Where different legal systems collide: the decision in *Labrouche v Frey & Ors* [2016] EWHC 268 (Ch)

Michael Furness QC, Emily Campbell, Tiffany Scott and Simon Atkinson*

Abstract

On 18 February 2016, Asplin J delivered judgment in *Labrouche v Frey & Ors* [2016] EWHC 268 (Ch). This long-running claim for breach of trust principally concerned the relationship between an English will trust of a Swiss resident and a Liechtenstein Establishment and issues regarding remuneration of the trustees. The claims, all but one of which were dismissed, were brought by a disgruntled beneficiary against former trustees including his mother, who is also the life tenant. This article deals with issues raised by the case, including the correct approach to drawing inferences from the evidence of events which happened a long time ago, the nature of a trustee's duty to account, and tracing.

This article deals with issues raised by the case including the correct approach to drawing inferences from the evidence of events which happened a long time ago, the nature of a trustee's duty to account, and tracing.

The case in a nutshell

Labrouche v Frey concerned the estate of Olga Martin-Montis, who died domiciled in Switzerland in 1980. The principal issue in dispute between the parties was whether certain rights, known as 'founder's rights', in a Liechtenstein corporate entity, Newin Establishment, or the right to call for restitution of those founder's rights, had fallen into the residuary estate upon the death of Olga. This raised questions of Liechtenstein, Swiss, and English law.

The claim, issued in February 2010, was brought by Forester Labrouche, the grandson of Olga and one of the remaindermen. The First Defendant was Markus Frey, a Swiss lawyer and professional trustee of the English will trusts who retired as a trustee in November 2011. The Second Defendant was the estate of Hugo Frey, the father of Markus and a former professional trustee. The Third Defendant, Soledad Cabeza de Vaca, was a former lay trustee and the life tenant, as well as being the daughter of Olga and the mother of Forester. The Fourth Defendant was Newin Foundation; Newin Foundation was formed in 1995 following the conversion of Newin Establishment into a foundation.

In addition to the claim relating to the founder's rights, Forester complained about fees which had been paid to the professional trustees and about commission payments which had been received by the asset manager of the will trusts, which company was owned by Hugo and Markus. Forester also alleged that there had been a breach of trust arising from the attribution of proceeds of liquidation of a company, SCI Soltin, in 2008. Finally, Forester sought accounts from the trustees, including a roving commission on the basis of wilful default.

The Judge, Asplin J, found the Claimant to be an evasive witness and dismissed all of his claims except for the claim relating to SCI Soltin. The Claimant has applied to the Court of Appeal for permission

* All authors are members of Wilberforce Chambers, 8 New Square, Lincoln's Inn, London WC2A 3QP; Tel: +44 (0)20 7306 0102; Fax: +44 (0)20 7306 0095

doi:10.1093/tandt/ttw093
Advance Access publication 13 May 2016

to appeal certain of the Judge's decisions. That application remains outstanding at the time of writing.

The case in more detail

The testatrix: Olga Martin-Montis

Olga was born in England in 1889. She emigrated to the USA and married her first husband, Frank J Mackey, in 1920. Olga inherited Mr Mackey's fortune upon his death in 1927. Olga subsequently married Antonio Cabeza de Vaca. Soledad, born in 1930, was one of two children born to that marriage. Olga was widowed for a second time in 1941. She married Isidro Martin-Montis in 1943.

Olga and Isidro moved to Switzerland in about 1956. Shortly before doing so, they were introduced to Hugo Frey, who began providing legal and tax planning advice.

Over the course of the next two decades Hugo continued to provide advice to Olga. In 1974 Olga executed her last will. Under a principle of Swiss law known as 'professio iuris', individuals resident in Switzerland but citizens of a foreign country could elect to have the succession of their estate governed by the law of that foreign country. Olga exercised that right by specifying her last will to be governed according to English law. In drafting the will, Olga and Hugo had sought the advice of an English solicitor, Derek Taylor.

Olga died on 8 February 1980. Isidro died in 1991. Derek Taylor died in 2003. Hugo died in 2005.

The last will of Olga

By clause 1 of Olga's will, Hugo was appointed her executor. The first trustees of the will trusts were appointed by clause 3; they were Hugo, Isidro, and Soledad. Hugo had a power to appoint new trustees. This power vested in Markus upon Hugo's death in 2005.

