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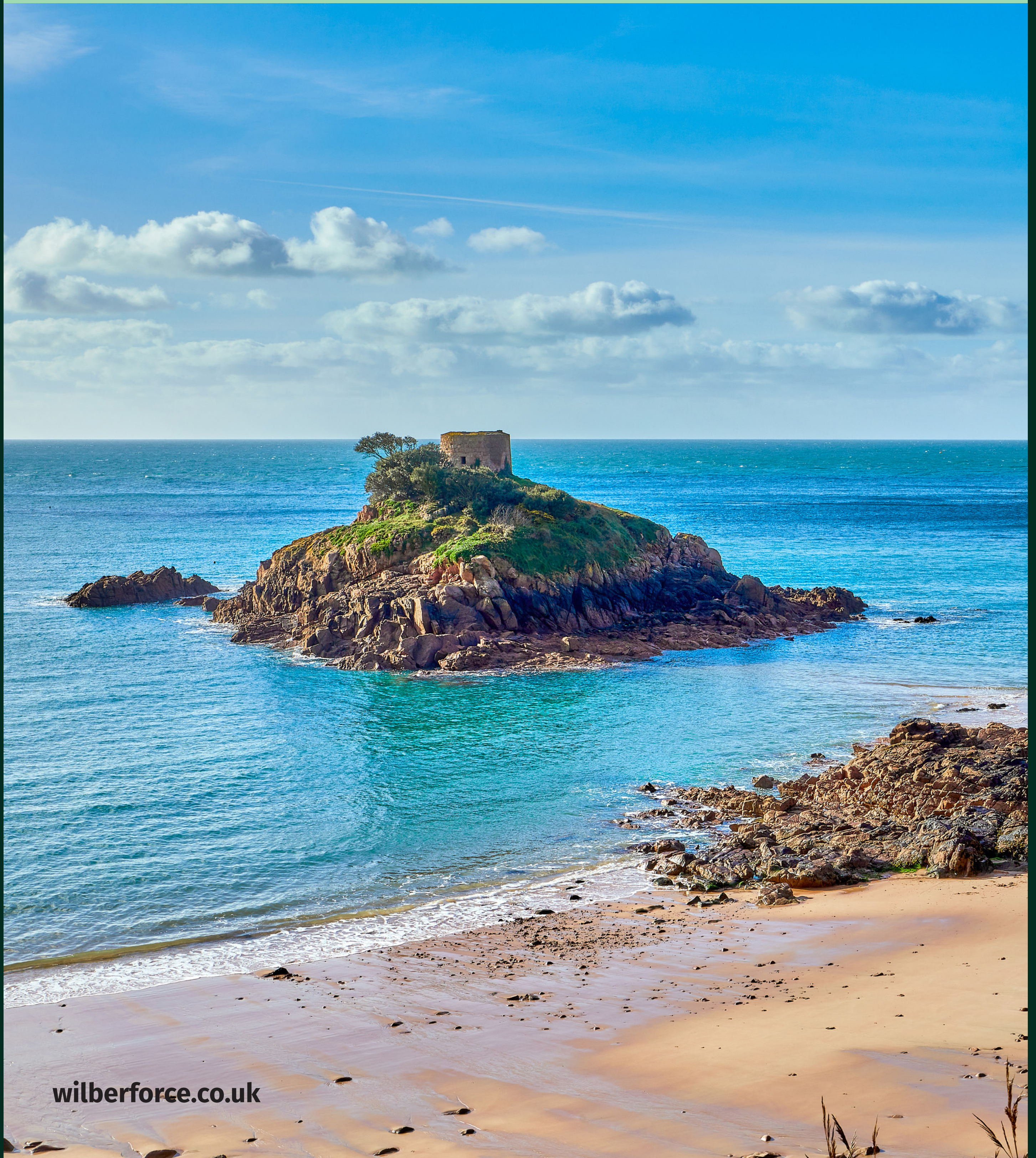
Thursday 26th September 2024



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Talk papers

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Speakers

Gilead Cooper KC
Gilead's practice has a strong international element. He has appeared in the courts of Hong Kong, the BVI, Bermuda, Cayman and Nevis, and has been involved in litigation in Jersey, Guernsey and Gibraltar. He provided expert advice in relation to the Panama Papers in Imran Khan's action against Nawaz Sharif in the Pakistan Supreme Court which led to Sharif being removed as prime minister. Gilead specialises in complex, high-value disputes, often involving allegations of fraud, breaches of trust and fiduciary duties, and professional negligence. Chambers & Partners 2024 says Gilead is "*one of the very finest KCs*" and that "*he gives a Rolls Royce service*". The guide adds that "*Gilead* (...) *has an encyclopedic knowledge of the law*".

Fenner Moeran KC
Fenner has a broad-based chancery / commercial practice with an emphasis on litigation. Whilst he has specialisms in pensions and financial services, civil fraud and asset recovery, and complex trusts/private client disputes, he also regularly acts in general litigious chancery matters as well as company, insolvency, property and general commercial matters. Fenner is called to the bars of Anguilla and Northern Ireland, and regularly litigates and advises in Cayman, BVI, The Bahamas, Jersey and Guernsey and other offshore jurisdictions. The Legal 500 2024 says "*Fenner is excellent all round. He is superb on the technical detail, but also a first-rate advocate and brilliant with clients*". Chambers & Partners 2024 says that Fenner's "*deep knowledge of the law, combined with his meticulous analysis, sets him apart".*

Jonathan Hilliard KC
Jonathan has a broad trusts and commercial practice. Much of his time is spent on private, commercial trust disputes and fraud cases, both on and offshore and in other jurisdictions like Hong Kong, where he recently appeared successfully in the Court of Final Appeal in a commercial trust case on the test for Quistclose trusts in relation to a bond issue. His litigation often takes him into other areas of law, and he has significant experience of cases with family, regulatory, insolvency and public law elements. He also has a significant advisory practice across this spectrum of work. He is consistently ranked in the directories for trusts, matrimonial: trusts, offshore, civil fraud, traditional chancery and high-net-worth work. Chambers & Partners 2024 describes Jonathan as "*a truly brilliant and rare KC*" and "*a superbly clever man: he's a go-to for langer, complicated matters*". The guide adds that "*there are very few of his generation with his firepower*".

Simon Atkinson
Simon is an experienced and in demand practitioner, specialising in trusts and estates work (onshore and offshore), property and commercial litigation, and professional negligence work. Simon is regularly instructed in complex, multi-party and multi-jurisdictional cases. Recent instructions with an international element have concerned matters in Hong Kong, Singapore, the Channel Islands, Bermuda, Trinidad and Tobago, the British Virgin Islands, Liechtenstein and Switzerland. He has particular experience of disputes concerning assets and/or parties based in the Middle East. Chambers & Partners 2024 says Simon is "*commercial and frank in his delivery, and his pleading are very thorough*". Chambers & Partners 2023 says "*Simon's technical knowledge is super. He is super responsive and crunches through the work*".

Sri Carmichael
Sri is recommended as a leading junior in all her practice areas: civil fraud, commercial litigation, company law and insolvency. She was shortlisted for "Chancery Junior of the year" in the Legal 500 Bar Awards 2024, and has been described in the legal directories as *"a superb and quick-thinking advocate"* who *"punches above her weight"*, is *"very bright and commercial"*, and has *"excellent client-handling skills"*. Much of Sri's practice focuses on fraud claims, often involving wrongdoing by directors. She also specialises in shareholder, joint venture and contractual disputes, as well as insolvency applications on behalf of officeholders and creditors. She is frequently instructed on complex cross-disciplinary disputes with an international dimension. The Legal 500 2024 says: "*A ferocious intellect, laser-like attention to detail and a trojan-like work ethic, Sri Is a super junior destined to be a super silk*". Chambers & Partners 2024 praises Sri as "*a fantastic junior who continues to perform to a very high standard in all areas of her practice"*.

Michael Ashdown
Michael has a specialist practice focusing on trusts and estates, pensions, charities, and related tax and professional liability matters. His experience encompasses advising, drafting trust documents, and litigating, in relation to both domestic and offshore trusts, and cross-border estates, and he has recent offshore experience in Jersey, Guernsey, Bermuda, and BVI. The Legal 500 2024 says Michael's "*drafting skills are second-to-none. Her is extremely bright, user-friendly and responsive*". Chambers & Partners describes Michael as "*just amazing. He is already essentially a KC in terms of the quality of his work*". The guide adds that Michael "*is everything that an instructing solicitor could want*".

Jamie Holmes
Jamie is a commercial chancery practitioner with specialist expertise in trusts and probate, corporate and personal insolvency, civil fraud (with extensive experience of freezing injunctions and other forms of interim relief) and commercial work (including international and London-based arbitrations). He is ranked in The Legal 500 2024 as a leading junior in civil fraud, and has been ranked as a "Rising star" for both commercial and offshore work. The Legal 500 2024 describes Jamie as "*exceptionally bright and endlessly hardworking. Tactically astute, he is always three moves ahead*". He is currently working on a matter that is listed for a 3-day trial in the Royal Court of Guernsey in early 2025. He has in recent years appeared in or assisted teams appearing in the Courts of Gibraltar, Cayman, the BVI, Malta and the Marshall Islands.

Joseph Steadman
Joseph is an in-demand and experienced barrister, who is recognised as a Leading Junior by both The Legal 500 and Chambers and Partners. His multi-specialist practice centres around business, trusts and property disputes. Joseph has experience of working on cases which span a number of jurisdictions and which require him to work closely with overseas lawyers and other professionals. His recent work has involved Hong Kong, the Channel Islands, the Isle of Man, the Cayman Islands, the British Virgin Islands, Cyprus, Monaco, Malta, and Switzerland. The Legal 500 2024 describes Joseph as "*one of the brightest juniors. Intellectually very capable but wears his learning lightly*". Chambers & Partners 2024 praises Joseph as "*a great person to have on your team*".

Lemuel Lucan-Wilson
Lemuel has a broad domestic and offshore chancery practice with particular emphasis on trusts and property, spanning the contentious and non-contentious area, including providing inheritance tax advice on wills and deeds of appointment, claims for breach of trust, removal of trustees and personal representatives, and approval of trust settlements for minors. Lemuel regularly appears in both the County Court and the High Court, whether on his own or as part of a larger counsel team. From August to October 2023, Lemuel was seconded to the litigation department at Carey Olsen, Guernsey, where he worked on a variety of trusts, insolvency and commercial disputes.

Samuel Cathro
Sam's practice has a strong emphasis on trusts and private client work, alongside commercial, property and insolvency instructions. His cases often have an offshore element, and he is involved in number of trusts disputes in Jersey and Guernsey, as part of a team and in his own right. He is acting on a large contested restructuring proposal which has dimensions in both Jersey and Guernsey, led by Jonathan Hilliard KC; and in a hostile trusts dispute in Guernsey, led by Robert Ham KC and Michael Ashdown. Unled, Sam assisted a local advocate in a Beddoe application in Jersey which (unusually) was listed for a one-week trail; and drafted proceedings in Guernsey in relation to a business dispute arising out of the sale of a trusts business. Sam regularly appears in both the High Court and the County Court in England and Wales on his own account, including in a three day trial in early 2024. Sam also accepts instructions in non-contentious trusts matters, including drafting deeds of variation. Before joining Wilberforce, Sam practised in New Zealand as a barrister, and as a solicitor in one of New Zealand's leading litigation firms.

Capacity, undue influence and fraud in the fiduciary context

Simon Atkinson, Joseph Steadman and Samuel Cathro

Introduction

1. We all know that transactions, apparently lawful and valid on their face, may upon closer inspection turn out to have been influenced by wrongful conduct so that they are in fact of dubious validity. The transaction may have been procured by the poisonous influence or fraud of some interested party. A party to the transaction may have not had the capacity to understand what he or she was doing; or the doing of the act may have been outside the legal powers of that party. An office-holder may have failed in his, her or its duties in various respects when deciding to enter into the transaction or otherwise in the administration of the asset-holding structure.

2. The presence of one or more of these features risks both upsetting the transaction in question and triggering a blame game amongst those involved, whether as party, advisor or otherwise. A transaction may be void *ab initio* or it may be voidable at the instance of an innocent but interested party; transactions may have to be unwound, consideration repaid, innocent third parties indemnified. Meanwhile, professionals may have to go back through their records to satisfy themselves (or others) that they discharged their duties; lay persons may need to seek independent legal advice. Insurers will need to be rung, and exoneration and indemnity clauses carefully checked.

3. These considerations arise in the context of fiduciary relationships just as much as they do in contractual and other common law relationships. Indeed, the incidents of fiduciary obligations and the more onerous standards to which fiduciaries are generally held than others, mean that the above risks and concerns are often front and centre in the minds of trustees, directors, agents, and others, as well as their advisors.

4. The purpose of this paper is to consider some of the principal issues that can arise in the creation and in the administration of asset-holding structures impressed with fiduciary obligations, how risks can in practice be avoided or at least mitigated and what strategies may be available to innocent parties looking either to uphold or to challenge tainted transactions.

Common scenario

5. Given the potential breadth of any discussion about the issues canvassed above, it may help to focus matters by reference to a hypothetical fact pattern the contours of which will be familiar to contentious and non-contentious private client advisors alike.

6. An aged testatrix, Annabelle, is in hospital. She has previously been diagnosed with moderate dementia and liver cancer. Her attentive daughter, Beatrice, waits upon her day and night. Annabelle is very sick and on powerful medication.

7. On day 10 of her stay in hospital, Anabelle executes, for the first time in her life, a will.

    a. The main asset of the estate is a shareholding in a family run business, of which Annabelle and Beatrice were the only directors.

    b. The will creates a testamentary trust, into which all of Annabelle's valuable estate is to be decanted and held on discretionary trusts for her 3 children, Beatrice, Charlie and Dean, and their remoter issue.

    c. Beatrice is appointed sole executrix of the estate; an offshore company, E-Sleep at the Wheel Inc, is appointed as corporate trustee of the will trusts.

    d. The will is drawn by Fast and Furious Will Writers LLP, non-legally qualified will drafters, and witnessed by Georgia and Harry, the two summer interns.

    e. A mini mental state examination ("MMSE") is undertaken by Ishmael, Annabelle's GP, at the time of the execution of the will; he records her as having testamentary capacity.

8. Annabelle dies four days later. Charlie and Dean are not aware of the will. Beatrice quickly extracts a grant of probate and completes the administration of the estate. Over the next few months, dividends from the family run business fall sharply while E-Sleep appoints out to Beatrice's children 80% of the capital of the will trusts. Unsurprisingly, Charlie and Dean are unhappy about this turn of events.

<u>Wills / settlements: Creation of asset-holding structures and their validity</u>

9. The process leading up to, and the moment of creation of, an asset-holding structure is, it hardly need be said, a critical one. It is the first focal point for investigation into the actions and intentions of settlors/testators/donors. If the process of creation is not undertaken properly the whole asset-holding structure may be imperilled.

a. Capacity

10. The capacity of a donor to effect the transaction in question is a critical issue and one which is surprisingly commonly overlooked even by experienced professionals. Capacity may be absent or at least limited in a number of ways. For example:

a. A donor who is an individual might lack mental capacity to make an *inter vivos* settlement (in England under the Mental Capacity Act 2005) or lack testamentary capacity to make a will (under the common law test of *Banks v Goodfellow* (1869-70) LR 5 QB 549). The interaction of the two tests was discussed in the recent case of *Baker v Hewston* [2023] EWHC 1145 (Ch).

b. A company might by the terms of its memorandum and articles of association lack capacity to enter into certain transactions such as the disposition of land either generally or for no consideration.

c. Trustees in England at least historically had very narrow powers of investment; and absent express powers contained in the trust instrument (and latterly increasingly by statute), investments in certain asset classes were *ultra vires* the trustees.

11. It is therefore essential that as a first step any advisor considers the question: does the donor have capacity to enter into this transaction? Often this will be straightforward; frequently, however, it will not be. Cases are legion of errors in checking for capacity. Two recent examples will suffice: in the wills context, *In re Leonard (decd)* [2024] EWHC 321 (Ch); in the *inter vivos* settlement context, *Blythe v Blythe* [2023] EWHC 1085 (Ch).

a. *In re Leonard (decd)*: A will was held invalid for want of testamentary capacity and lack of knowledge and approval. So far as capacity was concerned, although the will drafter had subjectively thought at each of her two meetings in person with the testator that there was no evidence of incapacity, the Judge held there were obvious failures by the advisor (who was not a solicitor) even to ascertain the question of capacity. There were obvious red flags, including the giving of inconsistent and confused instructions over several years. The Judge held that the testator had not had capacity by the time of the second meeting.

b. *Blythe v Blythe*: The deceased had made in September 2015 an *inter vivos* transfer of £200,000 to one of his daughters. The other daughter alleged that the transfer was invalid by reason of want of capacity and undue influence. The transferor had been seen on several occasions at the Memory Clinic and had been diagnosed with dementia in 2014. The transfer was upheld even though no formal assessment of the transferor's capacity was ever undertaken either at the time of the transfer or later when a power of attorney over his affairs had been registered by the daughter to whom the gift was made (2016). The Judge held that on the evidence incapacity had not been proved on the balance of probabilities.

12. Legal entities can alienate property as long as this is within the objects and powers of its memorandum and articles of association (or other governing documentation): Lewin, §2-002. Where modern companies are concerned, there should generally be no difficulty as to the question of capacity, as limited companies are usually vested with wide powers of investment and disposition of assets. It is of course always prudent to check.

13. In the hypothetical scenario, there are obviously likely to be questions of testamentary capacity arising given the medical condition of the testatrix. FFWW should have followed the 'golden rule', viz. the act of making of the will should have been considered by a medical practitioner who should have satisfied himself as to the capacity and undertaking of the testatrix and recorded and preserved his examination and findings. Note that an MMSE is not a test of decision-making capacity, although there is a correlation between capacity assessments and MMSE scores: *Gorjat v Gorjat* [2010] EWHC 1537.

14. Charlie and Dean's primary remedy will be to bring a claim challenging the validity of the will, and in turn of the testamentary trusts and the purported appointments out to Beatrice's children.

