

UPDATE

Grand Court confirms legal test for mental capacity

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The judgment in the Matter of the O Trust, delivered by the Grand Court of the Cayman Islands (Kawaley J) on 23 February 2018, has confirmed, for the first time in a reported judgment in the Cayman Islands, that the essential requirements for establishing mental capacity for the making of a will are the same for the exercise of any other impugned legal power, such as a reserved power of the settlor of a discretionary trust to amend the trust deed to change the beneficiary of the trust. The judgment also confirms that the applicable standard of proof is the civil standard, even where the person who prepared the impugned instrument stands to benefit from it.

Background

The settlor, who had emigrated from Europe to South America in her youth, resided in her adopted domicile without any children or other close family members, apart from her husband who had predeceased her. She established a discretionary trust, which reserved certain powers to her during her lifetime, including the power to amend the trust deed by replacing the beneficiary/remainderman of the trust. The trust deed required that power be exercised in writing and was subject to the trustee's acceptance.

The trust deed initially provided for the settlor's niece and nephew, who lived in Europe, to be the remainderman. Shortly after, the settlor replaced the niece and nephew with the first defendant, a trusted friend.

The settlor again sought to exercise the power by writing to the trustee in July 2012 (the **2012 Letter**), and again, by providing it with a declaration in 2015 (the **2015 Declaration**), both of which confirmed the settlor's request that the second defendant be appointed as the sole remainderman in place of the first defendant. The trustee, which had only recently assumed the role, and had no historic dealings with the settlor, expressed concerns about the settlor's mental capacity, and on each occasion declined to give effect to the settlor's amendment request. Initially, the trustee's reason was that it had difficulties in confirming the settlor's instructions, but the trustee subsequently decided that it would not accept the settlor's exercise of the amendment power as being valid, without the settlor first undergoing a medical or psychiatric examination to determine her capacity.

The settlor, who was 82 years old and suffering from various health issues at the time of the 2012 Letter, was in February 2015 able to travel to Miami to meet with the trustee's representatives. Following that meeting, the trustee required the settlor to undergo a medical examination by an independent physician approved by the trustee. The efforts to arrange such an examination before the settlor returned to South America were unsuccessful, following which the settlor was examined by doctors chosen by her and her representatives. She subsequently issued the 2015 Declaration, but died before the arrangements for an examination by a physician approved by the trustee could be arranged.

The trustee subsequently commenced the proceedings seeking a determination of the following issues:

1. Whether the trustee could, after the death of the settlor, accept an amendment to the trust deed made by her before her death;
2. Whether the 2012 Letter and the 2015 Declaration constituted an exercise of the settlor's power of amendment; and
3. Whether the settlor had the capacity to exercise the power of amendment at the time of the 2012 Letter and the 2015 Declaration.

At a preliminary trial in 2016, Clifford J determined the first two issues in the affirmative and subsequently gave directions for the determination the issue of whether the settlor had the requisite capacity at the relevant times.

Judgment

The Court heard evidence from a number of professional and lay witnesses, including: the trustee's in-house counsel who had sought to verify the settlor's instructions in 2012; the trustee's managing director who interviewed the settlor at the 2015 Miami meeting; the settlor's treating physician throughout the relevant period; an expert psychiatrist who examined the settlor close to the date of the 2015 Declaration; three lawyers who represented the settlor in relation to various legal matters close to the relevant period; the second defendant; the second defendant's husband, who was also the settlor's lawyer who prepared both the 2012 Letter and the 2015 Declaration; and a long-time friend of the settlor called by the trustee. Having heard this evidence, the Court was satisfied that the settlor had the requisite mental capacity to instruct the trustee to amend the trust deed both at the time of the 2012 Letter and at the time of the 2015 Declaration.

In coming to its conclusion, the Court held that the legal test for mental capacity has two dimensions: first, what does the law recognise as the essential requirements for establishing capacity; and second, how ought the test to be applied based on the factual circumstances of the case before the court?

As for the essential requirements, the Court confirmed that the applicable test is the same as that which applies to the determination of capacity for the making of wills and the exercise of any other impugned power. The Court adopted, as being of general application, the following well established principle stated by Cockburn CJ in the English Court of Appeal in *Banks v Goodfellow* (1870) LR 5 QB 549:

It is essential...that a testator shall understand the nature of his act and its effects; shall understand the extent of the property of which he is disposing; shall be able to comprehend and appreciate that claims to which he might give effect.

The Court also accepted, as stated by the English High Court in *Re Beaney* [1978] 1 W.L.R. 770, that the requisite degree of understanding, whether in respect of a testamentary disposition or the exercise of an *inter vivos* power, is relative to the nature and complexity of the transaction in question. Being analogous to a testamentary disposition, in that the exercise of the power would affect the entirety of the trust assets, the Court held that in order for the exercise of the power in the present case to be effective, a high degree of understanding was required.

The Court however counter-balanced against this principle *another important practical legal principle*, adopted from the judgment of the English High Court in *In re Walker (deceased)* [2014] EWHC 71 that the courts generally apply a low evidential threshold for testamentary capacity, so as not to deprive elderly persons the ability to make wills in their declining years. Critically, the Court accepted that mental capacity was *not a black and white issue* and a testator or donor who might suffer from conditions which deprive them of capacity under some circumstances, may, in other circumstances enjoy full capacity. As such, the Court determined that the crucial question was whether capacity existed at the time the relevant instrument was executed.

Applying these principles the Court determined that notwithstanding the fact that the settlor suffered from various health conditions, and may at times have exhibited signs of confusion, and may also have had an imprecise recollection of certain details, including the value of the trust assets, a number of factors supported the conclusion that she had the requisite capacity at the material times. These factors include:

- the settlor's nomination of the first defendant, a trusted local friend, rather than geographically distant relatives as the principal beneficiary shortly after establishing the trust;

- the essentially rational decision to nominate the second defendant, another trusted local friend, to replace the first defendant;
- the fact that the settlor had, shortly before the 2012 Letter, changed her will and made the second defendant the beneficiary of her domiciliary assets instead of the first defendant;
- the fact that the impugned exercise of the power of amendment involved essentially simple assets, being three accounts maintained by one financial institution, and only two individuals, one being substituted for another, neither of whom had a greater moral claim to benefit from the settlor's generosity than the other.

As for the question as to which party should bear the burden of proof, notwithstanding the basic legal presumption of capacity, the Court held that, in the circumstances of the case, the most practical approach was *to require the party positively asserting that capacity existed* to prove that capacity existed. The trustee had taken a neutral position and the first defendant did not appear. The practical burden of proof was therefore held to be on the second defendant.

Another important feature of the case was the fact that the second defendant's husband, throughout the relevant period, acted as the settlor's lawyer, and had drafted both the 2012 Letter and the 2015 Declaration. He could therefore be seen as a person likely to benefit from the exercise of the impugned exercise of the settlor's amendment power. This fact, although constituting grounds for greater scrutiny of the evidence relating to the settlor's capacity, was held not to elevate the required standard of proof beyond the civil standard of a balance of probabilities.

Comment

This decision may well attain the status of preeminent authority in the Cayman Islands on the elements and application of the principles relevant to the determination of mental capacity for the making of wills and for the exercise of all inter vivos powers. The case breaks no new ground in the development of the law on this subject, but trustees and those involved in making decisions based on the existence or lack of capacity will no doubt welcome the clear exposition of the principles and the rigour of the Court's analysis and application to the facts and circumstances of the case.

Mourant Ozannes acted for the successful Second Defendant.

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