Clause 3(f) of the will contained a charging clause entitling professionals to '*. . . charge and be paid all usual professional and other charges . . .*'

The gifts of residue were set out in clause 10. In the events which transpired following the execution of Olga's last will, the beneficial interests in the residue were as follows:

1. one-fifth was to be held on trust for Soledad absolutely;
2. one-fifth was to be held on protective trust to pay the income to Soledad for life;
3. two-fifths were to be held on trust to pay the income to Isidro for life and subject thereto on protective trust to pay the income to Soledad for life;
4. of the remaining one-fifth (as well as the three-fifths subject to the life-interests):
   a. three-quarters were to be held on trust for Forester, contingent on his attaining the age of 40 (which occurred in 1991);
   b. one-eighth was to be held on various trusts for US beneficiaries;
   c. one-eighth was to be held on trust for a family hardship fund.

The will contained no trustee exoneration clause.

The trustees

Following Isidro's death in 1991 Hugo exercised his power of appointment to appoint Markus as an additional trustee. Soledad attempted to resign as a trustee in 1994, but (as was common ground at the trial) that attempt was ineffective for want of compliance with section 39 of the Trustee Act 1925. Soledad and Hugo resigned as trustees in 1998. Markus resigned as a trustee in November 2011 following an order made by Peter Smith J in Part 8 proceedings brought by Markus for directions; two corporate trustees were appointed as replacements. Markus also released his power to appoint new trustees.

Newin Establishment and Newin Foundation

Newin Establishment was established in 1957. Its purpose was to be a corporate vehicle for holding in Europe a substantial proportion of Olga's wealth.

The holder of the founder's rights was able to alter the statutes and bye-laws of Newin Establishment, to

control the composition of its board and to wind the Establishment up.

Up until 1972 whenever the statutes or bye-laws of Newin Establishment needed to be amended, Olga would assign the founder's rights to Hugo, who would make the amendment, and then assign them back to Olga. In 1972 Hugo assigned the founder's rights to Interhold AG (a financial services company owned by Hugo). Interhold held the founder's rights from then on.

In 1995 Interhold exercised the founder's rights to convert Newin Establishment into Newin Foundation. It was common ground at trial that under Liechtenstein law this resulted in the destruction of the founder's rights. Forester claimed that this event, dubbed 'the Newin Conversion', was a breach of trust.

Bye-laws of Newin Establishment

The bye-laws of Newin Establishment set out the beneficial interests in that entity. There were various iterations of bye-laws promulgated during Olga's lifetime. In essence, they provided that Olga was to be the beneficiary during her lifetime but that after her death her family would be the beneficiaries. The version of the bye-laws which were in force at the date of Olga's death set out in full the post-death beneficial interests of Newin Establishment. These were in materially similar terms to clause 10 of Olga's will. The First, Second and Third Defendants submitted that, as evidenced by the express setting out of the post-death beneficial interests of Newin Establishment, Olga and Hugo had agreed that the assets of Newin Establishment were to be entirely separate from Olga's English residuary estate.

Distributions from Newin Foundation

Between 1999 and 2001 distributions totalling some USD22m were made by Newin Foundation to Soledad. Forester claimed the distributions were made in breach of trust; it was said that the trustees by making these distributions had failed to hold the balance reasonably between income and capital.

The expert evidence of the First and Second Defendants was that the real value of the capital aggregated over the various wealth structures of Olga had actually increased in value by about 8 per cent, even taking into account the distributions.

Fees

Hugo and Markus charged fees to the trust fund in accordance with a fee agreement embodied in the minutes of a meeting of the board of Newin Establishment in 1961. Forester claimed that fees charged in this way were not authorized by the terms of clause 3(f) of Olga's will.

The expert evidence of the First and Second Defendants was that the total fees charged were on average less than 1 per cent p.a., which the expert considered to be '*amazingly reasonable*'.

Commission payments

Forester's pleaded claim was that the existence of the commission payments had been kept from him until 2010: he described these as 'secret retrocession payments'. His oral evidence, however, was that he had known about these payments since sometime after his marriage in 1998, although he was unable to pinpoint a particular date.

SCI Soltin

Following the completion of the liquidation of SCI Soltin in 2008 the trustees credited c. USD1m of the proceeds to capital and c. USD600k to income. It was Forester's case that the proceeds should have been attributed to capital alone.