15. Might they alternatively be able to claim against FFWW for failing to follow the 'golden rule' and ensure Annabelle had sufficient capacity? In *Dorey v Ashton* [2023] PNLR 19, the Guernsey Court of Appeal held (applying the English Court of Appeal decision in *Worby v Rosser* [2000] PNLR 140) that a solicitor does not always owe a duty of care to disappointed beneficiaries who lose out because of a will executed when the deceased lacks testamentary capacity. The position may however differ depending on whether the beneficiary in question should have benefited but did not (where a duty of care is more likely to be recognised, as for example in *White v Jones* [1995] 2 AC 207), or whether an existing beneficiary was disadvantaged by a subsequent change in the testator's intentions (the court declined to recognise such a duty in *Dorey*).

b. Propriety / rationality

16. Even if a person, whether natural or legal, has the power to enter into the transaction in question, there will be a separate question to consider – if the settlor / testator / donor is himself or herself a fiduciary – as to whether the act of creating the asset-holding structure was undertaken for a proper purpose and having regard to relevant, but disregarding irrelevant, matters. Another way of putting the question is to ask whether, even if a fiduciary *had* the power to do the act in question, was the decision to exercise that power one that was reached consistently with the fiduciary's obligations? Answering this question requires consideration of various legal and factual matters, and it may not be obvious at all to principals or third parties who may not have had any direct involvement in the creation of the asset structure in question, whether the fiduciary's conduct

warrants investigation, let alone whether that conduct in fact transgressed the standards applicable to fiduciaries.

17. We will all have had cases where asset-holding structures are challenged from the moment of creation by reason of some mistake or some alleged failure by the creating fiduciary to exercise its powers properly: see, e.g., *Abacus Trust Co (Isle of Man) v Barr* [2003] Ch 409, considered in *Futter v HMRC* [2023] UKSC 26 at [36] – [43]. Commonly, of course, asset-holding structures are sought to be unwound where the exercise of the dispositive power has had unintended tax consequences.

18. In the scenario given above, the testatrix Annabelle is not (it seems) a fiduciary and so would be free to leave her estate as she saw fit following her death. Note, however, that a testatrix *may* be a fiduciary of assets within her estate. So, for example, a testatrix may be the trustee of an implied trust pursuant to the doctrine of mutual wills. Where two individuals, typically spouses, have agreed as to the disposal of their property and executed mutual wills in pursuance of that agreement, then following the death of the first testator, the property of the survivor which is the subject matter of the agreement will be held on an implied trust for the beneficiary named under the will.

c. Undue influence

19. It is important to remember that there are of course two different legal contexts in which undue influence may arise: testamentary dispositions and *inter vivos* dispositions. As to the former, coercion of the testator must positively be proved (see *Rea v Rea* [2024] EWCA Civ 169). As to the latter, undue influence may be presumed where there is a relationship of trust and confidence and a transaction which calls for an explanation; where those features are not present, actual undue influence must positively be shown: *RBS plc v Etridge (No 2)* [2002] 2 AC 773.

20. In Jersey, the Royal Court in *In the Matter of the Piedmont Trust and In the Matter of the Riviera Trust* [2018] JRC 210 has held that the English law position as set out in *Etridge* is materially the same as that under Jersey law ([28]-[29]). The Royal Court set aside notices revoking two trusts, on the grounds of undue influence. The settlors of both trusts had signed the revocation notices after receiving threatening emails from the original protector of the trusts (referred to in the judgment as the "father").

21. Although the relevant evidence was only hearsay, the Court was nevertheless satisfied that there was *"strong evidence that the father pressurised the settlors by means of threats inter alia of 'consequences' and an injunction and that each of them only executed the relevant revocation notice because of these threats"* (at [77]). The absence of denials from the father and the settlors when faced with allegations of undue influence was also significant to the court's conclusion ([79]-[80]).

22. As courts have been at pains to emphasise, it *"will be a common feature of a large number of undue influence cases that there is no direct evidence of the application of influence. It is of the nature of undue influence that it goes on when no-one is looking"*: Schrader v Schrader [2013] EWHC 466 (Ch) (in the testamentary context).

23. While of course the burden is always on the person asserting undue influence to prove it (or the facts giving rise to the presumption of undue influence in *inter vivos* contexts), advisors to settlors / testators must be alive to the risks of undue influence. Tactful but detailed probing of the settlor's / testator's wishes is the key here, the crucial question being: why do you wish to enter into this transaction? Understanding and probing the reasoning for the transfer and the personal circumstances of the transferor will help to elicit the presence of any red flags of undue influence (such as exclusion or isolation of the transferor, his or her physical or mental frailty, the presence of a dominating or overbearing figure in his or her life, etc). An advisor helping a settlor or testator to document in a letter (or other contemporaneous record) his or her wishes and explanations for the transaction may assist in overcoming future challenges to the validity of the transaction as a result of undue influence.

24. In the hypothetical scenario, Fast and Furious and Ishmael should have engaged in careful questioning of the testatrix, in the absence of any other family members, as to her reasons for the will. More experienced individuals at Fast and Furious should have conducted the interview and Ishmael should have sought the input of an expert in old age psychiatry to administer a capacity assessment. While of course we do not know the detail of the relationship between Annabelle and Beatrice, there are several red flags here which might indicate the presence of undue influence, specifically vulnerability and potential control. Set against this might be the fact that the terms of the will itself are even-handed as between Beatrice and her siblings.

d. Fraud

25. Claims of incapacity or undue influence are often be accompanied by allegations of fraud.

26. The most fundamental such allegation is that the document in question – or the signature of a testator, settlor or witness – is a forgery, in which case evidence of the drafting process (including metadata) will be crucial, as will handwriting analysis.

27. Absent forgery, a disposition will be invalidated where the court is satisfied that it was procured by fraud (a specific instance of which, in the testamentary context, is 'fraudulent calumny' where a false representation is made to the testator about the character of a current or potential beneficiary in order to poison the mind of

the testator). Where fraud is alleged, the civil balance of probabilities standard of proof applies, but with the need for *"a high degree of proof"* given the seriousness of the allegation: see, e.g., *Kunicki v Hayward* [2016] EWHC 3199 (Ch). The disposition procured by fraud might be the entire will or settlement, a particular gift within it, or a subsequent exercise of discretionary powers granted by it.

28. In the hypothetical scenario, there is nothing to indicate that Annabelle's will was procured by fraud (although further investigations might suggest otherwise) but it would be sensible to investigate the circumstances which led to E-Sleep appointing 80% of the capital to Beatrice's children.

Administration: Ensuring fiduciary office holders are fit for duty

29. The administration by fiduciaries of an asset-holding structure can likewise give rise to a number of concerns. Wrongdoing by fiduciaries may of course imperil the structure financially and legally; just the mere suggestion of wrongdoing, however, can bring the proper administration of the structure to a grinding halt. What are some of the lessons to be learnt from case law and what can Charlie and Dean in our example above do to find out whether E-Sleep and its directors have been acting properly?

30. The best way to secure proper administration of trust property is usually a combination of steps. Writing to the fiduciary in the first instance seeking an explanation to what has transpired is almost always the first step (unless there is compelling *prima facie* evidence of wrongdoing which may justify urgent injunctive steps or even calling the police). The extent to which the fiduciary may be willing to provide an explanation will obviously depend on a number of factors, including the governing law of the trust, the rights of beneficiaries under that law and/or the trust instrument, the existence or not of a protector who may be able to be prevailed upon to exercise rights to compel proper administration of the trust by the trustee, any regulatory regime to which the trustee may be subject and last (and definitely not least) the temperament of the trustee itself and of the beneficiaries.

31. Requesting regular trust accounts is always a good idea. Beneficiaries are usually (though not always) entitled to see trust accounts. A refusal by the trustee to provide the same may well, depending on the circumstances, amount to a breach of duty; even if it does not, it can look at least defensive (or worse). A trustee of course has a duty (sometimes equitable, sometimes statutory) to keep accounts: see, e.g., The Trusts (Guernsey) Law, 2007 ("TGL07"), s. 25; the Trusts (Jersey) Law 1984 ("TJL84"), s. 21(5).

32. It is also important to consider the powers of the court to compel a trustee to account for the performance of his or her duties. There are usually summary or interim procedures available to compel the production of accounts quickly: see,

e.g., in England CPR Part 24 (summary judgment) and r. 25.1(1)(o) (interim accounts). There may be statutory provisions empowering a court to compel trustees to give accounts or the auditing of trust accounts: see, e.g., TGL07, s. 69; TJL84, s. 29; the Public Trustee Act 1906, s. 13 (England; auditing of trust accounts by solicitor or accountant).

33. More complicated can be finding out what has been happening at levels below the trust structure if, as is often the case, the main asset within a family trust is the family business and the directors of those businesses are not trustees themselves but are members of the wider family. Trustees may frequently be protected by anti-*Bartlett* clauses which, depending on their terms, frequently exclude any duty to interfere in the management or administration of the underlying company in the absence of actual notice of wrongdoing amongst the directors of that company. A beneficiary's rights will usually be limited to proper administration of the trust, not the underlying company. The best option available to a beneficiary in this situation is usually to inform the trustee of any concerns about the administration of the company and request investigation and if appropriate the taking of action. Putting the trustee on notice of possible wrongdoing may practically compel a trustee to take steps to investigate or regularise the administration of the company (if the trustee is a majority shareholder) or to consider other options available to it, such as an unfair prejudice petition (if the trustee is a minority shareholder). Much will obviously depend on the jurisdiction(s) in which the trust is administered and in which the company is incorporated.

34. A further particular issue facing many corporate trustees is that of conflict. Fiduciaries are of course under a duty to avoid conflicts between their interests and their duties as well as a duty to avoid conflicts between the duties which they owe to their principals and other duties they may owe. In the modern world corporate trustees regularly act for multiple parties; a particular issue in the context of family trusts is that conflicts between branches of the family can arise and become acute particularly where one branch may be particularly involved in running the family business. Fiduciaries should ensure that they have appropriate practical measures in place to avoid conflicts; internal information barriers may well be needed and the formal segregation of sub-funds may also be required depending on the circumstances. Beneficiaries should not be shy of asking trustees as to the measures in place to deal with actual or potential conflicts of interest and of duties.

35. The ultimate remedy available to beneficiaries is of course removal of the trustee and proceedings for breach of trust. Removal may be desirable but can be practically difficult depending on the circumstances. Where the trust fund is illiquid or where the beneficiaries are all at daggers drawn and/or quick to threaten litigation, it may prove difficult to find potential trustees willing to take on the administration of the trust. In those circumstances, it is likely that trustees

and/or beneficiaries will need to seek directions from the court as to how to proceed.

36. Some examples of beneficiaries seeking to find out what has been going on are as follows.

    a. In _Re Rabaiotti_ (2000) JLR 173 at 178, the Jersey Royal Court quoted with approval the following passage from Snell's Equity: *"Trustees must… when required give any beneficiary all reasonable information as to the manner in which the trust estate has been dealt with and as to the investments representing it… Further, in the absence of special circumstances, they must allow a beneficiary to inspect all title deeds and other documents relating to the trust estate."* On the facts, the court required the trustees to disclose information regarding the trust to the English Court, for the purposes of divorce proceedings involving one of the beneficiaries. It is worth noting that this case precedes the introduction in 2018 of a statutory power (subject to court supervision) to refuse a request for disclosure if the trustees are satisfied in their discretion that it is in the interests of one or more of the beneficiaries, or the beneficiaries as a whole, to refuse the request: art 29(3) of the Trusts (Jersey) Law 1984.

    b. In the recent case of _BX v T Limited_ [2024] GRC 036, several individuals who were not yet beneficiaries but claimed to have "exceptionally strong" chances of benefiting from the trust sought information about the trust's assets and administration. The Guernsey Royal Court rejected the application on the ground that the applicants were not yet beneficiaries and it was not necessary or expedient for the proper administration of the trust to provide the information ([126], [156]). However, in stating the law as it applies to beneficiaries, it drew on _Stuart-Hutcheson v Spread Trustee Co Ltd_ [2002] WTLR 1213, a case said to be of *"very general application"*, which held that *"beneficiary has a right to require a trustee to provide an account and to perform its obligations properly"* (_BX_ at [98]).

37. As for the scenario given above, the options available to Charlie and Dean will obviously depend upon the jurisdiction in which the trust is administered and (if different) the jurisdiction in which E-Sleep is incorporated.

38. Given Charlie and Dean are not themselves shareholders in the underlying trust assets, their principal remedies will be as against the trustee itself. In our experience, where corporate trustees are little more than an expensive post-box for the instructions of some other person (such as the settlor or protector), there may be few options available beyond replacement. Requests for accounts and explanations as to the reasons for the appointments to Beatrice's children should be made. However, they presumably can anticipate receiving little by way of

explanation, if (as will often be the case) the trustee is under no obligation to give reasons for its dispositive decisions.

39. Online investigations into the corporate trustee and its individual directors may reveal something about their experience and any regulatory oversight to which they are subject. Checking to see if they are properly qualified / registered to perform the services they have been appointed to perform is an important step, but it is rare in our experience to find public evidence that a professional fiduciary has at least *prima facie* failed to meet these basic requirements. Reviewing any publicly available company accounts of assets held on trust may reveal suspicions as to the administration of underlying trust assets. If, for example, Beatrice or her children were directors (in particular sole directors) of underlying trust assets and if there have been any notable changes in the declared profits or dividends being paid up into the trust, this may be sufficient to put the trustee on notice that it needs to involve itself in the affairs of the company (or at least to exercise its rights as shareholder to appoint or replace directors).

40. Charlie and Dean may also, depending on the facts, wish to raise concerns about the administration of the company and to ask what steps the trustee took to investigate the management of the company and/or to appoint new directors. They may further wish to consider what claims and derivative claims they might be able to bring; though presumably they will wish to wait for answers from the trustee before doing anything precipitate (and costly) by way of litigation.

<u>Conclusion – Remedies for beneficiaries, shareholders and other interested parties</u>

41. As we have seen, the remedies available to interested parties seeking to challenge the establishment or administration of asset holding structures are many and varied. The availability and/or desirability of any given remedy will be highly fact dependent.
42. So far as the creation of asset-holding structures is concerned, usually the first port of call is seeking information from the settlor, testator, or donor (if still alive and with capacity) or their advisors. The extent to which information may be forthcoming will depend on the facts of the case and the relationship between the asking party and the recipient of the request for information. Applications for pre-action or third party disclosure may be available in a given case, but the costs and uncertainty may put many potential litigants off.

43. So far as the administration of asset-holding structures is concerned, for beneficiaries, the process of seeking accounts is usually the first step to ensuring that their fiduciaries are acting in accordance with the duties and explaining what is going on in the administration of the trust. Raising the question of conflicts (where appropriate) and asking for an explanation as to mitigation measures that are in place will force trustees to think about these issues (if they have not done so already) and, it is to be hoped, to put in place appropriate measures to ensure

that their duties do not conflict with other duties or their personal interest. Removal proceedings may be a precursor to, or sought as part of, a claim for breach of trust where wrongdoing is suspected; a claim for accounts will usually also feature. Where serious wrongdoing is suspected or anticipated, injunctive relief may be needed and/or reporting to regulatory or criminal enforcement authorities may be appropriate.

44. Remedies for shareholders in underlying trust assets are somewhat different. Trustees who hold sole or majority interests in an underlying company will likely have powers available at their disposal to effect a change of administration at board level; whether they wish to exercise their powers or can be required to do so will depend upon their rights and duties under the trust instrument and the law of the company's incorporation / administration. Frequently trustees are unwilling to exercise such powers at least in the absence of clear evidence of wrongdoing and seek to rely on the anti-*Bartlett* provisions which are standard in trust deeds. Trustees must, however, be alive to the fact that such clauses are unlikely to save them where they have actual notice of wrongdoing and, in any event, even if they could rely on these provisions, exercising their powers might help to avoid escalation of duties or further losses.

45. Where trustees are minority shareholders their powers of intervention are likely to be more limited. The absence of control over the company in question may leave them with limited options other than selling the shares in question (assuming there is a market for such shares) or bringing an unfair prejudice petition to have their interest bought out by the other shareholders. Whether to bring such proceedings will of course be a matter for the trustees to resolve in the exercise of their duties; challenging their decision (whatever it might be) may in practice be difficult for a beneficiary, particularly if the trustees do not bring such a petition. The uncertainty of whether any breach of trust has in fact occurred and, if so, what loss (if any) flows from that may make a well-advised beneficiary reluctant to embark upon a claim for breach of trust and/or removal.

The "virtually impenetrable drafting" of the Limitation Act 1980: Was *Williams v Central Bank of Nigeria* wrongly decided?

Lemuel Lucan-Wilson

In Williams v Central Bank of Nigeria [2014] UKSC 10, the Supreme Court decided that a knowing recipient of trust property or someone who dishonestly assisted with a breach of trust were subject only to the 6 year limitation period set out in s21(3) Limitation Act 1980 ("**LA 1980**"). That was because although they could be required to account as if they were trustees (and could therefore be constructive trustees) they were not "true trustees"[1] who had had trust and confidence placed in them by the beneficiaries[2]. As a result, they were "class 2" trustees to whom s21(1) LA 1980 did not apply. S21 applies only to "class 1" trustees; either express trustees, or those who are given the trust assets to manage for the beneficiaries (trustees de son tort).

As a result, claims for knowing receipt and dishonest assistance are subject only to the 6-year limitation period, rather than having no period applicable. The exceptions in s21(1) relating to fraudulent breaches of trust, or trust property received by a trustee were applicable only to trustees of express trusts, although in the intervening period they have also been applied by analogy to company directors.

The majority decisions turns (to a relatively large extent) on the position prior to the Limitation Act 1939, the definition of trustee as set down by the Trustee Act 1925 and whether the historical case law supported the amalgamation of the different classes of trustee for the purposes of limitation. Those arguments (and those based on close textual comparison between the two sub-sections) are already considered by Lord Mance and Lord Clarke in their dissents; what was left open is the policy reasons which might support the view that a knowing recipient or dishonest assister should be regarded as a trustee against whom no limitation period runs.

