trusts, this is one area where legislation has had an important simplifying role. As with the United States, over the decades, the English courts developed a complex webwork of rules regarding the recognition of trust arrangements established under legal systems other than those of England. This was, however, at times an incomplete or unclear framework.

The United Kingdom ratified the 1985 Hague Convention on the Law Applicable to Trusts and on Their Recognition (the "Hague Convention") and amended its domestic laws via the Recognition of Trusts Act 1987 for trusts created on or after August 1, 1987. This legislation adopts as England's conflicts of law rules in this area Articles 1-12, 14-18 and 22 of the Hague Convention. Importantly, these principles were extended in domestic law to apply to more kinds of trusts than the convention itself applies to. While the Hague Convention's rules for trusts are confined to those created voluntarily in writing, the Recognition of Trusts Act applies these rules to all trusts created by operation of U.K. law and all trusts established by virtue of a judicial decision, whether from a U.K. court or from elsewhere.

The effect of this legislation is that, under English law, a trust or settlement purported to be governed by a law other than English law will be recognized as valid in English law and the rules of the contrition, effect and administration of the settlement governed by the specified law if it is the law:

- Expressly chosen by the settlor;

- Impliedly chosen by the settlor (looking to the instrument creating the trust and the relevant surrounding circumstances); or, failing either of which

- To which the trust is most closely connected (focusing on the place of administration designated by the settlor; the location of the assets and the trustee; and the location of the beneficiaries at the time of creation); but, in all cases

- If a trust fails to be recognized under these rules, pre-existing common law rules may be relied upon if they would result in recognition of the trust.

A recent case considering the application of the Recognition of Trust Act is *Crescent Petroleum Company International Ltd and another company v Retirement, Saving and Welfare Fund of Oil Industry Workers*.[19] This case is interesting given its consideration of the core question: what is a trust for the purposes of recognition the first place. While this question is unlikely to vex practitioners where the arrangement is one established under a common law jurisdiction, the proliferation of offshore legislation developing and enabling more and more fiduciary arrangements akin to, but not necessarily four-square with, an English law trust, may well engage this question more often than anticipated.

The case concerned the ability of a judgement creditor, the applicant, to obtain a court judgment transferring U.K. real estate in the name of the respondent to the creditor in part satisfaction of an arbitration award. The respondent argued it held the real estate pursuant to an Iranian law arrangement, which was equivalent to being trustee of a foreign law trust, in favor of a non-U.K. pension fund. While not arguing that the relevant Iranian arrangement was a trust as understood in English law, the court was obliged to consider whether the Iranian law concepts or *amanat* and *amin* were "trusts" for the purposes of the convention, with the court noting:

> It is common ground between the experts that where an *amanat* exists the owner entrusts an asset to the *amin* but retains ownership of the asset. The *amin* has no ownership of the asset and has no right to deal with the asset or to enjoy the fruits of ownership other than in accordance with the terms of the *amanat*. An *amin* cannot be equated to an English law trust since a trustee has the legal proprietary interest in the asset which is the subject of the trust…. A trust and an *amin* "are not the same thing." In Iranian law there is no division between legal and beneficial ownership. There is one concept of absolute ownership.[20]

The facts of the case were exceedingly complex and required consideration of decades of ownership information. For present purposes, it is sufficient only to note that the court concluded because there was no division of legal and beneficial ownership, the *amanat* arrangement could not be viewed as equivalent to a trust and so no question of its recognition under the Recognition of Trusts Act ever arose. The court then applied the rule of the Hague Convention (which is also included in the U.K.'s domestic legislation) that should a trust fail to be recognized under the terms of the Hague Convention, one must consider if a non-legislative common law rule would recognize the purported trust arrangement. In short, while the Hague Convention's rules are the default analysis for the recognition of a trust, more generous common law rules which would recognize the trust arrangement are not displaced by the legislation.

The respondent argued that it held the U.K. real estate on an express trust under English law if there was a declaration of trust and there was an intent to create a trust. The court accepted as a matter of principle that an Iranian entity (i.e. established under a system of law which does not recognize the distinction of legal and beneficial ownership) could create a trust under English law of English situate property.[21] However, the court found on the facts while there were valid declarations of trust because they were of English situate property, they were not enforceable unless evidenced in writing signed by the settlor (due to U.K. formality requirements in the Law of Property Act 1925). As such, the case is a recent exploration of English law questions around the recognition of trust arrangements where they are either governed by foreign law or where there is an argument that English law is the governing law, by implication (assuming it was the fact the subject of the arrangement was in England).

Where the Hague Convention does not apply (e.g. to trusts created before 1987), the old common law English law rules apply. These are varied depending on the type of trust concerned (testamentary trusts;

[19] [2024] EWHC 835.
[20] *Id*. at ¶ 35.
[21] *See, e,g, Akers and others v Samba Financial Group* [2017] AC 424.

lifetime trusts of non-U.K. immoveable property; lifetime trusts of non-U.K. moveable property). These broadly reflected the English courts' approach that a settlor is free to choose the law of any jurisdiction he or she wishes to govern dispositions of moveable property provided:

- There was a reasonable connection between the settlor and the choice, albeit the precise extent of that requirement is unclear; and

- That the validity of a trust over foreign immoveable property will depend on whether the trust arrangement is recognized in that same jurisdiction.

If a trust met these criteria, then an English court would recognize the existence of the trust. In the absence of an express or implied governing law choice, the law that will apply to recognition is that to which the trust is mostly closely connected.[22]

Turning to the offshore world, perhaps not unexpectedly choice of law principles are invoked on a regular basis. The circumstances in which a trust was created and the location of the settlor, the trustee, the beneficiaries, the trust property, and the administrator of the trust will all be relevant. In many cases, each may well be so closely connected with the settlor's domestic jurisdiction that there are no foreign elements that require further consideration and no question about the law to be applied to whatever issue is under consideration. More often than not, however, there are a number of foreign elements coursing through the veins of the trust structure that will inevitably engage conflict of law rules and render the question of the law applicable to a trust highly significant.

The conflict of law rules applicable in non-U.S. trust law forums will ultimately determine whether or not the forum in question has jurisdiction over a particular dispute. The rules may vary from forum to forum, often fall to be determined by reference to common law, and rely on a high degree of judicial discretion.

Cross-border structures offer up an apparently infinite number of scenarios in which the question of choice of law does not solicit an easy answer. By way of example, an individual, C, who is domiciled in Country Y may transfer property to a trustee in Country Z for the benefit of beneficiary B. If the laws of Country Y prohibit such a transfer if it operates to defeat the claims of his heirs (and beneficiary B is not an heir) then the laws of Country Y may refuse to recognize the transfer (or indeed, the concept of a trust itself) and declare the transfer void such that the property is said to remain part of C's estate. However, Country Z will recognize the trust and its laws may not permit the transfer to be defeated. Where to from there?

If Country Z has "firewall provisions" of the type mentioned earlier, the answer as to which law governs the trust and its administrator may not be particularly elusive. As noted above, firewall legislation is designed to protect trusts from attacks by forced heirs and those claiming against the trust by reason of a personal relationship with the settlor. Such attacks might include, by way of example:

- Family provision or inheritance claims brought by a spouse, ex-spouse, child or other dependent;

- Claims brought based upon community property rules in civil law jurisdictions; claims pursued by a trustee in bankruptcy, a receiver or some other insolvency process concerning a settlor or beneficiary's estate; or

[22] *Iveagh v IRC,* [1954] Ch. 364.

- Forced heirship claims from the executors or administrators of the estate of a settlor or beneficiary or from apparent heirs themselves.

Claims of these kinds are typically quite complex and often require close consideration of forum, comity, and international conflict of laws principles. Inevitably, they also require an analysis of the location of the claimant, the assets in question, relevant treaties and international conventions, and governing law clauses.

An offshore trust to which the firewall provisions apply will be generally protected against orders of overseas courts based on their domestic matrimonial or inheritance laws. However, the relationship in question must be a personal relationship with the settlor of the trust (whether by blood or by marriage) or any beneficiary of the trust (whether that beneficiary is a discretionary beneficiary or otherwise). There are also a number of exceptions to this rule across the various offshore trust jurisdictions that have established a firewall which otherwise temper its effect. Protections against fraudulent conduct remain: the firewall provisions will not validate a disposition of property that the settlor does not own, nor will it validate any testamentary trust or disposition that is invalid according to the laws of the testator's domicile.

The Cayman Islands was the first offshore jurisdiction to introduce firewall legislation via its Trusts (Foreign Element) Law 1987. Other offshore jurisdictions soon followed suit, including Bermuda, the British Virgin Islands, Guernsey and Jersey. The legislation has remained far from static. Evidencing just how dynamic offshore legislation can be, and as shown below, many of the firewall provisions have since been the subject of legislative amendment in order to better reflect the evolving private client environment.

The 30-year old firewall provisions in the Cayman Islands operate so that if a trust is expressed to be governed by Cayman Islands law and has a jurisdiction clause in favor of the Grand Court of the Cayman Islands, all questions arising in relation to that trust must be determined in accordance with the laws of the Cayman Islands without reference to the law of any other jurisdiction with which the trust may be connected. This relates to, among other things, questions about the capacity of the settlor, any aspect of the validity, construction or administration of the trust, including the powers, obligations, liabilities and rights of trustees, their appointment and removal, and the existence and extent of powers in the trust. The legislation also confirms that if a foreign judgment is inconsistent with the laws of the Cayman Islands, that judgment will not be recognized or enforced by the courts of the Cayman Islands.[23]

The BVI took slightly longer to establish its firewall provisions, waiting until 2004 to enact section 83A of the Trustee Ordinance, which insulates BVI trusts against "rights, claims or interests conferred by foreign law upon any person by reason of a personal relationship to the settlor or by way of heirship rights." A 2021 amending statute has allowed for the further evolution of these provisions.[24] Essentially, the changes have been two-fold: not only do they offer greater certainty to fiduciaries, beneficiaries and practitioners, but they have also modernized the existing legislation to accommodate the evolution of family structures as well as advances in reproductive science. By way of example, the definition of "personal relationships" in section 83A(1) is expanded to encompass "every form of relationship by blood, adoption, marriage or cohabitation, whether or not the relationship is recognised by law" and particular examples

[23] Part VII of the Trusts Law (2021 Revision).

[24] The Trustee (Amendment) Act 2021), which was gazetted in the BVI on 12 March 2021 and amended section 83A.

which have been added including stepchildren and children born by means of artificial fertilisation or surrogacy.[25]

Bermuda updated its firewall provisions in 2020 via the Trusts (Special Provisions) Amendment Act 2020. The Bermudian legislation now gives the Bermuda Supreme Court express jurisdiction to adjudicate claims concerning the validity, construction, effects or administration of a Bermuda trust, where the trust instrument provides for it. Furthermore, section 10(3) of the Amendment Act contains a positive exclusion of the application of foreign law to Bermuda trusts subject to certain exceptions (such as matters concerning foreign land). Previously the legislation had been formulated to direct a blanket application of Bermuda law except in specified circumstances. These amendments were reinforced by an amended section 11 which prevents the enforcement or recognition of any foreign judgment in conflict with the amended section 10.

In Jersey, the firewall provisions as first drafted initially proved to be less robust and vulnerable to circumvention particularly in respect of the matrimonial orders made by the courts of England and Wales. In each of the cases of *Compass Trustees Ltd v McBarnett*[26] and *In Re IMK Family Trust*,[27] the Jersey Royal Court granted an order to vary a Jersey trust pursuant to the terms of the English Matrimonial Causes Act 1973, in spite of the firewall, on grounds of comity. These decisions obviously generated concern that the firewall was not operating as envisaged by the legislature and suggested to divorcing couples that the door was perhaps still open to pursue foreign assets held in trust. As a result, Jersey amended its firewall regime in 2019 to prevent local courts from enforcing judgments of foreign courts against a local trust where that judgment is inconsistent with local law. It is now understood that an application by a former spouse to enforce a foreign order for financial maintenance by varying a Jersey law-governed trust would be prohibited under the terms of the firewall. This change brought Jersey in line with other jurisdictions, making it more difficult for parties divorcing in England to access offshore assets.

Guernsey has gone one step further and is therefore emerging as one of the more robust regimes, with provisions capable of withstanding pressure from foreign divorce orders. Guernsey's legislation provides local courts with the power to refuse to recognize or enforce foreign judgments that do not protect beneficiaries' interests even if the judgment is consistent with Guernsey's legislation.[28] By contrast, as is the case in Jersey, most other firewall regimes prevent enforcement only where the foreign order is inconsistent with local law.

Returning to our example above, on C's passing extreme hostilities might break out between C's heirs and beneficiary B including in respect of entitlement to C's assets or in the form of a breach of trust action against the trustee. Litigation inevitably ensues. But in which jurisdiction should any challenges be heard?

When disputes arise offshore and the commencement of proceedings is anticipated, an initial matter for consideration is the question of what is the most convenient forum for resolution of the dispute; that is, the most appropriate and convenient jurisdiction in which the litigation should be pursued. Most frequently this is determined with reference to the provisions of the trust instrument. But, the particular circumstances of each case will warrant careful consideration and possibly trigger action in multiple jurisdictions.

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[25] As the BVI does not recognize same-sex marriage or civil partnerships, there is presently a tension between the overarching provision that personal relationships encompass those "whether or not … recognised by law" and the references in the particular examples to marriage and analogous arrangements recognized under BVI law.
[26] [2002] JLR 325.
[27] [2008] JRC 136.
[28] Section 14, Trust (Guernsey) Law 2007.

A good example of the complexities faced in determining the question of forum where trust structures are connected to multiple jurisdictions is the case of *Helmsman Limited and Hotham Trustee Company Limited v Bank Of New York Trust Company (Cayman) Limited,*[29] in which the Grand Court of the Cayman Islands considered an application by the defendant to stay the proceedings on the basis that the more appropriate forum for the trial of the action was England. The case involved two trusts governed by Cayman Islands law. The settlor of the trusts was an English resident, and the investment adviser appointed in respect of each of the trusts was, a Florida resident. The defendant in the action, Bank of New York Trust Co. (Cayman) Limited ("BNY Cayman") was the former trustee of the each of the trusts and had appointed Bank of New York in New York ("BNY New York") to the role of investment manager. The trustees filed proceedings against BNY Cayman in the Grand Court of the Cayman Islands, claiming breach of trust and seeking damages based on allegations that BNY Cayman had negligently failed to monitor the investment activities resulting in losses exceeded $68 million across two of the trusts attributable to a decision to invest in tech stocks, which subsequently suffered atrociously as a result of the burst of the dot com bubble in the early 2000s.

On being served with the writ, BNY Cayman applied to stay the proceedings on the ground that England was the more appropriate forum for the trial of the action. In doing so, BNY Cayman noted that two of the trusts contained a clause providing that the courts of England were the "forum for the administration" of the trust. The third trust deed, however, was governed by Cayman law. The trust deeds provided the trustees with the power to change the forum of administration at any time, and they had exercised this power immediately prior to issuing proceedings.

The Grand Court considered whether the "forum for administration" provisions in the trusts conferred exclusive jurisdiction on the English courts and in doing so noted the well-established principle that an agreement to submit to the jurisdiction of a foreign court must be expressed and cannot be implied. It was noted that the "forum for the administration" clause in the trust deeds was not designed to, nor did it have the effect of, giving the English courts exclusive jurisdiction over the trusts. Further, there were no other provisions in the deeds which could be considered to amount to an express agreement to submit to the jurisdiction of the English court, or to any other jurisdiction. It was therefore necessary to consider the most appropriate forum based on the information available during the hearing and by looking at which of the two jurisdictions was "clearly or distinctly" the more appropriate forum for the resolution of the dispute.

In considering BNY's arguments that England was the most appropriate forum, the court noted that BNY had no presence in England at all and the trustees were located in Bermuda and London, respectively. The judge also recorded his doubts that a trial judge in the Cayman Islands would view English law as "foreign law." Rather, as the Cayman Islands is a British Overseas Territory and, given the similarities between Cayman and English law, it was unlikely that the Cayman court would have to hear expert evidence on the English law. Most of the witnesses resided in the United States and most of the relevant documents were located in the United States, so the convenience of the witnesses and access to documents was not a factor which argued strongly for conducting the proceedings in either jurisdiction. The court also court noted that BNY Cayman was licensed to conduct business in the Cayman Islands and regulated by the Cayman Islands Monetary Authority.

The court considered it a matter of significant public concern that a Cayman trust company had failed to carry out its fiduciary obligations, and the Cayman court would be the most natural forum for such a claim. In the light of this, the court held that there was "no evidence of any possible advantage" in conducting proceedings in England and BNY Cayman had been unable to prove on the balance of

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[29] [2009] CILR 490.

probabilities that the English court was the most appropriate forum and its application to stay the proceedings was, therefore, dismissed.

C. Effect of the Hague Convention on the Recognition of the Law Applicable to Trusts

Although all the English-speaking countries have trust law by reason of their common legal heritage from England, the Hague Convention is also important among these countries with respect to choice of law issues. The Hague Convention is also important to keep in mind because some civil law countries have adopted it to facilitate the recognition of trusts for legal purposes within those countries.

In general, the Hague Convention is an attempt to harmonize choice of law rules so that one country will recognize a trust that is valid in another country. The convention does not require a party to adopt a domestic law of trusts. In addition, a signatory does not have to recognize a trust if its "significant elements" other than its choice of law, its place of administration, and the habitual residence of the trustee, "are more closely connected" to a state that does not recognize the trust as part of its domestic law.

The following countries have ratified the Hague Convention:

> Australia, Canada (subject to certain reservations and the nonapplication of the convention in Quebec), China (for the Hong Kong special administrative region only), Italy, Liechtenstein, Luxembourg, Malta, Monaco, Netherlands, San Marino, Switzerland, United Kingdom (including many of its territories, including Bermuda, Gibraltar, and the Isle of Man).

The United States, Cyprus, and France each signed the convention, but none of these countries has ratified it. Even though the United States has not ratified the convention, a U.S. person can receive the benefit of the convention in the countries that have adopted the convention.

Under Article 11 of the convention, a party must recognize a trust if that trust was created in accordance with the law of a country that recognizes trusts. In particular, an adopting country must recognize these key features of a trust:

- That personal creditors of the trustee shall have no recourse against the trust assets.
- That the trust assets shall not form part of the trustee's estate upon his insolvency or bankruptcy.
- That the trust assets shall not form part of the matrimonial property of the trustee or his spouse nor part of the trustee's estate upon his death.
- That the trust assets may be recovered when the trustee, in breach of trust, has mingled trust assets with his own property or has alienated trust assets. However, the rights and obligations of any third party holder of the assets shall remain subject to the law determined by the choice of law rules of the forum.

The Hague Convention has an interesting approach to choice of law issues. Under the Hague Convention, if a court in a jurisdiction that is party to the convention must resolve an issue related to the trust, the court will apply the law chosen by the settlor of the trust. Under this choice of law rule, the trust need not have any connection to the chosen jurisdiction. Instead, a court or government entity in the jurisdiction in which the trust is administered must apply the law specified in the trust instrument.

