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trusts & probate

If you can recover your cake, your creditors might eat it...

Mr Demirel controlled a group of companies that owned several Turkish banks. The banks collapsed with losses of over $1.2bn. Tasarruf Meduati Sigorta Fonu (Tasarruf) was an entity established by the Turkish state to administer the failed banks. Tasarruf's investigations revealed that Mr Demirel and associates had squirrelled away $726m during their administration of the banks. Tasarruf set about trying to recover what it could, and on 20 November 2001 it obtained judgment in Turkey against Mr Demirel in the amount of $30m, relating to certain fraudulent loan transactions.

Tasarruf discovered that Mr Demirel had established two discretionary trusts in the Cayman Islands, with combined assets of c. $24m. The trust deeds reserved a power to Mr Demirel to revoke the trusts: "this Trust may be revoked, amended, varied or altered in any manner whatsoever from time to time and at any time by the Settlor…"

The Cayman Grand Court Law (2008 revision) section 11(1) applies the Senior Courts Act 1981 section 37(1). That section empowers the court to appoint a receiver "in all cases in which it appears to the court to be just and convenient to do so". With a view to reaching the funds in trust, Tasarruf applied in the Cayman Grand Court seeking the appointment of a receiver by way of equitable execution over the power of revocation, and the delegation of that power to the receiver. The words "equitable execution" here signify that the appointment is: (i) to support the enforcement of a judgment, as opposed to the freezing of assets pending trial, and (ii) that it is a form of equitable relief necessary because common law execution (seizing of goods) is not available.

Smellie CJ in the Grand Court of Cayman dismissed the application, finding that the jurisdiction to appoint a receiver was limited to property and that there was a fundamental distinction between a power and property.

The Cayman Court of Appeal dismissed Tasarruf's appeal, but for different reasons. Mr Demirel had by this time been made bankrupt in Turkey and the court doubted whether, as a matter of policy, it could grant relief on behalf of a single creditor to enable that creditor to procure execution to satisfy its own judgment debt. After those disappointments, Tasarruf finally won the day following an appeal to the Privy Council: *Tasarruf Meduati Sigorta Fonu (Appellant) v Merrill Lynch Bank and Trust company (Cayman) Limited and others (Respondents)* [2011] UKPC 17.

The principal issues considered by the Board of the Privy Council were: (i) whether a power (in this case of revocation) is the property of the donee, and (ii) whether it was possible for a court to order the delegation of the power to the receiver.

The Board's survey of the authorities and commentaries on the status of powers revealed them to be divided. For example, Fry LJ in *Ex parte Gilchrist; re Armstrong* (1886) 17 QBD 521 said: "No two ideas can well be more distinct the one from the other than those of 'property' and 'power'… A 'power' is an individual personal capacity of the donee of the power to do something. That it may result in property becoming vested in him is immaterial; the general nature of the power does not make it property." But Upjohn J, in *Re Triffitt's Settlement* [1958] Ch 852,

said: "where there is a completely general power in its widest sense, that is tantamount to ownership". The Board sided with Upjohn J, finding that "there is no invariable rule that a power is distinct from ownership" and "the powers of revocation are such that in equity, in the circumstances of a case such as this, Mr Demirel can be regarded as having rights tantamount to ownership".

On the issue of whether it would be appropriate to order the delegation of the power of revocation to the receiver, the board distinguished between fiduciary and non fiduciary powers. Where the donee of the power has reposed in her a personal trust and confidence to exercise her own judgement and discretion, then such power may not be delegated (without express authorisation from the donor of the power).

The rule against delegation, however, is inapplicable in the absence of any fiduciary duty reposed in the donee, as where the power is exercisable entirely at the convenience of the donee and in her own interests. The Board found that "the power of revocation cannot be regarded in any sense as a fiduciary power… The only discretion which Mr Demirel has is whether to exercise the power in his own favour. He owes no fiduciary duties".

The Board was satisfied that the policy issue identified by the Court of Appeal was not a bar to the exercise of its discretion. It heard evidence that the power of revocation did not vest in the trustee in bankruptcy under Turkish law. Also, Tasarruf undertook to make any proceeds of the exercise of the power of revocation available to the creditors of Mr Demirel as a whole.