The knowing recipient as trustee

One of the grounds relied upon by the majority in Williams turns on the idea that a knowing recipient could not be properly considered as a trustee, as they are not a "true trustee". This however, puts too fine a distinction on the point. Certainly, in so far as a

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[1] Lord Sumption in Williams at [6]

[2] Lord Neuberger in Willaims, at [64]

recipient is still holding the original property, they hold that property on constructive trust for the beneficiaries. The constructive trustee may well not have duties of investment, but it is still akin to an express trust where property is held for the benefit of another – there are express trust which by their terms may well remove so much of the trustee's duties that they look similar to this not a true trust, as considered by the Hong Kong Court of Final Appeal in Zhang Hong Li v DBS Bank [2019] HKCFA 45 in relation to anti-bartlett clauses. The split of ownership and custodial relationship is the critical factor of the trust, and that can survive and apply perfectly well to the recipient of trust property.

It may be that one underlying policy ground is to prevent defendants from being subject to stale claims long after they have disposed of the property, since knowing receipt has both personal *and* proprietary claims. A defendant only becomes liable for knowing recipient upon obtaining the knowledge that the property transferred to them was transferred in breach of trust; for a volunteer, they can be constituted a knowing recipient after having had the property in question for a long period. The proprietary remedy to the original trust property exists as soon as the property is transferred, but the personal remedy against the recipient requires knowledge as to the breach.

The Limitation Act as it is can already distinguish between these remedies; if a knowing recipient is a true trustee of the property, then a beneficiary could recover it from them under s21(1)(b); the difficulty arises in relation to property "*received by the trustee and converted to their* use", which is liable to then include the personal remedy. The easier method of rectifying this however is to focus on the requirements for the personal remedy; if the property is converted before the recipient has the requisite standard of knowledge to render it unconscionable to be retained[3] then the claim is liable to fail in any event. For the proprietary claim to die in to protect personal liability of recipients who no longer have the property strikes an unjust bargain between the rights of potential defendants and the wronged beneficiary.

Comparison to theft

Moreover, it is particularly odd that the position of an accepted trust contrasts so poorly with that set out above; where there is no trust after a theft, limitation is preserved by virtue of s4 LA 1980, but where there is an accepted trust (which places the recipient under a positive obligation to transfer the items back upon request) limitation does not assist, a curious position to say the least. Section 4 has relatively impenetrable drafting, but as helpfully unpacked in De Preval v Adrian Alan Limited [1997] 1 WLUK 520:

1. Limitation for conversion is 6 years.

[3] Bank of Credit and Commerce International (Overseas) Ltd v Akindele [2001] Ch 437 at 455

2. Limitation runs from the first conversion even if there are successive conversions.

3. Limitation does not however, run from a theft, or conversions related to a theft.

4. Save where there is a purchaser in good faith, "*every conversion following the theft of a chattel before the person from whom it is stolen recovers possession of it shall be regarded for the purposes of this section as related to the theft*" – s4(2).

5. There is a presumption to any conversion which follows a theft is related to the theft unless the contrary is shown – s4(4).

6. Although not relevant to the case in question, s4 also treats the obtaining of a chattel by fraud (in the meaning of the Fraud Act 2006) as a theft.

Williams therefore means that a beneficiary is seeking to use the proprietary remedy to follow the specific asset that was held in trust is in a significantly worse position than that of someone seeking to recover stolen property. Whilst the analogy does not precisely match, the trustee can be regarded as the original converter (or perhaps thief in some cases) and the knowing recipient is the subsequent converter or recipient. Theft (or fraud) require dishonesty[4], but on the basis of s4 it is only the initial theft that would require dishonesty no subsequent recipient has any limitation protection even if they are wholly innocent and without notice, and no limitation period runs for the claimant in recovering the stolen property in the hands of innocent recipients. Only a bona fide purchaser breaks the chain.

It does therefore seem difficult to reconcile this level of protection (on the majority view) being deliberately removed by Parliament for the analogous situation of a beneficiary under a trust. From a policy perspective, a beneficiary will have a harder time in establishing if they have been wronged and seeking their due recompense because of the imbalance of information between them and the trustee regarding the assets which are held to their benefit. Indeed, on one view, the trust property is more deserving of enhanced protection than a chattel – whilst theft necessarily involves dishonesty and therefore is more "*serious*", a breach of trust whilst not involving dishonesty is still a serious issue; it is the breach of a significant duty which in most cases has been freely accepted, or enforced in order to prevent serious wrongdoing. In many cases it will be conduct of a level that can be described as dishonest, since they will be aware that they did not have the legal right to take the course of conduct that they did. Moreover, the recipient of trust property which they know is not their own is in

[4] S1 Theft Act 1968

a materially similar position to the converter of stolen goods; the converter does not need to know that the property was stolen or even have any inkling of this to be deprived the benefit of a limitation defence.

The dividing line of the initial dishonesty does not seem sufficient to justify the difference in treatment when taking into account the difficult position that a beneficiary occupies, especially given the fact that a knowing receipt claim will already fail against a bona fide purchaser for value and without notice. Indeed, it appears that it is not intended to be such a justification - Lord Neuberger states that the decision places those liable for knowing receipt or dishonest assistance "*in the same position as those who are liable in common law for improper or dishonest conduct*"[5]. This is to not compare like with like – as set out above, in most cases where limitation may be in issue the remedy in question is the proprietary remedy for the original asset itself; a knowing recipient is not in the same position as someone liable at common law for improper or dishonest conduct, they are in fact in a much *better* position, both because of the equitable protections, and because of limitation.

The dishonest assister as trustee

The majority decision has the effect that although the action against a dishonest assister was "*an action by a beneficiary to recover trust property or in respect of any breach of trust*" under s21(3) LA 1980, it was not "*an action by a beneficiary under a trust, being an action in respect of any fraud or fraudulent breach of trust to which the trustee was a party or privy*" for the purposes of s21(1)(a) LA 1980.

In many ways however, a dishonest assister can or should be considered to be sufficiently similar to a "*true*" trustee that they should be subject to the same limitation period.

The remedy for dishonest assistance

It is the remedy relating to dishonest assistance that has in the past created confusion as to whether a dishonest assister is a class 1 or 2 constructive trustee; a dishonest assister is required to account as if they were a true trustee, hence they can then be termed a constructive trustee[6]. The dishonest assister also has liability assessed at the date of trial through the application of hindsight[7].

[5] Williams at [118]

[6] See, for example, *Lewin on Trusts* at 43-015

[7] *Central Bank of Ecuador v Conticorp S.A.* [2015] UKPC 11 at [170]

The accounting as if they were a trustee includes the disgorgement of profits which have followed from their dishonest assistance; a rare remedy in other contexts but wholly par for the course in the case of a defaulting trustee who have the duties of property stewardship. If a party deliberately and wrongfully interferes with that duty of property stewardship (which is the case for a dishonest assister) there is no inherent issue of public policy in treating them as if they were also subject to those same managerial duties; that is what underpins the liability for a dishonest assister, but is seemingly not enough to underpin the limitation period applicable to a dishonest assister. Given how far the law goes already in punishing the assister for the breach of those duties, there is no real justification in Williams as to why it does not fully complete the circle, except for the statement regarding trust and confidence considered below.

Limitation (in England and Wales at least) bars the remedy by way of claim or set-off and not the right[8]. If the remedy which is sought against a dishonest trustee is the same, then there should be strong justifying grounds for limitation not to follow the same route that the remedy does. Indeed on an intellectual basis, if it is the accounting "*remedy*", there would be a basis for suggesting that there should be no limitation at all. A traditional trustee always had to be ready with his accounts, although the statutory changes discussed herein are what changed the basis of that liability so far as limitation is concerned.

Trust and confidence placed in the dishonest assister

The ground which was used in Williams to justify the difference in treatment was that as a class 2 constructive trustee, no one has ever placed trust and confidence in the dishonest assister, or indeed the knowing recipient. It is clear that a dishonest assister never takes the trust property, and therefore cannot easily be said to even have the potential for the duties of stewardship and management that would arise upon any kind of trustee office (contra the knowing recipient as set out above). Indeed, it could be said that since the liability is as an accessory to the defaulting trustee, that is sufficient reason allow a softer limitation period.

The difficulty is in whether that is sufficient. A dishonest assister still involves themselves in the management of the trust (or the property subject to the fiduciary duties); the requirement for dishonesty means that if a claim is to succeed, the conduct will already be wilful and worthy of censure; indeed it is for that reason the *remedy* itself is treated as a kin to a class 1 fiduciary.

[8] Halsbury's Laws of England, Volume 68 (2021), para 1044

Moreover, if the justification is whether the would-be fiduciary has ever been trusted with the administration of trust property (as is the case for trustees de son tort who are class 1 trustees), then there would need to be a much greater investigation of the facts, since this rationale does not apply as often as it may seem. A dishonest assister may often be involved in the express trust for a significant amount of time prior to the commission of the breach of trust from which liability flows; it is not realistic to presume that a dishonest assister's first interaction with the trust is in the moment of their dishonest assistance.

Whilst it involves stretches concepts slightly, it is perfectly fair to say that beneficiaries would expect that those in the shoes of a dishonest assister not to take the opportunity to interfere with the relationship which regulates the trust property in such a way as to cause the beneficiary loss. This is not merely the expectation regarding general legal wrongs; by definition a dishonest assister must be aware that the property in question is should not be subject to their interference, given the requirements for dishonesty as set out in *Ivey v Genting Casinos (UK) Ltd* [2017] UKSC 67. For practical purposes, the dishonest assister has to know enough about the scope of the trust to know that there are obligations which would prevent their course of conduct, and then to go ahead with the course of conduct in any event.

As such, although described as accessory liability, dishonest assistance turns more on the relationship between the assister and the trust property or trust itself, rather than the relationship between the assister and the trustee. Relatively little focus is placed on the measure of character of the assistance, it could be procuring a breach of trust, or assisting with a breach or trust, or inducing a breach of trust – each are possible grounds for liability[9]. Nor is it required that the dishonest assistance itself was causative of the loss that the beneficiary has suffered. Therefore, the liability arises for the breach of the duty that the dishonest assister has committed, in the same way that the trustee has breached the trust itself - It is for this reason the remedy is the same (the accounting remedy, which as above can include the disgorgement of gains in the way a fiduciary must) and why the limitation period applicable to their actions should also be the same.

[9] *Royal Brunei Airlines v Tan* [1995] 2 AC 378 at 392F–G.

One method available against a dishonest assister but not possible in most cases against a knowing recipient would be to invoke s32 LA 1980, as mentioned by Lord Neuberger[10] as potentially of assistance in other cases following the decision in Williams. Section 32 provides as follows:

"(1) Subject to subsections (3), (4A) and (4B) below, where in the case of any action for which a period of limitation is prescribed by this Act, either—
(a) the action is based upon the fraud of the defendant; or
the period of limitation shall not begin to run until the plaintiff has discovered the fraud, concealment or mistake (as the case may be) or could with reasonable diligence have discovered it. [...]"

An action against a dishonest assister would be an action based upon the fraud of the defendant, and therefore the protections of s32 could mean that a beneficiary might be able to claim a longer limitation period. However, it is notable that s32 still preserves a limitation period where as set out previously, a common law action against the recipient of stolen property has no limitation period, and an action for fraudulent breach of trust against a class 1 constructive trustee has no limitation period either. At best therefore, s32 can only extend the time which a beneficiary has. Not only that, but in all s32 cases a beneficiary can expect to be met with the argument that the fraud could have been discovered with reasonable diligence, and therefore face an additional hurdle in bringing their claim.

This is, difficult to square with principle– one basis for the lack of limitation for a trustee is the trust and confidence reposed in them by a beneficiary, but another justifying factor may well be the difficult which a beneficiary may have in determining that there has been a breach, given the power and information imbalance between the trustee and the beneficiary. That imbalance is equally applicable as between the beneficiary and a third party.

Conclusion

Whilst Williams turns to a great deal on evaluation of the statutory evolution surrounding limitation, it is disappointing that an effort was not made to consider the wider questions of principle, especially considering the fact that the old authorities did not speak with one voice on these issues. Limitation operates as an all or nothing bar, and should be carefully deployed.

[10] Williams at [119]

Trusts & Arbitrability

Fenner Moeran KC

1. Arbitration has many perceived advantages, including efficiency, flexibility, and privacy. Further, for those who are unable or unwilling to refer their disputes to court – such as members of certain religious communities – it may provide the only practical means of dispute resolution.

2. However, claims involving trusts bring with them complexities which – at the very least – mean that careful consideration is required before seeking to refer them to arbitration.

3. In this paper, I seek to present an overview of those complexities before turning to consider two competing approaches to the arbitrability of such disputes. The first is the statutory route which has been made available in various offshore jurisdictions, including the Bahamas; the second is the (current) English approach following the recent decision of Master Clark in *Grosskopf v Grosskopf* [2024] EWHC 291 (Ch). Finally, I briefly discuss some issues which may arise in relation to asset recovery following the arbitration of a trusts dispute.

Preliminary issues

4. In England and Wales (and Northern Ireland), the legislative code relating to arbitration is found in the Arbitration Act 1996 (the "**1996 Act**").

5. The foundation of an arbitral panel's jurisdiction is consent: in order for a dispute to be referred to arbitration, there must be an arbitration agreement. The definition of "arbitration agreement" is found in section 6 of the 1996 Act. It is:

   an agreement to submit to arbitration present or future disputes (whether they are contractual or not)

   and it must – pursuant to section 5 of the 1995 Act – be made or evidenced in writing.

6. The reference to "*present or future disputes*" draws out the distinction, in the context of fraud and asset recovery claims involving trusts, between:

   (a) arbitration provisions found in the governing instrument of the trust itself, which are intended to refer hypothetical <u>future</u> disputes to arbitration; and

   (b) freestanding arbitration agreements to refer a specific <u>present</u> dispute to arbitration.

7. The governing instrument of the trust itself will commonly be either a deed poll, i.e. a self-declaration by the trustee of the terms upon which the assets are to be held, or a bilateral agreement between the settlor and the trustee. That gives rise to two issues regarding who will be bound by an arbitration clause. First, the beneficiaries are not usually parties and do not normally provide their consent to the terms of the governing instrument. Second, it is not uncommon for trustees to resign and new trustees to be appointed from time to time. With that in mind, are those two categories of person bound by the arbitration clause?

8. In relation to beneficiaries, the answer as a matter of English law is uncertain, and the Trust Law Committee has recommended legislative intervention to clarify the law. In New Zealand, applying materially identical statutory provisions, the High Court has found that if any of the beneficiaries is not a party to the trust instrument, then the arbitration clause is – as between them – "null and void": *Ryan v Lobb* [2020] NZHC 3085 at [109]. If that decision were followed in England, then it would follow that such an arbitration clause would not comply with the 1996 Act.

9. However, there are arguments in favour of non-party beneficiaries nevertheless being affected by such clauses, just as they are by jurisdiction clauses (see *Lewin on Trusts (20th ed.)* at 49-010 onwards). In very broad terms, those arguments centre around the beneficiaries being prevented from taking the benefit of the trust without accepting the corresponding burden, such that the court ought to exercise its inherent jurisdiction to stay proceedings brought in breach of the clause—as to the discretionary nature of that jurisdiction, in the context of jurisdiction clauses, see *Crociani v Crociani* [2014] UKPC 40 at [36] and [37].
10. In relation to successor trustees, the position is still uncertain – in the absence of English authority – but the arguments are perhaps stronger. Successor trustees may (for the purposes of section 82(2) of the 1996 Act) be regarded as claiming "under or through" their predecessor trustees and therefore be treated as parties to the relevant arbitration clause.

11. Separately, what about cases where the entire trust instrument is alleged to have been created in fraudulent circumstances? Is anyone bound by it? By section 7 of the 1996 Act, an arbitration agreement is treated as a distinct agreement, and so is vitiated only by factors which directly concern the arbitration clause itself rather than a more general challenge to the transaction of which it forms a part. The dividing line is vividly illustrated by *Premium Nafta Products v Fili Shipping Company* [2007] UKHL 40—the fact that the agreement was procured by bribery or entered into by an agent without authority does not vitiate the arbitration clause, while the fact that the whole document is a forgery does so.

12. A freestanding arbitration agreement may be made by a trustee pursuant to the power of compromise conferred by section 15(f) of the Trustee Act 1925, which expressly authorises a submission to arbitration. If they do so, the effect is that all those interested in the trust property will be bound by the submission to arbitration and in

turn the arbitral award. However, that statutory power of compromise only applies to disputes "external" to the trust, such as a dispute between a trustee as landlord and a third-party tenant—see *Lewin on Trusts (20th ed)* at 36-094 onwards. In the fraud context, it may for instance apply to a claim against the trustees that the trust was settled with misappropriated assets, or to a claim made by the trustees to recover trust assets—see for example *Re MF Global UK Ltd* [2014] EWHC 2222 (Ch).

13. More difficult is the scenario in which a dispute arises which is "internal" to the trust. Then, an arbitration agreement may only be entered into by those parties who are of full age and capacity (and so will not bind, for example, beneficiaries who are minors, unless perhaps they can be said to be persons "claiming through or under" the trustee — see section 58 of the 1996 Act). Whether or not that matters will – as observed in *Grosskopf v* Grosskopf – depend on the particular relief sought.

14. I discuss the question of what relief may be sought below. Particular difficulties arise when the arbitral tribunal lacks the powers conferred upon the court by statute, such as the power to remove a trustee or to appoint a new one (although there are potential workarounds—see for example *Rinehart v Welker [2012] NSWCA 95* at [176]. Those powers may, of course, be of crucial importance to safeguard the trust fund when the existing trustee (or one of a number of existing trustees) is suspected of fraud.

The statutory route - The Bahamas Trustee Act 1998 s.91A and *Volpi v Delanson Services Ltd*

15. There are currently very few jurisdictions which have made express statutory provision for arbitration of trust disputes. They currently include The Bahamas, Guernsey, Malta and certain U.S. states[11]. (If you happen to know of any other jurisdictions with legislation on this, please do drop me a line and let me know.) However, and perhaps unsurprisingly given the nature of such matters, there are very few reported cases of how these jurisdictions statutes operate in practice. Possibly the best case I have at present comes from The Bahamas, with the ongoing case of *Volpi v Delanson Services Ltd*.

