IN THE GRAND COURT OF THE CAYMAN ISLANDS

CAUSE NO. 576 OF 2005

3-8-09

IN THE MATTER OF THE MENTAL HEALTH LAW

RE MRS. D

IN CHAMBERS
BEFORE THE HON. ANTHONY SMELLIE, CHIEF JUSTICE
THE 20TH AND 24TH JULY 2009

Appearances: Mr. Christopher McCall Q.C. instructed by Mr. Hector Robinson of Mourant for two of the guardians of Mrs. D

Mr. Neil Timms, instructed by Mr. Lee Freeman of Priestley's for Mr. D

Mrs. Warnock Smith Q.C., instructed by Ms. Sara Collins of Maitlands for the children of Mrs. D

RULING

1. Before me is a summons brought by Mr. B and Mr. C in their capacities as two of the Guardians of Mrs. D appointed by order of the Court on 22 December 2005 following the mental incapacitation of Mrs. D.

2. The two guardians seek directions as to whether and, if so, what provisions should be made out of the estate of Mrs. D:

   (i) In respect of any potential tax liabilities of Mr. D arising out of the proposed release of his contingent income interest under the Family Trust; and

(ii) In respect of the costs of all parties of and incidental to Cause Nos. 557 of 2008 and 128 of 2009.

3. This application arises against the background of many years of disagreement and disharmony within Mrs. D's family in relation to the Family Trust of which she is the primary beneficiary. This has engendered litigation in this jurisdiction, currently in two other jurisdictions; and the threat of litigation in other places.

4. Fortunately, before incapacitation, Mrs. D became a party to what is now generally referred to within the family as a "Peace Accord" – a written memorandum between the discordant branches of the family by which it was agreed, among other things, that all litigation involving family members anywhere in the world must cease (hereinafter "the Agreement").

5. As a central focus of contention had been the contingent beneficial interest of Mr. D under the Family Trust (and its offshoots, the X and Y Trusts), the Agreement provides for the modification and/or restructuring of the Trusts to eliminate beneficial interests in favour of Mr. D, who is also a party to the Agreement. Instead, Mr. D will be provided with an annuity.

6. Understandably, Mr. D who is a foreign taxpayer, requires that he should be indemnified as against any possible income or gift tax for which he may become liable as a consequence either of the Agreement itself or of the relinquishment of his interests under the Trusts in favour of others or further; as the consequence of the relinquishment of a judgment debt against Mrs. H - one of Mrs. D's three daughters – obtained in another jurisdiction in respect of litigation costs.

7. Mr. D has however taken advice from foreign Tax Counsel regarding the possible tax implications and believes that, at the least, he has a reasonable basis for taking the position that neither the Agreement under which there are to be exchange of interests (as only partially described above) nor any transactions forming a part of that exchange would result in his being liable for foreign income and/or gift tax. It is therefore only because of any small possibility, of such liability arising, that the indemnity is required.

8. It seems that under the foreign law, a transferee of a benefit may also become liable for any taxes the transferor incurs arising from the transfer. So, the daughters of Mrs. D, who, as secondary beneficiaries under the Trusts, may be regarded as the transferees or beneficiaries of Mr. D's relinquishment of his interests, could have imposed upon them a transferee liability for any taxes payable by Mr. D.

9. Again, remote though the possibility of liability to gift tax may be, the proposed indemnity will cover them as transferees, as well.

10. Based on tax advice, a maximum amount of potential income tax liability has been identified and so the proposed indemnity sets a limitation on liability of USD1.733 million. A maximum liability of USD3.6 million has been identified in respect of gift tax, but that liability is seen as so remote that no provision is to be made for it within the proposed indemnity. Instead, Mr. D is prepared to accept an unsecured indemnity in that amount.

11. The matter is before me for the giving of directions for the entering into the secured indemnity agreement ("the Indemnity") on behalf of Mrs. D by Mr. B and

Mr. C, as her court-appointed guardians. Mr. D, who is a also court appointed guardian, is obviously recused by conflict of interest but Mr. Timms informs me on his behalf, that the proposed directions would have his support. And while Mrs. D's Committee of Guardians also includes two of her three daughters, they too are precluded from joining in this application by their conflict of interests as transferees of interests under the Agreement.

12. The real difficulty, to put it bluntly; is that the potential liability under the Indemnity, such as it may be, is to be entirely assumed by Mrs. D or her estate. It is not to be shared by her daughters who would be, through their respective family trusts, the eventual beneficiaries of the relinquishment of Mr. D's interest.

13. I am told by Mr. B in his third affidavit that, after extensive negotiations and investigations, this is to be regarded as necessarily the case. On the advice of leading counsel Mr. McCall Q.C., Mr. B posits, as a primary factor for my consideration; that in considering what other party may have been expected to bear the burden of any tax, Mrs. D would have taken into consideration the fact that she, as the primary beneficiary of the various family trusts, has the means from which to offer assistance.

14. The Court's approach to an application such as this involving a transaction on the part of a person under guardianship is governed by sections 13 and 14 of the Mental Health Law (1997 Revision).

15. In this case, the transaction concerned and as described above, is the provision, in the context of securing family harmony, of an indemnity to or for the benefit of immediate family members in respect of potential liabilities which they may face.

16. Sections 13 and 14 bear being set out in full for the sake of examining the nature of the jurisdiction which they confer:

> *"13. In the case of –*
>
> *(a) a patient under this Law; or*
>
> *(b) a person in respect of whom the Grand Court has appointed a guardian under section 14 of the Grand Court Law (1995 Revision) and has thereafter found upon examination to be a person incapable of managing his own affairs,*
>
> *the Grand Court may, with respect to the property and affairs of such person, do or secure the doing of all such things as appear desirable for the maintenance or benefit of such person, of his family, of those for whom he might be expected to provide if he were not mentally disordered and for otherwise administering his affairs but shall, in so doing, have regard to the interests of creditors and obligees and to the making of provision for them notwithstanding that the relevant debts and obligations may not be legally enforceable.*
>
> *14. In the exercise of its jurisdiction under section 13, the Grand Court may, on behalf of a patient or person under guardianship –*
>
> *(a) Arrange for a person or persons to –*
>
> *(i) manage, sell, acquire, charge or deal with property;*
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> *(ii) enter into any settlement;*
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> *(iii) provide for the management of a business;*
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> *(iv) dissolve a partnership;*
>
> *(v) complete a contract;*
>
> *(vi) conduct legal proceedings; and*
>
> *(vii) act as trustee; or*
>
> *(b) appoint a Receiver.*

17. Mrs. D is a person under guardianship by virtue of section 13(b) as this Court has appointed guardians for her; being a person incapable of managing her own affairs. Her guardians now seek directions which would allow them to enter into a settlement pursuant to section 14(a) (ii).

18. Section 13 identifies two sets of circumstances under which the Court may act. The first is where it is desirable for the maintenance or benefit of three distinct classes of persons:

(a) the patient or incapacitated person herself;

(b) that person's family; and

(c) those for whom the person might be expected to provide if he or she were not mentally disordered.

19. The second set of circumstances in which the Court might act would not necessarily involve consideration of benefit to any of those three classes of persons but where it would be desirable to do so "otherwise [for] administering the affairs of the person".

20. The jurisdiction vested by section 13 is therefore cast in very wide terms: in either of the two sets of circumstances identified – where it is desirable for the benefit of persons in any of the three classes – or those where it is otherwise desirable to do so; the Court may act with respect to the property and affairs of the person.

21. Notwithstanding the legislation in England (in the Mental Health Acts of 1959 (sections 101-103) and of 1983 (sections 94-96)) having been in nearly identically broad terms, case law there developed which circumscribed the jurisdiction. This

was divined by the perceived need for the Court to identify a "lucid interval" during which it was to be assumed that the patient became of sound mind for sufficient time to review the issues to be determined and so in which the patient's wishes might be discerned by the Court. The Court could then direct action to be taken in respect of the patient's property or affairs being informed by the views to be so attributed to the patient.

22. It was first so decided in ***In RE L (W.J.G.) [1966] 1 Ch. 135.*** In that case, the applicant –the only surviving sister of the patient and the receiver of his estate and two nephews and a niece of his – children of a deceased sister – sought an order under sections 102 and 103 of the Mental Health Act 1959. They sought that the order should direct the receiver to execute, in the name of and on behalf of the patient, an irrevocable voluntary settlement of a substantial part of his property, the beneficiaries of which would be collateral relatives of the patient (including the nephews and nieces) and a stranger in blood who had befriended the patient.

23. The patient's mind had become affected when he was about 17 years of age. He was at the time of the application 68 years of age and had been in a hospital for 14 years since the death of his mother who had looked after him. He was in an advanced stage of mental deterioration and there was no prospect of his recovery. The patient owned property worth about £130,000 derived from relatives who had died intestate and from increases in value and accumulations of surplus income. The average cost of his maintenance was about £200 per year. One of the objects of the application was the saving of death duties which could only be achieved if the settlement were made irrevocable.

24. It was held firstly that, as on the true construction of section 102 of the 1959 Act, nieces and nephews were "collateral relatives" (as so defined in ***In RE D.M.L. [1965] 2 All. E.R. 129***) and not "members of the patient's family" within the meaning of the section, the Court must be satisfied that they, as the proposed beneficiaries were "***other persons...for whom...the patient might be expected to provide if he were not mentally disordered by way of inter vivos settlement in the manner and to the extent contemplated***".

25. Secondly, that, in determining that question, ***"it must be assumed that the patient became of sound mind for a sufficient time to review the situation but knew that after a brief interval he would relapse into his former condition"***.

26. Thirdly, that "***the settlement of any property of the patient***" in section 103(1)(d) [(the equivalent of the local section 14(a)(ii))] covered an irrevocable settlement and on the above assumptions, there could be no doubt that the patient would have executed an irrevocable settlement of a substantial part of his property with a view of the avoidance of death duties, and that the proposed beneficiaries all being persons for whom the patient might be expected to provide if he were not mentally disordered, the Court was empowered to give a direction of the character desired by the applicants.

27. In the present case, the persons to be benefited are, of course, firstly and naturally the patient herself. Secondly, the members of the immediate family – her husband Mr. D. and her daughters, her closest living relatives.

28. That being so, the requirement that the Court should assume that she "***became of sound mind for a sufficient time to review the situation***" (the so-called "lucid

interval") for the purpose of discerning what she might wish to do would not apply. It is a requirement that would apply to the third category of persons who may be regarded as collateral family members.

29. I am advised by Counsel for the applicants and the husband that the "lucid interval" test is to be nonetheless applied because of the widened ambit given to it by Sir Robert Megarry V.C. in his discussion of the matter ***In Re D [1982] 1 Ch. 237*** – an ambit which subsequently came in the English case law to govern the approach to the determination of all questions of benefit under section 102 as a whole (and its successor section 94 of the Mental Health Act 1983); not just the question of benefit to those persons who may be called "collaterals".

30. The advice that I should adhere to the lucid interval test is given notwithstanding that it has been swept aside by legislative reform in England itself in the form of the Mental Capacity Act 2005, in favour of an approach based on what may be a determination of what is in the patient's "best interests". This is so in England although that determination shall be reached pursuant to section 4 of the 2005 Act by, among other things, the court having regard to different and more objectively ascertainable considerations – the patient's past and present wishes and feelings; the beliefs and values that would be likely to influence his decision if he had capacity; and the other factors which he would be likely to consider if he were able to do so.

31. The widened ambit which had been given to the lucid interval test in ***In Re D*** by Megarry V.C. was given upon the apparent assumption that the same approach should be taken to the Court making a will for a patient (in exercise of powers

under section 103 of the 1959 Act) as had been taken by Cross J in ***In Re L*** (above) in determining – under section 103(d) – that the entering into the settlement to benefit collateral persons coming within the category of section 102(c) (as persons whom the patient may be regarded as wishing to benefit) would be something which the patient would wish to do. This is apparent from the following passage from ***In Re D*** (at p243 letter D):

> ***"The first of the principles or factors which I think it is possible to discern is that it is to be assumed that the patient is having a brief lucid interval at the time when the will is made. The second is that during the lucid interval the patient has a full knowledge of the past, and a full realisation that as soon as the will is executed he or she will relapse into the actual mental state that previously existed, with the prognosis as it actually is. These propositions emerge; I think, from the judgment of Cross J in In Re L (W.J.G.) [1966] Ch 135, 145. In that case the judge was dealing with the making of a settlement for the patient, not a will: but I cannot see that the distinction matters. Paragraph (dd), dealing with wills, has been inserted immediately after paragraph (d), dealing with settlements and gifts, and both are governed by the same general statutory provisions."***

32. It must now however be frankly recognised that the distinction does matter. Cross J's proposition – the lucid interval test – was developed in the context of his seeking to devise a settlement which reflected the notional views and wishes of a

settlor as to the bestowment of his bounty upon collateral relatives – that category of persons identifiable within the third category of our Law and paragraph (c) of section 102 of the 1959 English Act. The lucid interval test was not proposed to be applicable to the patient/settlor himself (category (a)) or to his immediate family (category (b)). The statutes rather appear, at least prima facie, to assume that those are categories of persons for whom the patient would wish to provide and so would wish to benefit, by the bestowment of his bounty. As much is to be gleaned from an earlier judgment of Cross J. himself, in the case of ***Re D.M.L.*** (above). The question before the Court in that case was whether provision should be made from the patient's funds to purchase life insurance policies on the life of the patient, one for the benefit of each of her 22 nieces and nephews; the policies being such as to be treated as settlements by themselves, for the purpose of estate duties.

33. In deciding that the proposed beneficiaries were "collaterals" who therefore had to satisfy the Court that they each came within category (c) – as a person for whom the patient might be expected to provide if she were not mentally disordered – Cross J. clearly distinguished their position from that of persons coming within the class of family (category (b)) in these words:

> ***"The Act of 1959 does not contain a definition of the word "family". The contrasting language of paragraph (b) and paragraph (c) of section 102(1) suggests to my mind, that the legislature considered that the word "family" consisted of***

persons for all of whom the patient might prima facie be expected to make some provision. This, I think indicates that the word does not include collateral relatives such as these nephews and nieces."

34. Accordingly, Megarry VC's wider application in ***In Re D*** of the lucid interval test for the purposes of writing a will which would benefit not only the patient's immediate family (her daughter) but also collaterals (nieces and nephews, children of one of her daughters) may well have been wrong in principle. Cross J's reasoning had no application to family members primarily so called. Megarry V.C. did not, however, decide as he did being oblivious to the possible effect and of its potential shortcomings. At pages 244-245 he commented as follows:

"Now I certainly do not say that these principles (including the lucid interval test) are either exhaustive or very precise, nor am I altogether convinced that the notional lucid interval is the best way of expressing what the court has to do.

Instead, Cross J more than once (in In Re L) referred to the "curious assumptions" that it involves. However, it has found its way into this branch of the law; in most ordinary cases I think it will suffice, and so I have adapted and, perhaps, expanded it."

35. It is that expansion of it that causes me concern in this case to the extent that it is proposed that the lucid interval test should be applied to determine whether Mrs. D would wish to provide for or benefit the members of her immediate family by the provision, in particular, of the Indemnity.

36. Apart from the "counter-factual (nature of the) assumption" explicit in the lucid interval test (as it was so described by Hoffman J (as he then was) in ***In Re C (a patient)*** ***[1992] 1 FLR 51)*** and the "mental gymnastics" that it involves (per Lewison J. in ***Re P*** ***[2009] WILR 651*** at paragraph 38), the expanded aspect of the test seems, to my mind, to be problematical because it could operate contrary to the intention of the legislation where the legislation rather assumes, at least *prima facie*; that a patient would wish to benefit the immediate members of her family. That prima facie assumption in the Law would be displaced by an enquiry into whether or not she would wish, during an imaginary lucid interval, to benefit her immediate family. This could lead to a conclusion which is contrary not only to common sense but the plain legislative intention as well.

37. For those reasons, I am not persuaded that I should follow and apply the decision of Megarry VC given in ***In Re D***.

38. Rather, the starting point must be with the prima facie acceptance that the patient would wish to provide for or benefit her immediate family. The question then becomes whether what is proposed is "desirable" (in the context of the Cayman Law) as being both reasonable and in the best interests of the patient herself and of her family.

39. I think I am also obliged not to let this occasion slip by without expressing my sympathy for the judicial skepticism that has attended the application of the lucid interval test, even if confined to the question whether the Court should make provisions from a patient's estate for collateral family members. That is, for those

persons coming within the third category of our Law or category (c) of the former English Mental Health Acts.

40. While the legislation clearly requires that the Court divines a way of deciding whether such persons probably are persons ***"for whom...the patient might be expected to provide if he were not mentally disordered"*** the lucid interval test does not commend itself, to my mind, as being the most logical or practical way of doing so.

41. Counter-factual an assumption as it is, the lucid interval can be informed by nothing more than the information which may be available to the Court as to the patient's state of mind before she lost capacity. Bear in mind, that here, at least in this case, we are not discussing a lucid interval like that which is recognised by both the law and medicine, as actually occurring from time to time with incapacitated persons: the kind of interval when they might be able to understand the nature of what is proposed and be able to express their views and wishes for the bestowment of their bounty. The notion of the lucid interval here is purely imaginary

42. Rather than go through the mental gymnastics of the counter-factual lucid interval, it seems to me that the legislation is entirely accommodating instead of an approach such as that which is now applied by the courts, in England, since the Mental Capacity Act 2005; an Act which followed a long process of consultation and reports of the Law Commission.

43. In particular, section 4 of the 2005 Act, in requiring the Court to ensure that whatever is done, is done in the patient's "best interests", goes on to expand upon

that concept by requiring the Court to consider all the relevant circumstances. In particular, among other things which must be considered depending on the questions raised, the Court must consider the patient's past and present wishes and feelings (and, in particular, any relevant written statement made by him when he had capacity).

44. The Act of 2005 goes on extensively to list matters which the Court must consider and steps which the Court must take in "a structured, decision-making process" different from that thought to have been given by the statutory instruction of the earlier legislation that the Court must do what the patient himself might be expected to do if he had not been mentally disordered (per Lewison J, in ***Re P*** (above at paragraph 21).

45. Given the very compendious meaning and wide ambit which might be applied when seeking to determine, under the Cayman Law, what may be "desirable" for the benefit of the patient herself, her immediate family or collateral persons for whom she might be expected to provide; there is no reason to think that any of the many factors helpfully identified in the English Act of 2005 for consideration must be precluded.

46. I agree with Counsel for the daughters that the approach advised by the English Act is to be preferred in modern times, even without express statutory authority, should this Court consider itself free to adopt it. I also agree that in the absence of binding or persuasive Cayman authority in a case where the issue has been fully considered, it is open to this Court to do so on the wording of section 13 of the local Law as it stands.

47. The Court is directed, in this case, mainly to consider what is "desirable" for the benefit of others in a case where Mrs. D cannot make her own decisions.

48. All parties accept and there is no doubt that the proposals are desirable: they ensure that the parties can achieve what Mrs. D herself expressly wished to achieve while capable and which is plainly in their own interests to achieve. It would be in Mrs. D's own "best interests" now to ensure that those around her – her closest relatives – have finally put to rest old conflicts with her assistance. As Lewison J. said in ***Re P*** at paragraph 44 (in the context of a statutory will):

> ***"What will live on after P's death is his memory, and for many people it is in their best interest that they be remembered with affection by their family and as having done "the right thing" by their will.***
>
> ***In my judgment the decision-maker is entitled to take into account in assessing what is in P's best interests, how he will be remembered after his death."***

49. As it always remains relevant to consider what Mrs. D's past and present wishes and feelings may be even without seeking to substitute the Court's judgment for hers, I would add that I have no doubt that she would wish to be regarded as having helped to restore harmony to her family.

50. For all these reasons, I pronounced the following decision on the 21 July 2009:

"(i) I am satisfied that Mrs. D continues to lack mental capacity to administer her property and affairs and that the application by Mr.

B and Mr. C as two of her Court-appointed guardians is one which they can properly bring.

(ii) I am satisfied that Mrs. D will not be financially or otherwise prejudiced by the proposed provision out of her resources for securing the Indemnity and that it is necessary that these provisions should come from her resources rather than being imposed upon any other party or parties.

(iii) The Law requires me to consider whether the directions sought by the applicants are for the doing of something which appears desirable for the maintenance or benefit of Mrs. D or of her family (no question of what has been termed "collateral interests" or the interests of creditors or obligees arising for consideration on this application).

(iv) I am satisfied from my understanding of all the circumstances, that Mrs. D, having herself been a party to the Peace Accord and being the person financially placed so as to be able to provide the proposed Indemnity without risk of financial or other prejudice to herself, would have wished to give the Indemnity for the sake of securing harmony within her family and to which end the proposed Indemnity will be instrumental.

(v) In this sense, I am also satisfied that the proposed Indemnity as a prerequisite to the Accord, would be of real emotional and financial benefit to Mrs. D's family and for that reason it is

desirable, in her and their the best interests, that the Indemnity agreement be entered into.

(vi) As I understand the Law, this latter basis by itself provides me with jurisdiction to give the directions for the provision of the Indemnity by the applicants as her guardians on behalf of Mrs. D, and I so direct.

(vii) It has been mooted in Mr. B's third affidavit whether these directions should be given only provisionally on notice to the other parties to the wider Family Trust Proceedings, so as to further specifically canvas their views.

(viii) However, because I am satisfied about the matters cited above, in particular as to the minimal nature of the risk of the Indemnity having to be actualized contrasted to its importance now to secure the relinquishment of Mr. D's interests under the Trusts and so ultimately, to secure the completion of the Peace Accord; I do not see the need to delay any further. Indeed, as I have stated, I am satisfied that ultimately, the directions will redound to the benefit of Mrs. D's family which embraces those unrepresented parties. These are all factors which, I trust, will be accepted as justifying the order being made final now.

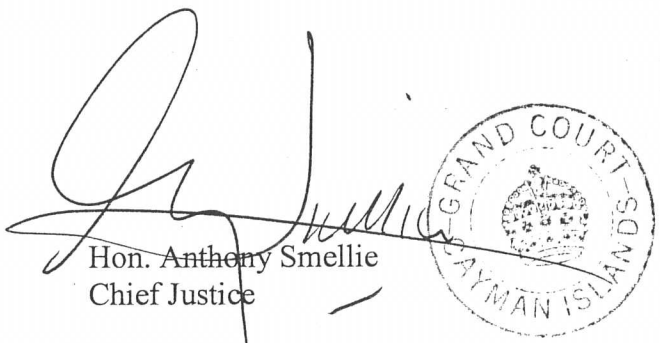
(ix) The question as to whether directions should be given to the applicants to make a contribution on behalf of Mrs. D to the costs of the Family Trusts Proceedings is in general the subject of the

second aspect of their summons. Mr B. expresses in his third affidavit, very cogent reasons why such a direction may be regarded as not being in Mrs. D's own best interests and so as not being desirable.

(x) It is therefore proposed that that question should be deferred to be decided in the context of the Family Trusts Proceedings themselves when all interested parties, including the Trustee, can be heard in respect of whether the Trust itself should bear some or all of those costs. An alternative then to be considered could be that Mrs. D's estate provides a loan to the Trust, rather than alienate Trust assets (shares in the underlying companies) which no-one sees as a desirable thing to do.

(xi) I accept the alternative proposed and direct that this aspect of the summons be stood down until after the hearing of the Family Trusts Proceedings in October.

(xii) I also direct, in keeping with the reasons advanced yesterday, that the Court files in these proceedings be sealed until further order."



Hon. Anthony Smellie
Chief Justice

August 3, 2009