As noted above, the Hague Convention has in essence become the principal domestic recognition of trusts law for England in relation to most lifetime trusts created after August 1, 1987 and most trusts arising by operation of court order. Some jurisdictions such as Jersey and Guernsey have extended the provisions of the Hague Convention into local law. The BVI took a hybrid approach by adopting the majority of the provisions by legislation. Meanwhile, the Cayman Islands opted not to ratify the Hague Convention at all and it has no effect on its laws. New Zealand took the same approach as the Cayman Islands and its courts are therefore not required to take into account the customary or legal requirements of foreign jurisdictions in relation to trusts.

One of the challenges encountered offshore for those jurisdictions that do recognize the Hague Convention is determining how to fit unique trust law concepts that have developed in jurisdictions such as the Crown Dependencies and Caribbean nations into the Hague Convention framework. By way of example, the concept of a declaration of trust (whereby a trustee simply declares that it holds assets on trust for beneficiaries or purposes, or both, rather than entering into a deed of settlement pursuant to which assets are transferred to the trustee by the settlor) arguably fits inelegantly into the Hague Convention. This is because the Hague Convention's definition of a trust envisages a trust arising "when assets have been placed under the control of a trustee."[30] The Hague Convention would arguably appear to recognize a trust settled by way of declaration of trust over the assets, anticipating instead that "a transfer of assets to the trustee is an essential condition for the creation of the trust." However, it would be odd for the Hague Convention to exclude this form of trust altogether, and it is now generally accepted that references to "acts by virtue of which assets are transferred to the trustee" will likely be understood as applying to questions of the validity of a declaration.[31]

Given the differences in approach across jurisdictions, regular analysis of the Hague Convention and its application to and interpretation of modern trust structures via common law is crucial. The courts of England and Wales have already been presented with the opportunity to clarify various aspects of the application of the Hague Convention in the case of *Akers v Samba Financial Group,* which concerned a declaration of trust and the transfer of assets out to a "non trust" jurisdiction.[32] While the matter was ultimately disposed of on other grounds, a number of the judgments issued throughout the life of the proceedings deal in dicta with important aspects of the Hague Convention, including those discussed above, and confirm that the Hague Convention applies to declarations by a settlor of himself as trustee and that a trust can be created in respect of property located in a non-trust jurisdiction. The courts suggested that a two-stage approach should be followed: firstly identifying *lex situs* which determined whether the trustee was able to alienate the property at all; but not whether the trust itself was valid, which was instead to be determined by the law applicable to the trusts, in accordance with the choice of law rules in the Hague Convention.

The intricacies behind the drafting of the Hague Convention, and certain lacunae in trust law identified as a result, have also generated new initiatives in offshore law designed to provide greater certainty for settlors of trusts. By way of example, while the Hague Convention provides a basic level of protection by granting settlors of express trusts the power to choose the law applicable to certain trust matters, it also provides that certain other issues, such as marital rights, should be dealt with under usual

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[30] *See* Article 2 of the Convention. Article 4 provides "'The Convention does not apply to preliminary issues relating to the validity of wills or of other acts by virtue of which assets are transferred to the trustee."'

[31] In *Akers*, discussed below, the England and Wales Supreme Court held there can be no doubt that it applies to declarations of trust, not only because the travaux make it clear that it was so intended, but more importantly, that is the clear effect of the Recognition of Trusts Act 1987, section 1(2), which provides that the scheduled provisions of the Hague Convention apply not only to the trusts described in articles 2 and 3, but also to all other trusts under U.K. law.

[32] [2017] U.K.SC 6; [2017] A.C. 424.

conflict of law rules, effectively re-introducing foreign law into the equation. These perceived gaps have spawned the firewall regimes discussed above, which have developed in the offshore jurisdictions by design and with the aim of supplementing the Hague Convention by fortifying choice of law rules for settlors.

Ultimately, while the Hague Convention is generally viewed as having been conceived to allow for common law states to have their trusts recognized as trusts in civil law countries that have no such domestic law institution, it is also understood that the Hague Convention was intended to be symbiotic and civil states benefit from its ratification. It operates so that jurisdictions without a domestic trust law can nonetheless promote investment and trustee services by guaranteeing that a trust duly created in accordance with the law of a jurisdiction that allows trusts will be recognized; and that the assets would not be treated as forming part of the wealth of the trustee. Italy, Liechtenstein, Luxembourg, the Netherlands, Monaco, San Marino, and Switzerland have all ratified the Hague Convention and have seen their trusts industries thrive as a result. Switzerland's adoption of the Hague Convention in 2007 in particular has facilitated the development of a trust management industry in Switzerland in which Swiss companies act as trustees of trusts established under the law of another country with trust law.

III. Trustees' Duty to Keep Beneficiaries Informed of the Administration of a Trust

A. Introduction

A core principle of the common law of trusts in all English-speaking jurisdictions is that trustees are fiduciaries who administer trusts for the benefit of beneficiaries and that beneficiaries may hold trustees liable for failing to live up to their fiduciary duties. The reliance on beneficiaries to hold trustees accountable presupposes that beneficiaries have sufficient information to determine whether a trustee has breached its fiduciary duty and the ability to hold trustees accountable. How the English-speaking jurisdictions have handled a trustee's duty to keep beneficiaries informed of the relevant facts of trust administration and how the beneficiaries can enforce their rights varies considerably. This section of the outline compares the United States' heavily statutory approach that as a general matter favors trust beneficiaries with other English speaking countries that tend to not provide beneficiaries with as robust rights. Understanding the differences in approaches and the legal principles behind the differences will help U.S. lawyers better advise their clients who know they are beneficiaries of non-U.S. trusts and would like more information about the trusts.

B. The U.S. Approach to a Trustee's Duty to Inform and Report

As a general matter of the U.S. common law of trusts, a trustee must keep a beneficiary reasonably informed about the trustee's administration of the trust. In recent years, most U.S. states have enacted legislation setting forth a trustee's duty to inform persons that they are trust beneficiaries, tell them about their beneficial interests, and provide periodic reports or accountings to trust beneficiaries. While you would think that legislation of this kind would be uncontroversial, the opposite is true: the "inform and report" provisions of trust legislation have been the subject of much controversy and disagreements over trust-related public policy. In fact, the inform and report provisions of the Uniform Trust Code were its most controversial provisions and states modified these provisions more than any other provisions of the Uniform Trust Code. At the same time some non-U.T.C. states allowed for the minimization or elimination of provision of trust-related information to beneficiaries with "silent trust" legislation. What were once fairly standard requirements – and boilerplate provisions in trust documents – now vary widely from state to state and from trust to trust.

The U.T.C. generally requires a trustee to keep the "qualified beneficiaries" of a trust "reasonably informed about the administration of the trust and of the material facts necessary for them to protect their interests."[33] The principal requirements of the U.T.C. are for a trustee to do the following:

- Within 60 days of the trustee becomes aware of the creation of an irrevocable trust, to notify the qualified beneficiaries of the existence of the trust, the identity of the settlor, that the beneficiary has a right to request a copy of the trust instrument, and that the beneficiary has a right to an annual report of the trustee's administration of the trust.[34]

- Provide a copy of the trust instrument to any beneficiary on the request of the beneficiary.[35]

- At least annually provide a report of the "trust property, liabilities, receipts, and disbursements, including the source and amount of the trustee's compensation, a listing of the trust assets and, if feasible, their respective market values" to the beneficiaries then entitled to mandatory or discretionary distributions from the trust and to other qualified and nonqualified beneficiaries who request this information.[36]

A "qualified beneficiary" is one of the following:

- A distributee or permissible distributee of trust income or principal;

- A person who would be a distributee or permissible distributee of trust income or principal if the interests of the distributees described in subparagraph (a) terminated without causing the trust to terminate; or

- A person who would be a distributee or permissible distributee of trust income or principal if the trust terminated.[37]

In another section of the U.T.C. the drafters provided states with a general rule that any claim for breach of fiduciary duty must be brought by a beneficiary within one year of the date the trustee sent that beneficiary a report that adequately disclosed the existence of a potential claim for breach of trust and notified the beneficiary of the one-year statute of limitation.[38] The U.T.C. also has what is essentially a five-year statute of repose by providing that to the extent U.T.C. § 1005(a) does not apply, a trust beneficiary must commence a judicial proceeding against a trustee no more than five years after the first to occur of the following:

- The removal, resignation, or death of the trustee;

- The termination of the beneficiary's interest in the trust; or

- The termination of the trust.[39]

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[33] U.T.C. § 813(a).
[34] U.T.C. § 813(b).
[35] *Id*.
[36] U.T.C. § 813(c).
[37] U.T.C. § 103(13).
[38] *See* U.T.C. § 1005(a).
[39] U.T.C. § 1005(c). *See generally* Newman, "Till (sic) It's Gone: Time-Barred Claims under the Uniform Trust Code, 48 Real Prop. Prob. & Trust J. 459 (2014) (explaining the background of statutes of limitations and interaction with the equitable doctrine of laches).

The current version of the U.T.C. has a provision that makes most of these rules not modifiable by the terms of the trust instrument, but those two provisions are in brackets, allowing state legislatures to easily omit them or modify them.[40] By contrast, in earlier versions of the U.T.C. the drafters did not signal that these provisions were optional, which of course they were because a state could pick and choose whatever parts of the U.T.C. it wished to enact. The drafters added the brackets in a concession to the disparate state responses to the "inform and report" provisions of the U.T.C. that would allow a state to change the U.T.C.'s default rules.

The states that adopted the U.T.C. routinely took the opportunity to modify the inform and report provisions, with the consequence that the U.T.C. is now anything but uniform among the states. Most of the U.T.C. states tinkered with these provisions in one way or another, which in large part defeats the purpose of uniform legislation. As a result, you have to look carefully at each state's version of the U.T.C. to determine the scope of the trustee's duty to inform and report. To this extent, "uniform" is a misnomer, at least with respect to these inform and report provisions.[41] Because the U.T.C. states modified the inform and report provisions with such regularity, it is now difficult to generalize about statutory U.S. inform and report requirements.

For example, some states picked up most of the substance of U.T.C. § 813 but provided the inform and report provisions could be modified by the trust instrument. In the Kansas version of the U.T.C., for example, the inform and report provisions are not on the list of provisions that cannot be modified by a trust instrument.[42] In North Carolina the legislature also omitted its version of section 813 from the list of nonwaiveable provisions and then proceeded to substantially rewrite section 813 to require a trustee to provide information about the nature and amount of trust property at reasonable intervals to a qualified beneficiary who is a distributee or permissible distributee of trust income and principal.[43] North Carolina also rewrote U.T.C. § 1005 to not tie the statute of limitations for breach of fiduciary duty to the trustee's provision of information to a beneficiary.[44]

States that have not adopted the U.T.C. have also widely varied inform and report statutes, some of which allow trust instruments or trust officeholders to limit a trustee's duty to inform and report to beneficiaries. Some non-U.T.C. states have rules similar to the U.T.C. that emphasize a trustee's duty to keep beneficiaries informed. For example, California law requires a trustee to notify trust beneficiaries when a trust becomes irrevocable and provide them with a copy of the trust instrument.[45] California law also requires trustee to "account" at least annually, on the termination of a trust, and on the change of a trustee, to each beneficiary to whom income or principal must or may be currently distributed.[46] California law provides detailed rules on what an "account" must contain, including all receipts and disbursements,

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[40] *See* U.T.C. §§ 105(b)(8), 105(b)(9).

[41] *See generally* Mel M. Justak and Anne-Marie Rhodes, "UTC's Duty to Inform and Report at 20 – How Mandatory is Transparency?" 45 ACTEC L. J. 49 (2019).

[42] *See* Kan. Stat. § 58a-105. As a result, a settlor can modify or exclude those provisions in the trust instrument. *See* Kan. Stat. § 58a-813(b). Interestingly, the Kansas legislature did not omit the rule in the U.T.C. that the one-year statute of limitations for breaches of fiduciary duty starts to run only when the trustee provides a beneficiary with a report that adequately discloses the existence of a potential claim for breach of trust and mentions the one-year statute of limitations. Kan. Stat. § 58a-1005(a).

[43] *See generally* N.C. Stat. § 36C-8-813. Any other qualified beneficiary may request this information, and all qualified beneficiaries may request a copy of the trust instrument. The North Carolina version of section 813 has additional rules about what kind of information will be deemed to satisfy the trustee's duties to inform and report and specifically provides that the trustee's duties under section 813 do not include a duty to give a beneficiary advance notice of transactions related to the trust property. *See id*.

[44] *See* N.C. Stat. § 36C-10-1005.

[45] *See* Cal. Prob. Code §§ 16061.5, 16061.7.

[46] Cal. Prob. Code § 16062.

the trustee's compensation, and the identity of the trustee's agents, their relationship to the trustee, and the agents' compensation.[47]

While some U.T.C. states have made some or all of a trustee's duty to inform and report modifiable in a trust instrument, some non-U.T.C. states have gone further in facilitating the use of "silent trusts." In Delaware, a trustee must ordinarily communicate "essential facts" about a trust to a beneficiary and provide a beneficiary trust information following a reasonable request by the beneficiary.[48] A trust instrument, however, may limit the beneficiary's right to be informed of the beneficiary's interest in the trust for a period of time specified in the trust instrument.[49] During that period, unless the trust instrument provides otherwise, a "designated representative" represents and binds the beneficiary for purposes of judicial proceedings and other trust-related matters.[50] Under Delaware law, a designated representative can be appointed in the trust instrument, by a beneficiary himself or herself, by a person given the power to make such an appointment in a trust instrument, or separately by the settlor.[51] The statute provides that a designated representative "is presumed to be a fiduciary," which suggests that a designated representative may not be a fiduciary under certain circumstances. Delaware has a general one-year statute of limitations on claims of breach of duty by a trustee that starts to run when the beneficiary or the beneficiary's designated representative, receives a report from the trustee that adequately discloses the facts constituting the claim.[52] The Delaware rule is similar, but not identical, to the one-year statute of limitation in U.T.C. § 1005. These statutes work together to provide a comprehensive way to create a "quiet" trust while allowing the beneficiaries' interests to be represented and the trustee to obtain finality with respect to matters related to the administration of the trust.

Under South Dakota law, a trustee has a general duty to notify qualified beneficiaries of the existence of an irrevocable trust, furnish a copy of the trust instrument to a beneficiary on request, and "promptly respond to a qualified beneficiary's request for information related to the administration of the trust, unless the request is unreasonable under the circumstances."[53] A settlor, however, may in the trust instrument or by directions to the trustee "expand, restrict, eliminate, or otherwise modify the rights of beneficiaries to information related to the trust."[54] The statute does provide that unless the settlor specifically provides otherwise in written directions, any such directions will be revoked on the settlor's incapacity or death.[55] A trust advisor or trust protector, which are defined terms under South Dakota law, may similarly modify a beneficiary's right to information. Unlike the settlor, however, a trust advisor's or a trust protector's directions will cease to apply when the trust advisor or trust protector ceases to act. A successor trust advisor or trust protector, however, can make a further direction related to trust information.[56] Despite these rules, South Dakota has a relatively traditional two-year statute of limitations for claims for breaches of trust which starts running from the date the trustee provided an accounting for the period when the breach allegedly occurred.[57]

Courts have not been particularly friendly to trustees who attempt to rely on a trust instrument's waiver of a trustee's duty to inform and report in order to provide no information to trust beneficiaries. The

[47] Cal. Prob. Code § 16063.
[48] *E.g. McNeil v. McNeil*, 798 A.2d 503 (Del. 2002).
[49] 12 Del. Code § 3303(c).
[50] 12 Del. Code § 3303(d).
[51] 12 Del. Code § 3339.
[52] *See* 12 Del. Code § 3585.
[53] S.D.C.L. § 55-2-13.
[54] *Id*.
[55] *Id*.
[56] *Id*.
[57] S.D.C.L. § 15-2-36.

best example of this is the North Carolina Court of Appeals' decision in in *Wilson v. Wilson*.[58] In this case, a settlor provided in a trust instrument that the trustee could, but was not required, to prepare or provide accounts for a beneficiary or any court. Although the trust was set up in 1992, the North Carolina version of the U.T.C. applied to the trust. In 2007 a beneficiary sued the trustee for breaches of various fiduciary duties, including failure to distribute income, and asked the court to order the trustee to prepare an accounting covering several years. The trustee claimed that the trust provision regarding accountings precluded the court from ordering the trustee to provide the beneficiary or the court with an accounting.

The trial court gave the trustee summary judgment on the grounds that the North Carolina version of the U.T.C. allowed the settlor to override any duty to account to the beneficiaries or to any court. The court of appeals, however, reversed the trial court, finding that the settlor's prohibition on disclosure did not limit a court from ordering a trustee to provide information "reasonably necessary to enable them to enforce their rights under the trust." The court pointed out that the North Carolina version of U.T.C. § 813 did not override a trustee's duty to act in good faith nor could it "obstruct the power of the court to take such action as may be necessary in the interests of justice."[59] The court emphasized that the trustee's accountability to the beneficiaries is essential to a trust and that to find otherwise undermines the notion of a trust, commenting that "any notion of a trust without accountability is a contradiction in terms."[60] While the court's general outrage makes it a bit hard to distill a particular rule, it seems to be that requests from beneficiaries to provide information reasonably necessary to enforce their rights cannot legally be withheld notwithstanding what the trust instrument provides. Any other conclusion would make the trust "unenforceable by those it was meant to benefit," which was against public policy.[61]

C. Other Jurisdictions

The essence of a trust in English law is that a trust can be enforced against the trustee[62]. This requires the beneficiaries under the terms of the trust to have knowledge of the trust's existence. Accordingly, trustees under English law have a duty to inform adult beneficiaries with an interest in possession in a trust asset of this fact.[63] There is an open question of whether to inform beneficiaries with future interests in the trust and, if so, when to do so. There is no settled law on this, but authoritative commentary supports that those with future, certain interests which are reasonably likely to vest should be advised of them when the beneficiary is an adult.[64]

What of discretionary trusts? This raises the question, in trusts with large – potentially unknowably large – classes of beneficiaries, who should be informed of the trust's existence? Whilst the negative proposition has been supported that not all discretionary beneficiaries need to be notified,[65] that does not resolve the issue of who should be informed of their status as a beneficiary. Again, while an open question, authoritative commentary supports the conclusion that those discretionary beneficiaries reasonably likely to benefit should be informed of their status as soon as is reasonably possible.

Potentially more complex considerations are in play. Offshore as jurisdictions such as Jersey, Guernsey, Bermuda, the BVI, and the Cayman Islands attempt to balance the rights to privacy and

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[58] 690 S.E.2d 710 (N.C. App. 2010).
[59] *Id*. at 715.
[60] *Id*. (quoting *Guardianship and Conservatorship of Sim*, 403 N.W.2d 721, 736 (Neb. 1987)).
[61] *Id*. at 716.
[62] *Armitage v Nurse*, [1997], EWCA Civ 1279.
[63] *Hawkesley v May*, [1956] 1 QB 304.
[64] *Lewin on Trusts*, 20th Edn. Chapter 21.
[65] *Re Hay's Settlement Trusts* [1982] 1 W.L.R. 202.

confidentiality established over the years via common law, and in some cases enshrined in statute[66] with first principles that oblige trustees to make some limited disclosure of trust documents to their beneficiaries.