16. There are two reasons why this is a good example of statutory provision. First, the Bahamian legislation is particularly comprehensive, which is unusual. For example, the Maltese legislation[12] simply states that it shall be "*lawful for a settlor of a trust to insert an arbitration clause in a deed of trust and such clause shall be binding on all trustees, protectors and any beneficiaries under the trust in relation to matters arising*

[11] Including at least Florida and Arizona.

[12] Maltese Arbitration Act 1998 s.15A.

under or in relation to the trust". It says nothing about, for example, representation orders, or the powers of the arbitral tribunal, or who a beneficiary is.

17. The Guernsey legislation is somewhat better, but still quite limited. It simply states that "*Where (a) the terms of a trust direct or authorise, or the Court so orders, that any claim against a trustee founded on breach of trust may be referred to alternative dispute resolution [which is defined to include arbitration]… [any] settlement [that results from the arbitration] is binding on all beneficiaries of the trust, whether or not yet ascertained or in existence, and whether or not minors or persons under legal disability*". Representation is somewhat dealt with under s.63(2)[13], but again there is nothing about powers of the arbitral tribunal, or what to do when the claims are not founded on breaches of trust or even when there is a mixed case, where there are aspects based on both breach of trust and otherwise. Equally, whilst it says that the outcome ('settlement') is binding on non-parties to the trust deed, this leaves open questions of enforcement in other jurisdictions (see below).

18. The Bahamas legislation is far more comprehensive and, to my mind, clearer. The relevant sections are set out in the Appendix to this paper, but to summarise:

    a. It goes as far as it can in treating non-parties "*as if those parties were parties to that agreement*" – s.91A(2);

    b. It expressly gives the tribunal the same powers of the Court, so including powers to remove and appoint trustees, or direct the exercise of powers – s.91B(2);

    c. It has express provisions for representation of parties, including minors and unborns, as well as parties under a disability, and grants powers to the tribunal to appoint litigation friends[14] – s.91B(3-4)(6-8);

    d. It has provision for approval of settlement by the arbitral tribunal on behalf of represented parties / classes – s.91B(5).

19. However, even with all that there are still issues which are not dealt with expressly – such as questions of jurisdiction of the arbitral tribunal as to questions going to the validity of the trust in the first place. If it is not actually a trust, how does the Trustee

[13] They have to have been represented, or at least had notice of the arbitration proceedings "and a reasonable opportunity of being heard", and in the case of minors / unborns / under a disability, independently represented by a person "appointed for the purpose by a court of law" – however that is supposed to work in parallel with arbitral proceedings.

[14] Still called next friend or guardian ad litem in The Bahamas.

Act s.91A apply to it to grant the tribunal jurisdiction to determine whether or not it is a trust?

20. The second reason why *Volpi v Delanson Services Ltd* is a good example, is that it has been in and out of the Bahamian Courts, and in open hearings with reported judgments. This solved some of the legal questions (e.g. the tribunal has jurisdiction to determine its own jurisdiction, including on issues of trust validity[15]), so a number of those issues have already been determined. But more practically the case has highlighted a number of practical issues that arise even in the context of such comprehensive legislation. These include:-

21. Delay. The original proceedings were issued in 2018 as Bahamian court proceedings, with applications for a world-wide freezing injunction. It took until 2020 to obtain partial awards, dealing purely with the breaches of trust in principle, but awaiting further proceedings to determine relief and quantum. Those partial awards were then appealed to the Bahamian courts by the losing parties, and it took until December 2023 to have those appeals dismissed. Applications for permission to appeal that appeal are currently outstanding. So it has now been 6 years, and we have yet to get to the remedies hearing.

22. Publicity. The proceedings were started in 2018 in the Bahamian courts. Those proceedings were ultimately stayed on the basis of the arbitration clause, but the case was already in the public eye, with no confidentiality orders being made. Whilst surprisingly little about the case was reported on in the wider world at that stage, when the December 2023 decision came out it did start getting reported on – and Google searches on relevant search terms turn out references to the case. And, of course, the December 2023 decision records a number of salient points from the arbitral awards, including findings of breach of trust (including underlying facts relating to those breaches) and various financial figures relating to what would otherwise have been private matters (such as matrimonial settlement figures, and private payments by parents to children).

23. Interim relief. In one of the earlier interlocutory decisions Winder J of the Bahamian Supreme Court held that there was no jurisdiction under Bahamian procedural law for him to grant a free-standing injunction in support of arbitral proceedings in respect of foreign *situs* assets; *Volpi v Delanson Services Ltd* (2018/CLE/gen/10404).

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[15] Determined in *Volpi v Delanson Services Ltd* (2020/APP/sts/00013) (2020/CLE/gen/00632) in December 2023: judgment at https://files.lbr.cloud/public/2024-01/VolpiRuling_Substantive-Appeal-Final.pdf

The (current) English approach - *Grosskopf v Grosskopf* [2024] EWHC 291 (Ch)

24. Whether you have an arbitration agreement or not, either under the terms of the trust documentation itself or under a freestanding post facto agreement, there is still the question of whether the disputes can be subject to arbitration at all. This is the question of arbitrability. In particular, trust disputes often involve the exercise of the Court's inherent supervisory jurisdiction over trusts, and in particular can involve remedies – such as replacement of trustees – which cannot be granted by arbitral tribunals, not least because to do so could affect third party rights. This issue is expressly recognised under the Arbitration Act 1996 ss.9(4) and 81:

> *9.(1) A party to an arbitration agreement against whom legal proceedings are brought (whether by way of claim or counterclaim) in respect of a matter which under the agreement is to be referred to arbitration may (upon notice to the other parties to the proceedings) apply to the court in which the proceedings have been brought to stay the proceedings so far as they concern that matter.*
>
> *(2) An application may be made notwithstanding that the matter is to be referred to arbitration only after the exhaustion of other dispute resolution procedures.*
>
> *(3) An application may not be made by a person before taking the appropriate procedural step (if any) to acknowledge the legal proceedings against him or after he has taken any step in those proceedings to answer the substantive claim.*
>
> *(4) On an application under this section the court shall grant a stay unless satisfied that the arbitration agreement is null and void, inoperative, or incapable of being performed.*
>
> *81.(1) Nothing in this Part shall be construed as excluding the operation of any rule of law consistent with the provisions of this Part, in particular, any rule of law as to—*
> *(a) matters which are not capable of settlement by arbitration;*
> *(b) the effect of an oral arbitration agreement; or*
> *(c) the refusal of recognition or enforcement of an arbitral award on grounds of public policy.*

25. *Grosskopf v Grosskopf* is the first English case which expressly considers this issue of arbitrability of trust disputes. NB: It was argued in November 2023 and decided in February 2024, so after *FamilyMart* but before *Sian Participation* (as to which, see below).

26. The case itself was factually a little unusual. It concerned a private trust of an orthodox Jewish family. Essentially the late father had settled a family trust, with his seven children being income and discretionary beneficiaries, and grandchildren and later descendants being discretionary beneficiaries. By the date of the dispute arising the father had died, two out of the seven children (the Defendants) were the trustees and at least one of the remaining children (the Claimant) was unhappy with how the Defendants were and had administered the trust, alongside how they had administered the father's estate. This was, of course, in the context of wider disputes within the family relating to, inter alia, various business dealings in both the UK and Israel. So far, so reasonably ordinary. What makes it odd is how the Claimant and Defendants sought to resolve their disputes (namely arbitration), and the arbitration process thereafter.

27. Because they are orthodox Jews the parties did not want, at least initially, to go to the secular courts. Instead in 2017 they brought their dispute before a Jewish rabbinical court, called a *Beth Din*, consisting of (at least in this case) three rabbis. As is standard with such matters the Beth Din required the parties to enter into an arbitration agreement, fixing the Beth Din as the arbitral tribunal. NB: Although this is absolutely standard procedure before Batei Din (the plural of Beth Din), the precise wording of the arbitration agreement varies from tribunal to tribunal. Some are more comprehensive than others. In this case the original agreement recited that "*a dispute or difference has arisen … in regards to a claim about full disclosure of the estate / assets of the late R'Myer Grosskopf*" and that the parties agreed that "*any and all disputes and differences between them regarding the above issue*" were referred to the Beth Din "*according to principles of halachah* [Jewish rabbinnical law] *and/or general principles of equity customarily employed in arbitration by the Beth Din and/or English law where applicable as decided by the Beth Din*". Accordingly, there was an arbitration agreement in place between the Claimant (one of the beneficiaries) and the Defendants (trustees, who were also beneficiaries) – at least in relation to some sort of dispute about "*full disclosure*".

28. The Beth Din proceedings then suffered from what might be called 'issue creep'. Effectively the issues covered by the arbitration agreement expanded, possibly by agreement, until by 2018 (by which time there had been three interim awards) when the Claimant sought to issue proceedings alleging breach of trust and seeking accounts and enquiries, the High Court held that that claim was subject to the arbitration agreement, and accordingly stayed the 2018 proceedings[16]. The Beth Din arbitral proceedings then continued, with a fourth interim award being granted.

[16] Unreported, but at (2018) EWHC 3272.

29. Not deterred the Claimant came back in 2022 with a fresh claim. This time the Claimant sought removal of the trustees and appointment of a substitute judicial trustee. The Defendants applied to have the 2022 proceedings stayed under the Arbitration Act 1996 s.9.

30. The Claimant's argument was (essentially) that the relief sought was one which the arbitral tribunal could not grant, and as such was non-arbitrable, could not be subject to an arbitration and the proceedings could not be stayed under the Arbitration Act. As Lewin on Trusts (20th edition) puts it:

    "An arbitrator will lack the powers conferred on the court by statute, such as the power to remove a trustee or to appoint a new one and similarly lacks the court's jurisdiction to give directions to trustees… Nonetheless, an arbitrator will frequently be able to make orders having a comparable effect; an arbitrator could give effect to a claim for removal, for example, by ordering the trustee to resign, to appoint a new trustee and to convey the trust property to that person. If arbitration requires the consent of the beneficiaries, it is only if all those concerned in the question to be determined are of full age and capacity that there can be an effective decision. In other cases there can generally be no effective decision in view of the lack of contractual capacity of some of the beneficiaries."

31. There is already some law on what sort of disputes might be non-arbitrable, in the context of company and insolvency disputes.

32. *Fulham Football Club (1987) Ltd v Richards* [2011] EWCA Civ 855 [2012] Ch 333 was a case involving an shareholders' unfair prejudice petition. However, the relief sought was simply injunctive (both mandatory and prohibitory) – so relief which the arbitral tribunal could have granted. However, it did give one of the earliest analyses of arbitrability, quoting from both Mustill & Boyd (2nd edition) Commercial Arbitration and Born (3rd edition) International Commercial Arbitration detailing known examples of non-arbitrability. Born in particular stated:

    "The types of disputes which are non-arbitrable none the less almost always arise from a common set of considerations. The non-arbitrability doctrine rests on the notion that some matters so pervasively involve public rights, or interests of third parties, which are the subjects of uniquely governmental authority, that agreements to resolve such disputes by 'private' arbitration should not be given effect."

33. The Court of Appeal then said this:

    40. This extract is interesting because it attempts to identify some common criteria applicable in the cases in which the matter in dispute has been held to be non-

arbitrable. But it also, I think, indicates that the limitation which the contractual basis of arbitration necessarily imposes on the power of the arbitrator to make orders affecting non-parties is not necessarily determinative of whether the subject matter of the dispute is itself arbitrable. As Mustill & Boyd *point out, it does not follow from the inability of an arbitrator to make a winding up order affecting third parties that it should be impossible for the members of a company, for example, to agree to submit disputes inter se as shareholders to a process of arbitration. It is necessary to consider in relation to the matters in dispute in each case whether they engage third party rights or represent an attempt to delegate to the arbitrators what is a matter of public interest which cannot be determined within the limitations of a private contractual process.*

41. Not surprisingly, the source of such restrictions cannot be found in the 1996 Act or what might be termed the law of arbitration itself. The statements of principle set out in the textbooks referred to above are simply recognitions that the scope of even the most widely drafted arbitration agreement will have to yield to restrictions derived from other areas of the law…

34. In the end the Court of Appeal concluded that unfair prejudice petitions were essentially arbitrable because, although in theory a winding-up order could be made by the courts, they are essentially private matters between the parties – and that doing so did not engage any public policy objective of protecting the public where a company continues to trade despite being insolvent. However, the Court of Appeal did recognise that winding-up would be a remedy which was outside the remit of the arbitrators. And finally, Patten LJ made an obiter suggestion (at paragraph 83) that an arbitrator could, in appropriate circumstances, make a ruling on whether it would be appropriate for a complainant to initiate winding up proceedings or be limited to some other remedy.

35. That conclusion leads to the next area of jurisprudence on non-arbitrable disputes – insolvency disputes. At the time of *Grosskopf v Grosskopf* being heard the leading English authority on the issue was <u>Salford Estates (No.2) Ltd v Altomart Ltd</u> [2014] EWCA Civ 1575 [2015] Ch 589. That was a highly contentious decision of the Court of Appeal which held that

    a. A winding up petition is not a "*claim*" for payment of the debt, so does not fall under Arbitration Act 1996 s.9(1)(4).

    b. However, the discretionary power of the Court in relation to winding-up companies under the Insolvency Act 1986 s.122 should be exercised to either dismiss or stay the winding-up petition whilst the underlying dispute as to the debts it was based on were determined by the arbitration proceedings – **irrespective of whether that dispute was a *bona fide* or genuine one**.

c. At that stage the petitioner could, if appropriate, come back to the Courts for a winding-up order.

36. That requirement for any dispute as to the underlying debt – however hopeless and plainly non-genuine – to be resolved by arbitration before going to the Court for a winding-up order was heavily criticised. Ultimately the decision has very recently (19 June 2024) been overturned by the Privy Council in the case of Sian Participation Corp v Halimeda International Ltd [2024] UKPC 16. That decision held that where there is no genuine dispute as to the underlying debt the Court can simply proceed to winding-up, although if there is a dispute then the proper place for it to be adjudicated will be the arbitral proceedings. Again, once the status of the debt was resolved the parties could return to the Courts for a winding-up order, if still required. NB: One point to note is that the PC specifically limited the decision to generally worded arbitration clauses. As it said – "*Different considerations would arise if the agreement or clause was framed in terms which applied to a creditor's winding up petition*". Perhaps most interestingly of all, the Privy Council made what is called a Willers v Joyce direction, which provides that although this was a Privy Council decision on a BVI appeal, it applies to the law of England and Wales and therefore Salford Estates is now overturned both in the BVI and in England and Wales.

37. Finally, it is important to note the only slightly less recent decision of the Privy Council in *FamilyMart China Holding Co v Ting Chuan (Cayman Islands) Holding Corporation* [2023] UKPC 33. That case was a 'just and equitable winding up' claim, where the shareholders agreement contained an arbitration clause. The Privy Council distinguished between subject matter non-arbitrability (e.g. the whole dispute is excluded due to public policy) and remedial non-arbitrability (e.g. the award of certain remedies is beyond the jurisdiction the parties can confer). In the latter case the PC emphasised that whilst some remedies may be unavailable, the underlying disputes (e.g. whether a party has breached a shareholders' agreement) may well be 'matters' which can be subject to arbitration (and the PC tended to follow up on the recent trend of authorities which takes a broad view of what constitutes such a 'matter'). However, the PC went on to hold that not only was winding-up not an arbitrable remedy, but also that Patten LJ's obiter suggestion in Fulham Football Club (i.e. that arbitrators could rule on whether seeking a winding up order was appropriate) was wrong, and that any ruling as to whether winding up was just and equitable would be "ineffective".

38. With that background, in *Grosskopf* the Claimant argued that the claim was non-arbitrable. At most, he said, the underlying facts relating to the Court's decision on whether to remove trustees and appoint judicial trustees in their place could be subject to arbitration (and in *Grosskopf* had in the majority of cases **already** been determined by the Beth Din under the fourth interim award), but the claim itself could not – by analogy to the insolvency jurisdiction. (Possibly with some more power, had *Sian Participation* been decided in time – if the facts are obvious, just get on with the application for removal / appointment?)

39. Master Clark held otherwise. Essentially she held:

    a. At paragraph 65 that the arbitral tribunal could make orders which were **similar** in effect to replacement of trustees: *"it could direct the defendants to stand down; and to seek the appointment of new trustees by Malka; and, if she failed to do so, an application to the court under s.41(1) of the Trustee Act 1925, or indeed for a judicial trustee, could be made."*

    b. And then, at paragraph 72:

        "The fact that the claim seeks relief which the Tribunal cannot grant does not, in my judgment, make the dispute inarbitrable since:
        "(1) the grounds on which the appointment is sought are clearly suitable for resolution by arbitration; and
        "(2) in such an arbitration, the Tribunal would have the power to make a direction as to the defendants' position which could, if necessary, be enforced outside the arbitration."

40. That decision is not being appealed. The current status of this decision is therefore that it is effective as between the parties, but is only by a decision by a Master – which in turn leads to the (probable[17]) conclusion that it is persuasive but not binding authority, at least at High Court level.

And if you win - asset recovery

41. There are three points to make regarding the enforcement of arbitral awards.

42. <u>First</u>, it goes without saying that one can only enforce an arbitral award insofar as it binds the parties to the arbitration. Where, say one has a claim for breach of trust regarding the misapplication of trust assets involving both claims against trustees and third parties, the claimant will want to ensure (prior to commencing proceedings) that the award will bind both the malfeasant trustee and the third party. The risk is that a claimant will have to go to the expense of resolving the dispute by arbitration and then having to revisit the same points again in litigation (albeit that as between the parties to the arbitration there will be res judicata).

[17] See Michael Ashdown's article on this issue at https://www.wilberforce.co.uk/article/precedent-value-of-chancery-masters-decisions-3.

43. That risk might be avoided by procuring that the third party either submits to arbitration or acquiesces in such a manner that indicates an intention to be bound by the award (in some circumstances they may, in others they may not). Some institutional arbitration rules contain a procedural framework for joinder of third parties, but since the tribunal's jurisdiction derives from the will of the parties, joinder is generally only possible with the consent of the concerned parties: *Bay Hotel and Resort Ltd v Cavalier Construction Co Ltd* [2001] UKPC 34.

44. Having obtained an award, where a party to an arbitration is a company, it might nevertheless be said that its director (who was not expressly a party to the arbitration) is a privy of the company and therefore has an interest in the arbitration, as was the case in *Dadourian Group International Inc v Simms* [2004] EWCA Civ 686, where a director was made subject to a worldwide freezing injunction as part of the claimant's actions to enforce an arbitral award. Further, in jurisdictions such as the United States, issue estoppel can, in certain circumstances, be relied upon in subsequent litigation involving a different party: *Parklane Hosiery Co. v Shore* 439 US 322 (1979); ILA, 'Interim Report on Res Judicata and Arbitration' (2009) 25 Intl Arb 1, at 48. Even if any of the above do not assist, the arbitral award might be of persuasive significance in that a subsequent tribunal is likely to consider the findings of the award to inform its own findings.

45. <u>Second</u>, obtaining the arbitral award is not the end of the matter. A party seeking to enforce an arbitral award may find that the losing party/parties will seek to challenge it. The grounds for challenge are nevertheless limited. In England, they are broadly contained in ss.67-69 of the Arbitration Act 1996, being concerned (in summary) with lack of jurisdiction, serious irregularity and (on a limited basis) on points of law.

46. <u>Third</u>, against this background, the obvious advantage of benefitting from an arbitral award is that its recognition and enforcement in the Courts of foreign jurisdictions are in fact easier than English Court judgments, due to the network of international and regional treaties providing for the recognition and enforcement of international awards being more widespread and better developed than corresponding provisions for the recognition and enforcement of foreign judgments. The most important of these is the New York Convention, which facilitates the recognition and enforcement of foreign arbitral awards in the territories of any of its more than 167 signatory states, irrespective of the arbitration rules under which the proceedings were conducted. That is especially attractive given the difficulties now encountered in enforcing English judgments in EU member states following the United Kingdom's departure from the European Union.

47. However, that raises the thorny issue of whether foreign jurisdictions will recognise an arbitration award arising out of a trust dispute generally, let alone a statutory trust arbitration provision. This is obviously case/jurisdiction specific, but it is worth noting that most if not all relevant jurisdictions laws derive from or reflect the New York

Convention – which only relates to agreements in writing between the relevant parties and is limited to arbitrable matters. For example, article II provides:

> *1. Each Contracting State shall recognize an agreement in writing under which the parties undertake to submit to arbitration all or any differences which have arisen or which may arise between them in respect of a defined legal relationship, whether contractual or not, concerning a subject matter capable of settlement by arbitration.*
>
> *2. The term "agreement in writing" shall include an arbitral clause in a contract or an arbitration agreement, signed by the parties or contained in an exchange of letters or telegrams.*

48. If trust disputes are, on another jurisdiction's interpretation of the law, non-arbitrable, will this work? And could it ever apply where there is no agreement in writing between the parties, but merely one imposed by statute?

Conclusion

49. The trend of the courts in England and across the common law world has been to favour the arbitrability of factual and legal disputes even where there are limits on the remedies which can be ordered by the arbitral tribunal.

50. For example, while the remedy of winding-up is only available from a court, the underlying question grounding the relief – such as whether there has been unfairly prejudicial conduct by a majority shareholder (*Fulham Football Club (1987) Ltd v Richards* [2011] EWCA Civ 855) or whether it would be "just and equitable" to wind up a company (*FamilyMart China Holding Co Ltd v Ting Chuan (Cayman Islands) Holding Corporation* [2023] UKPC 33) – can perfectly properly be decided by an arbitrator. On the other hand, with the decision in *Sian Participation Corp* v *Halimeda International Ltd* [2024] UKPC 16 there is now an emphasis on preserving the courts' jurisdiction to decide the ultimate non-arbitrable matter.

51. *Grosskopf v Grosskopf* continues that trend by again focusing on what the arbitrator <u>can</u> properly decide, and in that case thereby avoiding the issue of whether there are any remaining "gaps" to be filled by subsequent – and much more limited – court proceedings. In the absence of statutory intervention, practitioners in this space can no doubt expect to see more reported English cases on the boundaries of arbitrability in the trusts context. But whether any such decisions are actually enforceable, at least around the world, is still open to debate.

APPENDIX - EXTRACTS FROM THE BAHAMAS TRUSTEE ACT 1998 {AS AMENDED BY THE TRUSTEE (AMENDMENT) ACT 2011}

91A. Arbitration of Trust Disputes

(1) The object of this section is to enable any dispute or administration question in relation to a trust to be determined by arbitration in accordance with the provisions of the trust instrument.
(2) Where a written trust instrument provides that any dispute or administration question arising between any of the parties in relation to the trust shall be submitted to arbitration ("a trust arbitration"), that provision shall, for all purposes under the Arbitration Act, have effect as between those parties as if it were an arbitration agreement and as if those parties were parties to that agreement.
(3) The Arbitration Act shall apply to a trust arbitration in accordance with the provisions of the Second Schedule to this Act.
(4) The Minister may by order amend the Second Schedule.

91B. Powers of the Arbitral Tribunal

(1) This section shall apply except to the extent otherwise provided in the trust instrument.
(2) The arbitral tribunal (hereinafter referred to as "the tribunal") may, in addition to all other powers of the tribunal, at any stage in a trust arbitration, exercise all the powers of the Court (whether arising by statute (including this Act), under the inherent jurisdiction of the Court or otherwise) in relation to the administration, execution or variation of a trust or the exercise of any power arising under a trust.
(3) Without prejudice to subsection (2), and to any provisions made pursuant to subsection (4), the tribunal has the same powers to appoint one or more persons to represent the interests of any person (including a person unborn or unascertained) or class in a trust arbitration as the court has under Order 15 rule 14 of the Rules of the Supreme Court in relation to proceedings before the court.
(4) The terms of a trust may provide for the appointment of one or more persons to represent the interests of any person (including a person unborn or unascertained) or class in a trust arbitration.
(5) Where an appointment is made under subsection (3) or (4) —

(a) the approval of the tribunal is required in relation to a settlement affecting the person or class represented;
(b) the tribunal may approve a settlement where it is satisfied that the settlement is for the benefit of the person or class represented;
(c) any award given in the trust arbitration shall be binding on the person or class represented by the person or persons appointed.

(6) A person under a disability may not —

(a) bring or make a claim in a trust arbitration except by his next friend;
(b) defend, make a counterclaim or intervene in a trust arbitration except by his guardian ad litem ; or
(c) take any step in a trust arbitration except by his next friend or guardian ad litem, unless otherwise ordered by the tribunal,

(7) The terms of a trust may provide for the appointment of a next friend or guardian ad litem, for the cessation of an appointment, and for the service of documents upon a person under a disability.
(8) Subject to subsection (7), the tribunal may appoint a suitable person to be a next friend or guardian ad litem, may terminate an appointment, and may give directions for the service of documents upon a person under a disability.
(9) Where a next friend or guardian ad litem has been appointed under subsection (7) or subsection (8), no settlement affecting the person under a disability shall be valid, without the approval of the tribunal.
(10) Notwithstanding subsection (1), subsections (5), (6) and (9) shall apply irrespective of any provision in the trust instrument.
(11) The Minister may make regulations to extend or clarify the powers of the tribunal in relation to trust arbitrations.

91C. Powers of Court

(1) A person may apply to the court to declare the exercise of a fiduciary power voidable.
(2) The court may, on an application made under subsection (1), declare the exercise of the fiduciary power void or voidable and make such determination as it deems fit, if the court is satisfied that —

(a) a person with the fiduciary power —

(i) has failed to take into account relevant considerations; or

(ii) has taken into considerations; and

(b) such person — account irrelevant

(i) would not have exercised the fiduciary power; or

(ii) would have exercised the fiduciary power, but on a different occasion, or in a different manner, to that in which it was exercised.

(3) An application under subsection (1) may be made by —

(a) a trustee, protector, or any other person exercising the power;

(b) a successor in title of the trustee or protector;

(c) a power holder under section 81A;

(d) a beneficiary;

(e) an “authorised applicant” as defined in the Purpose Trusts Act;

(f) for a purpose trust, the Attorney-General if there is no authorised applicant;

(g) any person with leave of the court.

(4) Whether or not in the exercise of the power the person exercising the power, or any person advising such person, acted in breach of trust, in breach of duty or was otherwise at fault shall be immaterial to the making of a declaration by the court under subsection (1).
(5) No order may be made under subsection (2) which would prejudice a bona fide purchaser for value without notice of any trust property without knowledge of the matters which allow the court to set aside the exercise of a fiduciary power.

91D. Interpretation of Sections 91A, 91B and the Second Schedule

For the purposes of sections 91A, 91B and 91C and the Second Schedule —

"administration question" means any relief or question in respect of which an action, application or other reference to the court could, subject to section 91A and the Arbitration Act, be brought or made under Order 74 of the Rules of the Supreme Court under this Act or under the Purpose Trusts Act;
"beneficiary" includes an object of a power, whether or not ascertained or in existence and a charity;
"dispute" includes a difference;
"fiduciary power" means a power that, when exercised, must be exercised for the benefit of or taking into account the interests of at least one person other than the person who holds the power and in the case of a purpose or charitable trust, to advance the purposes of such trust;
"power holder" means any person holding a power in relation to a trust (including any power of appointment, consent, direction, revocation or variation, and any power to appoint or remove trustees or power holders) and includes a person in the position of a protector;
"the parties in relation to the trust" means any trustee, beneficiary or power holder of or under the trust, in their capacity as such.

SECOND SCHEDULE (Section 91A)
APPLICATION OF THE ARBITRATION ACT

The Arbitration Act shall apply and be construed with respect to a trust arbitration, as stated hereunder —

1. In relation to a trust arbitration, the Arbitration Act shall be construed and applied with a view to giving effect to the object stated in section 91A(l).
2. In the Arbitration Act, "dispute" includes an administration question.
3. Section 3(b) of the Arbitration Act shall apply as if it read —

   "(b) the settlor should be free to determine (by provision in the trust instrument) how, in relation to a trust, disputes are resolved, subject only to such safeguards as are necessary in the public interest;".

4. Other than in sections 42, 43, 73 and Part XII, where in the Arbitration Act reference is made to a matter agreed between the parties to an arbitration agreement (including a matter which may be authorised, chosen, conferred, designated, nominated or vested by the parties) that matter shall (except where no effective provision is made) be determined as provided in the trust instrument.
5. Neither section 7 of the Arbitration Act nor any rule of law or construction treating an arbitration agreement separate to any agreement of which it is a part shall apply in relation to a trust arbitration.
6. The term "legal proceedings" in sections 9 and 10 of the Arbitration Act includes an application or other reference to the court concerning an administration question which the trust instrument requires to be submitted to arbitration and a stay of that application or other reference may be sought by any of the parties in relation to the trust, whether or not a party to that application or other reference.
7. In any application or other reference to the Court referred to in paragraph 6, the court may stay the proceedings on its own volition unless all parties in relation to the trust affected by the application are before it or are represented by persons before it.

8. The reference to “contemplation of the parties” in section 12(3)(a) of the Arbitration Act shall apply as if it were a reference to the “contemplation of the settlor”.
9. Section 83 of the Arbitration Act shall apply as if it included the following subsection —

> “(3) Where a person is or has been a party to a trust arbitration in the capacity of trustee he shall, unless the tribunal otherwise orders, be entitled to the costs of the arbitration, in so far as they are not recovered from or paid by any other person, out of the fund held by the trustee; and the tribunal may otherwise order only on the ground that the trustee has in substance acted for his own benefit rather than for the benefit of the fund.”.

10. Section 85(5) of the Arbitration Act shall apply as if it included the following paragraph —

> “(c) Where a person is or has been a party to a trust arbitration in the capacity of trustee and is entitled to be paid his costs out of the fund held by the trustee any doubt as to whether costs were reasonably incurred shall be resolved in favour of the trustee. Costs shall be presumed to have been unreasonably incurred if they were incurred contrary to the duty of the trustee.”.

11. For the purposes of enforcing an arbitral award under section 88 of the Arbitration Act —

> (a) section 91A shall have effect for the purposes of section 5 and 6 of the Arbitration (Foreign Arbitral Awards) Act, as it does for the purposes of the Arbitration Act;
> (b) section 6(2)(a) of the Arbitration (Foreign Arbitral Awards) Act, which provides for the refusal of enforcement of an arbitral award against an incapacitated person) shall apply subject to the provisions of section 91B;
> (c) section 6(2)(d) of the Arbitration (Foreign Arbitral Awards) Act, which provides for the refusal of enforcement of an arbitral award that deals with a difference not contemplated by or not falling within the terms of the submission to arbitration), the term “difference” includes an administration question.

The BHS litigation and the Carillion discontinuance: directors' duties in the spotlight

Sri Carmichael and Jamie Holmes

(1) Introduction

1. The much-publicised insolvencies of high-street retailer BHS and construction giant Carillion plc ("**Carillion**"), two of the largest corporate collapses of recent times, led to equally high-profile legal action against the companies' former directors in respect of their management of the companies' affairs in the lead up to liquidation.

2. The lengthy decision of Leech J handed down in the '*BHS* litigation' in May of this year (*Wright v. Chappell* [2024] EWHC 1417 (Ch)) has been widely discussed because of its significance in two respects: (i) it is the first case in which directors have been found liable for what the Judge termed 'misfeasant trading', pursuant to their duty to have regard to the interests of creditors once insolvency is imminent, following the landmark decision of the UK Supreme Court in *BTI v. Sequana* [2022] UKSC 25, and (ii) it contains what is said to be the largest award ever made for 'wrongful trading' pursuant to the English Insolvency Act 1986 ("**IA 1986**"), section 214.

3. However, our focus is not on the specific insolvency claims dealt with in the *BHS* judgment. Instead, we seek to draw out the decision's general lessons on directors' duties, likely to be of broader relevance to company, trust and commercial lawyers, particularly in jurisdictions where non-executive directors are commonplace: (i) its helpful exposition of the standard of care required of a director – the 'notional director' standard, and (ii) issues to consider when defending a director's conduct, in terms of delegation, reliance on professional advice, and causation of loss.

4. As well as *BHS*, we consider the decision of the UK Insolvency Service ("**IS**") to drop its disqualification claims against Carillion Plc's five non-executive directors ("**NEDs**") on the eve of trial in October 2023. The IS brought its claims on the basis that NEDs have a strict "duty to know" the true financial position of a company. Despite the absence of a judgment in that case, it is worth exploring why the IS discontinued its (in our view, hopeless) claim against the NEDs for what it tells us about the scope of their duties.

5. Our paper is structured as follows:

    a. Section 2: Further background to the cases
    b. Section 3: *BHS*: The 'Notional Director' standard of care
    c. Section 4: *Carillion*: A 'duty to know'? The so-called 'NED Duty'
    d. Section 5: Potential lines of defence (i) delegation, (ii) reliance on advice, and (iii) causation

(2) Further background to the cases

BHS

6. The judgment in *BHS* spans 533 pages and covers a large number of events, characters and periods of time. In the briefest of outlines, the Joint Liquidators ("**JLs**") of 4 companies within the BHS Group brought claims against 4 directors. The claim against one (Mr Smith) settled before trial. The claims against two (Mr Henningson and Mr Chandler) were determined in the trial reported above. Each was found liable for wrongful trading i.e. having allowed a company that ultimately went into insolvent liquidation or administration to have continued to trade at a time when the director ought to have considered that insolvency was inevitable. This was found to be the case from the last of 6 pleaded 'knowledge dates', that being 8 September 2015 (¶901-4). Each of these 2 directors was ordered to make a contribution of **£6.5m** (¶1139-53). Each was also found liable for various discrete acts of misfeasance i.e. breaches of their duties under the English Companies Act 2006, in various sums as to various events (¶¶1006-1108, 1156-7).

7. In addition, each was found liable for 'misfeasant trading' from the *earlier* date of 17 June 2015. This was found to be the point from which insolvency was sufficiently imminent to engage the director's duty to take account of the interests of BHS' creditors, as part of the director's duty to act in the best interests of the company (that otherwise, amongst other things but primarily, being a duty to act in the interests of shareholders).[18] Indeed, the Judge found on the facts that the directors knew or ought to have known that insolvency was probable from that date (¶983), and further that they ought to have known at that date that it was more probable than not that BHS would go into insolvent administration (¶984). The Judge found that a reasonable director properly considering the interests of creditors and giving those appropriate weight, ought to have concluded at that time that the interests of BHS's existing creditors were now paramount or, at the very least, that those interests should carry more weight than the interests of BHS' sole shareholder (¶987-8). Accordingly, the directors ought to have concluded at that time that it was in the interests of the creditors to immediately put the companies into administration (¶990-991).

8. Following a further hearing in 2024, judgment was entered against the fourth director, Mr Chappell, for wrongful trading (in the amount of **£21.5m**), misfeasant trading and various discrete acts of misfeasance. This is addressed in the further judgment at [2024] EWHC 2166 (Ch) which also assessed the quantum of the

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[18] As a matter of English law this arose under the Companies Act 2006, Section 172.

misfeasant trading claims at **£110.23m** (against Mr Chappell and Mr Henningson, the JLs having settled with Mr Chandler).

Carillion

9. In January 2021, three years after Carillion's collapse, the IS issued disqualification proceedings under the UK Company Directors Disqualification Act 1986 ("**CDDA**") against the 3 executive directors and 5 NEDs of the company who had been in post during period leading up to its liquidation.

10. The gist of the IS's case was that each director had knowingly caused the company to publish misleading financial statements that did not comply with the applicable accounting standards and paid a dividend that was not justified in the circumstances of the company's performance.

11. In the months leading up the 4-month-long trial that had been listed to commence in October 2023, the executive directors accepted undertakings not to act as a director for periods of between 8 and 12.5 years. The IS also issued decision notices against them imposing financial penalties.

12. However, the IS pursued its case against the non-executives up until the Friday before the trial was due to start on the Monday, at which point the IS discontinued, at substantial cost to the taxpayer.

(3) BHS: The 'Notional Director' standard of care

13. The 'Notional Director' test, as referred to in *BHS*, is an expression coined by Mr Chandler's counsel, rather than the Judge. However, the Judge readily adopted it as shorthand for the statutory standard of care required of a director of a company on the brink of insolvency set out in s.214(4) IA 1986.

14. Section 214(4) provides that:

(4) For the purposes of subsections (2) and (3), the facts which a director of a company ought to know or ascertain, the conclusions which he ought to reach and the steps which he ought to take are those which would be known or ascertained, or reached or taken, by ***a reasonably diligent person having both—***

(a) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the same functions as are carried out by that director in relation to the company, and

(b) the general knowledge, skill and experience that that director has*.*

15. For the purposes of a claim for wrongful trading under s.214, the Notional Director test is relevant to (a) whether and when the director had the requisite knowledge of the company's impending insolvency set out in s.214(2) (termed the "Knowledge Condition" in the judgment), and, (b) if and once the Knowledge Condition is satisfied, whether he then took the steps he ought to have done to minimise potential loss to the company's creditors (s.214(3)) so as to avoid liability.

16. However, what appears not to have been brought out in the extensive commentary written on this decision but is apparent from a close review of the judgment[19], is that this newly termed Notional Director test is not specific to the insolvency context or to s.214 IA 1986. Rather, it is simply the standard of care to be met by directors at all times if they are to comply with their general duty of reasonable care, skill and diligence codified in England under section 174 of the Companies Act 2006 ("**CA 2006**"), arising under Article 74(1) of the Companies (Jersey) Law 1991 (as amended) and at common law in Jersey, and arising at common law in Guernsey.

17. The language used in s.174 CA 2006 is materially identical to that used in s.214 IA 1986 (s.214 additionally explaining how the standard of care applies to the relevant elements of the test for wrongful trading):

(1) A director of a company must exercise reasonable care, skill and diligence.
(2) This means the care, skill and diligence that would be exercised by ***a reasonably diligent person with—***
(a) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions carried out by the director in relation to the company, and
(b) the general knowledge, skill and experience that the director has.

18. As such, the Judge's detailed exposition of the Notional Director test in *BHS* is of general application. The Judge himself stated that he applied it when determining whether the defendant directors had breached s.174 CA 2006 (see footnote 2 below). It may well be that the term catches on in future judgments outside the wrongful trading context dealing with allegations of negligence by directors – including the 'asleep-at-the-wheel' type claims faced by NEDs if they fail to spot wrongful conduct or errors by executive directors.

[19] The wide application of the 'Notional Director' test was not highlighted in the section of the *BHS* judgment dealing with it, but the Judge did briefly note at ¶549 in discussion on s.174 CA 2006 that the standard of care required by directors under that provision and under s.214 IA 1986 were the same. He also then applied the Notional Director standard in finding that Mr Henningson and Mr Chandler breached their duties under s.174 CA 2006 at ¶¶960, 1036 and 1050.

19. At ¶¶466, 479 and 551 of his judgment, Mr Justice Leech helpfully collated and confirmed 13 propositions derived from previous cases concerning the standard of care a director must meet, 7 of which are of general application and not confined to how the standard is to be applied in a potential wrongful trading context. We suggest the _BHS_ judgment is therefore a key authority to cite when dealing with any negligence claim against directors. The 7 key takeaways are explored below.

20. **First**, the Notional Director standard of care is an irreducible base-level standard that may be raised for individual directors: ¶¶478-9:

    a. There is a minimum objective standard of the general knowledge, skill and experience reasonably expected of a person carrying out the functions of the director in question.

    b. However, if the general knowledge, skill and experience of a particular director is higher than that of a reasonably diligent person undertaking their role, then they should be held to that higher standard.

    c. Importantly, the ratcheting effect does not work in the other direction though: if the general knowledge, skill and experience of a director is lower than that of a reasonably diligent director discharging the same functions then it is no defence for that director to say he was out of his depth and did not have the requisite knowledge, skill or experience.

    d. The judge appeared to confirm that whilst factors potentially raising the standard of care are specific to the individual director, the standard of care test nonetheless remains objective. Whilst the Judge did not explain his decision on this point (at ¶479), we consider it to be correct. This is because the skill and experience of a director, or at least the skill and experience a director holds himself out to have, is demonstrable and therefore should be assessed objectively. Similarly, a director's actual knowledge must be demonstrable, and he will also be expected to have the knowledge that someone with his skill and experience ought to have or ought to be able to have ascertained in the circumstances (see takeaway 5 below). The test is not concerned with the director's subjective beliefs or intentions.

    e. The proposition that the two-fold standard of care / Notional Director test is entirely objective is contrary to previous authority (not discussed in _BHS_) which suggested that the second stage of the test looking at the particular qualities of the director in question was subjective (see, for example, _Lexi Holdings plc (in administration) v Luqman_ [2008] 2 BCLC 725, cited in _BHS_ but not in respect of this point, and _Carlyle Capital Corporation Limited v Conway_ (Guernsey Judgment No. 38/2017) at [501].

f. The irreducible minimum standard of care principle was of particular relevance to the wrongful trading claim against Mr Chandler, the former barrister. The findings against him provide a clear, if extreme, example of what can happen to directors who accept roles they are not qualified to undertake. Chandler came up short when measured against the Notional Director standard. His poor decision-making caused by inexperience was a key factor leading the court to find him liable. He was not spared by reason of being out of his depth, his honest conduct or his good intentions whilst in office.

21. **Second**, it follows from proposition one that the test is to be applied to each individual director, and not to the board of directors as a whole: ¶466(1).

a. Allegations of negligence against multiple directors must be considered separately by reference to each individual's knowledge, experience and skill, and the particular functions he carried out.

b. The *BHS* judgment carefully considers the allegations against the Defendants separately.

22. **Third**, the court's enquiry into the functions performed by each director will go beyond the mere consideration of his title and will *"examine the substance of what they actually do or did"*: ¶466(2).

a. So, for example, where a NED steps over the line and undertakes the functions of an executive director, he should be judged by that standard.

23. **Fourth**, the standard to be expected of the Notional Director will also depend on the size and sophistication of the company: ¶466(3).

a. A director overseeing a largescale business with involved operations or funding structures and complex accounting procedures will be expected to have a greater degree of knowledge, skill and expertise than one running a small family firm.

24. **Fifth**, in determining what a director ought to have known, the court is not limited to consideration of the material available to the director during the relevant period; its consideration may extend to material to which the director could with reasonable diligence have gained access (given the level of knowledge, skill and experience it is judged he should have): ¶466(4).

25. **Sixth**, the court should be very careful to avoid hindsight in scrutinising directors' decisions: ¶466(9).

a. If a director's alleged negligence concerns his failure to anticipate events, the court should focus on whether he held rational expectations of how matters might unfold.

26. **Seventh**, the court must be satisfied that the particular decision of the individual director under scrutiny went beyond an error of commercial judgment and was one which no director would have reached applying the Notional Director standard: ¶551.

a. This is connected to a key point made in another recent high-profile case, *ClientEarth v Shell Plc* [2023] EWHC 1137 (Ch), concerning a challenge by an environmental law group to the oil and gas producer's policies. There, the court accepted Shell's submission that the law does not superimpose on the duty of care more specific obligations as to what is and is not reasonable in every circumstance: the question is whether the decision falls outside the range of decisions reasonably available to the directors at the time

27. This Notional Director test was applied throughout the judgment to assess the conduct of Mr Henningson and Mr Chandler, particularly in the context of their claimed reliance on professional advice, as discussed in section 5(B) below.

(4) Carillion: A 'duty to know'? The so-called 'NED Duty'

28. The IS pursued what it described as a "test" case against the NEDs on a basis that it acknowledged had never previously been argued in disqualification proceedings. The Judge in an early case management hearing preferred to describe it as "novel".

29. The IS's case was founded on a key allegation that the NEDs had a 'duty to know' the true financial position of Carillion, the so-called "**NED Duty**", irrespective of any cover up by executive directors or failure of professional advisers to spot problems in the company's complex accounts.

30. The IS claimed the NEDs were unfit to be involved in the management of a company under s.6 CDDA as a result of their failure to pick up on misleading entries in Carillion's financial statements.

31. The absolute nature of this alleged NED Duty necessarily meant it fell to be assessed on a strict liability basis, and the reasonableness of the NEDs' conduct, the context in which they made decisions and causation were therefore all irrelevant to the determination of whether it had been breached.

32. It is notable that the IS did not allege that the NEDs had been negligent under s.174 CA 2006 (see [2022] EWHC 922 (Ch), at [5] and [27]) – a lesser duty, the scope and application of which depends on all the factors the strict NED Duty sidestepped.

33. Whilst we can never know, it may be that the IS chose to rely on the existence and breach of the NED Duty because of the factual difficulties it considered it faced establishing that the NEDs had behaved unreasonably in the circumstances and/or helped to cause the publication of misleading financial statements. In circumstances where the auditors had not identified the accounting problems in question, the IS would have had to show that there was something the NEDs should reasonably have asked the auditors that would likely have prompted them to uncover the issues. On the face of it, that is an intimidatingly high hurdle to overcome.

34. According to the IS, the NED Duty arose at common law primarily as a result of *Re Westmid Packing Services (No.2)* [1998] 2 All E.R. 124, and somehow escaped codification in CA 2006 (or the attention of the courts thereafter).

35. The NEDs' position was that *Westmid* is not authority for the proposition claimed, and the strict liability it was said to support was (i) inconsistent with s.174 CA 2006, and (ii) impossible and impractical to comply with, such that it was unfair and unworkable and should not be imposed.

36. They also argued that even had it been claimed and proven that they had breached their duty under s.174 CA 2006 (which they denied they had), such liability would not be sufficient on its own to justify disqualification under s.6 CDDA. The test of 'unfitness' was a much higher standard than mere negligence and required either a want of probity or gross incompetence to be established.

37. In our view, the NEDs were correct about the non-existence of the NED Duty, and the IS rightly capitulated. The NED Duty does not reflect the law and would have problematic and far-reaching implications if imposed.

    a. It would contradict the current understanding of NEDs regarding their role. NEDs are expected to have a supervisory role and participate in decisions of the board on strategy. They are not expected to have day-to-day management control over the business.

    b. Were such a duty to be introduced, it would likely lead to the mass resignation of NEDs in England and all jurisdictions where English law is considered to be persuasive authority, because of the impossible burden and risks it would place on them. The availability of insurance for NEDs would likely disappear, or at least become considerably more expensive and/or difficult to obtain.

(5) <u>Potential lines of defence</u>

38. Three potential lines of defence were raised in _BHS_: (i) delegation, (ii) reliance on professional advice, and (iii) causation. Before turning to these, it is helpful to set out some context to their application in the judgment.

BHS - The task faced by the new team

39. _BHS_ turned on the period of time from which the BHS Group had been taken over by a new shareholder ("**RAL**"). RAL was owned at various times and in various holdings by Mr Chappell and three others (Mr Parladorio, Mr Bourne and Mr Tasker) (¶48). Mr Parladorio in particular was a solicitor who was found to have been significantly involved in the 2015 acquisition and management thereafter but did not give evidence at trial (¶49-50). The takeover took effect as of 11 March 2015, and Mr Chappell and Mr Henningson were appointed as directors of the relevant BHS companies that day, with the others (Mr Smith, Mr Topp and Mr Chandler) appointed in following days and weeks (¶¶6, 108). Of those, Mr Henningson (¶51), Mr Smith (¶108) and Mr Chappell were also directors of RAL at the relevant times (¶51), amongst others including Mr Parladorio (¶49).

40. Up to that point the UBO of BHS had been Sir Philip Green and his wife (¶33). BHS had made a loss in every year from 2009-2014 and its cumulative operating loss on acquisition in 2015 was £442m (¶32). It also faced a significant pensions deficit (¶34-44). There were however some in its former management that considered that there were signs that it could have been turned around (¶32). The authors' impression is that the Judge considered that this would have been a challenging turnaround for the most experienced of professionals.

41. As to the relevant periods and points in time, the Judge noted that "*This case is an unusual one because it involves a Wrongful Trading Claim against directors almost from the moment they took office.*" (¶438). Following 11 March 2015, the JLs' 6 knowledge dates were: 17 April 2015, 6 May 2015, 26 June 2015 (the date found for misfeasant trading, once insolvency was imminent), 13 July 2015, 26 August 2015 and 8 September 2015 (the date found for wrongful trading, once insolvency was inevitable).

BHS - The new team

42. Mr Chappell. Sir Philip at first sought to sell the group to a Mr Sutton, for whom Mr Chappell had been working first as a driver and later as part of the team on the BHS deal (¶46). The Judge's findings (in particular at ¶46-47) as to Mr Chappell's background are striking, these primarily quoting from a 2016 Select Committee Report, and the remarks of Bryan J in 2020 when sentencing Mr Chappell to 6 years imprisonment for tax offences:

> *Dominic Chappell had scarcely, if any, more credibility than Paul Sutton as a suitable buyer for BHS. Mr Chappell had a record of bankruptcy, of which Sir Philip*

was aware, and neither retail experience nor any experience of running a similar-sized company. It has subsequently been reported that Mr Chappell was forced out of a previous venture in the oil business "after taking around €400,000 (£315,000) from the company for his personal use". It is amazing that his association with a convicted fraudster and previous bankruptcy did not lead to more thorough scrutiny of his credibility, not least when it became known that he had been misrepresenting the deal to his own advisers ...

... In October 2019 Mr Chappell was disqualified as a director for a period of 10 years. ...

... a backdrop of successive bankruptcies (four in total, the last of which was in 2009 the bankruptcy sum being £24m) as well as company insolvencies. ...

43. Mr Smith was Mr Chappell's Uncle (¶6).

44. Mr Henningson's background was in corporate finance, and he had known Mr Chappell since the 1990's (¶52-3). The findings as to his role are addressed further below.

45. Mr Chandler was a criminal barrister by training (¶50). The Judge found that he was right to describe himself as having been engaged as the General Counsel of the BHS Group after the takeover (¶855-7). However, Mr Chandler: "*had no experience as a corporate lawyer. As Mr Curl put to him, he was clearly out of his depth.*" Further, that he was "*clearly motivated by personal loyalty to Mr Chappell and his own personal interests.*" and "*willing to do what Mr Parladorio asked of him.*" (¶¶440-445, 858).

46. Mr Topp was not one of four directors sued (Chappell, Smith, Henningson, Chandler). He, unlike them, was part of the previous management team and board of directors, being the previous COO who was then appointed CEO after the takeover (¶80-81). The Judge ultimately found that his evidence had significant limitations given his experience and role ("*His experience was retail ... he was not involved in any of the attempts to raise finance which give rise to the Joint Liquidators' claims. Indeed, he admitted to having very little visibility in relation to any of them.*"). The Judge also found that "*His judgment was questionable at times and he was influenced by his relationship with Sir Philip Green.*" and that he was at least in one instance "*over-optimistic*" (¶¶446-7).

BHS - Evidence at trial

47. It is of note that of the 4 directors that were sued both (1) Mr Chappell and (2) Mr Smith did not participate in the trial (¶¶1, 3, 18-19). Further, (3) Mr Henningson did not give evidence, and the Judge held that he was unable to attach any weight to his two statements, finding these to be partial, misleading and in parts dishonest

(¶¶20-22, 448-451). That left (4) Mr Chandler, who gave evidence and was accepted to be an honest witness, although the Judge rejected his evidence in part: see the findings at ¶45 above.

48. The Defendants also called (5) Mr Topp, the fifth director, who was also found to have been an honest witness, albeit that his evidence was found to have significant limitations given his experience and role as referred to ¶46 above.

49. As a result, it is perhaps unsurprising that the Judge found that best guide to the findings of fact that he had to make were the minutes of the meetings of the boards (¶452).

BHS - The various discrete findings of misfeasance

50. Mr Henningson was found liable to pay (a) £300,000, being a commission that he was found to have accepted for (amongst other things) introducing a Mr Dellall to Mr Chappell, for which he failed to account to the relevant companies (in breach of the 2006 Act, s176) (¶¶1006-1021, 1156); (b) £1.5m in compensation for a £2m arrangement fee that he caused or permitted to be paid to RAL (in breach of ss171-2 and 174-5) (¶¶1062-9, 1157); (c) £1,671,236.70 in compensation concerning the purchase of one of BHS' stores ('Darlington') (in breach of ss172-174) (¶¶1087-97, 1157); and (d) £521,976 in compensation for a payment in that amount to a company ('Swiss Rock') ultimately owned by Mr Chappell and his father (in breach of ss173) (¶¶48, 1052-1061, 1157).

51. Mr Chandler was found liable in the same sum concerning Darlington (¶1157).

5A. Delegation as a defence

52. Part of Mr Henningson's case was that his functions as a director were limited to introducing financial contacts and dealing with the international side of the business (¶¶482, 861).

53. As a matter of the law, the Judge held that even if Mr Henningson was correct in that regard (at ¶480-482):

> *"it is trite law that the duties and responsibilities of a director are personal and that a director cannot delegate them to a fellow director or a non-board employee. However, the board of directors may delegate management functions to each other or to employees who are not also directors ...*
>
> *Even if directors delegate a number of functions either to individual directors or employees, it remains their duty to monitor and supervise the discharge of those functions ...*

even if it was agreed that Mr Henningson's responsibilities would be limited to these two areas of expertise, it was not open to him to leave to his fellow directors those decisions which were required to be made by the BHSGL board (or the boards of the other companies)."

54. The Judge went on to find that Mr Henningson's role was not limited in the way that he alleged, this not being reflected in his contract, the minutes, and in light of inconsistencies in his evidence (¶¶859-865, 995). He was "*a full-time executive director ... his function was to manage and supervise the business and operations of the BHS Group and, in particular, to focus on its turnaround. I also find that he had the general knowledge and skills of a corporate finance adviser with experience in the turnaround of companies.*"

55. Although delegation proved insignificant as a defence on the facts as found, the judgment provides a pithy summary of these well-established principles. It also demonstrates the link between those principles and the extent to which directors may escape liability by reason of their reliance on professional advice, the limits on delegation of powers forming part of the Judge's reasoning in respect of that defence.

5B. Reliance on professional advice

56. As a matter of law, the Judge held in particular as follows (at ¶483-5):

"*... where directors relied on the advice of reputable professionals, then they will prima facie have fulfilled their duties ... in general a director who takes and acts upon expert advice "has gone a long way towards performing his duties with reasonable care" ...*

... However, the weight which the Court will attach to the professional advice which directors take will depend on [a] the scope of the engagement, [b] the instructions which the adviser was given, [c] the knowledge which they had or the assumptions which they were asked to make, [d] the advice which they gave (or [e] did not give) and [f] the extent to which the directors relied on that advice (or not). Where a professional adviser did not advise the board of directors of a company that they should put the group into administration or liquidation, the weight to be attributed to the absence of that advice will depend on a detailed assessment of the facts."

57. The point arose in BHS as regards four main sets of advisors.

58. <u>First</u>, the legal advice (from Olswang) that the directors had received concerning their duties to consider the companies' solvency and/or ability to continue to trade. In particular, it was said that Olswang at no point advised that there was no reasonable prospect of avoiding insolvent administration or liquidation (¶905).

59. The Judge rejected this as a defence for the following reasons:

a. It was the directors' duty to consider these matters, not their legal advisors (¶905). Indeed, Olswang had themselves stated this for the directors to see (¶¶905, 271).

b. The directors had not turned their minds to the advice. At ¶906: "*I accept that in many cases the legal advice which directors receive may provide an evidential basis for dismissing a wrongful trading claim where those directors carefully consider and follow the legal advice which they have received. But I am also satisfied that they did not do so in the present case. In my judgment, Mr Turner raised all the right questions in his memo dated 25 August 2015 but his advice was never tabled or discussed …*". Similarly at 1138.(3): "*I am not satisfied that Mr Chandler obtained their advice except as a box-ticking exercise.*"

c. Had the notional director called a meeting to consider that advice, they would have put the companies into insolvency (¶907).

60. The second set of advisors were Insolvency Practitioners (Grant Thornton), who had been instructed (amongst other things) concerning what the parties referred to as 'the July 2015 Turnaround Plan' (¶239-249) and had attended the board meetings at which cash flow was discussed from May to September 2015 (¶908). It was said that the terms of GT's retainer stated they would "*assist in the development of "robust business cases and plans" and review and test the reasonableness of the BHS Group's financial forecasts.*" (¶908). The point again was the omission of advice that the companies were inevitably insolvent.

61. The Judge's reasons for rejecting this defence are at a more granular level of detail:

a. The main point was that the notional director would have fully understood the assumptions in the plan and whether those were reasonable, and that in fact the directors understood those assumptions and knew them to be unreasonable (¶910).

b. Much of the reasoning focusses on the position around 8 September 2015, that being the knowledge date that the Judge accepted as regards wrongful trading. This included (i) what was obvious to the notional director from GT's 1 September 2015 cashflow update (and "*It was not necessary for GT to spell out the obvious*") (¶911); (ii) what parts of the meeting on that date GT were and were not invited to attend (¶909.1), and (iii) that GT had effectively been stood down from that date (¶909.2-3).

c. More generally the Judge also found (iv) that the terms of GT's retainer were not as the directors had submitted above, and rather were narrower (¶909.4-7).

62. Further, similar points also arose as regards a proposed CVA, and advice from Weil (legal) and KPMG (insolvency practitioners) (¶914). As regards (3) KPMG, the defence failed because they had not been given complete and accurate information (¶923-936).

63. Fourth and finally, as regards Weil (¶937-941), it was common ground that they had attended the relevant board meetings and had stated that they were not aware of any reason why the companies could not continue to trade (¶¶939, 941). The Judge had also found that Weil were engaged to advise the boards of the four Companies on their duties and that the information which was provided to them was accurate in all material respects (¶941).

a. Nonetheless, Weil did not have all of the relevant information (¶¶941.2 and 6).

b. Further, their retainer was not with the individual directors and involved a conflict between RAL and BHS (¶941.1 and 3-4).

c. In any event, the Judge found that the advice given on each occasion was "*fairly typical advice and its obvious purpose was to invite the individual directors to consider this issue carefully*." (¶941.5).

d. Further, the Judge was not satisfied that the directors "*placed any real reliance on Mr Plainer's statements at the relevant board meetings. … In my judgment, the members of the BHSGL board were simply going through the motions. At each meeting Mr Plainer invited the board members to consider whether there was reasonable prospect of avoiding insolvency and their duties to creditors. But the minutes are formulaic and none of them record that there was any genuine discussion between board members about the risk of insolvency or the risks to individual creditors*." (¶941.10).

e. The Judge also relied explicitly in this regard on what he had found in the various individual misfeasance claims at ¶50-51 above (¶941.11).

64. As regards the minutes in particular, the Judge had found as follows at ¶452-3:

a. "*I have given less weight to minutes which have obviously been prepared in advance by lawyers to approve a particular transaction*."

b. "*I have given much less weight to language or statements which were drafted by Olswang and repeated at every meeting*."

c. And as regards those for 1 September 2015 he found: "*I am not satisfied that there was any consideration of the interests of creditors. The minutes use the same formula which Mr Turner [of Olswang] introduced in April 2015 but contain no discussion of the interests of creditors at all.*"

d. Similarly at [847]: "*… Mr Turner's formulation was simply adapted and tacked on at the end before "Any Other Business".*"

5C. Causation

65. The judgment contains a summary of the law of causation as to wrongful trading more generally at ¶491-8, and equitable compensation at ¶499-507. The further 2024 judgment considers these principles in the context of misfeasant trading.

66. The most interesting point in this regard is the defence run by Mr Henningson and Mr Chandler, to the effect that because they made up only a minority of the board (2 out of 5) their conduct had no causative effect (¶496). They further relied on the fact that neither of them was a shareholder in RAL itself, and so had they taken the position that the JLs said they ought to have (that the companies were insolvent and/or needed to be put into an insolvency process) they would have been voted off the respective boards (¶496).

67. The Judge held that it was necessary to show more than a 'but for' connection between the director's conduct and the losses suffered (the greater deficiency in assets) (¶¶497, 509). That did not require the director to be the sole cause (¶¶498, 509). Rather, the proper approach was to consider the counter-factual scenario: if the director had complied with their duty, would the loss (still) have occurred (¶¶505, 508, 1109).

68. The Judge's analysis of this defence across the trading misfeasance, wrongful trading and individual misfeasance claims highlights that it is a highly fact-sensitive issue. The Judge essentially considered and found what the various other personalities on the board would have done, had Mr Henningson and Mr Chandler made the objections they ought to have.

69. The result was that several allegations of individual misfeasance in addition to those that are referred to above at ¶50-51 were dismissed. The Judge was not satisfied that had Mr Henningson done as ought to have, it would have made any difference, and accordingly, those breaches did not have the necessary causative effect: ¶¶1119, 1121 and 1126.

70. The Judge found to the contrary on all of the other allegations. In particular on trading misfeasance and wrongful trading, and the point as to what the majority would have done, the Judge found that had Mr Henningson and Mr Chandler raised

these matters as they ought to have, Mr Smith and Mr Topp would have followed suit (¶¶1110.1-3, 1112, 1114).

71. As to what Mr Chappell might then have done, the Judge found (a) he would likely have accepted the inevitable, being unable to operate the companies without Mr Chandler and Mr Topp (¶¶1110.4), alternatively (b) he would have been unable to appoint new directors who could command the confidence of the various stakeholders (¶1110.5), alternatively (c) it is unlikely that the particular transactions as were executed on the various dates would have been in those circumstances (¶1110.7). The position was somewhat simpler for the June date for misfeasant trading, because if the financing as was executed then had been voted down, Mr Chappell would have had no choice but to accept the inevitable (¶1112).

72. Similar findings were made, concerning the particular individuals and circumstances in question, as regards each of allegations of individual misfeasance referred to above at ¶50-51: ¶¶1122, 1123-4, 1127-1130. As part of these findings, the Judge notable found that it was possible that Mr Chappell would (as majority shareholder in RAL) have tried to dismiss the board, but very unlikely: ¶1125.

Hot topics in trust, tracing receipt and accessory claims

Jonathan Hilliard KC and Michael Ashdown

Trust derivative actions

1. Often a beneficiary is a few steps removed from the loss when things go wrong in relation to a trust.

2. A beneficiary of a discretionary trust may find that a trust has entered into dubious transactions with a connected third party, hurting the trust fund but not directly taking money out of the beneficiary's pocket.

3. Or- increasingly- a beneficiary may feel that the fund has been hurt by an unenlightened view towards ethical investment and climate-friendly investments.

4. And someone who holds rights in respect of intermediated securities may find that any loss occurs many links along the chain between the victim and the pool of cash or other assets.

5. One answer to this is to sue the immediate wrongdoer, the trustee.

6. However, as a starting point such an action will be brought at the costs risk of the individual beneficiary. That may be an unattractive cost from the beneficiary's perspective, and doubly unattractive if one beneficiary is funding an action that is in the interests of all beneficiaries.

7. Another answer to this is to seek to obtain advance costs protection to sue on behalf of beneficiaries, as was done in Jersey in *In re X Trust* [2012] (2) JLR 260. Such a jurisdiction is a controversial one, although one can see circumstances where the sensible course will be for beneficiaries to sue in this way rather than have for example to seek to remove the trustee and have a replacement sue the former trustee.

8. Recently, beneficiaries have sometimes reached for a third option, that of a derivative action on behalf of the trustees or estate. Such relief if granted normally allows a beneficiary to take its costs from the trust or estate as it is standing in the shoes of the trustee or executor and taking the action for the benefit of the trust of estate.

9. The ramifications of that necessarily mean that its limits have been carefully considered.

10. It is worth exploring these, because there are a number of examples of these being used in recent years by individuals who disagree with the actions of trusts or corporations with which they are associated. These actions are important in practice, but often comparatively little explored in the trust context.

11. We will deal with five aspects of such actions, aside from the requirement that the beneficiary show special circumstances disabling the trustee from bringing a claim.

12. The first is the Courts will consider whether the claim should really be brought *against* the trustee. In *McGaughey v University Superannuation Scheme* [2023] EWCA Civ 873, some beneficiaries of a pension scheme sought to bring a derivative claim on behalf of the company set up to administer the scheme against its directors for a number of alleged failings, including relating to their attitude towards fossil fuel investments. The Court of Appeal refused permission to continue proceedings on behalf of the trustee company, holding among things that the claim should have been brought as a beneficiary claim against the trustees: e.g. [178]. The duties that were pleaded in relation to the directors were really in substance duties owed by the trustee to beneficiaries.

13. This does not of itself shut out "dog-leg" claims in relation to single-purpose trust companies in the right case, but it does highlight that the jurisdiction to allow the beneficiary to take over the role of a trustee will be carefully guarded. The trustee remains the primary decision-maker in relation to the trust and this should be reflected in this area as much as it is when considering how the trustee might exercise its dispositive discretions.

14. The second point is that the claimant is going to need to convince the Court that there is a sufficient prima facie case to justify allowing the claimant to sue in the place of the trustee or executor if the trustee or executor disputes this and the matter proceeds to a hearing to determine this. A good recent example of this in the company context is *ClientEarth v Shell plc* [2023] EWHC 1897 (Ch), where a non-profit organisation that held a small number of Shell shares sought to bring on behalf of the company an action against its directors for failing to fulfil their duties to take proper steps to meet the net zero strategy that the company had decided to adopt. The Court held that it could decide at the permission stage that the claims lacked the merit to continue, and took a robust approach to evaluating such claims.

15. The third point is that if there is disagreement between the beneficiaries as to whether an action should be brought in the trustees' name, the views of the beneficiaries should normally be canvassed and a procedural similar to a Beddoe application used to ventilate the different perspectives of the beneficiaries and allow the Court to decide on the appropriate course: *McGaughey* at [83].

16. The fourth point is that the trustee (or executor) must form a view as to how to deal with the derivative action. Sometimes they will consider that it lacks any merit and should not be allowed to proceed. However, some care is needed on their part. The Bermuda Court of Appeal in *Ingham v Wardman* [2022] CA (Bda) 7 Civ criticised the executor for taking sides between the beneficiaries and stated that it should have remained neutral: [26].

17. The fifth point is that such claims, like in the company context, can encompass "multiple" derivative claims, and can be powerful tools in the right case. For example, one situation increasingly being grappled with in litigation over financial instruments and the literature over it is the rights of the holder of an "intermediated security", that is a security held through one or more intermediaries. Where securities are held through an intermediary, there is no relationship between the investor and issuer, only between the investor and its intermediary.[20] There are typically a number of intermediaries in practice and the investor is at risk in the event of the insolvency of an intermediary or misappropriation of the assets held to back the security a number of links up the claim. One answer to dealing with such misappropriation is to seek to bring a multiple derivative claim, given that the analysis one commonly finds in the literature on the topic is that the intermediary at each level has a proprietary interest in the underlying securities so that the investor is a beneficiary under a sub- (or as the case may be, sub-sub or even sub-sub-sub) trust.

Tracing and knowing receipt claims: complex cases and civil law jurisdictions

18. Important cases in recent years have addressed a number of situations of particular complexity which arise in tracing and knowing receipt claims. These are (i) the problem of backwards tracing, in *Federal Republic of Brazil v Durant* [2016] AC 297 and *SFO v Hotel Portfolio II UK Ltd* [2021] EWHC 1273 (Comm), (ii) the availability of so-called "cherry picking" to the claimant in a tracing claim, in *Lapome Ltd v Kemp* [2023] EWHC 1564 (Ch), and (iii) the consequences for both tracing and knowing receipt claims of assets passing through civil law jurisdictions, in *Byers v Saudi National Bank* [2023] UKSC 51.

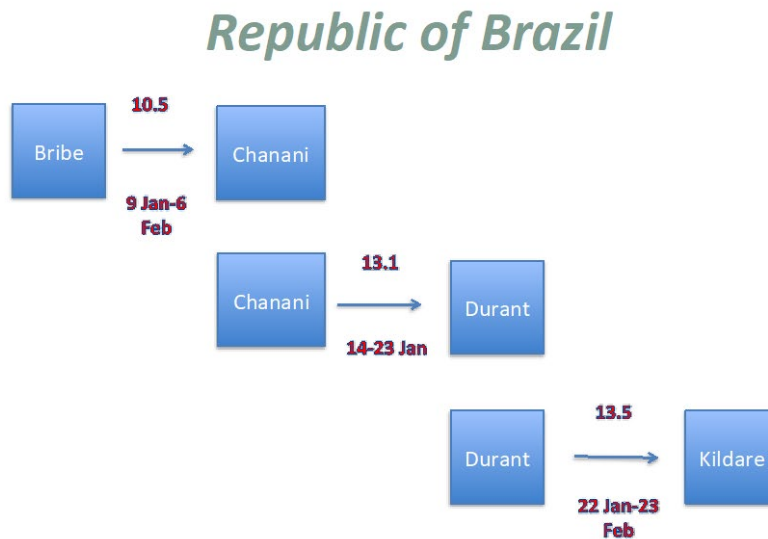
Backwards tracing

19. A wrongdoing defendant may acquire a new asset before receiving the original asset e.g. D may buy a luxury car with his overdraft on day 1, and then pay off the overdraft on day 2 using trust monies.

20. The question in such a situation is whether the victim – in the above case, the trustee and beneficiaries of the trust – can trace backwards in time by establishing a tracing chain that runs through the overdraft. The first link in the tracing chain from the trust would be the day 2 paying off of the overdraft, and the second link the day 1 acquisition of the car. The second link occurs earlier in time than the first link.

[20] E.g. Goode and Gullifer on Legal Problems of Credit and Security (7th ed, 2022) at [6-11].

21. In *Federal Republic of Brazil v Durant* [2016] AC 297, the Privy Council held that the claimant could backwards trace where the acquisition of the new asset and receipt of the original asset were part of the same co-ordinated scheme. There the links in the chain were as follows:



22. This raises the following questions.

23. The first is how broad the concept of a coordinated scheme is. In *Durant*, the existence of such a scheme was admitted by the defendant.

24. The second is how broad the doctrine of backwards tracing goes. Is it limited to tracing through the overdraft as in my example above, or- as the reasoning of the Privy Council might suggest- broader, and if the latter how broad?

25. The third is whether there are policy considerations that could cause a future court difficulty in a less straightforward case. If one expands the circumstances in which one can establish a tracing chain through allowing backwards tracing, one is potentially setting up a competition between two rival victims to the same asset. Therefore, future courts may have to resolve that.

26. In *SFO v Hotel Portfolio II UK Ltd* [2021] EWHC 1273 (Comm), Foxton J held that the present state of English law was that backwards tracing was <u>not</u> permitted, save in certain narrow circumstances, and that those exceptions included:

> *"i) cases where the payment of money through the banking network for the purpose of effecting a payment from A to B involves credits occurring before debits;*

ii) cases in which the debit of trust property and the credit to be traced into were effected as part of a single transaction intended to achieve that outcome through a series of co-ordinated elements, whatever the chronological ordering of those elements…;

iii) cases of anticipatory substitution…where an asset is acquired on the basis of an undertaking that the trust property will be exchanged for it (as, in due course, it is); and

iv) conventional bilateral exchange transactions where the respective transfers are not simultaneous (e.g. Professor Smith's example of the car sale where the price is payable after property in the car passes)." ([46])

27. This is the most detailed summary in English law to date of the law governing backwards tracing.

28. One can see scope for argument in situations where there are competing victims as to the breadth and existence of these categories, in particular where the traceable product of victim A's money is used to buy assets, but there is an intention that victim B's money will subsequently be used to replenish the account such that the misappropriation of victim B's money could be said to be part of a co-ordinated scheme to buy the asset. That is a useful test of how far the test for backwards tracing should go beyond cases where there is a strict asset for asset exchange.

Cherry-picking valuable assets

29. Unsurprisingly, misappropriated trust funds are rarely kept neatly segregated from other assets; instead, a wrongdoing defendant will frequently mix the trust funds with his own money, or that of other innocent third parties.

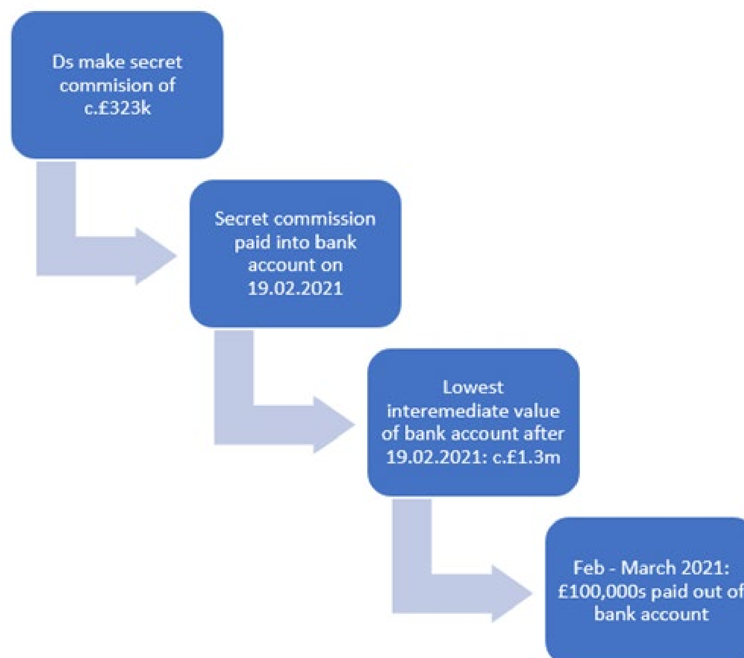
30. The process of tracing through mixed funds is subject to a number of rules, two of which are relevant for present purposes:

    a. Where trust funds are mixed in a trustee's personal account, any expenditure is presumed to deplete the trustee's own funds before those of the beneficiary: *Re Hallett's Estate* (1880) 13 Ch D 696. However, this is subject to the 'lowest intermediate balance rule', whereby if the balance of the account falls below the sum to which the beneficiary is entitled, equity limits a beneficiary's claim to the lowest balance which the account reached between the date of the wrongful deposit and the date of the claim: see *Roscoe v Winder* [1915] 1 Ch 62.

    b. Where mixed funds are used to purchase an asset and the remainder of the mixture is dissipated, the wrongdoer is deemed to have used the trust funds to purchase the asset so that the claimant is able to trace into it: *Re Oatway* [1903] 2 Ch 356.

31. In *Lapome Ltd v Kemp* [2023] EWHC 1564 (Ch), the question arose of whether a claimant is entitled to 'cherry pick' between these two rules so as to trace into assets acquired by the mixed fund despite the lowest intermediate balance remaining higher than the value of the claim. If possible, this may be a particularly potent remedy for a claimant if an asset acquired by the wrongdoer has since appreciated in value, as a claimant with a proprietary claim would be entitled to the benefit of any increase in the value of the trust property.

32. The facts, as illustrated below, arose in circumstances where the lowest intermediate balance of the bank accounts into which a secret commission had been paid (which were treated as a single account for the purpose of the defendants' summary judgment application) had always been considerably higher than the secret commission said to have been received, but the defendants had also paid significant sums out of those accounts which, it was inferred, had been used to acquire assets of appreciating value. The claimants, unsurprisingly, sought to trace into these assets.



33. The defendants argued that, following the decision of Patten J in *Turner v Jacob* [2006] EWHC 1317 (Ch), the claimant was not entitled to 'cherry pick' in this way.

34. The Master declined to grant summary judgment on this basis. In particular, he noted that Patten J had not been taken to *obiter dicta* of Lord Millett in *Foskett v McKeown* [2001] 1 AC 102 at 132 and Rimer J in *Shalson v Russo* [2005] Ch 281 at [144] suggesting that a beneficiary is entitled to trace through whichever part of the mixture he chooses: as Rimer J put it, "*if the beneficiary is not entitled to do this, the wrongdoing trustee may be left with all of the cherries…*". He further noted that a lively academic debate exists, with the majority of commentators preferring the approach in *Shalson v Russo* (although the textbook of which he was himself an editor, *Lewin on Trusts*,

adopts a more sceptical view). In those circumstances, it was not appropriate to summarily determine the claim while the law remained in flux.

35. The debate is therefore one which will have to be determined by a future court. This may involve a court grappling with the following issues.

36. First, it may involve a fundamental reconsideration of the basis of the rules in *Re Hallett* and *Re Oatway*. Consistently with the view that tracing is itself an evidential process, rather than a substantive remedy, these have generally been explained as rules of evidence whereby any evidential doubt is resolved against the wrongdoer. But the types of evidential presumption which it is desirable to draw must depend to some extent on the injustice being addressed. If the concern is simply to reverse the beneficiary's primary loss, there may be little injustice in confining the beneficiary to the rule in *Re Hallett* in circumstances where there is sufficient money for this to provide an adequate remedy. If, on the other hand, the intention is to protect the integrity of the fiduciary relationship, or to vindicate the property rights of the beneficiary, it is perhaps easier to see why the wrongdoer should not get the benefit of any profit made from a mixture in which misappropriated trust funds formed an inherent part.

37. Secondly, the question arises of where the limits of the presumptions lie.

a. In *Re Hallett* itself it was held that evidence that the errant fiduciary intended to spend trust money first would disapply the presumption. But what sort of evidence might suffice? For example, would it be sufficient to show that the trustee would not have spent the sum in question without the cushion of the misappropriated trust funds in his account?

b. What role does temporality play? In *Lapome* itself at [34] the Master suggested that the true ratio of *Turner v Jacob* may be that the claimant is not entitled to trace into property other than that first acquired from the mixed fund after the date of the wrongdoing.

c. In *In Re Tilley's Will Trusts* [1967] Ch 1179 it was suggested that a beneficiary may be entitled to elect to trace into a rateable proportion of property acquired from a mixed fund, thereby entitling them to the benefit of a proportionate part of any increase in value.

d. Do different rules apply in the context of mixtures of physical goods? (see e.g. *Lupton v White* (1808) 33 ER 817).

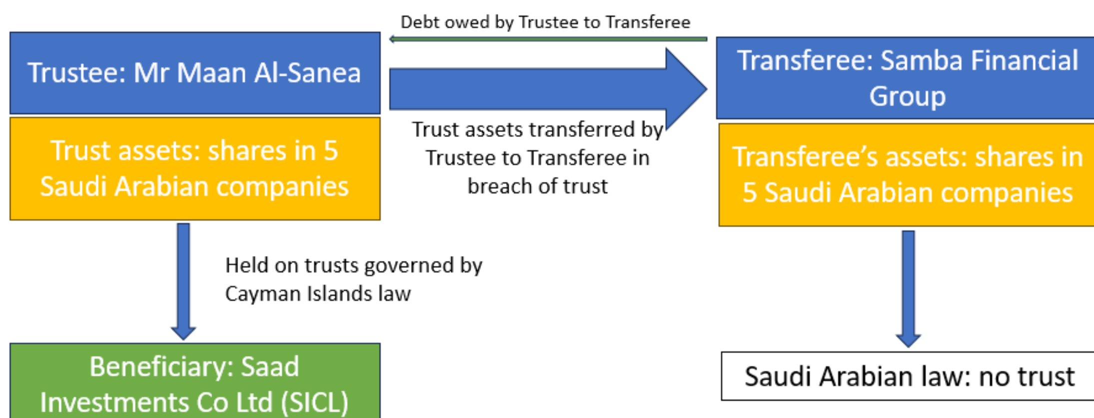
38. Thirdly, whilst the defendants in *Lapome* were errant fiduciaries, should cherry-picking be permissible against innocent recipients, such as those in *Re Diplock* [1948] Ch 524?

Tracing through civil law jurisdictions and knowing receipt claims

39. Traceable assets often pass through numerous transactions after the initial wrongdoing and before a claim is brought. Sometimes this will involve transfers which are located – as a matter of fact or law – in jurisdictions which do not have a law of trusts and which do not recognise the concept of tracing or ownership in equity.

40. The question this gives rise to is whether the recipient in such a case can use the transfer through a non-trust jurisdiction as a defence to a proprietary tracing claim, or to a claim for knowing receipt or dishonest assistance.

41. This was what happened in *Byers v Saudi National Bank* [2023] UKSC 51:



42. The <u>first</u> question is how to deal with transactions which have a foreign *situs*.

43. English law recognises certain transactions as giving an indefeasible title and so necessarily bringing tracing to an end. Bona fide purchase for value without notice is the best known and most important, but others are possible e.g. under the Land Registration Act 2002.

44. English conflict of laws rules apply the *lex situs* to the proprietary effect of transactions. That can be a physical *situs* in the case of land and chattels. Shares have their legal *situs* in the jurisdiction of incorporation. The *lex situs* may have different rules conferring an indefeasible title, and English law will (usually) recognise these, even if they have no English equivalent.

45. This means that English law will recognise the overriding effect of foreign transactions according to the *lex situs*, and where that gives an indefeasible title to a transferee, tracing will cease.

46. Sometimes the law applicable to the transfer may be different from the *lex situs* e.g. the law expressly chosen to apply to a contract. The same applies as in relation to the

lex situs, and after *Byers* the law appears to be that the transferee receives an indefeasible title where the transferee takes free under either the *lex situs* or the law applicable to the transaction (see *Byers* at [21]). That might be thought to go somewhat too far: it is unclear why a law which is not the *lex situs* should confer enlarged proprietary rights.

47. Two possible exceptions are relevant. There is likely to be an exception where the asset comes back into the hands of the wrongdoer: he cannot rely on the legal effect of a prior transaction to deny that he holds the assets on trust. There is probably not now (despite what has been said in earlier cases) a further exception where the asset comes back to England (or other jurisdiction of origin): foreign transactions cannot now be ignored, however inconvenient.

48. The second question is whether this inconvenient result can be avoided by bringing a claim is knowing receipt or dishonest assistance, rather than a tracing claim.

49. In relation to knowing receipt, the Supreme Court in *Byers* says "no": it is an essential element of the knowing receipt claim that the recipient received the property subject to the claimant's "continuing proprietary interest". Because Saudi law gave Samba an indefeasible title, the knowing receipt claim fails for the same reason as a tracing claim would. This is the same result as occurs in England when traceable proceeds are acquired by a bona fide purchaser.

50. In relation to dishonest assistance, there is no problem. It is not a requirement of a dishonest assistance claim that any trust property or traceable proceeds be received *at all*, let alone that the claimant has a "continuing proprietary interest" in them. The hurdles are the usual (high) ones, of establishing both assistance and dishonesty. Neither may be present in some pure receipt cases.

51. Does *Byers* amount to a "*money launderer's charter*"? The Supreme Court thought not, but only because they thought that the law of dishonest assistance (relied upon by Lord Briggs) and the criminal law (relied upon by Lord Burrows) would remain available to deter or pursue wrongdoers. It might be thought that it is indicative of a problem with the law of tracing and knowing receipt if neither can now be relied upon to deal satisfactorily with such wrongdoers.

Compensation, causation and directors' liability in dishonest assistance

52. Two very recent cases have re-examined accessory liability and the equitable remedies that are available, particularly with reference to accounts of profits, both in dishonest assistance (*Hotel Portfolio II UK Ltd (in liquidation) v Ruhan* [2023] EWCA Civ 1120) and in tort (*Lifestyle Equities CV v Ahmed* [2024] UKSC 17).

53. In each case, the Court was confronted with the question of how to deal with an accessory to a principal wrongdoer who had made substantial profit, but where the accessory had not made or retained the same profit. Was the accessory liable, either

in dishonest assistance or in tort, in respect of the principal wrongdoer's profit? Or does the law limit the victim's claim to the profit the accessory has himself made?

54. In both cases the answer was the latter: only the more limited remedy was available. Whilst the factual scenario was quite different in each case, both appear to reflect an underlying trend, namely the English court adopting fairly restrained and (some would doubtless argue, unduly) generous approach to directors who are liable as accessories to their companies' wrongdoing.

55. In *Hotel Portfolio II*, the claimant sold the London hotels it owned for what it understood to be their market value to a company known as Cambulo Madeira, which was controlled by Mr Stevens. It transpired that Mr Stevens (and via him, Cambulo Madeira) was acting as nominee for Mr Ruhan, who was a director of the claimant vendor. When the claimant became insolvent, its liquidator sued Mr Ruhan for breach of fiduciary duty, claiming equitable compensation or an account of profits (at its election), and also sued Mr Stevens for equitable compensation (or an account of profits) for dishonestly assisting Mr Ruhan. Before Foxton J the claims succeeded. The claimant elected an account of profits from Mr Ruhan, and equitable compensation from Mr Stevens. According, Mr Ruhan was ordered to pay £102 million by way of account of profits, and Mr Stevens was ordered to pay £102 million by way of equitable compensation (notwithstanding that his own profit was only some £1.5m).

56. This result – which might be thought rather hard on Mr Stevens – was reached by treating Mr Ruhan as committing two distinct breaches of fiduciary duty: first in abusing his position as a director to make a profit by failing to disclose his interest in Cambulo Madeira; and second in failing to account to the claimant for the proceeds of sale, but rather applying them for his own benefit. Since Mr Stevens was a dishonest assistant in relation to both breaches of fiduciary duty, it was said that he could be liable to pay equitable compensation for the loss caused by Mr Ruhan's second breach, namely the whole value of the profit made.

57. This novel analysis led to Foxton J doing what might be thought to be an "end run" around the long-standing decision of Lewison J in *Ultraframe (UK) Ltd v Fielding* [2005] EWHC 1638 (Ch) that whilst a dishonest assistant can be jointly and severally liable for a loss suffered by a beneficiary as a result of a breach of trust, and liable to disgorge any profit he has made himself, he is not jointly and severally liable for the profit made by the fiduciary which the assistant has not himself made: this conclusion had given Foxton J some pause for thought: see [59]-[60].

58. The Court of Appeal took a fundamentally pragmatic approach, with Newey LJ holding that Mr Stevens was <u>not</u> liable to the same extent as Mr Ruhan. Rather than proceeding on the basis of there having been two distinct breaches of fiduciary duty by Mr Ruhan, which Mr Stevens assisted, it was right to look at the totality of what was done. The two supposed breaches were part of a single scheme, which Mr Ruhan and Mr Stevens were involved in from the start. This scheme in fact caused the claimant to suffer no

loss, since it had in fact (as Foxton J had found) been paid the market value of the hotels it sold.

59. It followed that if the claimant suffered no loss, there could be no equitable compensation claim against Mr Stevens: recovery would always be limited to the loss suffered. Re-asserting the orthodoxy of *Ultraframe*, the Court of Appeal was clear that Mr Stevens could not be liable for Mr Ruhan's profit (having rejected the "two breaches" analysis upon which this depended). All that the claimant could claim from Mr Stevens was his own, much smaller, profit.

60. This decision is therefore a helpful confirmation and re-statement of orthodoxy: equitable compensation is limited to the claimant's actual loss; there is no joint and several liability for an account of one party's profits; and claimants cannot circumvent these rules by recasting a single scheme as multiple breaches entitling them to multiple remedies. In particular, an account of profits cannot be turned into equitable compensation by treating the defaulting fiduciary's handling of the profits he has made into a second and apparently separate breach. Males LJ (at [84]) relied in this regard on the analysis of Brightman J in the trusts case of *Bartlett v Barclays Bank Trust Co Ltd* (Nos 1 and 2) [1980] Ch 515, to the effect that a trustee cannot set off profits and losses from distinct breaches of trust "*unless they arise in the same transaction*". That was the case here.

61. Although not forming part of the *ratio*, some interesting *obiter dicta* of Newey LJ also pave the way for further clarification in relation to equitable remedies.

62. First, Newey LJ considered that breach of the self-dealing rule renders a transaction *voidable* not void, and the same would apply to a breach of fiduciary duty consisting in a failure to disclose (as in the case of Mr Ruhan): see [27]-[29]. It follows that the hotels were not automatically held on constructive trust for the claimant. Rather, the claimant had the right to rescind the sale. This avoids the surprising consequence of the liquidators' argument that the claimant could at the same time be the beneficial owner of both the hotels it had sold and the purchase money it had receive: see [30]. This is plainly right, and accords with the post-*Pitt v Holt* [2013] UKSC 26 of voidability and rescission in equity.

63. Second, Newey LJ also considered (at [71]) that a dishonest assistant can only be liable where the principal wrongdoer is liable to pay compensation. In his view, if the claim against the principal wrongdoer for breach of fiduciary duty is a claim for an account of profits only, there can be no dishonest assistance liability. Whilst Newey LJ may well be right, for the reasons already considered, to think that there should be no accessory liability in relation to dealing with the profits made by the principal wrongdoer in breach of fiduciary duty (see [72]), the wider argument goes too far: the liability of a dishonest assistant is a direct liability based on his own conduct, and does not derive solely from the liability of the principal wrongdoer: see e.g. *Michael Wilson & Partners Ltd v Nicholls* (2011) 244 C.L.R. 427 at [106]. There is no difficulty in principle with the

claimant electing one form of remedy against the defaulting fiduciary, and another against his dishonest assistant.

64. The approach to accounts of profits taken in *Hotel Portfolio II* was recently endorsed in the UK Supreme Court. In *Lifestyle Equities CV v Ahmed* [2024] UKSC 17, the question for the Supreme Court concerned whether the directors of a company which was liable in tort for the infringement of statutory intellectual property rights were jointly and severally liable (the company having gone into insolvent liquidation since it had, in previous proceedings, been ordered to account for the profits it had made from the infringement).

65. Although this case is some way from the assistance liability and equitable remedies for breaches of trust and fiduciary duty with which this section of this paper is concerned, it is notable for two points.

66. First, the Supreme Court was unwilling to impose strict liability on accessories to a strict liability tort. Although a person who did not herself commit the statutory wrong could be liable as an accessory for having authorised or procured the primary infringer to commit the tortious act, or for having participated in a common design with the primary infringer – and directors are not exempt from such liability – strict liability would be unjust; rather, it has to be shown that that it followed that accessory liability in tort required proof that the accessory person knew all the elements of what had been done that made it a tort. This might be thought to reflect a similar hesitance to over-extend accessory liability as was seen in *Hotel Portfolio II*.

67. Second, the Supreme Court also had to consider (albeit *obiter*, having found that the directors were not, on the facts, liable as accessories to the company's tortious infringement) whether an account of profits would be available. It was contended that the directors, if liable as accessories, would be liable to account for the company's profits made from the infringement (and not merely their own). The Supreme Court followed Lewison J in *Ultraframe* and the Court of Appeal in *Hotel Portfolio II* in rejecting this argument: "*it follows from the very nature of the remedy of an account of profits that the only profits for which a person should be ordered to account are profits which they have made, and not profits made by someone else. A person ordered to account for someone else's profits would not be giving up a gain but paying a penalty or a fine*." (Lord Leggatt at [158]).

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