The decision in more detail

The founder's rights

The Judge held that Forester had failed to prove on the balance of probabilities that Newin Establishment was intended to form part of the residuary estate or that Olga retained a right to control the founder's rights at the date of her death. Asplin J held that it

could readily be inferred from the factual evidence that Olga intended, and agreed with Hugo, to divest herself of all assets and rights in relation to Newin Establishment (including the right to revoke her instructions) at the date of her death, so as to benefit the beneficiaries of Newin and to exclude her heirs under her English will. The Judge agreed with the evidence of the Defendants' Swiss law experts that this could be achieved by Olga and Hugo entering into a 'qualified contract for the benefit of third parties' (ie the beneficiaries of Newin).

The Newin Conversion

Since the Judge held that the right to call for restitution of the founder's rights did not pass to Olga's personal representatives, she did not need to consider whether the First, Second and/or Third Defendants were liable for any alleged breach of trust arising from the Newin Conversion. The Judge stated that, had she been required to decide this, she would have granted the trustees relief under section 61 of the Trustee Act 1925.

The Newin Distributions

Again, since the Judge held that the right to call for restitution of the founder's rights did not pass to Olga's personal representatives, she did not need to consider whether the distributions to Soledad between 1999 and 2001 were breaches of trust. The Judge said that, had she been required to decide this, she would have held that there was no breach of trust. She accepted the expert evidence adduced by Markus and she held that a reasonable balance between income and capital had been kept. Even if she were wrong on that, the Judge would have granted relief under section 61.

Fees

The Judge held that the fees charged by Hugo and Markus under the 1961 fee agreement were 'usual' fees within the meaning of clause 3(f) of the will and that they were reasonable. She also held that Forester's claim was barred by laches as he had the means of obtaining detailed knowledge of the fees since (at the latest) 1999.

Commission payments

Asplin J held that Forester's claim in relation to the commission payments was barred by laches given the documentary evidence and his oral evidence. The Judge would also have granted relief under section 61; the expert evidence adduced on behalf of the First and Second Defendants was that such payments were the norm in Switzerland.

SCI Soltin

Given that proceeds on liquidation of a company would under English law be classified as a return of capital, Asplin J held that the proceeds arising from the liquidation of SCI Soltin should have been attributed entirely to capital. Accordingly, the trustees had in 2008 been in breach of trust by attributing c. USD600k to income.

Outcome

The result of Asplin J's decision was that all claims against Soledad and Hugo's estate were dismissed. All claims against Markus were dismissed save in relation to SCI Soltin. The Judge did not order any accounts to be provided by the former trustees. She held that the First, Second and Third Defendants were entitled to 95 per cent of the costs of the Part 7 claim on the indemnity basis; the Judge held that the conduct of the claim by the Claimant had been such as to take the case 'outside the norm' and justified an award of costs against the Claimant on an indemnity basis.

The result of Asplin J's decision was that all claims against Soledad and Hugo's estate were dismissed. All claims against Markus were dismissed save in relation to SCI Soltin. The Judge did not order any accounts to be provided by

the former trustees. She held that the First, Second and Third Defendants were entitled to 95 per cent of the costs of the Part 7 claim on the indemnity basis;

The Judge refused permission to appeal. The Claimant has sought permission from the Court of Appeal to appeal certain parts of Asplin J's judgment, but at the time of writing this application has not yet been determined.

The challenge of presenting a positive factual case

Limited direct evidence on key question

A significant challenge of the case was posed by the limited amount of direct evidence on a principal factual question for the Court, namely as to the nature and content of the agreement between Hugo and Olga. Put simply, what were Olga's instructions to Hugo as her long standing trusted adviser? The Defendants' position was that instructions were given as to the manner in which the founder's rights and Newin should be dealt with after Olga's death.

It should be mentioned that Forester's position was that there was no foundation at all for concluding that Olga gave lifetime instructions to Hugo in connection with the preservation and/or exercise of the founder's rights after her death.

In the present case, there was a known practice of Olga giving oral instructions. Indeed, there were very few documents signed by her other than wills. Furthermore, it must be emphasized that the course of instructions was given over the period from 1957 (around the time that Olga first moved to Switzerland from the USA) to her death in 1980.

As with many cases involving events of a long time ago, the key witnesses—Olga and Hugo—were dead. The solicitor who had prepared Olga's Will (Derek Taylor) was also dead. There was a certain amount of documentation from the period 1957 to 1980 (eg the files of Derek Taylor), but over time it is natural to expect that some documentation might have gone missing.

