28/7/06

IN THE GRAND COURT OF THE CAYMAN ISLANDS
HOLDEN AT GEORGE TOWN, GRAND CAYMAN

CAUSE NO. 453 OF 2004

IN THE MATTER of the Circle Trust dated 8th December 2000

AND IN THE MATTER of the Trusts Law (2001 Revision)

BETWEEN:

HSBC INTERNATIONAL TRUSTEE LIMITED

PLAINTIFF

AND:

(1) WONG KIT WAN
(2) FUNG MEI LIN
(3) FUNG MEI YEE
(4) FUNG KWOK KEUNG
(5) FUNG HON KEUNG
(6) FUNG KWONG FAT

DEFENDANTS

Appearances:	Ms. Ziva Robertson of Maples & Calder for the Plaintiff Mr. Andrew Fletcher and Mr. Steven Barrie of Nelson & Company for the First, Third and Fourth Defendants Mr. Tom Lowe and Ms. Cherry Bridges of Ritch & Connolly for the Second Defendant Mr. George Giglioli of Giglioli & Company for the Fifth Defendant Ms. Shan Warnock-Smith Q.C. and Martin Jones of Campbells for the Sixth Defendant
Before:	Hon. Justice Henderson
Heard:	March 7, 8 & 9 2006

JUDGMENT

The parties have submitted seven questions to the court for a preliminary determination.

They have now agreed that no response is required on questions 4, 5 and 6 and that the

resolution of question 7 should be adjourned generally with liberty to all parties to restore. Questions 1 – 3 are:

1. "Whether a majority of the *sui juris* beneficiaries had the power to appoint a Protector, in light of the fact that no Protector had been appointed at the date of the execution of the Circle Trust Deed;

2. If a majority of the *sui juris* beneficiaries did have the power to appoint a Protector, whether the exercise of the power would be invalid if tainted by (i) irrationality, (ii) absence of good faith, or (iii) impropriety of the majority's purpose;

3. If the answer to issue two is "no", whether the appointment of the sixth Defendant on 11th June, 2004 was valid and effective."

The parties are also agreed that the answer to question three will, for present purposes, be determined by my answer to question two.

The Circle Trust was created by settlement on December 8, 2000. The nominal settlor was Cheung Wai Man, but all are agreed that the real settlor was the sixth defendant, Fung Kwong Fat ("Mr. Fung"). The first Defendant is Mr. Fung's wife; defendants two to five are his children, all of full age. These five defendants are the beneficiaries of the trust. Mr. Fung is named as a member of the Excluded Class.

The trust assets are derived from a family business established by Mr. Fung and in which two of his children worked for many years.

In recent years, an unfortunate dispute has pitted the second and fifth defendants against the other members of the family. Those two defendants say that Mr. Fung has withdrawn trust assets without authority and has sought to intermeddle in the trust by demanding

information to which he is not entitled. On June 11, 2004 the first, third and fourth defendants appointed Mr. Fung as Protector in an effort to assert control in the partisan war then developing. The fourth defendant then executed a deed disclaiming his beneficial interest in Circle Trust. The deed purported to be revocable. The following day, Mr. Fung as Protector purported to remove the Plaintiff as trustee and appointed the fourth Defendant instead.

The second and fifth defendants now assert that Mr. Fung's appointment as Protector was invalid because it is tainted by irrationality, absence of good faith, and impropriety of motive on the part of those voting for his appointment. They say that his subsequent attempt to remove HSBC and appoint the fourth Defendant as trustee is invalid as a consequence.

Did the Beneficiaries have the power to appoint a Protector in light of the fact that no Protector had been appointed at the date of execution of the trust deed?

This is a point of pure construction. It requires a consideration of the terms of the deed itself to determine the probable intent of the settlor at the date of execution. His intent must be assessed in light of those elements of the factual matrix known to him at the time.

The relevant portions of the trust deed are as follows:

> "1(j) 'Protector' means the person named in the Fourth Schedule hereto (if any) or other Protector for the time

being, being such person as appointed to the office of the Protector in accordance with Clause 16 hereof.

16(a) The power to appoint any person not being a person named in the Sixth Schedule hereof as an additional Protector or in substitution for a Protector shall be exercisable by a notice in writing delivered to the Trustee and signed by a majority of the *sui juris* beneficiaries.

16(f) In the event that there is no Protector named or appointed pursuant to the provisions hereinbefore, all terms conditions and provisions of this Deed shall be read and construed as if all references to the Protector were omitted until such time that a new Protector is appointed."

