

UPDATE

How ought a Jersey trustee balance its duties in respect of inter-related trusts?

Update prepared by Stephen Alexander (Jersey)

It is common knowledge that a Jersey trustee may hold office in respect of more than one trust. Indeed a professional trustee may often act as trustee in respect of numerous trusts as part of carrying out its business. Sometimes those trusts are inter-related, forming part of the same, or a connected structure.

This article examines that scenario in the context of the recent Royal Court of Jersey decision in *The Representation of V Trustees Limited re K and N Trusts* [2020] JRC 220 and considers how trustee duties under Jersey law are impacted in circumstances where a professional trustee is trustee of two or more inter-related trusts.

The starting point is Article 31 of the Trusts (Jersey) Law 1984 (the **Trusts Law**). This expressly provides as follows:

- A trustee acting for the purposes of more than one trust shall not in the absence of fraud be affected by notice of any instrument, matter, fact or thing in relation to any particular trust if the trustee has obtained such notice by way of acting or having acted for the purposes of another trust (Article 31(1)).
- A trustee of a trust shall disclose to a co-trustee any interest that they have as trustee of another trust, if any transaction in relation to the first trust is to be made with the trustee of such other trust (Article 31(2)).
- Subject to the general duties of a trustee provided for by the Trusts Law (such as to act with impartiality), a trustee may in their capacity of trustee of one trust enter into a contract or other arrangement with themselves in the capacity as a trustee of one or more other trusts (Article 31(3)).

Recently, the Jersey Court considered the duties of a trustee of inter-related trusts and the practical application of Article 31 in the case of the *Representation of V Trustees Limited re K and N Trusts*. A Jersey trustee had asked the Court to accept the surrender of its discretion and make orders to restructure two inter-related trusts administered by it.

The trusts in question were the Bermudan law governed K Trust and N Trust. The K Trust was established in 1988 when the Fourth Respondent settled funds on trust with V Trustees' predecessor trustee for the benefit of his children, the First, Second, Third Respondents in the proceedings. The Fourth Respondent and his wife were irrevocably excluded from benefitting from the K Trust at the outset. Subsequently, acting as trustee of the K Trust, V Trustees acquired a shareholding in the Fourth Respondent's business. In 1996, the K Trust's stake in the business was sold for £48.3 million, the sale consideration comprising a mixture of cash and loan notes.

In 1999, a significant restructuring took place. The purpose of that restructuring was for the trust fund of the K Trust to be split into two parts. The first part comprising one third of the assets by value was to be retained in the K Trust for the benefit of the Third Respondent. The second part comprising two-thirds of the assets by value being appointed to the N Trust (established by the Fourth Respondent in 1999), for the benefit of the First and Second Respondents. The trustee at that time divided the assets in specie.

The K Trust and the N Trust had a combined value of £53.6 million at the time of the restructuring. The value of the K Trust being £18.7 million. The value of the N Trust being £34.3 million. Broadly speaking, this reflected a one third/two third split.

The family had agreed to this restructuring for tax purposes with the express hope (so it was said) that the trusts could be welded together again in the future. V Trustees was appointed as trustee of both trusts in 2013.

The assets of the N Trust were illiquid and non-income producing. The acquisition of the N Trust assets was financed by a combination of trust capital and bank debt with the investments. Successive re-financing saw increasing borrowing to meet running costs so that by 2010, the predecessor trustees of the N Trust had borrowed £25.6 million. By 2020, some £10.5m of that borrowing came from an unsecured loan by the K Trust.

Thereafter, the First and Second Respondents were irrevocably excluded from benefitting from the K Trust. The K Trust assets were held to produce a lifetime income for the Third Respondent and, although he had no right to capital, he was presumptively entitled to the entire fund. In respect of the N Trust, each of the First and Second Respondent had a defeasible interest in possession of one half of the trust fund, with powers of advancement and subject thereto, the capital and income are held for their children at 25. Their interests were subject to an overriding power of appointment in conventionally wide terms. The Fourth Respondent settlor was excluded from benefitting from both trusts.

By 2020, the increasingly desperate financial situation of the N Trust and the imbalance between its assets and those of the K Trust was apparent. V Trustees recognised that unless terms could be agreed for the debt due to the K Trust to be converted in substantial part into a term loan, valuable real estate held by the N Trust (the sale of which would generate a CGT liability) would have to be sold. Otherwise, there would be insufficient assets in the N Trust to discharge the loan. V Trustees reached this conclusion having first obtained Bermudan law advice, which reached somewhat troubling conclusions that:

- (a) The two trusts could not be put back together again.
- (b) The two trusts could not be rebalanced by the First and Second Respondents being added back as beneficiaries to the K Trust.
- (c) The inter-trust loan in favour of the K Trust could not be written off by the trustee of the K Trust because the Third Respondent (the sole beneficiary of the K Trust) had demanded that it be repaid.

V Trustees asked the Court to accept its surrender of discretion under Article 51 of the Trusts Law and proposed that it be directed to enter into a transaction with itself in its two capacities by which the K Trust would agree to the conversion of the debt to the loan. V Trustees acknowledged that the ordinary self-dealing rule – that a single trustee of two different trusts can enter into dealings with itself in its different capacities – did not apply because the First and Second Respondent were Excluded Persons for the purposes of the K Trust. However, V Trustees submitted that it could enter into that transaction with the approval of the Court, which retained the power to sanction the transaction in the trustee's view. In the alternative, V Trustees asked that the Court direct it to continue to lend funds from the K Trust to the N Trust on an ongoing basis in its capacity as trustee of the K Trust. The V Trustee's rationale was that doing so would allow it to avoid the liquidation of N Trust assets until later date.