The Board therefore considered that it did have the necessary jurisdiction under section 37(1) to appoint a receiver over a power of revocation and to order the delegation of that power to the receiver. After considering the particular circumstances of the case, it exercised its discretion in favour of Tasarruf and made the orders requested. Mr Demirel may struggle to attract much sympathy. However, one of the many motivations for settlors in the establishment of trusts is a desire to "future proof" wealth by insulating it from claims from creditors that may arise in the future. *Tasarruf* demonstrates that a reluctance to accept absolute loss of ownership, manifested by retention of a power to revoke the trust, may undermine that intention. ■

Creation of a sub-fund may be administration, not variation of beneficial interests

Where, in the administration of a trust, the trustees desire to carry out a transaction that they consider to be "expedient", but find that they do not have the necessary power, either under the terms of the trust instrument or the general law, they may apply to the court under section 57 Trustee Act 1925 for grant of such power as is necessary.

Section 57 provides:

"*Where in the management or administration of any property vested in trustees, any…transaction, is in the opinion of the court expedient, but the same cannot be effected by reason of the absence of any power for that purpose vested in the trustees by the trust instrument, if any, or by law, the court may by order confer upon the trustees, either generally or in any particular instance, the necessary power for the purpose…*"

The principal restraints on the section 57 power are that (i) the transaction must be in the interests of the beneficiaries as a whole, and (ii) the proposed transaction must relate to the administration of trust property. Decisions in several cases in the 1950s established that the section 57 jurisdiction could not confer the power to "eliminate, vary or re-mould dispositions or trusts that the settlor himself has sought to establish" (*Re Downshire* [1953] Ch 218), but was limited to "managerial supervision and control of trust property on behalf of beneficiaries"(*ibid*). The expression "trust property" could not "by any legitimate stretch of the language include the equitable interests which a settlor has created in that property" (*ibid*).

The regime for variation of the equitable interests established under a trust depends on consent. Where all possible beneficiaries of a trust are of full age and capacity, they may consent to a trustee's departure from the terms of the trust. The Variation of Trusts Act 1958 (**VTA**) enabled the court to give approval on behalf of certain categories of persons as were unable by incapacity or otherwise to give their approval to any arrangement varying or revoking all or any of the trusts, or enlarging the powers of the trustees of managing or administering any of the property subject to the trusts.

In *Christopher Southgate & Anor* v *Peter Sutton & others* [2011] EWCA Civ 637 the Court of Appeal

was asked to confer a section 57 power on trustees to create a sub-fund. A group of beneficiaries under the relevant trust was resident in the United States. Along with other UK resident beneficiaries, they had an interest in the income and capital of the whole trust property. The US beneficiaries were exposed to double taxation, which could be avoided by the creation of a sub-fund to be administered by US trustees. The trustees did not have the power to establish the sub-fund, and the Court of Appeal heard evidence that it would not be possible to obtain the consent of all adult beneficiaries, ruling out a VTA application.

There were two potential stumbling blocks in an application under section 57. First, could a transaction designed to mitigate taxation for one group of beneficiaries be "expedient", i.e. in the interests of the trust as whole? Secondly, does the creation of interests in the whole of a part of the trust property, as opposed to shared interests in the whole of the trust property, represent a variation in the beneficial interests?

The Court of Appeal held that the transaction was expedient. It heard evidence of a deepening rift between the US and UK beneficiaries, such that each thought any proposed administration of the trust property favoured the other. The trustees argued that division of the trust property offered a pragmatic solution to that difficulty. This was accepted by the court.

At first instance, Mann J had refused the application, holding that the transaction was a variation of the beneficial interests requiring VTA approval. He had been influenced by *Re Freeston's Charity* [1978] 1 WLR 741, in which Goff J said: "it is manifest that an interest in half the income of an undivided fund is quite different from the whole income of a divided half of that fund". The Court of Appeal distinguished *Freeston*, finding that it recognised only that there "may" be variation in the beneficial interests of a partitioned fund, and that the proposed partition in *Freeston* would have led to "more than an incidental impact on the beneficial interests", whereas here the impact was "incidental only".

Applications under section 57 will turn on their own facts. However, the decision in *Southgate* demonstrated a willingness on the part of the Court to extend its jurisdiction to confer transactional powers on trustees where: (i) there is a plain benefit to a body of beneficiaries, (ii) that benefit cannot be achieved by any other means, (iii) the transaction can be seen to be in the interests of all beneficiaries, and (iv) any potential impact on the structure of the beneficial interests is merely "incidental".

It is notable that the UK beneficiaries were not represented on the appeal. It will be interesting to see what happens should a group of beneficiaries seek to prevent a partition in similar circumstances in reliance on *Freeston* in the future.■

Further information?

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