A significant challenge of the case was posed by the limited amount of direct evidence on a principal factual question for the Court, namely as to the nature and content of the agreement between Hugo and Olga. Put simply, what were Olga's instructions to Hugo as her long standing trusted adviser?

The approach of the Defendants

The Defendants approached the case by relying on the inferences to be drawn from the primary facts and the presumptions which applied. It was argued, for example:-

1. That Hugo's intentions / actions after as well as before Olga's death evidenced his agreement with / instructions from Olga. Indeed (see paragraph [143] of the judgment) it did not appear to be in dispute that it could be inferred that Hugo's apparent intentions evidenced his discussions and arrangements with Olga and that Hugo's subsequent conduct could be relied upon as evidence of the parties' intentions at the time: *Chartbrook Ltd v Persimmon Homes Ltd* [2009] 1 AC 1101 (see below) and *Gallaher v Gallaher Pensions Ltd* [2005] PLR 103; and
2. That it should be presumed that Hugo's acts were authorized. Reliance was placed on the presumption of regularity and also the reasonable inferences which could be drawn from those acts.

For example, in *Chartbrook v Persimmon* [2009] 1 AC 1101 at [65] Lord Hoffman stated as follows (when considering the admissibility of evidence of subjective intention in rectification proceedings);

'In a case in which the prior consensus was based wholly or in part on oral exchanges or conduct, such evidence [i.e. evidence of a party as to what terms he understood to have been agreed] may be significant. A party may have had a clear understanding of what was agreed without necessarily being able to remember the precise conversation or action which gave rise to that belief. Evidence of subsequent conduct may also have some evidential value. On the other hand, where the prior consensus is expressed entirely in writing, (as in George Cohen Sons & Co Ltd v Docks and Inland Waterways Executive 84 Ll L Rep 97) such evidence is likely to carry very little weight. But I do not think that it is inadmissible.' [emphasis added].

Approach of the Claimant

Forester's pleaded case (as supplemented in a Skeleton Argument) was interpreted by the defendants as an allegation that Hugo had gone off on a 'frolic of his own'. By the time of the closing speeches, no such allegation was being maintained. The Defendants submitted that Forester had substantially changed his case, a proposition with which the Judge agreed.

The position is summarized in the judgment (at paragraphs [150]–[151]) as follows:-

'Mr Taube submits therefore, that Hugo's conduct is entirely consistent with Hugo, in his capacity as executor, exercising the Claim Rights vis à vis Newin Establishment and the estate in what he genuinely considered to be the best interests of the beneficiaries of Olga's Will Trusts and that Forester's case does not require any inference that Hugo was "on a frolic of his own". He says that this is consistent with a possible desire to continue to use Newin as a shelter entity in the light of Soledad's potential difficulties with the French tax authorities and Markus' answer in cross examination that one of the purposes of the Newin, F&H and Soltega was to enable capital gains from those entities to be distributed to the income beneficiaries of the trusts.

This way of putting the case arose for the first time in written closings and is contrary to Forester's Re-Re-Re-Amended Particulars of Claim in which it is alleged that Hugo continued Newin Establishment after 1980 with the dishonest motive of generating additional fees and acted in breach of trust in not collecting in its assets. Subsequently it was confirmed in a further written note produced on the 22nd day of the trial, that Forester was indeed abandoning the allegations of dishonest motive attributed to Hugo, the claim that in breach of trust he had failed to dissolve Newin Establishment and submit the assets to the estate in 1980 or shortly thereafter, and the claim that Hugo and Markus were not entitled to fees based on the 1961 Fee Agreement in relation to Newin Establishment, F&H and Soltega from 1980 to 1995, at least on the basis of a duty to dissolve. It also seems that the allegations/implications contained in Mr Taube's written and oral opening to the effect that the form of the 1980 Byelaws was as a result of an improper motive of Hugo's to mislead the relevant tax authorities, is no longer pursued.'

Judgment of Asplin J

The relevant parts of the Judge's judgment are found at paragraphs [182]–[204]. In summary, she agreed with the submissions put forward on behalf of the Defendants. The Judge applied the presumption of regularity. She held that there was no reason to doubt Hugo's integrity. The alternatives were that Hugo was following his instructions (likely) or that he had misunderstood them (unlikely).