Regarding disclosure more specifically, the leading authority in England and Wales with regard to a beneficiary's rights to information concerning is the Privy Council decision in *Schmidt v Rosewood Trust Ltd*.[67] This decision confirmed that a beneficiary of an ordinary trust does not have a proprietary interest in trust documents and therefore no automatic right to access them. Instead, whether a beneficiary should receive disclosure of trust documents, and the extent of trust documentation that should be disclosed, is a matter for determination by the trustee with reference to the circumstances in which the particular request is made (including reasons for and against disclosure), and the interests of the beneficiaries and the trust as a whole. If the trustee is uncertain as to whether it should disclose information, or if a beneficiary objects to a decision by the trustee not to disclose information, a beneficiary's rights to trust information can be determined by a court as part of the court's inherent jurisdiction to supervise the administration of a trust.

The default position at common law is therefore that, while a beneficiary does not have an entitlement to trust documentation as of right, a trustee should generally provide beneficiaries with trust accounts on request, the trust instrument (and supplemental deeds), and documents that provide details of the trust assets. The English trust law principles set out in In *Re Londonderry's Settlement,*[68] which have largely been adopted in the Commonwealth and remain good law, provide further guidance to the effect that the trustee decision-making process should be treated as a confidential one and trustees are not obligated to provide beneficiaries with reasons for, or disclose documents, relating to the exercise of their discretion. However, it should be noted that civil procedure rules can override this in the context of litigation.[69]

The decision in *Schmidt v Rosewood Trust Ltd* is persuasive in almost all of the offshore financial centers already discussed, including the Crown Dependencies. In Guernsey, beneficiaries are entitled to information as to the state and amount of trust property. This can be excluded by the terms of the trust deed, but the beneficiaries will still have the right to apply to court for an order requiring provision of that information. In Jersey, the terms of a trust deed can restrict a beneficiary's right to information, and a trustee may refuse a request for disclosure where it is satisfied that it would not be for the benefit of one or more of the beneficiaries, or the beneficiaries as a whole, to make the disclosure. The court retains ultimate power regarding disclosure so that it can overrule the trustee's decision and override the terms of the trust concerning disclosure, either in relation to a particular instance or more generally. In the Isle of Man, the position set out in *Schmidt v Rosewood* has been codified and provides clarity as to who may apply for trust information, and when a trustee may refuse to provide trustee information.[70]

The extent to which beneficiaries of a Cayman Islands trust can obtain trust information and documentation from a trustee at their request will ultimately depend on the type of Cayman Islands trust of which they are a beneficiary, the categories of documentation they are requesting, and the purposes of which they intend to use the information. The leading Cayman Islands judgment on the issue of disclosure to beneficiaries is the judgment in *Re Ojjeh Trust,*[71] in which the Grand Court of the Cayman Islands

[66] An example is the principle of open justice and the rights of privacy which are constitutionally protected under Cayman Islands law via section 7 of the Cayman Islands Constitution.
[67] [2003] U.K.PC 26.
[68] [1965] Ch 918.
[69] See for example the English Civil Procedure Rules, Part 3, particularly where the dispute is around the propriety of the trustee's actions.
[70] Sections 1 and 2 of the Trust and Trustees Act 2023.
[71] [1992-93] CILR 348.

confirmed that a beneficiary will normally be permitted to inspect and take copies of essential trust documents such as trust deeds and accounts.

However, this does not extend to detailed information about the affairs of companies owned by the trust or about the trustee's decision-making processes. In *Lemos v Coutts,*[72] the Cayman Islands Court of Appeal held that although a beneficiary has a proprietary right to trust documents, it is by no means absolute and there may be documents or categories of documents that it would be just and proper to exclude from inspection by beneficiaries. In practice, and for categories of documents beyond the essential trust documents described above, the beneficiary would need to make a special case, specifying what it is he or she wishes to see and give proper assurances that he or she will not disclose documents received to any third parties to other than to their legal or other advisers.

With all of this front of mind, the trustee could still have grounds to refuse to disclose trust documentation if it in good faith believed that such disclosure would not be in the interests of the beneficiaries as a whole.[73] It is also important to note that parties seeking information about a Cayman STAR trust, being a unique form of special purpose trust peculiar to the jurisdiction, will have far fewer rights. Information about, and rights to enforce, STAR trusts sit solely with the person appointed to the role of enforcer, meaning that beneficiaries are not entitled to receive any information about the trust at all

The need to balance the requirement for open justice with the need for individual privacy is acute offshore. As noted by the former Chief Justice of the Grand Court, Sir Anthony Smellie KC:

> Duties of confidentiality, as part and parcel of the duties of loyalty and good faith, are necessary incidents of a fiduciary relationship, a relationship established by duties which come from the wellspring of equity; from the obligations, policed by the courts of equity, to hold identified property for the benefit of others. These obligations, forming part of the moral code which governs fiduciaries, are the hallmarks of personal relationships of "trust and confidence", underpinned by the solemn obligation of the professional or entrusted person to respect the privacy of those whose interests he must protect. This is an idea with deep roots in the common law of both England and the United States of America.[74]

Helpfully, the Grand Court has also given extensive judicial consideration to the public policy considerations which are relevant to considerations of the wider disclosure of trust information (or other confidential information exchanged in the course of a professional or fiduciary relationship). However, the common law principle that the trustee (or any fiduciary) owes a duty not to divulge confidential information must also now be considered with reference to the increased requirements for the sharing of information between governments and other competent authorities and the growing (and welcomed) push for the elimination of cross-border criminal activity.

Interestingly, in the light of global transparency initiatives, the situation continues to evolve. Using the Cayman Islands as an example, section 6A of the Trusts Act imposes several obligations on trustees of Cayman Islands trusts. Designed to further boost efforts by the Cayman Islands to meet global regulatory and information sharing initiatives, these relatively new provisions impose obligations on trustees to maintain and keep an up to date and accurate record of the identity and particulars of any settlor or

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[72] [1992-93] CILR 460.

[73] In recognition of its fiduciary duties to the beneficiaries of the trust in question, and if there are any concerns at all about the appropriateness of disclosure of information to beneficiaries, the trustee of a Cayman Islands trust will ordinarily apply to the Grand Court under Section 48 of the Trusts Act for directions.

[74] "*A New World of Trust Litigation,*" Sir Anthony Smellie KC, 2012 The Jersey and Guernsey Law Review, page 38.

contributor to the trust, any beneficiary, any protector or enforcer of the trust, service providers to the trust, including any investment adviser, manager, accountant or tax advisor; and persons exercising ultimate effective control of the trust (a requirement that may pose practical difficulties for some trustees). In addition, section 6A(2) of the Trusts Act expressly requires trustees of Cayman Islands trusts to maintain and keep up to date accounting records relating to the trust.

Finally, litigation involving the English courts or offshore trusts is common, and as a matter of process will often require the disclosure of information about the trust structure, family wealth, and, on occasion, the wishes of the settlor of the trust. It is important for a trustee faced with an application to consider the extent to which this information should form part of the court record, and whether it is appropriate or necessary to obtain confidentiality or anonymization orders at the commencement of any proceedings. Guidance has been provided by the Cayman Islands judiciary as to when orders as to confidentiality should be issued in that jurisdiction,[75] which acknowledges that it is increasingly common for persons who have accumulated significant wealth to wish their children to live, as far as possible, "ordinary" lives and to be left unaware of the scale of wealth to which family members potentially have access.

The Cayman Islands courts have also subscribed to the view that everyone has the right to a fair and public hearing in their determination of his or her legal rights and obligations and that all proceedings instituted for the determination of any civil right or obligation shall be held in public. However, it is open to the court to hold private hearings in circumstances where publicity would prejudice the interests of justice, or where the welfare of minors or the protection of the private lives of persons concerned in the proceedings is warranted. The "public hearing" requirement is therefore not an absolute one and subject to these exceptions.

Offshore, the question of what trust information should be disclosed to whom is increasingly complex, and a trustee will not only have the demands of beneficiaries to address but potentially also the more formal requests from competent authorities and statutory bodies to respond to against the threat of liability and fines from a variety of avenues.

IV. Trustee Discretionary Powers

A. Introduction

Much trust law in the United States and other English-speaking jurisdictions relates the exercise by trustees of discretionary powers, particularly with respect to distributions of income and principal. Every trust instrument will contain provisions that direct the trustee how to distribute income and principal, and most trust instruments will give a trustee other discretionary powers in relation to the beneficiaries such as a power to make a distribution to another trust, the power to retain or dispose of certain trust investments, and the power to allocate receipts between income and principal. Although the general idea of trustee discretionary powers is the same in the United States as it is in other trust law countries, U.S. law and practice tends to be unique when compared to trust law in other countries. In particular, most other trust law countries tend to give trustees greater discretion than you typically find in U.S. trusts. This section of the outline describes some key differences in trustee discretionary powers between the United States and other trust law jurisdictions that are important to appreciate in advising U.S. clients who are beneficiaries of non-U.S. trusts.

[75] *In the Matter of a Settlement dated 16 December 2009*, Grand Court of the Cayman Islands, unreported, 25 July 2018 (IKJ).

B. Trustee Discretionary Distributions

1. The U.S. View

In the United States irrevocable trusts often one of three forms when it comes to the distribution of income and principal: mandatory income trusts or unitrusts, ascertainable standard or "support" trusts, and discretionary trusts, though sometimes you see a combination of two of these or all three in a trust instrument. While each trust instrument presumably reflects the intention of a settlor in establishing the trust, tax law often dictates the provisions for income and principal distributions. For example, in order for a trust to qualify for the federal estate tax marital deduction, the trust must pay all of the trust income to the surviving spouse for his or her lifetime. Another familiar example is when a beneficiary is acting as trustee with the power to make distributions to himself or herself, the beneficiary will have a general power of appointment for federal estate tax purposes unless his or her power is limited to an "ascertainable standard." The most famous of these ascertainable standards is the beneficiary's "health, education, maintenance, and support" described in IRC § 2041, but there are other tax rules that rely on ascertainable standards or reasonably definite external standards.

Because of the central role of tax law in principal and income distribution provisions in U.S. trusts, the drafters of the U.T.C. even included a definition of "ascertainable standard" in the U.T.C. that refers to tax law:

> "Ascertainable standard" means a standard relating to an individual's health, education, support, or maintenance within the meaning of Section 2041(b)(1)(A) or 2514(c)(1) of the Internal Revenue Code of 1986, as in effect on [the effective date of this [Code] [amendment] [, or as later amended].[76]

Given the widespread use of ascertainable standards there is also a substantial body of court decisions addressing the meaning of words and phrases related to ascertainable standards in both the trust law context and the tax law context.

A "discretionary" trust typically gives the trustee broad discretion over the purposes for which distributions may be made to a beneficiary. For example, a trustee may have "sole and absolute" discretion to make distributions to a beneficiary for his or her "best interests and welfare" or "for any purpose the trustee believes desirable." The trustee exercises powers of this kind in a fiduciary capacity, but a trustee must follow a reasonable procedure in considering the facts and circumstances surrounding a potential distribution and in making a decision to distribute or to not distribute. The trustee is not free to act whimsically or frivolously even if the trustee has very broad discretion. A discretionary power, even if described as broad, does not confer truly unlimited discretion.

The drafters of the Uniform Trust Code included a general rule related to discretionary trusts that notwithstanding an otherwise broad grant of discretion, a trustee must act "in good faith and in accordance with the terms and purposes of the trust and the interests of beneficiaries."[77] Following U.S. common law principles, the U.T.C. does not impose a reasonableness standard on trustees when they consider discretionary distributions, though the drafters pointed out that a court could consider the reasonableness of an exercise of discretion "if the document adds a standard whereby the reasonableness of the trustee's

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[76] U.T.C. § 103(2).
[77] U.T.C. § 814(a).

judgment can be tested."[78] The drafters, however, conceded that when it comes to determining the meaning of an income and principal distribution standard, the legal standard is usually "it depends:"

> [W]hether the trustee has a duty in a given situation to make a distribution depends on the exact language used, whether the standard grants discretion and its breadth, whether this discretion is coupled with a standard, whether the beneficiary has other available resources, and, more broadly, the overriding purposes of the trust.[79]

2. Discretionary Powers in Other Trust Law Jurisdictions

In other English-speaking jurisdictions, however, it is much more common to give trustees what lawyers in the United States would consider to be very broad discretion in making distributions. In English law and in most offshore jurisdictions, the trust instrument of a discretionary trust will confer a number of powers on trustees which vary in their nature and extent. Many of those powers will be similar to powers conferred by statute but modified to suit the particular trust or the needs and wishes of the settlor. Discretionary powers can be either administrative or dispositive in nature. Administrative powers are given to facilitate the management of trust assets in the interests of the beneficiaries and do not entitle the trustees to make any alterations to the beneficiaries' interest in the trusts, such as powers to invest trust funds, manage land, and delegate trustee functions. Dispositive powers, on the other hand, enable the trustees to alter or create the beneficial dispositions of the trust, such as an overriding power of appointment, a power to distribute capital, and a power to allocate income among a class of beneficiaries.

These powers can also be conferred on parties other than trustees and they can be categorized as either personal or fiduciary in nature. Generally, holders of personal powers are entitled to exercise those powers in their own interest, whereas holders of fiduciary powers are required to exercise their powers in the best interests of the beneficiaries.

When it comes to making distributions from a discretionary trust, the trustee of a discretionary trust will have complete discretion in distributing income or principal to a designated beneficiary or a class of beneficiaries. There are no specific rules or standards save that such distributions must be made with due care and skill and in the best interests of the beneficiaries, having regard to all relevant factors and no irrelevant factors.[80] The settlor of the trust, however, could provide guidance to the trustee as to how (and even in what amounts) he or she wishes to see trust assets distributed. This is usually done via letter of wishes in which the settlor may, for example, indicate that the trust is primarily for the benefit of the settlor's spouse versus his or her children or grandchildren. A trust with these discretionary powers of distribution is often favored because it protects the beneficiaries from their creditors. Essentially, because the beneficiaries have no enforceable right to trust distributions, their creditors have no rights either.

Trustee decision-making during the life of a discretionary trust is nevertheless not always straightforward, and an extensive body of case law exists regarding the proper exercise of trustee powers and confirming that the English and offshore courts will be willing to provide helpful guidance in navigating what can be very difficult situations for all of the parties involved. If faced with a complex scenario that renders decision-making concerning the exercise of a discretionary power difficult, a trustee may apply to a local court for pre-approval for momentous decisions made by the trustee, guidance as to the extent of consultation required with beneficiaries as to the exercise of the trustee's discretion, to surrender the

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[78] Comment to U.T.C. § 814(a) (referring to Restatement (Third) of Trusts Section 50 (Tentative Draft No. 2, approved 1999); Restatement (Second) of Trusts Section 187 (1959). *See also* Edward C. Halbach, Jr., Problems of Discretion in Discretionary Trusts, 61 Colum. L. Rev. 1425 (1961).
[79] *Id*.
[80] *Edge v Pensions Ombudsman* [2000] Ch. 602.

trustee's discretion to the court, and to ensure the interests of minor and unborn beneficiaries are properly considered at all times prior to the exercise of a power.

Public Trustee v Cooper[81] jurisdiction is a particularly well-used mechanism for trustees to seek a court's guidance or approval on a matter relating to the trust including where the trustee anticipates making a significant distribution from the trust either to a beneficiary or by way of appointment out to a new trust. Such an application is a form of insurance policy for the trustee: with a *Public Trustee v Cooper* "blessing" in hand, the trustee will be protected from future allegations of breach of trust. There are four recognized categories of application:

- Seeking guidance as to whether a proposed action is within the trustee's powers (ultimately a question of construction of the trust deed);

- Seeking a court's blessing of a momentous decision the trustee proposes to take;

- Cases in which the trustees wish to surrender its discretion to the court; and

- Cases in which a trustee has already undertaken an action and is being attacked for it by the beneficiaries or by a successor trustee.

An example of the *Public Trustee v Cooper* jurisdiction is *AA v BB*,[82] in which the Grand Court of the Cayman Islands was asked to consider an application by a trustee of a Cayman Islands trust for the approval or blessing by the Grand Court of a proposed plan of liquidation and distribution of all the assets of a trust among certain members of the discretionary class of beneficiaries, followed by the winding up of the trust. The settlor was the patriarch of a Middle Eastern Arab Muslim family and the principal beneficiary of the trust. He was a devout Muslim and was educated in and familiar with the Islamic law principles applied in his home country. Over time, a series of letters of wishes were prepared on the settlor's instructions, which recorded in express terms his dispositive intentions, and in particular for the ultimate disposition of the trust's assets after his death to be among the settlor's heirs in accordance with the rules of inheritance of Islamic law.

The settlor had passed away some time before the trustee made its application, and was survived by his wife and adult children (referred to in the judgment as the heirs). The heirs had been officially identified as the settlor's heirs under the Islamic law of inheritance applied in the Middle Eastern country of which they were all nationals, and it was to the heirs (rather the wider group of members of the beneficial class as a whole) that the trustee intended to distribute all of the assets of the 1990 Trust. The application was a "Category Two" *Public Trustee v Cooper* application pursuant to which the trustee sought the sanction of the court for a particularly momentous decision.

The parties agreed in this case that the trustee's proposed course of action was indeed "momentous" in nature, given that it would involve the realization and distribution of all of the trust's assets and thereafter the termination of the trust. However, the question was whether the trustee, in the exercise of its discretionary powers to distribute the assets and wind up the trust, was obliged to inquire into and consider the circumstances of every member of the wider class of beneficiaries with a view to benefitting them or whether it could reasonably decide to benefit only those beneficiaries who were the settlor's heirs under Islamic law. The Grand Court concluded that it was well within the bounds of rationality for the trustee to have concluded that the wider ambit of the beneficial class as defined was simply to allow for flexibility of dispositive intent to be informed by the settlor's wishes during his lifetime and should not be construed as

[81] [2001] WTLR 901.
[82] Grand Court of the Cayman Islands, FSD 137 of 2019 (ASCJ).

contradicting his intentions as amply and clearly expressed in his letters of wishes. The Chief Justice accepted that the trustee could reasonably decide to take the action proposed and proceed to appoint the assets only to the heirs and gave sanction to the trustee to do so.

Beneficiary consultation can be a crucial component of this process, but trustees are not necessarily required to "consult to the death," as evidenced by in the Cayman Islands case of *In the Matter of the A Trust*.[83] The A Trust was a Cayman Islands trust, the settlor of which was the father of the three defendants to the proceedings. Following the death of the settlor, the trustee prepared a final distribution proposal which provided for how and to which beneficiaries the assets of the trust would be distributed. The proposal was supported by the two of the siblings but strongly opposed by the third who alleged bias on the part of the trustee. The Grand Court of the Cayman Islands was asked by the trustee to bless a momentous decision under "Category Two" of *Public Trustee v Cooper* jurisdiction, which the trustee was empowered to make but did not wish to implement without the court's confirmation that it did not entail an improper exercise of the relevant power. Noting that the consultation process had spanned four years and had not achieved the desired result, the court concluded that the trustee's actions in deciding to cease consultation was entirely reasonable and warranted the trustee proceeding to implement the distribution plan without further consultation.