These provisions are not free of ambiguity. The second and fifth defendants say that the language of clause 16(a) contains the power of appointment but is limited to the appointment of a Protector "as an additional Protector or in substitution for a Protector." Appointment of a Protector where none has yet been appointed cannot sensibly be held to be an appointment "in substitution for" anyone. The phrase "an additional Protector" necessarily means that the appointment must be additional to an already appointed Protector. These defendants say that the language of this clause must be given its plain and ordinary meaning and therefore can have no application at all where no Protector has been appointed in the first instance.

The language of the Fourth Schedule ("no Protector has been appointed as at the date of this Deed") (underlining added) militates against this inference. If the settlor's intention was to appoint no Protector and thus preclude the possibility of any subsequent appointment, he would not have included the underlined words.

Clause 16(f) provides for the operation of the deed in the event that no Protector has been named at the outset (as is the case here). It requires the provisions of the deed to be read "as if all references to the Protector were omitted until such time that [sic] a new Protector is appointed" (underlining added). Again, if the failure to make an appointment initially was intended to prevent any subsequent appointment, the settlor would not have included the underlined words.

The appointment of a protector is intended to provide an additional layer of control over the trust and enhanced security for its beneficiaries. It is a common feature of trusts originating in this jurisdiction. It is not uncommon to leave the position vacant initially but provide a mechanism for later appointment of a protector if circumstances warrant that.

It is in such circumstances that these beneficiaries now find themselves – feuding with each other over fundamental aspects of the administration of the trust. This settlor included provisions in his deed defining the powers of a Protector (in clause 17), describing the way in which a Protector may resign (clause 16(b)), limiting the liability of the Protector (clause 16(g)), and providing for indemnification of the Protector (clause 16(h)), amongst others. Why would he have troubled to do so if his intention was as the second and fifth defendants have argued?

The deed as a whole demonstrates an intention on the part of the settlor to provide for the appointment of a Protector in the future even though he felt that none was needed at the

time of execution. To give effect to this intent, the phrase "additional Protector" in clause 16(a) must be read as meaning "additional to the trust structure itself" and not confined to its more literal meaning of "additional to an already appointed Protector." My answer to question one is that a majority of the beneficiaries do have the power to appoint a Protector, even though no Protector was appointed at the time of execution of the deed.

Would the exercise of the power to appoint a Protector by a majority of the beneficiaries be invalid if tainted by (i) irrationality, (ii) absence of good faith, or (iii) impropriety of the majority's purpose?

A power of appointment, properly so called, is a distributive (as opposed to administrative) power which grants authority to deal with or dispose of property: Underhill and Hayton, *Law Relating to Trusts and Trustees*, 16th edition, page 25 ff. The "power to appoint" a Protector, though it may be spoken of as a power of appointment, is better termed a right of nomination; it is an administrative power: see *Farwell on Powers*, 1916, page 11.

Many judgments and texts draw a clear distinction between personal powers and fiduciary powers leaving the implicit suggestion that there is no third category. In this analysis, a personal power may be one of three types:

1. A power in the donee to act as selfishly as he wishes and purely for his own benefit in discharging his legal or moral obligations (Underhill says this case is "rare"); see *Re Wills Trust Deed* [1964] Ch. 219.

> 2. A power in the donee which may be exercised without any accountability to the court so long as there is no fraud upon the power, i.e., so long as the power is not excercised for a purpose, or with an intention beyond the scope of, or not justified by, the instrument creating it;
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> 3. a power in the donee which imposes a fiduciary duty from time to time to consider whether or not it is appropriate to exercise the power but the actual decision to exercise it (or not) cannot be challenged in the court unless it amounts to a fraud on the power. See generally as to classification: Underhill, op. cit.; *Thomas on Powers*, 1st edition, 1998, p. 4 et seq.; *Lewin on Trusts*, 17th edition, 2000, p. 362 et seq.

In contrast to a personal power, a true fiduciary power is held for the sole benefit of the beneficiaries. The holder must independently and consciously consider from time to time whether or not to exercise the power and must exercise it responsibly in accordance with the purpose for which it was granted. It may not be exercised capriciously, arbitrarily, or in bad faith, and cannot be released unless the trust instrument specifically authorizes that: Underhill, *op. cit.*, page 29.

Trustees, of course, acquire fiduciary powers and obligations by virtue of their office. A trustee's "power to appoint" (which is really, as suggested above, an administrative power consisting of a right of nomination) a new trustee is a fiduciary power: *Webb v. Earl of Shaftesbury (1802)* 7 Ves. Jun. 481. Because of the nature and extent of the authority often conferred upon a protector, there is a trend in the authorities to attach fiduciary obligations to the exercise of his authority as well. Underhill says the role of a protector is "usually" a fiduciary one: op. cit., p. 30. Examples of that are found in *Steele*

v. Paz Ltd. (unreported) October 10, 1995 (Isle of Man) and *Knieriem v. Bermuda Trust Co. Ltd. et al* July 13, 1994, unreported (Supreme Court of Bermuda). It is open to a settlor to provide expressly that the powers of the protector are exclusively and merely personal: Underhill, *op. cit.*, page 32.

For obvious reasons, the status of beneficiary, in and of itself, imposes no obligations of a fiduciary nature. The first, third, fourth, and sixth defendants argue that, as mere beneficiaries, their right to nominate (i.e., vote for the election of) a Protector must be a personal power. They say they may exercise it in any way they wish, with a view to protecting their own and only their own interests, as long as they do not commit a fraud upon the power. They say this right of nomination is a personal power which falls in category 2 or 3 above (it does not matter which, as the power was in fact exercised). Since the second and fifth defendants have not argued that the election of Mr. Fung as Protector amounts to a fraud on the power, that (say the other defendants) is the end of the matter. The result of the election is not reviewable in the court.

Not all powers or exercises of authority can be classified as readily as these defendants suggest. A question likely to be of fundamental importance is the intention of the settlor, to be inferred largely from the terms of the settlement itself together with some consideration of the surrounding circumstances existing at the time of settlement and apparent to him then (without, however, the admission of any evidence of the settlor's subjective intent – a point likely to be of importance in the present case). As Chief Justice Smellie of this court said in *Re Z Trust 1997* CILR 248, at p. 275:

" ... the facts and circumstances of settlements vary infinitely and the intentions of a settlor are not to be readily discerned by reference only to a doctrinaire application of the decided principles. It must be a question of construction in each particular case whether the power is given personally or whether it is given by virtue of office, as being fiduciary ... "

Passages lifted from cases involving construction of powers of appointment, i.e., dispositive powers, must be treated with caution in any analysis of an administrative power, whose *raison d'etre*, nature and effects may be quite different. While the status of the holder of the power is undeniably significant, it is not determinative. Even a beneficiary may be clothed with a power to which some fiduciary obligation is attached: examples may be found in *Cardigan v. Curzon-Howe (1885)* 30 Ch. D. 531 and *Re Papadimtriou [2004]* WTLR 1141 (Isle of Man); also see *Re Z Trust, supra.*

Decisions involving the right to nominate a trustee are instructive. In *Re Skeats' Settlement (1889)* 42 Ch. D. 522, a husband and wife were given a power to appoint trustees in place of the retiring trustees. They purported to appoint the husband himself. That decision was challenged. Kay, J. had no difficulty concluding that the appointment of the husband was invalid. He said:

"The ordinary power of appointing new trustees, under a settlement such as this is, of course imposes upon the person who has the power of appointment the duty of selecting honest and good persons who can be trusted with the very difficult, onerous, and often delicate duties which trustees have to perform. He is bound to select to the best of his ability the best people he can find for the purpose. Is that power of selection a fiduciary power or not? I will try it in this way, which I offered as a test in the course of the argument. Suppose, as happens not unfrequently, that trustees, under the terms of the deed of trust, are entitled to remuneration by way of annual salary or payment. Could the person who has the power of appointment put the office of trustee up for sale, and sell it to the best bidder? It is clear that

> would be entirely improper. Could he take any remuneration for making the appointment? In my opinion, certainly not. Why not? The answer is that he cannot exercise the power for his own benefit. Why not again? The answer is inevitable. Because it is a power which involves a duty of a fiduciary nature; and I therefore come to the conclusion, independently of any authority, that the power is a fiduciary power."

In *Re Shortridge [1895]* 1 Ch 278, the donee of a power of appointing new trustees of a settlement was a lunatic. The Court of Appeal, applying *Skeats*, held that the power was a fiduciary power, was vested in the lunatic "in the character of trustee", and could therefore be transferred by the court to a more suitable recipient.

In *Inland Revenue Commissioners v. Schroder [1983]* STC 480, a taxpayer settled his interest in certain assets on discretionary trusts. A committee of protectors was appointed with power to remove and appoint trustees. A member of the committee of protectors could be removed by a majority of the committee, in which case the taxpayer (settlor) himself had the power to fill the vacancy. He also had the power to appoint additional members of the committee of protectors. The committee itself had power to remove a trustee, while the taxpayer (settlor) retained the power to appoint a substitute or additional trustee. For the purpose of resolving a tax question, the court had to determine whether, as the Crown contended (see page 489), the taxpayer was able to control the application of the trust income because he had power under the settlements to appoint additional trustees and to fill a vacancy in the committee of protectors (increasing the number of members as he might think fit). The Crown's contention was rejected because of the fiduciary nature of the right of nomination reserved by the settlor to himself. The court said:

> "I do not think the settlor has in fact power even indirectly to make and unmake trustees. The power to remove trustees is vested in the committee, and although the settlor can fill vacancies or possibly appoint additional members of the committee even when there is no vacancy, that power, like the power to appoint new trustees, must I think be a fiduciary power. It could not properly be used to 'pack' the committee to ensure that the settlor has a majority which will follow his directions. Similarly, the committee's power to remove and his power to appoint new trustees are fiduciary powers. Even though these powers are unusual it cannot in my judgment be said that the settlor has put himself in a position where he can secure the appointment of trustees who would follow his wishes and who would not exercise any discretion of their own. The terms of the settlements, therefore, do not in my judgment found or support the inference which counsel for the Crown seeks to draw."

In *Burton v. Burton et al (1994)* 126 ALR 557, a trustee in bankruptcy sought to restrain the bankrupt from exercising his power to appoint trustees. The court held that the power was fiduciary in nature and not "property" which vests in the trustee in bankruptcy; "nor was it a power as might have been exercised by the bankrupt for his own benefit." The bankrupt was a beneficiary of the trust.

In *Re Osiris Trustees Ltd. et al (1999)* MLR 206 (Isle of Man, Chancery Division), the settlor reserved to himself the power to appoint additional trustees. His exercise of that power was challenged. The court held that a power to appoint additional trustees involved a duty of a fiduciary nature which must be exercised in the interests of the beneficiaries and in good faith. Any improper exercise of this power to appoint additional trustees is not void but voidable at the instance of the beneficiaries (at page 418).

Knieriem v. Bermuda Trust Co. Ltd. et al, *supra*, was a case where the power of appointing and removing trustees was given to a Protector. After the Protector removed the existing trustees and appointed new ones, his exercise of the power was challenged. The court held that the Protector's power of appointing and removing trustees was fiduciary in nature and could not be exercised for the Protector's own benefit.

In *Re Newen [1894]* 2 Ch 297 was another case where the administrators of an estate, having the power to appoint trustees, appointed one of their number. Kekewich, J. applied *Skeats*, *supra*, but also said "quite apart from that, I have not myself the slightest doubt that it is wrong in principle."

In all of these cases, the power at issue was a right to nominate or appoint trustees. In *Cardigan*, *Papadimitriou* and *Burton*, the person holding the right of nomination was a beneficiary. Collectively, these authorities establish that the right to nominate a trustee, even when it resides with a beneficiary, will likely impose fiduciary obligations. That will not always be the case. Everything depends upon the intentions of the settlor and the surrounding circumstances. *Rawson Trust Co. Ltd. v. Perlman et al* (unreported) April 25, 1990 (Supreme Court of the Bahamas) is an example of a case where protectors, who were given a power of veto over trust distributions and who were also beneficiaries, were found not to have fiduciary obligations. They had been appointed protectors for the purpose of safeguarding their own personal interests as beneficiaries.

I return to the question of the settlor's intent. The settlor of the Circle Trust has provided that the office of Protector shall be "immediately determined and vacated" if the Protector is found to be of unsound mind or a bankrupt: clause 16(c). The Protector is given the right to renounce any power conferred upon him: clause 16(e). The Protector is exempted from liability for any loss to the trust fund arising from any act or omission of his except those due to wilful neglect or default, fraud or dishonesty on his part: clause 16(g). There is a right of indemnification: clause 16(h). The Protector may charge for his time and services: clause 16(i). He is entitled to receive accounts from the trustee: clause 16(j) (ii).

The Protector may remove any trustee at any time: clause 17(a). He may appoint new trustees: clause 17(b). He may also appoint a sole trustee for a part of the trust fund located in a particular geographical area "to the exclusion of the Trustee in regard to such part.": clause 17(c). The Protector may not appoint himself as trustee: clause 19(d) (ii). He is forbidden to appoint as trustee any person who is under his own control or influence, or any company in which he owns shares: clause 19(d) (v) and (vi). Beyond this, there are no express limitations upon the Protector's power to remove and appoint trustees. Much of the language used to describe the powers and obligations of the Protector mirrors the language describing the role of the trustees.

I am satisfied that the settlor's intent was that the Protector (if any) is to assume a fiduciary role. He is intended to exercise his powers for the good of, and only for the good of, the beneficiaries as a whole. He is a fiduciary in the classic sense. I am also

satisfied that this court has an inherent jurisdiction to remove the Protector upon good cause being shown, and to appoint another in his stead. