The Offshore & International Taxation Review

DISCLOSURE OF TRUST DOCUMENTS

Patrick O'Hagan[1]

1. Two important offshore cases in the area of disclosure of trust documents have been decided in the last eighteen months. February 2001 in *Rosewood v Schmidt* (Court Transcript) saw the Staff of Government Division of the High Court of Justice of the Isle of Man, the highest court of appeal on the island, examine to whom a duty to disclose trust documents is owed. Earlier, in May 2000, the Royal Court of Jersey in *Re the Rabaiotti Settlement* [2000] 2 ITELR 763 considered the nature of this right and whether trustees must disclose the contents of a letter of wishes to beneficiaries.

Disclosure and Discovery

2. The outcome of these cases has favoured the trustees in their tussles with beneficiaries over disclosure of information. This statement must, however, be tempered by reference to the distinction between disclosure of trust documents to beneficiaries, which by itself has nothing to do with attacks on trustees or litigation, and discovery of documents as a right of a plaintiff (or other litigant) in litigation. As Sir Robert Megarry intimated ((1965) 81 LQR 196) shortly after the decision in *Re Londonderry* [1965] Ch 918, discussions about beneficiaries rights to *disclosure* may be academic if a plaintiff beneficiary is entitled to discovery. With the exception of documents which are subject to legal professional privilege, upon discovery, all documents, including deeds, accounts, trustees minutes (whatever they may disclose in terms of reasons for the exercise of discretion) and letters of wishes, indeed everything relevant and material to the action, held by the trustee must be listed and disclosed to an attacking beneficiary.

3. The only solace from a trustee's perspective is that a plaintiff beneficiary will have to establish a *prima facie* case in order to obtain discovery. The

1 Patrick O'Hagan is Head of Trust Product at UBS, AG Private Banking in Zurich, Switzerland. UBS AG P.O. Box 8098 Zurich Tel: +41 1 234 23 81 Fax: +41 1 234 42 28. E-mail patrick.ohagan@ubs.com

discovery process itself cannot be used to provide the information upon which a claim can subsequently be mounted (*Re Londonderry; Hartigan v Rydge* (1992) 29 NSWLR 405).

4. Trustees should also bear in mind that beneficiaries may sometimes obtain documents to which they would otherwise have no entitlement indirectly, through the appointment of a new trustee. (*Tiger v Barclay Bank* [1951] 2 KB 556).

Rationale for the Rule on Disclosure

5. In the House of Lords' decision of *O'Rourke v Darbishire* [1920] AC 581, the right to information of beneficiaries was stated to rest upon their proprietary rights. Lord Wrenbury observed that a beneficiary is entitled to see trust documents because they "are in a sense his own". This dictum was adopted by Salmon LJ in *Re Londonderry*. However, a proprietary right as the basis of a right of disclosure has been subject to considerable criticism. In his seminal paper "The Irreducible Core Content of Trusteeship", in Oakley's *Trends in Contemporary Trust Law* (1996) page 5, Professor David Hayton observed that the "beneficiaries" rights to inspect trust documents are now seen to be better based not on equitable proprietary rights but on the beneficiaries' rights to make the trustees account for their trusteeship.

6. This move away from proprietary rights was approved in both the Isle of Man and in Jersey. In *Rabaiotti* the Jersey court approved the language of the Jersey Law Commission Consultation Paper No. 1 (Hochberg and Norris) which in turn had adopted Professor Hayton's analysis. The Isle of Man appeal court, having re-examined *O'Rourke v Darbishire* and *Londonderry,* concluded that "the existence of a proprietary right is a sufficient, but not a necessary, justification to obtain disclosure of trust documents". The move away from a property analysis is welcome as it is artificial and it fails to address the problem presented by beneficiaries of discretionary trusts who individually have no proprietary interest.

***Rabaiotti* - Is the Right to Disclosure Absolute?**

7. The Jersey decision examines the nature of the right of disclosure and what documents have to be disclosed. One of the beneficiaries of the four trusts in question was going through a divorce in England and had had served on

him an order to make discovery of various trust papers including the letter of wishes of his late father as settlor of the trusts. Two of the trusts were governed by BVI law but administered in Jersey whilst the remainder were governed by Jersey law. The court accepted that BVI law was on all fours with the law of England. The trustees sought directions of the court upon whether to make disclosure in the terms sought by the beneficiaries under general equitable principles (the law of England) and under Article 25 of the Trusts (Jersey) Law 1984.

8. The court confirmed that it had discretion to permit the trustees to refuse disclosure in certain circumstances as there is no absolute right to disclosure either in equity or under Article 25 of the Jersey statute. In this regard, the court followed the 1992 decision of the Grand Court of the Cayman Islands in *Lemos v Coutts* [1992-93] CILR 26 where the Cayman court permitted the trustees not to make disclosure of accounting documents to beneficiaries who were attempting to set aside a trust. This same principle was applied again recently in *Rouse v IOOF Australia Trustees Ltd* (1999) 2 ITELR 289, a decision of the Supreme Court of South Australia. In that case where trustees were involved in litigation a small hostile group of beneficiaries failed in an attempt to obtain copies of the trustees' witness statements, expert reports and legal advice. The Australian court permitted non-disclosure on the grounds that the information was confidential and that it was in the interests of the beneficiaries as a whole not to disclose.

9. Two points in the judgment of the Jersey court should be noted; first, the presumption is that disclosure should be made to beneficiaries upon their request. Secondly, if the trustees do not wish to disclose they must seek the directions of the court upon whether to make disclosure. If the trustee fails to seek the directions, it is open to any beneficiary to bring the matter before the court which will balance competing interests and make a decision in the interests of the class of beneficiaries as a whole. In this regard there was a divergence of views from *Rouse* in which the Australian court suggested that the proper remedy is to remove the trustee

Should Letters of Wishes Be Disclosed?

10. Letters of wishes are immensely important documents in offshore trusts. Invariably, pro forma trust documents are used so that apart from changes of names of settlor and of the class of beneficiaries, all the trust deeds of an institutional trustee will be virtually identical. Letters of wishes, however, differ enormously from trust to trust. They are loosely drafted, eschew

legalese, outline the reason for the creation of the trust and the hopes and aspirations of the settlor. They are the tinderwood of potential litigation.

11. The court in *Rabaiotti* was also asked to consider whether a letter of wishes was a trust document which should be disclosed to beneficiaries. The only other case on letters of wishes up to that time was the 1992 decision of the Court of Appeal of New South Wales in *Hartigan Nominees v Rydge* (1992) 29 NSWLR 405. In *Hartigan*, the letter of wishes of Sir Norman Rydge was not disclosed to beneficiaries for two reasons. First, it was implicitly held to be confidential. In *Londonderry*, it was stated that one of the principal reasons for the exercise of discretion were not to be disclosed because they could, inter alia, lead to family disharmony. The judges in *Hartigan* concluded that a letter of wishes might contain personal matters of a nature likely to give rise to internecine disputes against which the English Court of Appeal sought to protect both trustees and family members. The Jersey court followed this approach. Thus, a letter of wishes will only be disclosed in exceptional circumstances at the discretion of the court. In the instant case disclosure was considered to be in the interests of the class of beneficiaries as a whole to avoid the English divorce courts obtaining an incorrect and exaggerated notion of extent of the likely distributions to the settlor's son.

Rosewood - Trusts and Powers; To Whom must Disclosure be Made?

12. *Rosewood* concerned an attempt by the discretionary object of a power to obtain trust documents to enable him to consider whether to bring an action for breach of trust against Rosewood Limited, an Isle of Man trustee. At first instance it was conceded by Counsel for the trustee that the object had the same rights to accounts and other trust documents as any beneficiary. On appeal, however, the pleadings were amended with leave to enable the trustees to contend that the object of a power had no such rights.

13. A short digression may assist at this point. It is clear that beneficiaries with fixed interests in capital or remainder have rights including the right to call for disclosure of information. Similarly, those with a contingent interest upon termination of the trust (often referred to as ultimate beneficiaries) have rights to disclosure of information. This right exists even though the contingent right is subject to defeasance if the trustee exercises a power in favour of the object. In offshore trusts, language in this sphere is loosely employed; frequently, those to whom trustees can make distributions at their discretion are simply referred to as the "beneficiaries". This term, whilst

perhaps not inaccurate, is not sufficiently precise. To understand the decision in *Rosewood*, we have to distinguish between the various types of powers.

The Nature of Dispositive Powers

14. Dispositive powers take three broad forms. The first category includes powers exercised by non-fiduciaries, "a non fiduciary mere power". Such a power is not subject to any duty and the holder of the power can simply ignore it and not consider its exercise. A common example of such a power is one retained by the settlor or granted to his widow upon his death.

15. Then come two different classes of powers where the holder of the power is a trustee or other fiduciary. The first of these fiduciary powers can be called a "fiduciary mere power", where the trustee must consider whether to exercise the power and must act properly, *but is not subject to any obligation to actually exercise the power*. Secondly in this category come "trust powers" where the trustee must exercise the power but can decide upon when and in whose favour it will be exercised. These are true "discretionary trusts" where the trustee must make a distribution of income or capital or of both.

16. In offshore trusts, there is invariably, a class of objects, who are generally called "Beneficiaries" or "the Specified Class" to whom trustees may at their absolute discretion make distributions. Strictly speaking, these then are objects of a fiduciary mere power. There is rarely in offshore instruments a requirement to make a payment to one or more members of the class of objects, so that there rarely is a trust power or a discretionary trust properly so called.

17. What one frequently, although not invariably, sees is that the contingent beneficiaries who will take on termination are the beneficiaries or members of the Specified Class living on the date of termination. This is not always the case. It is by no means uncommon to have totally different people named as the ultimate beneficiaries or to have a specific charity or charity in general specified. Indeed, *Rosewood* took the latter form, with several Russian businessmen with links to Lukoil, a large Russian Energy concern named as discretionary objects whilst the Royal Lifeboat Institute was named as the ultimate default beneficiary. Could the members of the discretionary class as fiduciary mere objects require disclosure of information?

18. Two approaches can be adopted to answer this question. The first equates the rights of fiduciary mere objects with objects of a trust power or a discretionary trust properly so called and requires disclosure by the trustee to the object. In the Irish decision of *Chaine-Nickson v The Bank of Irelan*d [1976] IR 393 Kenny J, (as he then was) held that "a potential beneficiary under a discretionary trust is entitled to copies of the trust accounts and to information as to the investments which represent the trust fund. The obligation of the trustees is not satisfied by giving particulars of the payments made by them". If it were otherwise, the possibility arises that the trustees may not be accountable to anyone for their actions. Information must be given to the objects to render the trustees accountable and to enable the objects to "police" the trust.

19. Similar reasoning guided Powell J, in *Spellson v George* [1987] NSWLR 300 where he stated:

> "The question then is, whether a person whose status is only that of a potential object of the exercise of a discretionary power can properly be regarded as one of the cestui que trust of the relevant trustee. I do not doubt that he can, and should properly be so regarded, for although it is true to say that, unless and until the trustees exercise their discretion in his favour, he has no rights to receive, and enjoy, any part of the capital or income of the trust fund, it does not follow that, until that time arises, he has no rights against the trustee."

The Narrow View?

20. The narrow view that the rights of mere objects are very limited is generally attributed to Templeman J (as he then was) in *Re Manisty's Settlement* [1974] Ch 17 where, basing himself on, inter alia, dictum of Lord Hodson in *McPhail v Doulton* [1971] AC 424, the learned judge observed (at page 25):

> "If a person within the ambit of the power is aware of its existence he can require the trustees to consider exercising the power and in particular to consider a request on his part for the power to be exercised in his favour. The trustees must consider this request and, if they decline to do so or can be proved to have omitted to do so, then the aggrieved party may apply to the court which may remove the trustees and appoint others in their place. This, as I understand

it, is the only right and only remedy of any object of the power."

England

21. The matter of the rights of mere objects to trust documents had never been directly addressed in English law until *Murphy v Murphy* [1999] 1 WLR 282 in which Neuberger J. appears to have equated the rights of fiduciary mere objects with those of trust objects. *Murphy* was a case where a plaintiff sought information in relation to the identity of trustees of three trusts. He was an object of a discretionary power of the first settlement He may have been the object of a discretionary power or a discretionary beneficiary of the second. He was not a beneficiary of the third, but he had settled it.

22. Although it is not entirely clear, Neuberger J appeared to regard the plaintiff as the mere object of a power of the first settlement. Basing himself in part on *Chaine Nickson* and in part upon common law requirements of a third party to disclose information to a potential litigant, he was prepared to develop equity to ensure that the identity of the trustees would be disclosed to the plaintiff. It should be noted, however, that no order to disclose was made against the trustees as such. Rather, the order of the court in relation to the first trust was that a third party (the plaintiff's father) should disclose the identity of the trustee to the plaintiff. This does not go as far as requiring disclosure of information by the trustees. It does, however, enable the object to request the trustee to consider his application for a distribution and is, therefore, in keeping with the dictum of Templeman J in *Re Manisty's Settlement*. Furthermore, and significantly, the right of different classes of object to disclosure of information was not argued before the court as Counsel for the defendant conceded the point. For the appeal court of the Isle of Man this concession undermined the decision in *Murphy* as persuasive authority.

***Rosewood* - Isle of Man**

23. In *Rosewood*, neither *Murphy v Murphy*, nor *Spellson v George* nor *Chaine Nickson v The Bank of Ireland* were followed. On the basis of the dictum of Templeman J in *Re Manisty* and of Lord Hudson in *McPhail v Doulton*, the court concluded that the rights of an object of a power are limited to requiring the trustee to consider the exercise of the power in the object's favour and that only the person or entity to whom the trust results in default of the exercise of such power has the power to object to any wrongful

exercise of the power and to obtain an account of the trustees' stewardship of the trust assets. The court suggested that the issue of disclosure of information was synonymous with *locus standi* and stated: (page 26 of transcript).

> "We accept that our conclusion may result, as [Counsel] submitted, in cases where assets are held on the terms of a lengthy discretionary trust period, in a situation where, until towards the end of the primary discretionary period where substantial assets remain unappointed, there may well be no persons or entity with both the legal standing and the economic interest to hold the discretionary trustee to account."

24. Cayman STAR trusts were innovative, in part because they could be used to remove the equitable right to enforce the trust from the beneficiaries. If this decision is correct, then it confirms the view stated on several occasions by Professor Hayton ('The Irreducible Core Content of Trusteeship', *ibid*; Exploiting the Inherent Flexibility of Trusts' [1999] JTCP 69 at 79) that it is possible to create a blackbox trust in favour of (i) a class of mere objects who have no right to disclosure nor *locus standi* to bring an action against the trustee and (ii) ultimate beneficiaries who are not currently living.

25. The idea of a trust without an enforceable beneficiary is not novel. It is possible for X to transfer property to trustees upon trust for X's great grandchildren living at the end of the applicable perpetuity period. The validity of such a trust is not effected by X not having grandchildren. However, there may be a distinction between such a trust and one where there are living mere objects who wish to "police" the trust. It may be, as Professor Hayton has suggested, that it is ultimately a matter of construction to determine the intention of the settlor which may turn, among other matters, upon the size and identity of the class of objects. If a settlor who has created a trust with a small class of mere objects wishes to ensure that they have no rights to information nor remedies under the trust then he should expressly say so.

26. It cannot be certain, however, that the dictum in *Re Manisty's Settlement* exhaustively sets out the right of objects of a fiduciary mere power. Even, assuming that it is correct that mere objects do not have the right to call for information, it does not follow that they cannot seek remedies against the trustees. If there is excessive execution of a power so that it is improperly exercised, e.g., if improper conditions are annexed, or excessive interests are granted, then why should the only possible complainant be a default

beneficiary? Similarly, if there is a fraud on the power why shouldn't the object of the power also have *locus standi* to complain to the court? As the learned author of *Thomas on Powers* observes, both the object of a power and discretionary object of a discretionary trust have a hope or expectancy which they have a right to defend (see, paragraph 9.14 9.15). Of course, the matter becomes circular because if it is accepted that they have standing to seek a remedy, should they not have rights of disclosure to enable them to determine if their expectancy or hope has been so prejudiced?