At paragraph [186] of the judgment, she stated as follows:-

'. . . I do not consider that it is sufficient for Forester not to put forward a case in relation to the arrangement immediately prior to the death, but merely to seek to rely upon what was described as a default position, that all rights held by Olga would have fallen into the residuary estate and to seek to place the onus on the Defendants to prove what the position was. It seems to me that having abandoned the allegation of a 'frolic of his own' or dishonest misconduct on the part of Hugo and it seems, the allegation that the 1980

> documentation was merely window dressing for the purposes of avoiding tax, it behoved Forester to put forward a positive case . . .'.

Forester's conduct in impugning Hugo's integrity was one ground for the award against the claimant of costs on an indemnity basis rather than the usual standard basis. In the Judge's costs judgment,[1] she stated:-

> 'I conclude, taking all of those indicators as to the test to be applied into account, and in the light of the relevant circumstances, that the conduct here was out of the norm. In that regard I take particular note of the matters to which my attention was drawn by Miss Campbell in this regard . . .: the making of allegations of professional misconduct, if I put it at its lowest, in relation to the way in which Hugo behaved with regard to the Swiss tax authorities, and also the way that it was alleged that Markus and Hugo behaved, continuing the Newin institutions as a means of continuing to accrue fees, for example. It seems to me those matters were raised and for the most part they were abandoned. There were also unpleaded allegations which appeared for the first time in the footnotes to the skeleton. I also take into account the evasive evidence of the claimant in the witness box, which went to the very heart of the case.'

Accounts

Because the claims in the action were all based on breaches of trust against former trustees, the relief claimed was for the most part in the form of accounts against the trustees. These were claimed as either common form accounts, or accounts on the footing of wilful default. In the event of the latter form of accounts being ordered, the claimant sought to rely on any further breaches of trust which might come to light in the process of taking the account (the so-called 'roving commission').

The distinction between common accounts and wilful default accounts, and the circumstances in which a wilful default account can give rise to a roving commission are important. A common account simply requires the trustee to account for the assets he has actually received, and explain what he has done with them. To the extent that assets have been misapplied they will not be allowable as a deduction from the assets received, with the consequence that the account will, to that extent, show a balance in favour of the claimant. An account on the footing of wilful default seeks to charge the trustee not only with assets actually received, but also with assets which he has not received, but which he would have received but for his breach of duty. As Brightman J said in *Bartlett v Barclay's Bank (No 2)* [1980] Ch 515 at 546C (quoted with approval by the Judge at paragraph [217] of the judgment):

> 'Wilful default by a trustee . . . means a passive breach of trust, an omission by a trustee to do something which, as a prudent trustee, he ought to have done – as distinct from an active breach of trust, that is to say, doing something which the trustee ought not to have done.'[2]

To obtain a common account it is not necessary to prove a breach of trust (*A-G v Cocke* [1988] Ch 414). In principle, every beneficiary of a trust has the right to an account from his trustee of trust money and assets received by the trustee. But in practice the Court will not order an account to be taken before the Court (which is a time-consuming and expensive process) unless there is some good reason for doing so (*Libertarian Investments Ltd v Hall* [2014] 1 HKC 368 (CFA), at [172]). Clearly, where the trustee has failed to produce any accounts at all an order for an account may well be appropriate. But where the trustee has

1. Also delivered on 18 February 2016.
2. Reference should also be made to Millet LJ in *Armitage v Nurse* [1998] Ch 214 at 252 where he said: '*A trustee is said to be accountable on the footing of wilful default when he is accountable not only for money which he has in fact received but also for money which he could with reasonable diligence have received. It is sufficient that the trustee has been guilty of want of ordinary prudence: see e.g. In re Chapman; Cocks v Chapman [1896] 2 Ch 763.*'

produced comprehensive audited accounts the Court is not going to order an account unless the beneficiary can show some grounds for suspecting the audited accounts are wrong. One obvious way of doing that would be to plead and prove a breach of trust by the trustee, but it can be enough simply to show that there are grounds to suspect a breach of trust (although in that case the costs of obtaining the order for the account may be reserved until it is known whether the suspicion was justified).

By contrast, it is always necessary to prove a breach of duty (usually in failing to get in or to maintain or preserve a trust asset) in order to get an account on the footing of wilful default. In order, in addition, to obtain a roving commission, the past conduct of the trustee must be such as to give rise to a reasonable *prima facie* inference that other breaches not yet known to the claimant or the Court have occurred (see *Re Tebbs* [1976] 1 WLR 924 at 930).