Trustees of offshore trusts can also find themselves in a position of conflict when considering whether to exercise a power to make distributions from trust assets. *In the Matter of HSBC International Trustee Limited v Tan Poh Lee and Ors,*[84] a beneficiary of a Cayman Islands trust sought to require the trustee to distribute the trust assets and terminate the trust, claiming the trustee was liable for breach of fiduciary duty in failing to comply with the previous requests to do so. This created a potential conflict for the trustee given the threat of a breach of trust claim if the trustee did not accede to the request to terminate the trust and distribute the assets in circumstances where the other beneficiaries were "violently" opposed to that course of action and there was a freezing injunction in place which had the effect of freezing the accounts held by the trustee.

The trustee applied to surrender its discretion to the Grand Court and sought directions as to the stance. In this case, Judge Ian Kawaley held that "it was clear that no reasonable trustee would accede to the Third Defendant's requests which appeared to be based on a fundamental misconception about the character of an irrevocable discretionary Cayman Islands trust." Judge Kawaley recognized that it was seriously arguable that the proposed distribution fell outside of the parameters of the settlor's wishes, and terminating the trust and distributing the bulk of the assets to the beneficiary was wholly at odds with the best interests of the other beneficiaries of the trust. The court determined that it was appropriate for the court to accept that surrender in the circumstances of this particular case. In exercising the trustee's discretion on behalf of the trustee, the court, having regard to the duties under the trust deed, directed the trustee not to make the distribution sought by the beneficiary, not to terminate the trust, and not to resign as trustee.

Finally, when considering whether a power under a trust has been properly exercised, the courts will consider not only the literal wording of the power, but also the purpose for which it was conferred.[85] This means that an act of a powerholder, although apparently falling within the scope of the power, could be open to legal challenge if it is used for a purpose different from that for which the power was intended.

The point was illustrated in the case of *Grand View Private Trust Co Ltd v Wen-Young Wong,*[86] which concerned a trust established under the law of Bermuda. The trust was established for the benefit of

[83] 2016 (2) CILR 416.
[84] Unreported, Grand Court of the Cayman Islands, FSD 175 of 2019 (IKJ).
[85] *Crociani v Crociani* [2017] JRC 146, or the older English authority of *Vatcher v Paull* [1915] 1 A.C. 372.
[86] [2022] U.K.PC 47.

the children and other descendants of the trust's founders. On the same day, the founders had also established a separate "purpose" trust which did not have specified individuals as beneficiaries, but which was established to further a mix of charitable and other purposes. The trust's founders subsequently decided that significant family assets would pass to the founders' children on the death of the founders and therefore took the view that it was no longer necessary to have a trust to benefit their children and other descendants. The trust contained a wide power for the trustee to add and remove beneficiaries and so, in accordance with the founders' wishes, the trustee sought to exercise this power to remove the founders' children and other descendants as beneficiaries and effectively substitute the purpose trust as the beneficiary.

The Privy Council held that the trustee had used the power to appoint and remove beneficiaries for an improper purpose. On a literal reading of the power there were no limits on who could be appointed or removed as a beneficiary. However, having considered the wording of the trust as a whole and the circumstances of its establishment (i.e. that the founders had established two trusts simultaneously, one to benefit their descendants and one to further charitable and other purposes), the Privy Council concluded that the proper purpose of the power to add or remove beneficiaries was to further the interests of the founders.[87] In this case the parties agreed that the purported exercise of the power would be void if the power had been exercised for an improper purpose.[88]

C. Trustee Decanting Powers

1. U.S. Trust Decanting Law

Before 1992 a question that routinely came up for trustees of discretionary trusts in the United States was whether a trustee with broad discretion had an implied power to make a distribution to a beneficiary in further trust. Courts in a few of the U.S. states had recognized a decanting power.[89] State legislative activity in this area started in earnest in 1992 when New York enacted its rule that allowed trustees with broad discretion to make distributions in further trust.[90]

In light of the proliferation of state decanting legislation and IRS Notice 2011-101, in 2012 the Uniform Law Commission decided it made sense to work on uniform decanting legislation. The committee in charge produced a first draft in 2013 and finalized the Uniform Trust Decanting Act or "U.T.D.A" in 2015. So far 18 states have adopted the U.T.D.A., though a few of those states replaced existing decanting legislation with the U.T.D.A. After 2015 a few states adopted decanting legislation that was not the

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[87] Although Privy Council decisions are not technically binding on the English courts, the Privy Council judges are U.K. Supreme Court judges, so Privy Council decisions are indicative of how the Supreme Court would be likely to rule, and are likely to be followed in the English courts.

[88] If the exercise of a power is voidable rather than void, the exercise will stand unless set aside by the courts.

[89] *See, e.g.*, *Estate of Spencer*, 232 N.W.2d 491 (Iowa 1975) (trustee with a "special" power of appointment may exercise it by appointing trust property in further trust); *Wiedenmayer v. Johnson*, 254 A.2d 534 (N.J. Super. 1969), *aff'd sub nom Widenmayer v. Villanueva*, 259 A.2d 465 (N.J. 1969) (trustee's authority to make distributions in its "uncontrolled and absolute discretion" allowed for an appointment in further trust); P*hipps v. Palm Beach Trust Co*., 196 So. 2d 299 (Fla. 1940) (trustee's power to distribute property in fee simple to beneficiaries essentially allows the trustee to distribute property with a lesser interest to those beneficiaries, including in further trust).

[90] *See* N.Y. Est. Pow. & Trust L. § 10-6.6. A number of other states followed suit in the years that followed: Alaska (1998), Delaware (2003), Tennessee (2004), Florida and South Dakota (2007), New Hampshire (2008), Arizona, North Carolina, and New Hampshire (2009), Indiana (2010), Missouri (2011); Kentucky, Rhode Island, South Carolina, Ohio, Michigan, and Virginia (2012); Texas, Illinois, and Wyoming (2013); and Wisconsin (2014).

U.T.D.A.: Minnesota in 2015,[91] (based on the New York statute), North Dakota in 2017,[92] and Georgia in 2018.[93]

Decanting now is a regular feature of U.S. trust legislation, and many trustees have decanting powers by reason of state law. The decanting legislation varies considerably from state to state, but all states consider the decanting power a fiduciary power, to be exercised only in the best interests of a beneficiary. Because decanting statutes are relatively new, and because only a few states permitted trust decanting under common law, there are not many court decisions in the United States that provide guidance on how a trustee can discharge its fiduciary duty to all beneficiaries when making a decanting distribution.

Unfortunately to date there has been only one reported case that has seriously considered these issues: the New Hampshire's Supreme Court's 2017 decision in *Hodges v. Johnson*.[94] This case involved the question of whether a trustee breached his fiduciary by making three separate decanting distributions, all of which were in theory permitted under the New Hampshire decanting statute.

The three decanting distributions collectively had the effect of eliminating certain trust beneficiaries, which had initially included the settlor's wife and several descendants. The first decanting narrowed the definition of descendants used the trust instrument, which eliminated two beneficiaries. The second decanting revised the definition of descendants to omit another beneficiary from the class of descendants. Similarly, the third decanting removed the settlor's wife from the class of permissible beneficiaries.

The three excluded descendants sued to remove the trustees who directly or indirectly accomplished the decantings and to declare the decantings void ab initio. The trial court considered many issues related to the decanting and ultimately determined that the decantings were invalid because the trustees "accomplished them without considering the plaintiffs' beneficial interests."[95]

In a lengthy opinion, the New Hampshire Supreme Court affirmed the trial court's decision that the decantings were invalid because in making the decisions, the trustees violated their duty of impartiality. The court reviewed all the evidence that the trial court considered and concluded that the trial court had made the right decision. The court pointed out that even though the affected beneficiaries were remainder beneficiaries with contingent interests, the trustees nevertheless owed them a duty of impartiality. One of the trustees, however, testified that he did not give the excluded remainder beneficiaries' interests any consideration:

> McDonald, the decanting trustee and trustee of the distributee trusts, agreed that he "never gave [the plaintiffs'] financial interest any consideration." Additionally, as the trial court observed, the record does not include "emails, memorand[a], or letters concerning, or research into, ... whether alternatives to complete disenfranchisement were considered or explored as a solution that would take into account both the 'terms and purposes' of the 2004 Trusts and the 'interests of the beneficiaries.'[96]

The court rejected the trustees' claims that the exclusion of the beneficiaries made it so that it would be less likely that those beneficiaries would later engage in "fractious litigation" that would impede the

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[91] Minn. Stat. § 502.851.
[92] N.D.C.C. § 59-16:1 (based on the Minnesota statute).
[93] Ga. Stat. § 53-12-62 (based on the Tennessee statute).
[94] 177 A.3d 86 (N.H. 2017).
[95] *Id.* at 92.
[96] *Id*. at 97.

purpose of the trust, which was to hold interests in a family company. The court pointed out that the trustees actually accomplished the opposite with the decanting:

> Indeed, by eliminating the plaintiffs' future beneficial interests, the decantings actually increased the risk that the plaintiffs would engage in litigation. As the trial court found, and as the record supports, although the "No Contest" provisions revoke the plaintiffs' beneficial interests if they institute proceedings to impair the trusts, by eliminating those interests through decanting, the defendants left the plaintiffs with "nothing to risk" and "nothing to lose" under those provisions.[97]

In its conclusion to its discussion of the decanting issue, the court quoted from an article by Anne Marie Levin and Todd Flubacher, "Put Decanting to Work to Give Breath to Trust Purpose," implying that the court was skeptical that a decanting that eliminated a trust beneficiary would ever be permissible:

> '[W]hen 'a trustee has the power to make discretionary distributions of principal among one or more beneficiaries, the trustee may decant the assets to a new trust that eliminates one of those beneficiaries as a beneficiary of the new trust,' but also acknowledging that 'it is difficult to imagine the factual scenario where the trustee would not violate its fiduciary duty of impartiality owed to that [eliminated] beneficiary.'[98]

Not surprisingly, the court also affirmed the trial court's decision to remove the trustees. Three years later, though, the case was back at the Supreme Court of New Hampshire, which again not surprisingly affirmed a subsequent ruling by the trial court that the trustees were not entitled to be reimbursed by the trust for their fees defending the decantings that they paid personally and that the trustees must reimburse the trust for the expenses they paid with trust funds to defend themselves in the decanting case.[99]

2. Decanting Outside the United States

By contrast, as a matter of the common law of trusts of England a trustee with broad discretion could make distributions in further trust.[100] As a starting point, English trust law has traditionally acknowledged the concept of a very broad power of appointment whereby a trustee holds the trust fund on specified trusts unless and until the trustee exercises a power of appointment to "rewrite" the trusts.[101] In essence, this can be a power to "resettle" the trusts. Indeed, the statutory power of advancement – normally contained in all English law trusts in slightly modified form – in section 32, Trustee Act 1925 has been held capable of being used to make transfers into new trusts.[102] In the past century, much of the judicial consideration of the exercise of the power has focused on the tax consequences of the exercise of such a power. This is so much the case that U.K. tax law has extensive anti-avoidance provisions addressing the very act of trustees transferring assets from one trust to another. As such, recent case law in England is less focused on what are the limits on the exercise of trustee powers of appointment and more on what are their tax consequences.[103]

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[97] *Id*. at 98.
[98] *Id* (quoting from 38 Est. Plan. 3, 10 (2011)).
[99] *Hodges v. Johnson*, No. 2019-0319 (N.H. September 23, 2020).
[100] *E.g.*, *Re Clore* [1966] 1 WLR 955; *Re Pauling* [1964] Ch. 303; *Pilkington v. IRC* [1964] AC 612; *Re Ropner* [1956] 1 WLR 902; *Re Halsted* [1937] 2 AER 570; *Roper-Curzon v. Roper-Curzon* (1871) 11 Eq. 452).
[101] In England and other trust law countries, a trustee may hold a "power of appointment" that is a fiduciary power. This contrasts with the usual U.S. understanding of a "power of appointment" as a beneficiary-held power that is exercisable in a personal, rather than fiduciary, capacity.
[102] *Swires (Inspector of Taxes) v Renton*, [1991] STC 490.
[103] *See, e.g.*, *Roome v Edwards*, 54 TC 359; *Bond v Pickford*, 57 TC 301.

Consequently, trustee-held powers of appointment and powers of advancement are regularly relied on to abandon or modify problematic provisions of an existing trust. Commonly such powers may be exercised to decant all the trust assets out of the trust and into another trust with the desired provisions; such restructuring is increasingly common as global transparency initiatives increase and the families of internationally mobile private clients grow, move, and change focus.

Many of the offshore jurisdictions do not have any statutory concept of decanting so it is common for trustee of offshore trusts (and with the consent of another empowered party if required by the trust deed) to engage in decanting exercises in reliance on these powers and in conjunction with onshore attorneys and tax advisers where assets are being moved between jurisdictions. This is because cross-border decanting exercises may not always be straightforward, particularly if the trust deed contains provisions restricting the categories of trusts that can properly accept assets decanted from the trust, or if the recipient trust is a type of offshore trust not readily recognized by the jurisdiction in which the onshore trust is located.

In considering whether to use an overriding power of advancement to decant trust assets, the trustee's first step will be to consider whether it is appropriate to exercise the power to achieve the decanting in the first place. As noted in *Thomas on Powers*:

> The nature and extent of the trustee's 'duty to consider' in relation to a power of appointment conferred on his qua trustee clearly varies with the circumstances of each case and with the nature of the power, for example whether it is dispositive...or administrative, whether it is found in the context of a private family trust or a pension scheme, or whether it is ancillary to a commercial agreement, such as a joint venture. Every power must be exercised only for the purpose for which it was conferred, or, at least, in accordance with what the trustees honestly consider to have been the purpose.

A complicated decanting process from an offshore trusts to onshore trusts took place in the case of *CIBC Bank & Trust Company (Cayman) Limited v T & S.*[104] There, and as part of a restructuring exercise requiring assets of a Cayman Islands trust to be decanted to two onshore trusts, the Grand Court of the Cayman Islands was asked to reform two Cayman Islands STAR trusts on the basis that their purposes had become obsolete (a statutory concept under Cayman Islands trusts law). The two trusts in question, the AR Trust and the Ta Trust, had been established by the settlor for the benefit of himself, his second wife and their only son (as well as the son's descendants). The purposes of both trusts were the same: to hold the trust income and principal for the benefit of the beneficiaries in accordance with the terms of the trust.

The evidence showed that the settlor had chosen to establish special purpose trusts in the Cayman Islands because of the jurisdiction's "political and economic stability, adherence to the rule of law, and the fact that Cayman is a tax neutral jurisdiction." The evidence also showed that the settlor wished for the trusts to benefit his son and his son's descendants to the maximum extent possible regardless of their place of residence or domicile. At the time the trusts were established, the settlor's wife and son were living in the United Kingdom and had residences throughout Europe and T's country of birth. At no time had it been anticipated by the settlor that T, the primary beneficiary of the trusts, would relocate to the United States; the family had no connection to the United States. However, in mid-2018, the son decided to relocate to the United States largely for business reasons to pursue his interests in the technology sector. He applied for a visa under the U.S. Immigration Investor Program, which was expected to be approved imminently.

In preparation for his move to the United States, the son sought the advice of U.S. tax and immigration attorneys who informed the trustee that, despite the fact that the son and his family had no previous connection with the region, his relocation to the United States and his new residency status would

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[104]Unreported, 16 July 2021, written reasons of the Hon. Chief Justice.

trigger very serious adverse tax consequences, exposing the trust assets to U.S. income, estate, gift and generation-skipping transfer tax laws. Because of the way in which the trust deeds had been drafted, those laws would apply to (and significantly diminish) the assets in the trusts unless steps were taken beforehand to mitigate those consequences. The mitigation strategy identified by the son's attorneys involved decanting of assets from the trusts to newly formed U.S. trusts.

As the trusts were STAR trusts, it was necessary to protect the interests of the beneficiaries of the trusts by making an application to the court to reform the trusts *cy-près*[105] so that the trusts could then be varied to allow for the decanting of assets from the trusts to new onshore trusts. The trustee took the position that the execution of the trusts in accordance with the terms of the governing trust deeds had become obsolete in that, because of the son's changed circumstances in deciding to relocate to the United States, the general intent of the trusts could no longer be achieved. The Grand Court accepted that the substance or spirit of the settlor's gift could no longer be achieved on the son's relocation to the United States unless the trust deeds were significantly reformed. The son's proposed relocation to the United States had by necessity led to a complete and extensive restructuring plan to be drawn up by his U.S. advisers to deal with the relocation, which he had provided to the trustee. With this information in front of it, the trustee was no longer in a position to ignore the potential and very significant U.S. tax liabilities that would accrue on his relocation: U.S. tax provisions had to be taken into account by the trustee in any exercise of its discretion.

Perhaps most importantly, the trustee had determined that if it was to exercise its discretion without proper regard to the U.S. tax position of the beneficiary, in light of the information provided to the trustee by the tax advisers, such an exercise would be liable to be set aside, or could expose the trustee to a breach of trust claim, for failure to exercise its discretion having taken into account all relevant considerations. The Grand Court noted that the proposed reforms to the trusts were far-reaching and transformative but that they nonetheless remained within the basic intention underlying the spirit of the settlor's gifts to the beneficiaries and were therefore approved.

D. Trustee Powers to Add and Exclude Beneficiaries

One important feature of U.S. trust decanting legislation is that while a trustee may exercise a decanting power to exclude a beneficiary, a trustee generally cannot exercise a statutory decanting power to add a beneficiary.[106] It is possible that a decanting power in a trust document will give a trustee the power to add a beneficiary, particularly a charitable beneficiary. In exercising either power, however, the trustee must act in the best interests of all the trust beneficiaries. Given the fiduciary nature of a power it is difficult to imagine a circumstance in which a trustee could reasonably exclude a beneficiary without his or her express or implicit consent or to reasonably add a beneficiary without the consent of the other beneficiaries.

By contrast, trust documents in other trust law jurisdictions routinely give a trustee the fiduciary power to add and exclude beneficiaries, and this power can be exercised without the consent of the beneficiary provided that the power is being exercised in the best interests of the beneficiaries as a whole.

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[105] A centuries-old doctrine, cy-près has allowed the courts to save a charitable trust from failing when a charitable objective has become impossible or impracticable to fulfill by altering its objectives to be performed as closely as may have been originally expected by the settlor. Section 104(1) of Cayman's Trusts Act provides that, if the execution of a STAR trust in accordance with its terms becomes, in whole or in part (a) impossible, impracticable; (b) unlawful or contrary to public policy; or (c) obsolete due to a change in circumstances, the trustee shall apply to the Grand Court to reform the trust cy-près. At English common law, a cy-près application can only be made in respect of property subject to charitable trusts. However, in the Cayman Islands, STAR trusts are intended to be innovative in ways which would not be recognizable at common law, and the application of the cy-près doctrine to special trusts (even those without charitable purposes) by way of statutory provision reflects this intention.
[106] *See, e.g.*, U.T.D.A. § 11(c).

In fact, for offshore trusts, the inclusion of provisions for the addition, appointment, or removal of beneficiaries is considered to be crucial to ensure that trustees can consider and respond appropriately to developments during the life of the trust. It is common for changes in the personal circumstances of beneficiaries to require the addition or removal of individuals from the class of beneficiaries, particularly as a result of movement between jurisdictions or the expansion of a family.

In considering the exercise of such powers, it is important to note the status of a beneficiary of a discretionary trust settled under English law or the trust laws of other jurisdictions including those offshore jurisdictions in which English law is persuasive. In these jurisdictions a beneficiary of a discretionary trust is categorised as a person in whose favor a discretion to distribute income or capital of a trust may be exercised. However, a person who is a possible object of a power to add beneficiaries holds a very different status and is not in fact a beneficiary unless or until the power is exercised in his or her favor and he or she is added as a beneficiary. Until that moment, the trustee may not apply income or capital for his or her benefit, and he or she does not have any of the rights attached to being a beneficiary of the trust. In short, there is an interesting analytical question about whether the power to add to the beneficial class is validly used only if pursuing the interests of one or more of the members of the current beneficial class and – strictly – blind to whether or not it is in the interests of the person to be added to the class.

In some of the offshore jurisdictions, the power to add or remove a beneficiary is statutory. In Jersey, for example, Article 9A(2)(e) of The Trusts (Trust) Law 1984 provides, among other things, for a trust deed to allow a settlor to retain or grant to a third party "a power to appoint or remove any … beneficiary." Similar provisions can be found in the trust's laws in force in the BVI and the Cayman Islands. As a result, it is not uncommon to see trusts governed by the laws of these jurisdictions with clauses giving power to add or remove beneficiaries, most often exercisable by the trustees either freely as they decide, or only with the consent of another person such as the settlor or a protector.

As noted above, the fiduciary nature of the trustee-beneficiary relationship dictates that a trustee's actions in the exercise of powers are subject to the well-known "no profit" and "no conflict" prohibitions that apply to the trustee's conduct. Subject to anything to the contrary in the trust deed, these operate to prohibit the trustee from exercising a power to add itself to the beneficial class. This prohibition may also extend to adding a related party where the trustee can be seen to benefit from the appointment. Essentially, a trustee's discretion must be exercised for the purpose conferred and not irresponsibly, capriciously, or wantonly.[107]

Despite the above legal principles governing a trustee's exercise of a power, beneficiaries of offshore trusts have limited ability to influence a trustee's exercise of a power (whether that power is a power to add or exclude beneficiaries or otherwise). The practical reality is that the English courts are generally reluctant to interfere in trustee decisions. Generally speaking, a court will not upset the exercise of such a power unless the trustee acted in bad faith or no reasonable trustee could have exercised the power in the way it was exercised if they had taken into account relevant factors and ignored irrelevant factors. Trustees can nonetheless still run into trouble on this front particularly if they have not considered the consequences of the addition or removal of a beneficiary. For example, offshore trustees have encountered issues where the power to remove is exercised such that there is no one left in the class of beneficiaries, or if the power is exercised improperly and subject to challenge by a disadvantaged beneficiary. Similarly, if a trustee exercises a power revocably when intended to have been exercised irrevocably, this may result in a failure to achieve desired tax effects. On the other hand, if a trustee exercises a power irrevocably when

[107] *Lutheran Church of Australia South Australia District Incorporated v Farmers Co-Operative Executors and Trustees Ltd* (1970) 121 CLR 628.

the trustee intended the exercise to be revocable, it may be necessary to apply to the relevant court for relief. Great care is therefore needed in the exercise of such powers.

E. Reversing Exercises of Trustee Discretion

From time to time a trustee may make a decision that turns out in hindsight to have been based on faulty or incorrect information. For example, a trustee may have made an income or principal distribution to a beneficiary based on a mistaken or incorrect assumption that the beneficiary would not be taxable on the distribution. The trustee might have also agreed to a decanting distribution that later turned out to be a bad idea. It could be that the trustee was mistaken about a beneficiary's tax residency or the legal effects of a distribution. Alternatively, the trustee may have failed to obtain tax or legal advice or obtained legal or tax advice that was incorrect. You could also imagine a situation in which a trustee made a discretionary decision that the trustee was not permitted to make, such as making a distribution to someone who was not a beneficiary.

The trust law around such botched exercises of discretion and whether a court can effectively reverse a botched exercise of discretion in the United States is not extensive. Cases of this kind typically come up in the tax context, and the courts and more importantly the IRS are not particularly friendly to attempts to reverse exercises of discretion in a way that changes the tax effects of an exercise of discretion.

As a general matter, if a trustee makes an erroneous distribution and the beneficiary returns the distribution to the trustee, the beneficiary is entitled to a refund of any tax he or she has paid with respect to the distribution, provided the beneficiary timely files the claim for refund.[108] Overlaying these general principles are the "annual accounting period" and "completed transaction" doctrines. The two doctrines generally provide that the tax effects of a transaction are determined at the end of a tax year and that a rescission changing the effect of the transaction in a later year has no effect for tax purposes.[109] In wealth transfer-related tax cases, courts typically rely on a variation of the annual accounting period doctrine called the "completed transaction" doctrine to limit the tax effects of retroactive reformations of transactions.[110]

The law in this area is quite a bit different outside of the United States and demonstrates an important contrast between U.S. trust law and practice and offshore law and practice. Historically a court applying English trust law would not void a voluntary trust distribution or other trustee decision if the

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[108] *See, e.g., De Vilbiss v. United States*, 41-2 U.S.T.C. ¶ 9552 (N.D. Ohio 1941). *See also, e.g., Salonstall v. Hassett*, 32 F. Supp. 583 (D. Mass. 1940).

[109] See, e.g., *Penn v. Robertson*, 115 F.2d 167 (4th Cir. 1940) (income erroneously paid to an employee in 1930 was taxable to him despite the rescission of the transaction in 1931); Revenue Ruling 80-58, 1980-1 C.B. 18 (seller taxed on the sale of land in 1978 even though buyer reconveyed the land the seller in 1979 due to the failure of a condition subsequent related to the potential upzoning of the land). In a more recent articulation of the annual accounting period doctrine, the IRS stated that two conditions are necessary for a rescission to be effective for tax reasons. The first is that the parties must restore each other to the same position as before the rescinded transaction. The second is that the restoration must take place in the same taxable year as the transaction. PLR 200923010.

[110] *See, e.g., Estate of Kraus v. Commissioner*, 875 F.2d 597 (7th Cir. 1989) (upholding IRS refusal to recognize state court reformation); *Sinopoulo v. Jones*, 154 F.2d 648 (10th Cir. 1946) (holding that state court retroactive reformation of trusts did not affect the rights of the government that attached under its tax laws); *Estate of Simpson v. Commissioner*, T.C. Memo. 1994-359 (holding Florida circuit court decision issued after the decedent's death not binding on Tax Court); *Estate of Bennett v. Commissioner*, 100 T.C. 42, 61 (1993) ("a valid reformation of a trust instrument may have retroactive effect under local law as between the parties to the instrument but not as to third parties, including [the federal government], who had previously acquired rights under the instrument"); *Estate of Nicholson v. Commissioner*, 94 T.C. 666 (1990) (holding that a state court order may have retroactive effect for state law purposes but has no effect on the government's right to collect federal taxes on a completed transaction); TAM 9127008 (advising that the state court rescission of trust termination to obtain an IRC § 1014 step up in basis would not change the federal tax consequences of the termination).

trustee had made a mistake that led to the distribution or the decision having an unforeseen tax consequence. From 2000 to 2013, however, an English court could void a trustee's discretionary decision that led to an unforeseen tax consequence if the decision was "manifestly unreasonable" in the sense that in reaching its decision the trustee had failed to consider things which it ought to have considered or considered things which it ought not to have considered. The so-called "rule in *Hastings-Bass*"[111] effectively provided a "get out of jail free card" to trustees and their professional advisers where they had failed to properly consider the tax consequences of a trustee's decision. The rule allowed a trustee who realized that a decision had an unforeseen adverse tax consequence to apply for a court order which would void the trustee's exercise of discretion. The U.K. government was typically the only loser in decisions in which a court applied the rule in *Hastings-Bass* because the government lost out on the tax revenue that would have otherwise resulted from the trustee's decision.

Several years ago, however, the U.K. tax authorities challenged the application of the *Hastings-Bass* principle in two cases, *Pitt v. Holt* and *Futter v. Futter*.[112] In 2013, the U.K. Supreme Court significantly limited the rule in *Hastings-Bass* by holding that a fiduciary decision is voidable (as opposed to void and thus only prospective in effect rather than retrospective for various tax purposes) on the petition of a beneficiary but only when the trustee was in breach of fiduciary duty. As a result, if a trustee followed proper procedures in obtaining professional advice and relying on that advice, an English court will no longer reverse the trustee's exercise of discretion.

However, the Supreme Court also revisited the law of mistake in respect of voluntary distributions and concluded that if an error as to the tax consequences of a decision was a breach of trust, it would be unconscionable for equity to leave the mistaken disposition uncorrected. Thus, if a trustee breaches its fiduciary duty by failing to obtain proper professional advice or unreasonably relying on professional advice, an English court may reverse the trustee's decision. The court is also free to choose from remedies other than voiding the decision, such as surcharging the trustee. On the other hand, if the trustee did not breach its fiduciary duty in making the mistake, such as in a case where the professional advisers gave incorrect tax advice but the trustee properly relied on the advice, the trustee may have to look to the professional advisors for damages.

The decisions in *Pitt* and *Futter* are binding only on the courts in England and Wales and not to other English trust law jurisdictions. However, many of the offshore financial centers have as their final court of appeal the Judicial Committee of the Privy Council, which has the same judges as the English Supreme Court. As a result, it stands to reason that if the Privy Council were presented with a case out of an offshore financial center with facts similar to *Pitt* or *Futter*, the Privy Council would likely reach the same decision as it did in *Pitt* and *Futter*. However, in a recent Isle of Man decision, *AB v CD*,[113] the court indicated no assumption should be made that the Manx courts would follow English law in respect of the comments made therein about artificial tax avoidance as the decisions in *Pitt* and *Futter* were largely driven by U.K. policy, which should not influence Manx jurisprudence.[114] It should be noted, however, that the Privy Council has positively endorsed the concept of "mistake" as being a positive action rather than mere ignorance drawn in *Pitt* and *Futter* in the 2023 case of *Perry v Lopag Trust Reg*,[115] in a non-tax Cayman Islands law judgment,

[111] [1975] Ch. 25.
[112] [2013] U.K.SC 26.
[113] Isle of Man High Court June 30, 2016.
[114] *See also In the Matter of the L Trust* [2017] JRC 191 (applying Jersey law).
[115] 26 ITELR 247.

The uncertainty around the effect of the *Pitt* and *Futter* decisions outside of England has led a few jurisdictions to enshrine the *Hastings-Bass* principle in legislation with retrospective effect, such as in the Cayman Islands, Jersey, the BVI and Bermuda.[116] Guernsey has not codified the Hastings-Bass principle.

Many of the offshore jurisdictions have continued to favor the original *Hastings-Bass* rule because it treats a breach of duty by a trustee as immaterial to the question of whether or not a mistake should be remedied. Offshore trustees in particular were attracted to the rule because it enables them to apply to the court to escape from very detrimental overlooked consequences of exercises of their discretionary distributive powers in favor of beneficiaries. In reliance on the rule, the trustees could have the court set aside what they had done if they would, or perhaps might, not have done it but for failing to take account of a relevant consideration or but for taking account of an irrelevant consideration. The judicial policy presented in the *Pitt* and *Futter* decisions, which arguably favors the tax authority to the prejudice of individual citizens and excludes from the ambit of discretionary equitable relief mistakes giving rise to unforeseen fiscal consequences, has therefore been passed over in many offshore jurisdictions in favor of preserving the *Hastings-Bass* rule.

The statutory *Hastings-Bass* provisions have already been the subject of judicial commentary in both Bermuda and the Cayman Islands. The judgment in *In the Matter of GC Settlement*[117] sets out a decision by the Supreme Court of Bermuda in respect of an application set aside a variation of a trust on the basis that it resulted in a flaw in the operation of the amended trust instrument. The variation by the trustee was considered to be a flawed exercise of fiduciary power, within the remit of the court's jurisdiction. On the facts of the case, the court was satisfied that, in exercising the power to vary the terms of the trust, the trustee had failed to take into account relevant considerations (concerning the effect of certain provisions upon the death of one of the beneficiaries). The court was also satisfied that had the trustee taken those considerations into account, the trustee would not have exercised its power to vary in this way. Rather, the trustee would have effected a variation that had the intended outcome. The court exercised its discretion in deciding it was appropriate to set aside the trustee's exercise of power.

In *Re Settlements made by Declarations of Trust dated 9 May 2013*[118] the Grand Court of the Cayman Islands considered a case involving the settlement of shares in a company on three family trusts, effected many years prior, by the settlors and the unpaid lay trustees without getting advice about the tax implications of the settlements in the settlors' onshore domicile. Ultimately, a professional trustee services company was appointed to administer the trusts and soon discovered that these settlements had given rise to a significant unforeseen tax liability, both for the settlors and for the trust funds. The new trustee applied an order to void the mistake, which was duly granted on the basis that the statutory provisions are intended to facilitate a flexible approach to setting aside the flawed exercise of fiduciary powers, and the court will generally be obliged to give it effect subject to appropriate limitations. These limitations were that the court had been satisfied with reference to the evidence before it that the mistake amounted to the improper exercise of a fiduciary power, and that the applicant had not deliberately pursued a course of conduct designed to gain some undisclosed and impermissible onshore tax advantage or some other improper benefit

In most of the offshore jurisdictions, a range of interested parties, including the trustee or some other "holder" of the fiduciary power, can make applications for a decision to be set aside; the remedy is not one simply in the hands of the trustee. This position is consistent with English common law and in

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[116] *See* Trusts (Amendment) Law, 2019 (Cayman Islands), The Trusts (Amendment No. 6) (Jersey) Law 2013; Trustee Amendment Act 2014 (Bermuda). Both Bermuda (s 47A(2))and Jersey (Art 47H(3)) limit their legislation to "would not" situations and are so restricted in their scope.

[117] [2021] SC (Bda) 63 Civ.

[118] Grand Court of the Cayman Islands, FSD 228 of 223 (IKJ).

particular the case of *Power Adhesives Ltd v Sweeney & Ors*,[119] which strongly supports the view that the *Hastings-Bass* rule is available to companies, their directors, and other "fiduciaries" when exercising fiduciary powers, just as it is available to trusts and trustees. The directors in this case sought apparently competent advice and acted upon it. The claimant company sought a declaration that a decision taken by the defendant directors in relation to company shares was in breach of their fiduciary duties and should be set aside. The court granted the declaration.

In the Matter of the Ta-Ming Wang Trust,[120] the Grand Court of the Cayman Islands also accepted, in principle, that the rule in *Hastings-Bass* could be applied to decisions of company directors on the basis that it may apply to the exercise of a fiduciary power by any person in a fiduciary position. However, the court noted that in the case before it there was no evidence of what factors the directors took into consideration and no basis on which the court could assume that the directors had the interests of the trust or its beneficiaries in mind when making their decision. It is clear from the judgment that had there been evidence as to the intentions and state of mind of the directors of the company sufficient to attract the rule, the court would have been prepared to make the further declaration sought.

V. Trust Protectors and Other Decision-Makers

A. Introduction

An essential feature of a trust is that a trustee holds legal title to the trust assets and has exclusive authority to manage those assets, albeit as a fiduciary for the trust beneficiaries. Other people related to a trust, however, have long had a role in the administration of a trust. For example, a beneficiary with a personally held power of appointment has a nonfiduciary power to rewrite the terms of the trust. A trust instrument may also confer a power to remove and replace a trustee on someone who is not a trust beneficiary. Over time, other "offices" that had a role in the administration of a trust emerged, sometimes without titles but sometimes with titles such as "protector" or "adviser." In many instances a trust instrument appointed an officeholder whom the trustee must consult with or obtain the consent to make certain decisions. In other instances trust instruments gave persons other than trustees powers to make decisions that a trustee would ordinarily make.

The U.S. approach to the diffusion of trust-related roles among various people differs considerably from the approach of other jurisdictions. In fact, the law in this area tends to be more developed and considered in non-U.S. trust law jurisdictions than in the U.S. states, particularly in the offshore financial centers. In contrast to much of the U.S. law in this area, which is statutory, the law in this area in offshore financial centers is case law driven. This section of the outline describes the U.S. approach, focusing on "directed trusts," and then summarizes how other trust law jurisdictions approach these issues.

B. The U.S. Approach: "Directed Trusts"

U.S. trust law and the drafting practices of U.S. trust law lawyers have long divided fiduciary responsibilities among co-trustees and other officeholders. In particular, trusts with co-trustees have long been a part of trust law and practice, and trust instruments often give one trustee an exclusive power, such as a special investment trustee or an independent trustee with tax-sensitive powers. But U.S. lawyers have also long drafted trusts with non-trustee fiduciary officeholders. To this extent, the concept of a trust with split fiduciary powers is not particularly novel. In the last few decades, however, there has great enthusiasm (or perhaps renewed enthusiasm or greater awareness) among trust lawyers and clients in the United States for trusts with multiple fiduciary officeholders and nonfiduciary officeholders. What was missing in the

[119] [2017] EWHC 676.
[120] Grand Court of the Cayman Islands, FSD 89 of 2010.

United States, however, was legislative and court guidance on how these arrangements should work, in particular whether these non-trustee officeholders had fiduciary duties and the relationship between such officeholders and the trustees.

Happily, the Uniform Law Commission jumped into the fray when it put together the U.T.C. and included section 808 that dealt with directed trusts in a summary fashion. In 2017 the U.L.C. developed the Uniform Directed Trust Act (the "U.D.T.A.") that helpfully provided states with much more extensive model legislation that addressed these two key issues and other more minor issues. As of the date of this outline, 20 states have adopted the U.D.T.A.

Central to the U.D.T.A. is the concept of a "trust director." A "trust director" is a person other than a trustee who has a "power of direction" under the provisions of a trust instrument.[121] The U.D.T.A. uses term "trust director" to generally cover anyone with a power of direction whatever the office the person holds is called under the trust instrument. As a result, if a protector, adviser, power holder, or office holder has a power of direction, the U.D.T.A. applies to acts or omissions that person takes in that role whatever the trust instrument calls that person's "office."

A "power of direction" is "a power over a trust granted to a person by the terms of the trust to the extent the power is exercisable while the person is not serving as a trustee."[122] A power of direction may include "a power over the investment, management, or distribution of trust property or other matters of trust administration."[123] A power of direction, however, does not include a "power of appointment" in the traditional sense (of which more later) a settlor's power to revoke a revocable trust, or a power to remove and replace a trustee, all of which are personally held powers.[124]

The U.D.T.A. does not limit the particular powers a trust director may have, instead generally providing that a trust instrument may grant powers of direction to a trust director.[125] The comments to U.D.T.A. § 6 include this nonexclusive list of powers a trust director may have:

- acquire, dispose of, exchange, or retain an investment;
- make or take loans;
- vote proxies for securities held in trust;
- adopt a particular valuation of trust property or determine the frequency or methodology of valuation;
- adjust between principal and income or convert to a unitrust;
- manage a business held in the trust;
- select a custodian for trust assets;
- modify, reform, terminate, or decant a trust;

[121] U.D.T.A. § 2(9).
[122] U.D.T.A. § 2(5).
[123] *Id*.
[124] *See id.*; U.D.T.A. § 5(b).
[125] U.D.T.A. § 6.

- direct a trustee's or another director's delegation of the trustee's or other director's powers;
- change the principal place of administration, situs, or governing law of the trust;
- ascertain the happening of an event that affects the administration of the trust;
- determine the capacity of a trustee, settlor, director, or beneficiary of the trust;
- determine the compensation to be paid to a trustee or trust director;
- prosecute, defend, or join an action, claim, or judicial proceeding relating to the trust;
- grant permission before a trustee or another director may exercise a power of the trustee or other director; or
- release a trustee or another trust director from liability for an action proposed or previously taken by the trustee or other director.

The U.D.T.A. helpfully clarified the sometimes vexing question of whether a non-trustee officeholder is a fiduciary by providing a general rule that a "trust director" is a fiduciary and has the same duties as a sole trustee or co-trustee "in a like position and under similar circumstances."[126] A trust instrument may vary the trust director's fiduciary duties to the same extent the trust instrument could vary a trustee's fiduciary duties in similar circumstances.[127] The gist of section 8 is that a trust director is essentially performing a fiduciary function and therefore should be subject to all the same duties and responsibilities of a trustee who would have similar powers. In other words, using a name other than trustee for an officeholder without additional detail does not change the substance of the officeholder's responsibilities and duties if he or she is a fiduciary. The comments to section 8 do point out that it is possible to give a trust director a "springing power" that comes into play only in certain circumstances, which would differentiate a trust director from a trustee. For such a trust director, his or her fiduciary duties are triggered when the event that "springs" his or her direction power to life is triggered.[128]

The U.D.T.A. also helpfully clarified that a trustee of a directed trust must take "reasonable action" to comply with a trust director's exercise or nonexercise of a power of direction and is not liable for taking such a reasonable action.[129] A directed trustee is not under a duty to monitor a trust director or inform or advise the beneficiaries, the settlor, another trustee, or a trust director if the directed trustee would have acted differently than the trust director unless the terms of the trust instrument provide otherwise.[130] A trust director is similarly excused from monitoring other trust directors with different powers.[131] In both cases, if the trustee or trust director does comment or bring an aspect of a trust director's actions to the attention of the settlor or a beneficiary, doing so does not mean the trustee or trust director assumes the particular duty.

Many other states have also adopted directed trust legislation in a form different than the U.D.T.A. Delaware was the first state to adopt directed trust legislation, and its legislation was the model for a number of other states' directed trust legislation. Delaware called what we now usually call a trust director an

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[126] U.D.T.A. § 8(a)(1).
[127] U.D.T.A. § 8(a)(2).
[128] *See* Comment to U.D.T.A. § 8.
[129] U.D.T.A. § 9(a).
[130] U.D.T.A. § 11(a).
[131] U.D.T.A. § 11(b).

"advisers."[132] The Delaware legislation specifically applies to "protectors" acting under trust instruments, including protectors with the following powers:

- The power to remove and appoint trustees, advisers, trust committee members, and other protectors;

- The power to modify or amend the governing instrument to achieve favorable tax status or to facilitate the efficient administration of the trust; and

- The power to modify, expand, or restrict the terms of a power of appointment granted to a beneficiary by the governing instrument.

This is in contrast to the U.D.T.A., which provides that a power to remove and replace a trustee is not a power of direction.[133]

The Delaware legislation does not directly address the fiduciary nature of an adviser's role or the adviser's fiduciary duties. Foreshadowing what would later become part of the U.D.T.A., the Delaware legislation exonerated a "fiduciary" required to follow the direction of an adviser from liability if the fiduciary acted in accordance with the adviser's direction except in cases of "willful misconduct."[134] If, however, a trust instrument directs a fiduciary to make a decision with the consent of the adviser and the adviser fails to provide consent after the trustee requests the adviser to do so, the fiduciary will not be liable for any loss directly or indirectly related to the adviser's failure to provide consent other than in cases of the fiduciary's "willful misconduct or gross negligence."[135] These rules are generally consistent with Delaware's rule that a trust instrument may exculpate a fiduciary for all acts or omissions other than those that resulted from willful misconduct.[136]

Many other states followed Delaware by adopting various forms of directed trust legislation similar in effect to Delaware's legislation, including designating the equivalent of trust directors as fiduciaries.[137] While Idaho's directed trust legislation provides that a trust advisor with the power to direct or consent to investments is a fiduciary, a trust instrument may provide that the advisor is not a fiduciary.[138] Similarly, New Hampshire's directed trust rules provide that unless otherwise provided in a governing instrument, a "trust advisor" or "trust protector" of a noncharitable trust is a fiduciary.[139] Nevada's directed trust legislation takes a slightly different approach, providing that "investment trust advisers" are fiduciaries unless otherwise provided in the instrument but does not have a corresponding rule for "distribution trust advisers."[140] Nevada's legislation also provides that "investment trust advisers" and "distribution trust

[132] 12 Del. Code § 3313(a) (referring to persons with powers to "direct, consent to, or disapprove a fiduciary's actual or proposed investment decisions, distribution decisions or other decisions").
[133] *See* U.D.T.A. § 5(b)(2).
[134] 12 Del. Code § 3313(b).
[135] *Id*.
[136] *See* 12 Del. Code § 3303(a).
[137] *E.g*. Alaska Stat. § 13.36.072; S.D.C.L. § 55B-1-4 (including special rules allowing the limitation of liability for fiduciary "advisors" who appoint "nonfiduciary trust advisors"); Tex. Prop. Code § 114.0031 (applying to an "advisor" as defined in the statute, with an exception allowing an advisor who has a power to remove and replace a trustee to be a nonfiduciary position if the trust instrument so provides as long as the advisor cannot appoint himself or herself as trustee).
[138] Idaho Code § 15-7-501(4).
[139] N.H. Stat. § 564-B:12-1202(a).
[140] Nev. Rev. Stat. § 165.5555.

advisers" may exercise the powers given to them in the trust instrument "in the best interests of the trust," the meaning of which is not clear from the statute.[141]

Some states also tackled "trust protectors," sometimes differentiating them from "trust advisors" or similar fiduciaries but sometimes not. The legislation in many respects seems simply like a response to the fact that trusts governed by the laws of the states appointed "protectors," therefore leading to a need for some legislation. Some states did not spend too much time on this, like Texas which provides that a "protector" has whatever powers a trust instrument gives a protector and that the protector is an "advisor" and, therefore, a fiduciary other than in a limited circumstance related to trustee removal and replacement powers.[142]

Nevada similarly provided that a "protector" is someone appointed as a protector in a trust instrument, but also provides that the protector may exercise the powers conferred on the protector in the protector's sole discretion and in the "best interests of the trust."[143] South Dakota's directed trust statute addresses the role of "trust protectors" in considerable detail. As a general rule, trust protectors under South Dakota law are not fiduciaries unless the governing instrument provides otherwise or if someone called a protector is in fact a distribution trust advisor or investment trust advisor.[144] South Dakota follows the general convention of providing that the protector's powers are whatever the instrument provides they are but also provides a long list of permitted powers, which can include the power to "increase or decrease beneficial interests in the trust" and to [m]odify the terms of any power of appointment granted by the trust."[145] South Dakota also gives protectors and other officeholders certain abilities to modify the rights of beneficiaries to information about the trust.[146] South Dakota also generally provides that a protector acts in the best interests of a trust and in the "sole and absolute discretion" of the protector. Idaho's directed trust statute has provisions similar to South Dakota's directed trust statute as they relate to protectors.[147]

C. The Offshore View

In trusts administered in offshore financial centers, divvying up fiduciary duties among various officeholders is routine and has been so for decades. Almost any trust administered in an offshore jurisdiction will have "power holders," "protectors," "consent holders," or other officeholders. Trustees in offshore financial centers also typically hold trust investments through one or more wholly owned limited companies, which effectively allow the delegation of investment management and administration to the company's officers and directors. Because of the popularity of these arrangements, there is a decent-sized body of court decisions in the offshore trust law jurisdictions that addresses the various legal issues that what we think of as trusts raise, including a trustee's relationship to a wholly owned investment company managed by other persons. To a large extent, offshore trusts are the original "directed" trusts that are now popular in the United States.

Settlor-reserved powers trusts are the most common form of directed trust found in offshore jurisdictions such as the BVI, Jersey, Guernsey, and the Cayman Islands. Trust legislation in those jurisdictions renders it possible for a settlor to reserve certain powers for himself or herself (or to confer such powers on others) under the terms of a trust instrument and confirms that the reservation of such powers will not, ipso facto, invalidate the trust. Powers to add and remove trustees, make alterations to the class of beneficiaries, change the proper law or forum of administration of the trust and withhold consent

[141] Nev. Rev. Stat. § 165.5557.
[142] Tex. Prop. Code § 114.0031(d).
[143] Nev. Rev. Stat. §§ 165.5547, 165.5553.
[144] S.D.C.L. § 55-1B-1(2).
[145] *See* S.D.C.L. § 55-1B-6.
[146] S.D.C.L. § 55-2-13.
[147] Idaho Code § 15-7-501(6).

from specified actions of the trustees are all expressly recognized as capable of being reserved. It is also possible to reserve powers to direct the trustees in relation to the investment of the trust fund and the distribution of income generated by the trust fund. Though a settlor may in principle reserve powers for themselves, the extent to which a settlor chooses to do so is the most significant issue. Without proper consideration of how these powers affect the trust assets and the administration of the trust, the legitimacy of a trust with extensive settlor reserved powers may be open to challenge.

Protectors are commonly used in offshore trusts, and will be given powers to assist in the administration of the trust. Subject to considerations as to the personal impact of holding such a role (including with reference to fiscal triggers), the protector of an offshore trust may be the settlor, a beneficiary of the trust, or an independent outsider. The protector's role does not need to be restricted to one individual; it may be a committee which fulfils the role by voting on proposed courses of action. In the usual course, it is the settlor who determines who is appointed protector and how that role will affect the governance of the relevant trust. However, the right choice for the role will depend on whether it is anticipated to be an active role requiring constant policing of the trustee, or a role requiring limited participation.

The roles and powers of protectors in discretionary offshore trusts were recently considered in landmark decisions of the Supreme Court of Bermuda and the Royal Court of Jersey, which took different approaches to the question of whether the powers of consent of protectors confer an independent decision-making discretion on the protectors (known as the "wide view") or merely a discretion to ensure that the trustees' substantive decision was a valid and rational one (considered to be the "narrow view").

In the case of *Re the X Trusts*[148] the trustees of the trusts were required to obtain the consent of the protectors to finalize proposals for the restructuring of the trusts to enable a division of the trust assets. The narrow view would place the protectors' veto powers within limited bounds whereas the wide view would expand them by conferring an unfettered veto power on the protectors. The presiding judge favored the narrow view which was said to reflect the true construction of the consent powers conferred on the protectors because the terms of the relevant instruments made it clear that their dominant purpose was to ensure the due exercise of the powers vested in the trustees. The protectors' role was said to be limited to ensuring due execution by the trustee of the powers vested in them and it was noted that the drafting of the trust deed clearly provided that the protectors' powers were not intended to be powers exercised jointly with, or entirely independently from, the powers conferred on the trustees subject to protector consent.[149]

Shortly after the *X Trusts* judgment was handed down, the Royal Court of Jersey handed down its judgment in *Re Piedmont and Riviera Trust*.[150] This case involved an application by the trustees of two trusts for the Royal Court's approval of their decision to distribute all the assets of the trusts amongst the beneficiaries in specified proportions. The protector in the trusts had a power to consent to or veto the trustees' proposal. One of the issues that the Royal Court was required to consider was the nature of the protectors' powers of or consent. The Royal Court favored the wide view, noting that a protector should exercise his or her own judgment in matters where their consent is required, rather than to simply review the trustee's decision in the same way that the court would do. It followed that, depending on the circumstances, a protector may well be entitled to veto a decision of a trustee if he or she thinks the trustee's

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[148] [2021] SC (Bda) 72 Civ.

[149] The decision of *PTNZ v AS* [2020] WTLR 1423, where it was held that consent powers conferred on a protector embodied an independent discretion jointly exercised with the trustee, was not persuasive because the protector provisions in that case were drafted in wider terms and the court had not received the benefit of exhaustive adversarial arguments on that issue.

[150] [2021] JRC 248.

decision is not in the best interests of the beneficiaries. The role of the protector was therefore considered to be critical to imposing supervision on the exercise of the trustee's powers.

Another relevant role in directed trusts offshore which is similar to that of protector is the role of "enforcer" of Cayman Islands STAR trusts.Unlike ordinary Cayman Islands trusts, a STAR trust is required to have one or more enforcers who are the only persons who have standing to enforce the terms of a STAR trust. Enforcers are appointed by the settlor when the trust is established or pursuant to the terms of the trust instrument, and they can be corporate entities or individuals. The STAR regime expressly stipulates that an enforcer is deemed to have a fiduciary duty to act responsibly with a view to the proper execution of the trust, but this is subject to evidence of a contrary intention in the trust instrument. Subject to the terms on which they are appointed, enforcers enjoy the same rights and remedies as beneficiaries under ordinary trusts. Enforcers have standing to seek the direction of the Grand Court concerning the administration of the STAR trust in appropriate cases and rights to obtain information concerning the STAR trust and its administration from the trustee and to take copies of trust documents. Enforcers also enjoy rights of indemnity out of the trust fund in the same way as trustees of an ordinary trust in discharging the performance of their duties.

In *AA v JTC*[151] the enforcer of a STAR trust decided to exercise one of the fiduciary powers conferred on him by the trust deed pursuant to which he would instruct the trustee to exercise certain of its own powers. This decision related to the manner in which rights attached to shares in an underlying company were exercised. The enforcer considered this decision to be a "momentous" decision and, before implementing it, made an application to the Grand Court in reliance on the principles set out in *Public Trustee v Cooper*. In considering the enforcer's application, the Grand Court confirmed that it was appropriate for the enforcer to exercise the powers granted to him to give directions to the trustee to exercise rights attaching to share in a company forming part of the trust assets. The court noted that the enforcer clearly had the power to direct the trustee for a number of reasons. The trust deed required the trustee to exercise the rights attaching the shares as instructed in writing by the enforcer. Also, the enforcer had genuinely decided that the decision he had made was in the best interests of the trust and in furtherance of its purposes. Finally, the enforcer was not impeded by any conflicts of interest from reaching his decision to instruct the trustee in respect of the shares.

As noted above, delegation of investment management and administration to the company's officers and directors is common and trustees of offshore trusts will regularly include exoneration clauses to ensure that the trustees are not liable for any decisions made, directions given, or liabilities incurred by their delegates other decision makers. These clauses, known as "anti-Bartlett clauses" are a product of English common law following the decision of *Bartlett v Barclays*,[152] where it was held that in circumstances where a trust holds a controlling block of shares in a company, the trustee has a consequent duty to take action when the affairs of the company are not being conducted appropriately and to use its powers to obtain information and decide whether to intervene. This in essence amounts to a duty to be involved in the underlying business and is a duty which most offshore trustees wish to avoid given that the types of business ordinarily held in offshore structures can be extensive, require specialist management, and operate across numerous international borders. To address this, offshore trusts regularly include an anti-Bartlett clause in trust deeds, to exclude that duty to enquire and supervise in respect of situations where the trust holds a controlling interest in underlying companies.

The 2017 decision of the Hong Kong Court in *Zhang Hong Li v DBS Bank (Hong Kong) Limited*[153] had raised questions about the validity of anti-Bartlett clauses. In that case, the trust documentation

[151] Unreported, 12 February 2024, FSD 12 of 2024, Grand Court of the Cayman Islands (IKJ).
[152] [1980] Ch 515.
[153] [2019] HKCFA 45.

included an extensive and bespoke anti-Bartlett clause and other relevant provisions. Of particular note was a provision stating that "… the trustees shall leave the administration management and conduct of the business and affairs of such company to the directors officers and other persons authorised to take part in the administration management or conduct thereof." The investment adviser to the underlying company engaged in reckless trading during a period of high market volatility eventually leading to a market crash and significant losses for the trust. The trustees were then sued by the beneficiaries and the successor trustee for both dishonest and negligence breach of fiduciary duty for failing to supervise and intervene in the conduct of the investment advisor. The case ultimately made its way to the Hong Kong Court of Final Appeal, which held that the effect of the anti-Bartlett clause was to restrict the powers of the trustee to interfere in management of the underlying investment business and it therefore had no obligation to intervene in the business of the company, and no obligation to obtain information regarding the company.[154]

A word of caution may be sounded when applying English trust law to settlor-reserved powers. Until the mid-1980s the English courts were conflicted in concluding that a power of revocation was consistent with the valid creation of a settlement. English law continues to express greater discomfort than many other common law jurisdictions with ongoing settlor (direct or indirect) involvement with trust decision making. This may well be the function of a dearth of English legislation addressing so-called "reserved powers." The case of *JSC Mezhdunarodniy Promyshlenniy Bank v Pugachev*[155] is instructive. The case concerned the applicant's claims for declarations that assets purportedly held in valid trusts was owned by the respondent and the trusts illusory. The respondent settled various New Zealand law trusts which reserved to himself, as protector, the power to consent to various trustee decisions. Whilst the protector could not "initiate" dispositive decisions and whilst the trustee was professional (run by a New Zealand lawyer), the context of the creation of the trusts intimated that the protector's powers were personal, not fiduciary, and so Mr. Pugachev had not divested himself of ownership. Of particular weight was the fact Mr. Pugachev was settlor, protector and a discretionary beneficiary and he held, as protector, the power to remove the trustee "with or without cause." While each trust's true interpretation must always turn on the specific facts, this case is, at best, a cautionary tale of form inviting detailed inquiry of substance made possible by the extensive use of retained powers.

VI. Trustee Succession

A. Introduction

One thing trusts around the world have in common is trustees. This means that all trust law jurisdictions must deal with issues related to changes in trustees, including how to fill vacancies in the office of trustee, how to transfer trust property from one trustee to another, and how to manage the relationship between current trustees and former trustees. While U.S. law in this area has some similarities to foreign trust law, there are significant differences, particularly with respect to a former trustee's rights to indemnity from the trust assets, that impact how trustee succession issues are negotiated and managed outside of the United States. This section of the outline covers several key differences in this area of trust law and practice that U.S. lawyers should understand to effectively advise clients who are beneficiaries of foreign trusts or who otherwise encounter foreign trust-related issues.