The first issue for the Court to consider was one of jurisdiction. Bermudan law governed both trusts, though each was administered in Jersey, as noted above. For this reason, the Jersey Court accepted jurisdiction over the trusts pursuant to Article 5 of the Trust Law¹. Furthermore, the Court accepted that the opinions provided by Bermudan counsel were largely consistent with the equivalent principles of Jersey law. Albeit the Jersey Court found that Section 47 of the Bermuda Trustee Act 1975 (which allows the Court to confer powers on a trustee to implement restructuring in the absence of such powers from the trust instrument(s)) was not relevant in this case given that the desired rebalancing was expressly forbidden.

Having accepted the surrender of V Trustee's discretion, the Jersey Court declined to direct V Trustees, in its capacity as trustee of the K Trust, to enter into the proposed transaction. This was on the basis that the proposed transaction would primarily benefit the beneficiaries of the N Trust, not the sole beneficiary of the K Trust. This, it was considered, would not be a proper exercise of the powers of the trustee of the K Trust.

¹ Article 5 provides that the Jersey Court can make orders not only in respect of (a) a Jersey law trust but also potentially in respect of a foreign law trust where (b) the trustee is Jersey resident; (c) the trust property is situated in Jersey; and/or (d) the administration of the trust property is carried on in Jersey

Loan Forgiveness

There was no question that V Trustees had the power to forgive loans in respect of both trusts. Nevertheless, the Jersey Court found that in order to approve any loan forgiveness, it would need to see that V Trustees had not offended any of the stringent rules surrounding trustee self-dealing. V Trustees would need to demonstrate that it had obtained the consent of all beneficiaries of each trust, which it could not do because the Third Respondent did not in fact consent. This was unsurprising given that to forgive the N Trust's indebtedness to the K Trust would mean that the net value of the N Trust would increase to approximately £17.7 million while the net value of the K Trust would decrease to approximately £8.8 million.

The Jersey Court affirmed that V Trustees was compelled to deal with each trust on its own terms and to avoid the risk of making an apparent sham out of the separation arrangements. The fact that V Trustees had administered K Trust and N Trust alongside one another did not alter or override the fact that they are two separate trusts with different beneficiaries. In respect of determining beneficial interests, the Court accepted that relevant considerations go beyond the purely financial and can include maintenance of good relationships within families. Nevertheless, the Court found, this of itself is not sufficient reason to forgive a substantial inter-trust debt because doing so for such reasons cannot represent a proper use of a discretionary administrative power.

Other Potential Steps

The Jersey Court found that the transfer of assets from the K Trust to the N Trust to enable the latter to settle debts owed to third parties could not be permitted on the basis that V Trustees was essentially conflicted in respect of its respective powers and duties in respect of the two trusts. The Court found that it would need to be satisfied that any proposed transaction was at an arms-length and not commercially disadvantageous to the K Trust. It was very difficult, if not impossible, to see how this could be the case. The principle reason V Trustees was considering the step was to preserve liquidity in the N Trust. The Third Respondent as sole beneficiary of the K Trust had not consented to this course of action and his consent was necessary in order for it to be followed. The Third Respondent was entirely within his rights to demand that V Trustees seek full repayment of the debt owed to the K Trust.

Excluded Persons

The Jersey Court found that V Trustees' proposed course of action was inappropriate for a further reason: not only were the beneficiaries of the N Trust not beneficiaries of the K Trust, they were expressly excluded from benefit under the terms of the latter. The Court could not sanction a transaction designed to facilitate the N Trust's retaining of a particular asset at the expense of depriving the K Trust of the use of those funds to benefit its own beneficiaries for the duration of its term.

For the above reasons, the Jersey Court found that V Trustees could not demonstrate that the proposed transaction was for the benefit of the beneficiaries of the K Trust. The Court also found in favour of the Third Respondent's argument that the V Trustees resign as trustee of the K Trust as a result of the conflict and directed it to do so without delay. The Court directed that the Third Respondent should be given the right to nominate a successor trustee on the basis that he was the sole beneficiary of that trust.

Lessons for trustees of interrelated trusts

The decision in *The Representation of V Trustees Limited re K and N Trusts* [2020] JRC 220, illustrates several key points to which trustees of interrelated trusts must be aware:

- The trustee must exercise the highest level of care and prudence before entering into a transaction between the two (or more) trusts. The Courts will be wary of pursuing alleged overarching family objectives if such objectives threatened to undermine the fundamental principles of the trustee-beneficiary relationship arising in each distinct trust. This is especially the case where material disagreements as to how such objectives should be achieved exist among the family.
- When determining beneficial interests in any restructuring of interrelated trusts, relevant considerations can go beyond the purely financial and can include maintenance of good relationships within families. However, a balance must be struck. In cases where the financial effect of the restructuring is very significant, less weight is likely to be attached relationship factors.
- A trustee should think carefully prior to fundamentally altering a trust with the intention of later reverting the structure to a previous form. Legal advice should be taken on the difficulties and risks of implementing that reversion.

- Finally, a trustee must never entirely lose sight of ordinary commercial principles. That is to say, a trustee must always ask itself the question of whether a proposed transaction is fundamentally disadvantageous to a particular beneficial class.

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