The present case offered an interesting case study as to the difference between an active and a passive (wilful default) breach of trust A claim was made against Soledad in respect of the destruction of the founder's rights in Newin Establishment (see above). At the time the trustees of the will trust were Hugo, Markus, and Soledad, but all three of them wrongly believed that Soledad had retired as a trustee as a result of executing a letter of resignation some years earlier. Soledad was told of the intention to convert Newin from an establishment to a foundation. She asked if it would affect her as a beneficiary and was told it would not. Soledad then indicated that she had no objection to the conversion. Her actual participation in the conversion was not required to make it effective, because the founder's rights were not vested in the trustees but in Interhold, which was under the control of Markus and Hugo.

The present case offered an interesting case study as to the difference between an active and a passive (wilful default) breach of trust

The claim against Soledad was pleaded in the alternative. Her words and conduct were said either to be a breach of duty by omission—ie a failure to intervene to stop Hugo and Markus procuring Interhold's destruction of the founder's rights, or positive breach of duty—ie a participation in a wrongful decision by the trustees to destroy a trust asset. Both analyses faced serious obstacles. In the end, the Claimant opted for the second analysis, but the Judge held that there was insufficient evidence of an active participation in a wrongful trustee decision on the part of Soledad (paragraph [231] of the judgment).

The abandonment of the wilful default allegation relating to the Newin Conversion formed part of a wider re-orientation of the Claimant's case which took place during the course of the trial. The claim moved away from allegations of wilful default seeking accounts with a roving commission, to claims for common accounts, not necessarily based on any breach of trust at all. This raised two issues:

1. To what extent is it necessary to plead the facts and matters relied on in support of a claim for a common account, if those facts and matters are not said to constitute an actual (as opposed to a suspected) breach of trust and
2. Should a claimant who has brought a defendant trustee to trial on the basis of a claim to an account which is founded on allegations of breach of trust be permitted at the end of the trial to abandon the allegation of breach of trust and claim a common account on the basis of the fiduciary relationship (thereby deferring the question of whether there has been a breach of trust until the taking of the account)?

The first of these questions was addressed in an interlocutory judgment handed down on 27 November 2015 [2015] EWHC 3493 (Ch). The Claimant in opening sought to rely on unpleaded allegations relating to the trustees' dealing with a company called Tricor in 1980, and to alleged discrepancies between income received by the trust and income shown as distributed in the trust

accounts. He relied on these allegations in part to support an argument that the Court should order a common account of the trustees' dealings on the basis that they raised a suspicion of breach of trust, and in part to support his argument that the trust had been so badly managed that if he could prove an instance of wilful default, a roving commission should be ordered. The Court held that the Claimant could only rely, for either purpose, on facts and matters which had been pleaded.

The second issue was dealt with in the main judgment, where, following *Smith v Armitage* (1883) 24 ChD 727, the Judge held (at paragraphs [308] and [318] of the judgment) that having brought Soledad to trial on the basis of a breach of trust in failing to prevent alleged overcharging by the trustee, the Claimant ought not to be allowed, at trial, to abandon the breach of trust claim and claim merely a common account (the effect of which would be to push off the issue as to whether there had been a breach of trust to a future hearing at which the account was taken, instead of dealing with it at the main trial of the action).

Tracing—what happens if the original trust property is destroyed?

Newin Establishment was a corporate body, and the founder's rights were constitutional rights which enabled the holder of them to, for example, control the board of the establishment, alter the beneficial interests under its byelaws, and ultimately to wind up the establishment and have its assets transferred as the founder wished.

So if, as Forester claimed, the founder's rights of Newin Establishment (or the right to control them) became an asset of Olga's trust, then the question arose whether the act of converting Newin Establishment to a foundation was a breach of trust, because as part of the conversion process the founder's rights—which were said to be valuable trust property—were destroyed, and so the ability to bring the assets of Newin back into the trust was lost at that point.

Forester argued that if the Newin Conversion was a breach of trust, then the value previously represented by the founder's rights could be 'traced into' the value of the assets held by Newin Foundation. This would give rise to a constructive trust and effectively prevent the conversion itself from causing any loss to Olga's trust.

The difficulty with that from Soledad's point of view was the very substantial distributions that had been made to her from the assets of Newin Foundation between 1999 and 2001. The parties all agreed that those distributions were lawful under the bye-laws of Newin Foundation and as a matter of Liechtenstein law; but if Newin Foundation held its assets on constructive trust, then the lawfulness of those distributions would fall to be judged by the terms of Olga's trust and under English law, and there was some doubt as to whether they could be justified in those circumstances.

In support of the tracing argument, it was said that Newin Establishment had held its assets subject to the possibility that the founder could call for them back by exercise of the founder's rights at any time. Therefore, the holder of the founder's rights had the ability to extract all the value from Newin for the benefit of the trust—and when the founder's rights were extinguished there was a shift of that value into the Newin Foundation. At that point Newin Foundation held its assets free from the possibility of them being clawed back by exercise of the founder's rights.

The interesting thing about this tracing argument is that it is based on value shifting rather than on straightforward proprietary substitution. Forester raised an argument by analogy with a general power of appointment or with an option to purchase: if Olga's trustees had the option to acquire the assets of the Establishment, then they had an asset of value. Once the founder's rights were destroyed the trustees no longer had that option—they had lost something of value; but the question was where that value had gone, if it had gone anywhere.

The interesting thing about this tracing argument is that it is based on value shifting

rather than on straightforward proprietary substitution

Forester said it did not matter whether one could identify through the accounts of Newin Establishment and Foundation an augmentation in the value of the assets of Newin Foundation as a result of the destruction of the founder's rights. It was said that in common sense and economic terms the value of the founder's rights was in Newin Foundation which held its assets free from the possibility of a claw back.

So what happens in a situation where the original trust property is destroyed? Is it possible to trace into a different asset that is already in the hands of a third party, where the original property has ceased to exist and there has been no obvious transfer or receipt of property?

The leading case on tracing is *Foskett v McKeown* [2001] 1 AC 102, where it was held that the function of tracing is an evidential one and in order to trace there must be specific property now capable of being identified in the defendant's hands into which the misappropriated trust property has been converted. Tracing is the process by which one property is identified as the substitute of another and the exercise involves the defendant 'acquiring' or 'receiving' property or the value of property which in law 'represents' or 'may be taken to represent' the original property. So (Soledad argued) there needs to have been a 'transaction' of some sort (to give rise to the 'transactional links' to which Lord Millett refers in *Foskett*) or there has to be a similar process which results in the defendant receiving a 'substitute' or 'different' asset into which the value of the original asset can be traced.

Forester relied on *Federal Republic of Brazil v Durant* [2015] UKPC 35 which was concerned with so-called 'backward tracing'. The orthodox view of tracing is that the claimant cannot trace into property that was already in the defendant's possession before the claimant's property was received, because in those circumstances the defendant's property cannot be regarded as representing the claimant's property. That was the view of the Court of Appeal (Leggatt LJ) in *Bishopsgate Investment Ltd v Homan* [1995] Ch 211.

However, *Durant* was concerned with a sophisticated fraud in which the fraudsters made various payments into and out of the bank accounts of companies with which they were associated, the timing of which were not always simultaneous or sequential. The Privy Council held that in the particular circumstances of the case in *Durant* the Court:

> should not allow a camouflage of interconnected transactions to obscure its vision of their true overall purpose and effect

and decided that it was on the facts possible to trace the value of the assets through the bank accounts. Importantly, it was said that in order to extend the tracing exercise beyond its orthodox scope the Court must be satisfied that '*the various steps are part of a co-ordinated scheme*' ([38]) and that:

> the Court should be very cautious before expanding equitable proprietary remedies in a way which may have an adverse effect on other innocent parties.

Soledad argued that the Martin-Montis case was far removed from the facts of *Durant*. She made 5 main arguments against the tracing claim.

1. There had to be a transfer of trust property in order for the tracing exercise to succeed. However there never was any transfer of the founder's rights from anyone to Newin Foundation. They were extinguished on the Newin Conversion and not transformed into some other form of property, and Newin Foundation cannot have received them or any property representing them.
2. If any property was transferred to Newin Foundation, that property can only have been the underlying assets of Newin Establishment; but those assets were not themselves held as part of the trust fund of Olga's trust. So there was never any receipt by Newin of trust property (or its substitute).
3. In fact, Newin Foundation did not receive any assets from Newin Establishment at all. The

experts in Liechtenstein law agreed that the Newin Conversion proceeded simply by the alteration of the legal status of Newin from Establishment to Foundation, which did not involve a liquidation or dissolution of Newin Establishment or the transfer of any assets. The two entities were in fact the same legal person, and that same legal person continued to own its assets throughout.

4. Although after the Newin Conversion Newin Foundation held its assets free of the founder's rights, any proprietary interest that Olga's trustees had in the founder's rights could not be traced into those assets because (a) the founder's rights were not transformed into a new or different asset held by Newin as a substitute for the original asset, and/or mixed with Newin's assets—Newin simply continued to hold its assets as it had done before and the founder's rights simply ceased to exist; and (b) except in the particular circumstances of the *Durant* case, which were not the circumstances of this case, a claimant cannot trace into assets that were already in the hands of the defendant when the misappropriation occurred. So the orthodox view, of no 'backward tracing' should prevail.
5. Even if there had been a transfer of assets at the point of the Newin Conversion, nonetheless the value of those assets remained the same before as after the conversion. So there was no acquisition of anything of value by Newin Foundation.

It could be said that the value of the rights of the beneficiaries of Newin may have been enhanced after the conversion since Newin could no longer be required to pay over its assets to the holder of the founder's rights. That last point gave rise to an argument that was put by Markus and Hugo. They argued for an analysis by analogy with the way the English tax regime approaches the valuation of settled property, interests in settled property, and powers of appointment (see for example *Melville v IRC* [2002] 1 WLR 407 (CA)). Newin Establishment held its assets, which had a particular value; and the founder's rights (which are akin to a general power of appointment) had a broadly equivalent value (giving rise to a duplication of value); but so long as the founder's rights were present the individual beneficial interests under the Newin Establishment bye-laws had a nil market value because they were revocable. When the founder's rights were destroyed, the beneficial interests under Newin became irrevocable and so value flooded from the founder's rights into those interests allowing Olga's trustees to trace into them instead of into the assets of Newin Foundation; and having done so, the trustees would then own all the beneficial interest in Newin Foundation and a bare trust would spring up, which would enable the trust to be collapsed and the assets taken by Olga's trust.

Soledad's response was that the beneficial interests are just as much previously owned assets as the assets of Newin themselves, so the reverse tracing problem remained; and there was no evidence before the Court about the effect of destroying the founder's rights on the beneficial interests of Newin. In fact Forester's case was that his own interest under Newin was not marketable even after the destruction of the founder's rights because it remained to an extent at the discretion of the trustee. There was also no evidence that a *Saunders v Vautier* type principle existed under Liechtenstein law and applied to the beneficial interests in a foundation, allowing its beneficiaries to collapse the structure and get to the assets.

The Judge dealt with all these arguments at paragraphs [267ff] of her judgment and her conclusion is at paragraph [276ff]. She said that had it been necessary to do so, she would have decided that the destruction of the founder's rights did not entitle Forester to trace into the assets of Newin Foundation—she agreed that there was no transaction, no transactional links and no steps in a co-ordinated scheme which could form the basis of the evidential process.

She held that Newin Foundation neither acquired nor received property or the value of property which could be taken to represent the founder's rights; and

there was no evidence that the value of the assets or the value of the beneficial interests was enhanced as a result of the founder's rights being extinguished. Forester is seeking permission to appeal these findings.

The professional trustees were represented by Emily Campbell and Simon Atkinson of Wilberforce Chambers. The claimant's mother was represented by Michael Furness QC and Tiffany Scott, also of Wilberforce Chambers.

Michael's *practice has three main strands: contentious trust litigation; advice and litigation concerning occupational pension schemes; tax litigation. He also undertakes professional liability litigation in areas related to the three main areas of his practice. Michael has wide litigation experience, at all levels and in a variety of jurisdictions. www.wilberforce.co.uk. E-mail: mfurness@wilberforce.co.uk*

Emily's *practice encompasses a broad range of chancery and commercial work. She is particularly experienced in both the litigation and advisory sides of the law relating to pension schemes, trusts, estates and taxation. Whilst her practice has an emphasis on matters involving complex technical issues, such as those with a significant actuarial or mathematical content, she has a reputation for giving clear, practical and commercial advice and being very user-friendly. E-mail: ecampbell@wilberforce.co.uk*

Tiffany *has a broad chancery commercial practice. She is a member of STEP and she deals with all aspects of trusts and probate work, and also specializes in property litigation, professional liability claims and 'business' litigation, including fund and partnership disputes, shareholder disputes, claims against fiduciaries, and claims arising out of insolvency. E-mail: tscott@wilberforce.co.uk*

Simon *has a busy and diverse practice. He appears regularly in the High Court and County Court, both in his own right and as part of a larger team. Simon's practice encompasses Chambers' principal areas of work, though his particular interests are in property, trusts (including charities) and pensions work. E-mail: satkinson@wilberforce.co.uk*