B. U.S. Law and Practice

Issues related to trustee succession have long been central to the U.S. common law of trusts, U.S. trust legislation, and trust drafting. Most trust instruments have provisions related to trustee succession; legislation and the common law of trusts fill the gap in situations where trust instruments do not consider

[154] *Id.*
[155] 20 ITELR 905.

particular trustee succession situations. For example, trust documents commonly address trustee resignation, trustee removal, the appointment of successor trustees, a former trustee's duty to account to a successor trustee, and vacancies in the office of trustee due to death, disability, or other reasons.

Because each trust instrument stands on its own it is difficult to generalize about mechanics of trustee succession in a particular state or for a particular kind of U.S. trust. States have enacted legislation to fill gaps in drafting when for whatever reason a vacancy in the office of trustee cannot be filled in accordance with provisions in a trust instrument. For example, section 7.04(c) of the Uniform Trust Code provides that the qualified beneficiaries can fill an otherwise unfilled vacancy in the office of trustee without the need for a court application or court approval. Also, the Uniform Trust Code does not require the appointment of a successor if a co-trustee ceases to act. As long as at least one trustee is acting, the vacancy need not be filled. The Uniform Trust Code does not require a minimum number of co-trustees if individuals are acting as trustees.

While the common law rule in the United States was that a trustee cannot resign without court approval, most U.S. trust instruments permit a trustee to resign, sometimes with notice to beneficiaries, co-trustees, or other persons. The drafters of the Uniform Trust Code rejected the common law rule: section 7.05 allows a trustee to resign by giving notice to the trust's qualified beneficiaries, to the trust's settlor (if living), and to all co-trustees. States that have adopted the Uniform Trust Code generally included this provision, sometimes with minor changes.[156] Florida adopted the substance of section 7.05 but added additional language that provides that "notwithstanding any provision of the terms of a trust" a trustee may resign by giving 30 days' notice to the trust's qualified beneficiaries or with court approval.[157] Many other states have statutes similar to U.T.C. section 705 rejecting the common law rule related to trustee resignation.[158]

A related issue for a former trustee in the United States is whether he or she will be liable for obligations of the trust incurred while the former trustee was acting as trustee. At common law, a trustee is personally liable for contracts, torts, and other actions taken with respect to trust property. As a result, if after ceasing to act a predecessor trustee was sued for breach of contract, that trustee would be personally liable for the damages but would not have recourse to the trust assets to reimburse himself or herself from the trust property.

The U.S. states have overridden the common law of personal liability for trustees by statute. In particular, under the Uniform Trust Code a trustee is not personally liable for most contracts or torts undertaken while he or she is trustee if he or she disclosed his or her fiduciary capacity.[159] The trustee may do so by simply saying he or she is acting as trustee or by using the name of the trust in the contracting documents; it is not necessary for the trustee to both say that he or she is acting as trustee and provide the name of the trust (though that may be good practice).

Similarly, the Uniform Trust Code provides that trustees are not personally liable for torts committed in their capacity as trustee or from liabilities related to the trustee's ownership of trust property unless the trustee was personally at fault.[160] Responding to a particular concern of trustees, the drafters of the Uniform Trust Code referred specifically to liability for a violation of environment law in this context.

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[156] *See, e.g.*, Minn. Stat. § 501C.0705; Mass. Stat. § 203E 7 705; Colo. Rev. Stat. § 15-7-705; 760 ILCS 3/705 (making slight wording changes).
[157] Fla. Stat. § 736.0705.
[158] *E.g.* Cal. Probate Code § 15640; Nev. Rev. Stat. § 163.600; RCW § 11.98.029.
[159] U.T.C. § 1010(a).
[160] U.T.C. § 1010(b). The U.T.C.'s exoneration of a trustee in this situation is broader than the view articulated in the Restatement of Trusts (3d), which had taken the position that a trustee was personally liable for torts or other obligations as a result of ownership of trust property without regard to fault.

For many years trustees had been concerned about the strict liability of landowners to pay costs of environmental remediation of real property even if the contamination was the fault of prior owners. Absolving trustees of personal liability when they were without fault was a major policy change in U.S. trust law and a marked improvement for trustees.

Most of the states that have adopted the Uniform Trust Code have included these default rules, though a few states have added some additional protections.[161] While California has not adopted the Uniform Trust Code in its entirety, it has adopted the substance of these provisions.[162] Nevada has a helpful statute that makes it clear a trustee is not personally liable for a contract the trustee makes as trustee as long as it is clear that the trustee is acting in a representative capacity:

> [A] trustee is not personally liable on a contract properly entered into in the capacity of representative in the course of administration of the trust unless the trustee fails to reveal the representative capacity or identify the trust in the contract. The addition of the word "trustee" or the words "as trustee" after the signature of a trustee to a contract are prima facie evidence of an intent to exclude the trustee from personal liability.[163]

Nevada law also addresses a trustee's liability for a tort committed while acting as a trustee, providing a broad range of exoneration:

> A trustee who has incurred personal liability for a tort committed in the administration of the trust is entitled to exoneration therefor from the trust property if the trustee has not discharged the claim, or to be reimbursed therefor out of trust funds if the trustee has paid the claim, if:
>
> (a) The tort was a common incident of the kind of business activity in which the trustee was properly engaged for the trust;
>
> (b) Although the tort was not a common incident of such activity, neither the trustee nor any officer or employee of the trustee was guilty of personal fault in incurring the liability; or
>
> (c) The trust instrument authorizes the exoneration or reimbursement of a trustee and the actions of the trustee did not constitute willful misconduct or gross negligence.[164]

Because of the general now-statutory rule that a trustee is not personally liable for his or her actions and omissions taken in his or her capacity as trustee, when a trustee resigns he or she does not ordinarily need an indemnity from a successor trustee. If a third party in the United States has a claim based on a contract or an obligation of a former trustee of a trust, that third party will simply pursue the claim against the current trustee. Also, by statutes trustees in the United States typically have a broad right to reimbursement for expenses they incurred in the administration of the trust, which would include funds the trustee has to pay personally related to a trust expense, including a judgment against a trustee for the acts of a predecessor trustee.

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[161] *See, e.g.*, 130 ORS § 1010(d) (trustee not personally liable even if instrument of title did not show trustee was acting in a fiduciary capacity).
[162] Cal. Prob. Code §§ 18000 – 18005.
[163] Nev. Rev. Stat. § 163.120(3).
[164] Nev. Rev. Stat. § 163.130(1).

Another important issue related to trustee succession is a successor trustee's duty to review the accounts and the actions and omissions of a predecessor trustee. As a general matter, most trust instruments governed by U.S. law include a provision to this effect:

> A successor trustee may accept the account furnished and the property delivered by or for a predecessor trustee without liability for so doing, and such an acceptance will be a complete discharge to the predecessor trustee.

Such a provision is a departure from the U.S. common law of trusts, which is quite strict and requires a trustee who knew or should have known of a breach of fiduciary duty committed by a predecessor trustee and either permits it to continue or fails to take proper steps to hold the predecessor trustee accountable.[165]

The drafters of the U.T.C. considered this general issue and included a provision requires a successor trustee to take "reasonable steps" to require a predecessor trustee to deliver trust property to the trustee and to "redress a breach of trust known to the trustee to have been committed by a former trustee."[166] A successor will "know" of a breach of trust by a predecessor trustee then the trustee has actual knowledge of the breach of trust, has been notified of the breach of trust, or "from all the facts and circumstances" known to the successor trustee, "has reason to know it."[167] The knowledge requirement included by the drafters reflects a departure from the common law view but it also was consistent with many state statutes that exonerated successor trustees from liability for not pursuing unknown breaches of trust by predecessor trustees.[168] The drafters of the U.T.C. also pointed out that the successor trustee's duty "is not absolute" but depends on the facts and circumstances:

> Pursuit of a claim is not required if the amount of the claim, costs of suit and enforcement, and likelihood of recovery, make such action uneconomic.[169]

The states that adopted the U.T.C. generally adopted these provisions, though of course not without some slight variations. Minnesota, for example, did not adopt U.T.C. section 812 but instead included a rule in its version of U.T.C. section 811 that requires a successor trustee to take "reasonable steps to redress a breach of trust known to the trustee to have been committed by a former trustee."[170] New Jersey adopted U.T.C. section 811 but added a more descriptive title and split out the trustee's duties in subsections, both of which improved the readability of the statute.[171] Massachusetts and Arizona adopted section 812 verbatim.[172]

Non-U.T.C. states also address a successor trustee's duty – or lack thereof - in their trust legislation. Under Washington law, for example, unless a trust instrument provides otherwise, a successor trustee is not liable for the acts and omissions of a predecessor trustee, need not inquire as to the validity of the acts of a predecessor trustee, and may accept "as conclusively accurate any accounting or statement of assets" tendered by the predecessor trustee to the successor trustee. Washington law also allows a successor trustee

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[165] Restatement (Second) § 223(2). *See also, e.g.*, *Barash v. Lembo*, 303 A.3d 577, 596 (Conn. 2023).
[166] U.T.C. § 812.
[167] U.T.C. § 104(a). Section 104(b) has a special rule describing when an organization acting as a trustee is deemed to "know" a fact for purposes of the Uniform Trust Code.
[168] *See* Comment to U.T.C. § 812 (citing as an example Mo. Rev. Stat. § 456.187.2, though Missouri later adopted section 812 in its entirety as Mo. Rev. Stat. § 456.8-812).
[169] Comment to U.T.C. § 812.
[170] Minn. Stat. § 501C.811(a).
[171] *See* N. J. Stat. § 3B:31-66(b).
[172] Mass. Gen. Law § 230E.812; Ariz. Rev. Stat. § 14-10812.

to receipt for assets actually delivered by the predecessor trustee and does not impose a duty on the successor trustee to inquire further about undisclosed trust assets.[173]

By contrast, California follows the Restatement (Second) view of a successor trustee's liability for acts of a predecessor trustee. Under California law, a successor trustee is not liable for a breach of fiduciary duty committed by a predecessor trustee except in limited circumstances:

- Where the successor trustee knows or has information from which the successor trustee reasonably should have known of a situation constituting a breach of trust committed by the predecessor trustee and the successor trustee improperly permits it to continue.

- Where the successor trustee neglects to take reasonable steps to compel the predecessor trustee to deliver the trust property to the successor trustee.

- Where the successor trustee neglects to take reasonable steps to redress a breach of trust committed by the predecessor trustee in a case where the successor trustee knows or has information from which the successor trustee reasonably should have known of the predecessor trustee's breach.[174]

A related issue is for how long can trust beneficiaries hold a predecessor trustee liable for breaches of fiduciary duty. In general, if the predecessor trustee provided the trust beneficiaries with sufficient information to determine whether or not the trustee breached a fiduciary duty, the beneficiaries must bring the claim within the time allowed by the state's statute of limitations. For example, under the U.T.C., as long as a trustee satisfies its duty to report relevant information to the trust's qualified beneficiaries, those beneficiaries will have one year to sue the trustee for breach of fiduciary duty. If the resigning trustee fails to provide sufficient information, a trust beneficiary has five years to file a claim against a trustee for breach of fiduciary duty.[175]

A resigning trustee will often attempt to manage this risk by seeking the trust beneficiaries' approval of the trustee's accounts and a release by the beneficiaries for any breaches of fiduciary duty. The U.T.C. has greatly facilitated this process with its provisions on nonjudicial settlement agreements, which are discussed in more detail below in connection with the modification and termination of trusts.

C. The View Outside the United States

Trustee succession under English law and in the offshore financial centers is governed by both statutory and common law rules which seek to deal with the complexity of the transfer of trusteeships in circumstances where trust assets can be located around the world, the trusteeship may have been held by multiple trustees since establishment, and the trusts themselves may have moved jurisdiction over their lifetimes.

There are various circumstances in which the need to replace a trustee from a trust may arise, including for practical reasons, such as following death or retirement. In other cases, removing a trustee removal and appointing a successor is an important mechanism for assuring the proper administration of the trust. The most common method of removal is pursuant to an express provision in the trust instrument, which may either be a power of removal or a provision for the automatic removal of a trustee in specified circumstances. Such a provision will ordinarily specify the proper procedure for removal. It is common for

[173] RCW § 11.98.039(5)(a).
[174] Cal. Prob. Code § 16403 (applicable to acts and omissions after June 30, 1987).
[175] *See* U.T.C. § 1005(c).

powers of removal to be included in the instruments of offshore trusts governed by the laws of Jersey, Guernsey, BVI, the Cayman Islands, or Bermuda trust and the power to remove the trustee will often be given to the protector of the trust or the settlor if appropriate.

If the protector or a settlor has an express power to remove trustees but does not have any beneficial interests under the trust, then the power is normally fiduciary. This means that when the power to remove a trustee is exercised, the powerholder must be satisfied that the proposed removal is in the best interests of the beneficiaries in mind.

If there are no express powers or provisions dealing with removal of trustees within the trust instrument (or they are limited), it may be necessary to look at statutory powers to change the trustee. In England and Wales, section 36 of the Trustee Act 1925 is a way of replacing a trustee out of court. Similar statutory provisions drafted with reference to section 36 are in operation in the Cayman Islands and the BVI.[176] Importantly, this form of statutory power is not in itself a power of removal but confers a power to replace a trustee (by appointing a new one). The power may be exercised when a trustee has died, if a trustee has been outside of the relevant jurisdiction for more than 12 months, where a trustee wishes to be discharged from its duties as trustee, or if a trustee refuses to act or is unfit or incapable of acting (for example due to incapacity, age, or infirmity). The power must be exercised in writing and by either those expressly named in the trust instruments with the power to appoint new trustees or by the remaining trustees.[177]

In terms of trustee indemnities, the leading case is the judgment of the Privy Council in *Equity Trust (Jersey) Ltd v Halabi and ITG Ltd and others v Fort Trustees Ltd and another*[178] from the Jersey and Guernsey Courts of Appeal. The judgment confirms that a trustee's right of indemnity in respect of expenses incurred reasonably in its capacity as trustee confers a proprietary interest in the trust assets. This proprietary interest takes priority over the interests of the beneficiaries, and the proprietary interest of a retiring trustee survives the transfer of assets to a successor trustee. However, a former trustee's proprietary interest in the trust assets does not take priority over the equivalent interests of successor trustees. Accordingly, in the event that the trust fund has insufficient assets to meet the claims of all of the trustees (i.e. in the case of an "insolvent" trust), the trustees' claims rank *pari passu*.

Caution should be exercised by trustees who enter into contracts because at common law they will generally be personally liable under the contract and their personal liability to the other contracting parties (subject to any contractual limitations) will be unlimited. To avoid this, a trustee will often negotiate a contractual limitation on his liability to a specified amount or to the extent of the trust assets available to meet a claim. Several of the offshore jurisdictions (including BVI, Jersey and Guernsey) have statutory provisions that limits the contractual liability of a trustee in certain cases to the trust assets.

The fact that a trustee has the right to indemnity from the trust fund for liabilities reasonably incurred will usually provide appropriate comfort for a trustee while in office. But a retiring trustee is more exposed and once the trust property is passed over to the continuing or new trustees, the property will be placed outside the outgoing trustee's immediate control. Furthermore, if the new trustees are based out of the jurisdiction, the trustee and the trust assets will no longer be under the effective control of that trustee's "home" courts, and the trustee may have to resort at great time and cost to a foreign court in order to obtain

[176] *See* Section 10 of the Cayman Islands Trusts Act (2021 Revision); Section 36 of the BVI's Trustee Act (2020 Revision).
[177] *Id.* The courts will only put into effect the replacement of a trustee if it is expedient to appoint a new trustee and it is otherwise inexpedient, difficult, or impracticable to do so without the assistance of the court. The court may order the replacement of a trustee when a trustee lacks capacity to fulfil their duties; if a trustee is deemed bankrupt; or where a trustee (that is a corporation) is in liquidation or has been dissolved.
[178] [2022] U.K.PC 36.

an effective indemnity or reimbursement of expenses. For these reasons, under the trust laws in most offshore jurisdictions the duty to surrender trust property is subject to the right of the surrendering trustee to reasonable security. In practice, it is common for trust instruments to make provision expressly for this particular situation, and in any event for there to be a negotiation of some kind between the retiring and the continuing trustees.

In the offshore jurisdictions, a trustee is considered to have has a non-possessory lien over the trust fund. This is effectively a floating charge against the assets comprising the trust fund from time to time. As a non-possessory lien, it survives both the trustee's ceasing to be a trustee and ceasing to possess the trust fund. The former trustee can have recourse to the lien in priority to a subsequent trustee's right to do so which can potentially exhaust the trust fund.

It is not uncommon in the event of the retirement or removal of a trustee for the parties to disagree over outstanding fees owed to the departing trustee. However, under English law, a trustee is at risk of losing the right to a complete indemnity for its costs from the trust fund as a result of the trustee's unreasonable conduct in forcing the continuing trustee to bring unnecessary trust proceedings or because of the trustee's conduct in the proceedings themselves. A retiring trustee is not permitted to allow resolution of its fee position to delay its retirement, providing adequate arrangements are in place to provide security for any such fees. In fact, by putting his or her personal interests in settling his or her fee position first he is at a risk of failing to properly exercise those obligations.

In the decision of the Royal Court of Jersey in *Re the Velloz Settlement*,[179] a trustee had agreed to retire subject to agreeing reasonable security for disputed fees. His co-trustee had provided him with draft retirement terms and security, which included indemnification and an undertaking with regards to the ring-fencing of assets sufficient to meet the disputed fee liability. However, the outgoing trustee was not satisfied with the security offered, and negotiations between the parties were inconclusive. In light of this deadlock and the detrimental effect on the trust in having the retirement unresolved, the co-trustee applied to the Royal Court for a direction, among other things, that it be required to execute the retirement terms. The Royal Court ruled that it had jurisdiction to direct a retiring trustee to execute an instrument of retirement and to surrender all trust property in its possession or control and do any other necessary acts to assist the new trustees to assume the trusteeship.

VII. Modifying and Reforming Trusts

A. Introduction

One area in which there has always been a substantial difference between U.S. trust law and trust law in other jurisdictions is how irrevocable trusts may be modified or reformed. In particular, the common law of the United States made it much more difficult for beneficiaries of trusts to terminate a trust than the common law of England. The United States continues to follow a different path in this area than most other trust law jurisdictions. The United States, however, has also been an innovator in this area with the use of nonjudicial settlement agreements, which could be said to be pushing the United States closer to the English approach. This section of the outline highlights the differences between the current U.S. approach to modifying and terminating irrevocable trusts with the non-U.S. approach, highlighting the key differences but also the developing areas of similarity.

[179] [2021] JRC 140.

B. The U.S. View

Modification and termination of irrevocable trusts to adapt to changed circumstances was particularly challenging in America. Under the American common law of trusts, beneficiaries of an irrevocable trust cannot by agreement terminate or modify the terms of a trust. A court, however, could modify or terminate an irrevocable trust if doing so did not impair a material purpose of the trust.[180] If, however, the settlor is living, the beneficiaries and the settlor could agree to modify or terminate the trust without an inquiry into whether the material purposes of the trust would be frustrated by the amendment.[181]

A number of states have codified the common law rules in legislation, though with some tweaks. Under California law, for instance, a court may terminate a trust if all the beneficiaries agree unless the continuance of the trust "is necessary to carry out a material purpose of the trust."[182] If that is the case, California nevertheless allows a court to in fact terminate the trust unless the court determines that under the circumstances, terminating the trust "outweighs the interest in accomplishing a material purpose of the trust."[183] California also by statute codified the common law rule that if a settlor is living and agrees with all of the beneficiaries to terminate a trust, court approval is not required to terminate the trust.[184]

Under Arizona law, a court may approve an agreement by trust beneficiaries to terminate a noncharitable irrevocable trust "if the court concludes that continuance of the trust is not necessary to achieve any material purpose of the trust." Following such a termination, the trustee will distribute the trust assets as agreed by the beneficiaries.[185] Arizona has an interesting "out" that allows a court to terminate a trust in the absence of an agreement among all the beneficiaries provided that if the beneficiaries had all agreed the court could have terminated the trust (i.e. continuance was not necessary to achieve a material purpose of the trust and that the interests of the consenting beneficiaries are "adequately protected.").[186]

The drafters of the Uniform Trust Code gave states a choice with respect to agreements modifying trusts with the agreement of the settlor and all beneficiaries: such agreements were valid with or without court approval.[187] On the other hand, the drafters were more conservative with respect to agreements among beneficiaries to modify a trust without the settlor's consent. Under U.T.C. § 411(b), such an agreement is valid only if a court determines that the modification "is not inconsistent with a material purpose of the trust." The current version of U.T.C. § 411 includes an optional provision that provides that the inclusion of a spendthrift clause in a trust "is not presumed to constitute a material purpose of the trust." Taken together, all of these provisions limit the beneficiaries' ability to agree to trust modifications through a nonjudicial settlement agreement and effectively preserve the "American rule" related to trust modifications without the settlor's consent. Instead, under the general provisions of the U.T.C. a trust modification continues to require both court approval and a determination that the modification does not impair a material purpose of the trust.

Despite the U.T.C. provisions that generally follow the U.S. common law rules on trust modification and termination, the U.T.C. also permits nonjudicial settlement of trust-related controversies and has a comprehensive scheme for virtual representation to facilitate the agreements. Under U.T.C. § 111(b), "interested persons" may enter into a binding nonjudicial settlement agreement with respect to "any

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[180] *See generally Claflin v. Claflin*, 20 N.E. 454 (Mass. 1889); Restatement (Third) of Trusts § 65 (2003).
[181] *See generally* Restatement (Third) of Trusts § 65(2) (2003); Restatement (Second) of Trusts § 338(1) (1959).
[182] Cal. Prob. Code § 15403(a), (b).
[183] *Id*. Section 15403(b) further provides that if the trust instrument contains a "valid restraint on the transfer of a beneficiary's interest" a court may not terminate the trust under the statute "unless there is good cause to do so."
[184] Cal. Prob. Code § 15404(a).
[185] Ariz. Rev. Stat. § 14-10411(A).
[186] Ariz. Rev. Stat. § 14-10411(C).
[187] *See* U.T.C. § 411(a).

matter involving a trust." The U.T.C. includes a nonexclusive list of matters that can be resolved by a nonjudicial agreement:

- The interpretation or construction of the terms of the trust;
- The approval of a trustee's report or accounting;
- A direction to a trustee to refrain from performing a particular act or the grant to a trustee of any necessary or desirable power;
- The resignation or appointment of a trustee and the determination of a trustee's compensation;
- The transfer of a trust's principal place of administration; and
- The liability of a trustee for an action relating to the trust.[188]

Section 111 includes a further requirement that a nonjudicial agreement is valid only if it does not "violate a material purpose of the trust" and includes provisions that "could be properly approved by the court under the [U.T.C.] or other applicable law."[189]

Among the states that adopted the U.T.C., section 111 was a popular one to tinker with, particularly with respect to the list of matters that may be addressed by a nonjudicial settlement agreement. The adopting states generally retained the provision that an agreement only among beneficiaries to modify a trust is permissible only if it does not modify a material purpose of the trust and they obtain court approval of the agreement. A few U.T.C. states, however, modified the agreement-related provisions to include explicitly include modifications within the class of matters that a nonjudicial settlement agreement can address. The following paragraphs describe some, but not all, of these variations.

Florida retained U.T.C. section 111 in substance but supplemented it with a separate statute that addresses nonjudicial modifications of irrevocable trusts. Under Fla. Stat. § 736.0412, after the settlor's death the trustee and all qualified beneficiaries of a trust may modify a trust established after December 31, 2000, at any time even if the trust has a spendthrift clause or has a provision saying the trust is not revocable or amendable. The statute, however, refers back to Fla. Stat. § 736.04113(2), which provides a list of what modifications are allowed:

- Amend or change the terms of the trust, including terms governing distribution of the trust income or principal or terms governing administration of the trust;
- Terminate the trust in whole or in part;
- Direct or permit the trustee to do acts that are not authorized or that are prohibited by the terms of the trust; or
- Prohibit the trustee from performing acts that are permitted or required by the terms of the trust.

188 U.T.C. § 111(d).
189 U.T.C. § 111(c).

Florida's version of the U.T.C. has the helpful representation provisions that facilitate the use of these agreements.[190]

When Illinois adopted the U.T.C. it replaced its former nonjudicial agreement statute with a version of U.T.C. section 111 that has a longer list of matters that can be the subject of nonjudicial agreements and that specifically allows for the modification of administrative provisions of trusts.[191] Illinois's version of U.T.C. section 111 also includes an extensive provision allowing termination of trusts by agreement, but only with court approval and a finding by the court "that continuance of the trust is not necessary to achieve any clear material purpose of the trust."[192] The statute further provides that a court should consider spendthrift provisions as a "factor" in making a decision, but that a spendthrift clause "is not necessarily a material purpose of a trust."[193]

Pennsylvania similarly substantially modified U.T.C. section 111 by expanding the list of permitted subjects of nonjudicial agreements and specifically included the "modification or termination" of a trust on the list.[194] The Pennsylvania statute, however, includes the limitations in U.T.C. section 111 that a nonjudicial settlement agreement is valid only if it does not violate a material purpose of the trust and includes terms and conditions that could be properly approved by a court.[195] The Pennsylvania statute provides that all the beneficiaries and all trustees of the trust are necessary parties to an agreement, taking the representation provisions into account.[196]

When Oregon adopted the U.T.C. it also modified U.T.C. § 111 to expand the list of matters that could be addressed by a nonjudicial settlement agreement, including "modifying the terms of the trust, including extending or reducing the period during which the trust operates."[197] This reflects the historical fact that the original Oregon nonjudicial settlement agreement legislation explicitly allowed the modification of trusts by nonjudicial agreements but provided that any modification could not be inconsistent with "any dominant purpose or objective of the trust."[198] Like Pennsylvania, an Oregon nonjudicial settlement agreement will be valid only if it does not violate a material purpose of the trust and includes terms and conditions that a court could properly approve. Oregon also retained the provisions of its prior law related to nonjudicial settlement agreements, including provisions related to special representatives who could sign binding agreements on behalf of minor and unborn beneficiaries and the option to file or not file the agreement with a court.[199]

Ohio entirely rewrote U.T.C. § 111 in a comprehensive and thoughtful fashion that, among other things, allows modification of trusts by agreement.[200] Ohio, however, retained the requirement that an agreement modifying a trust could include only terms and conditions that a court would approve and cannot be inconsistent with a material purpose of the trust. The Ohio statute specifically limits agreements that change the interests of beneficiaries except in particular tax-related situations. The Ohio statute also has considerable detail related to who must be a party to a nonjudicial settlement agreement, including some interesting provisions describing when creditors are necessary parties to an agreement.

[190] *See* Fla. Stat. §§ 736-0301 – 736.0306.
[191] 760 I.L.C.S. § 3/111(b).
[192] 760 I.L.C.S. § 3/111(b)(13).
[193] *Id*.
[194] 77 Pa. Consol. Stat. § 7710.1(d).
[195] 77 Pa. Consol. Stat. § 7710.1(c).
[196] 77 Pa. Consol. Stat. § 7710.1(b).
[197] ORS § 130.045(5)(i).
[198] *See* ORS § 128.177(d) (repealed in 2005).
[199] *See* ORS § 130.045(3); ORS § 130.305 (significantly rewriting and expanding U.T.C. § 305).
[200] *See generally* Ohio Rev. Code § 5801.10.

Iowa's nonjudicial settlement agreement statute generally allows for modification of trusts by a nonjudicial agreement and includes provisions for the appointment of a special representative to bind the interests of various persons.[201] However, Iowa law also includes the limitation found in U.T.C. § 111 that an agreement may not violate a material purpose of the trust.[202] The Iowa statute also suggests that an agreement may not modify the dispositive provisions of a trust, instead requiring that a court approve such an agreement, which a court may do only if the existing provisions are not necessary to carry out a material purpose of the trust. The Iowa statute provides that the inclusion of "a spendthrift provision or discretion in the trustee to distribute income or principal to a beneficiary or among beneficiaries" is "presumed to constitute a material purpose of the trust."[203]

New Jersey's version nonjudicial settlement agreement statute does not explicitly allow a nonjudicial settlement agreement to modify a trust, though the New Jersey statute suggests by negative implication that a modification may be permissible subject of an agreement:

> A nonjudicial settlement may not be used to produce a result that is contrary to other sections of Title 3B of the New Jersey Statutes, including, but not limited to, terminating or modifying a trust in an impermissible manner.[204]

New Jersey law does allow a trust to be modified by the consent of the trustee and all the beneficiaries if the modification is not inconsistent with a material purpose of the trust.[205] Taken together, all of these suggest that some, but not all, trust modifications may be made by agreement in New Jersey.

Many non-U.T.C. states have also embraced nonjudicial settlement agreements as a way to terminate and modify trusts by agreement rather than through court approval. Washington law has long facilitated and encouraged the use of nonjudicial settlement agreements and lawyers to modify and terminate trusts and trustees frequently use agreements of this kind to address trust-related matters without having to get a court involved. Although the original Washington law enacted in 1984 did not specifically say that a trust modification or termination could be the subject of a nonjudicial agreement, lawyers in Washington routinely used these agreements to modify trusts. The original legislation required that nonbinding agreements be consistent with the intent of the settlor of the trust. As part of a 1999 update to the legislation, however, the Washington legislature removed the requirement that agreements be consistent with the settlor's intent, which effectively paved the way for trust modifications by agreement without court approval.[206]

In 2005 Idaho enacted nonjudicial settlement agreement legislation that is very similar to Washington's legislation, including extensive rules related to the appointment and powers of a special representative.[207] Like the Washington statute, the Idaho statute generally provides that a nonjudicial agreement may address any "matter," which is broadly defined in a nonexclusive manner similar to the Washington statute.[208]

South Dakota generally provides for nonjudicial trust modification agreements if agreed to by all beneficiaries as long as "continuance of the trust on its existing terms is not necessary to carry out a material

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[201] *See* Iowa Code §§ 633A.6307, 663A.6308.
[202] Iowa Code § 633A.6308(3).
[203] Iowa Code § 633A.2203(5).
[204] N.J. Rev. Stat. § 3B:31-11(f).
[205] N.J. Rev. Stat § 3B:31-11(c).
[206] *See generally* Mautner and Orr, *supra*, 35 ACTEC L. J. at 176 and text accompanying fn. 122.
[207] *See* Idaho Code §§ 15-8-301 – 305.
[208] *See* Idaho Code § 15-8-103. *See also* Mautner and Orr, *supra*, 35 ACTEC L. J. at 163 – 173.

purpose."[209] The trustee and all the beneficiaries may agree to a modification "[w]hether or not continuance of the trust on its existing terms is necessary to carry out a material purpose."[210] South Dakota has extensive statutes related to representation of beneficiaries with respect to court proceedings and nonjudicial agreements, including the concept of a "court representative" who can represent a person in connection with a nonjudicial agreement.[211]

While Delaware is not a U.T.C. state, it has a nonjudicial settlement agreement statute very similar to U.T.C. § 111.[212] Delaware has an extensive representation statute that applies to nonjudicial settlement situations, including a helpful provision that allows the holder of a nongeneral power of appointment exercisable in favor of any person or persons other than the holder, his or her estate, his or her creditors, or the creditors of his or her estate to represent and bind those persons "whose interests, as takers in default, are subject to the power" provided there is no material conflict of interest with respect to the matter.[213]

Nevada also has a nonjudicial settlement agreement statute that has a long list of matters that may be addressed in an agreement, including the termination of a trust or the "addition, deletion, or modification of a term or condition of the trust."[214] An agreement, however, will not be void "to the extent it violates a material purpose of the trust and to the extent it includes terms and conditions that could not be properly approved by the court."[215] Nevada has extensive representation rules that apply to nonjudicial settlement agreements.[216]

C. The Non-U.S. View

Amending an English law trust in modern practice is almost always done by exercising a trustee-held power of appointment to 'rewrite' the trusts, but where the settlor or beneficiaries are U.K. residents care must always be taken to avoid the departing so far from the original trust as to triggering negative U.K. tax considerations. In the absence of a suitable trust power, amendments to trusts may be made by agreement:

- Where all beneficiaries whose interests are impacted are adults and have capacity, with their consent thereby precluding them from objecting in the future;[217]

- Where there are minor or unborn beneficiaries, but all other relevant parties agree, it is possible to seek court approval on behalf of those minor and unborn beneficiaries through an application under the Variation of Trusts Act 1958, to vary both beneficial and administrative powers.

In comparison, the flexibility of the offshore financial centers can be seen again in the mechanics that are available to ensure trusts can be modified, reformed, and otherwise evolve to meet the needs and best interests of the beneficiaries. Circumstances inevitably arise during the life of an offshore trust where a variation or modification to the trust deed is desirable, and possibly even necessary, in the interests of efficient administration or to protect the interests of the beneficiaries. In such cases the trustees will first

[209] S.D.C.L. § 55-3-24.
[210] *Id*.
[211] *See* S.D.C.L. § 55-18-9.
[212] *See* 12 Del. Code § 3338.
[213] 12 Del. Code § 3547(c).
[214] Nev. Rev. Stat. § 164.940(3)(c).
[215] Nev. Rev. Stat. § 164.940(2).
[216] *See* Nev. Rev. Stat. §§ 164.942, 164.038.
[217] *Stephenson (Inspector of Taxes) v Barclays Bank Trust Co Ltd*, [1975] 1 WLR 882.

consider whether a variation is possible without the assistance of the court, failing which the trustees will then turn to the court for assistance.

It is usually the case that the trust deed will have been drafted so as to confer on the trustees powers wider than those contemplated by the general law. A modern English law or offshore trust deed will usually include, at a minimum, trustee-held powers of appointment, powers of advancement and powers of amendment that will offer a number of options in terms of maneuvering to ensure the trust continues to function as initially anticipated. If a trustee finds itself encumbered with a deficient trust deed it may be able to address the problems by way of amendment or variation; if the trustee it has sufficient powers to do so under the trust deed and where all beneficiaries of the trust (who must be of age and have capacity) have expressly consented to the amendment. A trustee's powers must be exercised for the benefit of the beneficiaries, so if the desired amendment is solely for the benefit of the trustees or designed only to protect them from liability (for instance to introduce trustee charging provisions or exculpation clauses), there is potentially a question as to whether it would be valid.

If express powers of amendment or variation in particular are not included in the trust deed, then many of the offshore jurisdictions offer statutory provisions that allow for the assistance of the local court to effect variations to the trust. By way of example, the Grand Court of the Cayman Islands has the power approve the variation or revocation of a trust deed pursuant to section 72 of its Trusts Act provided that the variation or revocation must is not to the detriment of the beneficiaries.

This was a concept considered in the judgment of *In the Matter of Butterfield Trust (Cayman) Limited v A, B, C et. al*[218] in which the Grand Court's approval was sought on behalf of the minor and unborn beneficiaries to vary a trust known as the Parakeet Trust and, assuming the variation was approved, to bless the distribution of the entirety of the trust fund to the First Defendant (the mother of the minors). The need for the application arose because of the unexpected decision of the First Defendant, connected to welfare concerns exacerbated by the Covid-19 pandemic; to return with her family to Australia shortly after the trust was established and the First Defendant had taken up residence in the Cayman Islands.

The primary difficulty arose due to a restriction in the trust deed which prohibited even an indirect benefit on Australian residents. The First Defendant had indicated that she would provide for her children through her estate, something which would constitute an indirect benefit for the minor beneficiaries and therefore meant that the distribution could not be undertaken without first varying the trust deed to remove the restriction on "indirect" benefit. The trustee, therefore, sought a variation of the trust pursuant to section 72 of the Trusts Act to enable the distribution to be made to the First Defendant. In considering the application, the judge noted that if he was prepared to approve the substantive transaction (i.e. the distribution), he would have no issue approving the variation. When looking at the substantive transaction the judge accepted the submissions of the trustee that it had made genuine and thorough enquiries as to the possible implications of the exercise of the power and the associated tax risks and that the requirements for approving the proposed exercise were met. The judge also noted that to act precipitously and liquidate the trust assets before the trustee had developed a coherent plan of action, as the First Defendant initially wanted, would have been foolhardy and unprofessional on the trustee's part and the trustee was right to have taken additional time, despite the urgency of the circumstances, to ensure the implications of the proposed exercise have been properly thought through.

In the absence of express powers to vary or modify, it may be possible to effect a variation of the trust by taking advantage of the rule in *Saunders v Vautier*.[219] This rule provides that, collectively, the beneficiaries, so long as they are all adult, *sui juris*, and between them entitled to the entirety of the trust

[218] 215 Grand Court of the Cayman Islands, FSD 119 of 2020.
[219] [1835-42] All ER Rep 58.

property, can bring the trust to an end and resettle the property on any terms they wish without going through the process of dissolving and resettling the property. The rule remains good law in all of the offshore jurisdictions.

Termination may also be an option, and offshore trusts may come to an end in a number of ways. For example, the settlor may exercise a power of revocation or a power of appointment reserved to them in the trust instrument. A trust may be set aside pursuant to statutory provisions relating to the avoidance of transactions at an undervalue or to dispositions in fraud of creditors on the ground that the disposition was induced by fraud, duress, undue influence or mistake. A trustee may also exercising a power of advancement or a power of appointment to terminate the trust either in whole or in part. Beneficiaries can also terminate a trust application of the rule in *Saunders v Vautier*.

Whatever the manner of termination, the trustees will be under a duty to distribute the trust assets to the right beneficiaries. Failure to distribute to the correct beneficiary can subject the trustees to liability for breach of trust. Statutory provisions ensuring the automatic vesting of trust assets in the new trustee exist in many of the offshore jurisdictions.[220]

[220] See for example Section 9 of the Cayman Islands' Trust Act (2021 Revision).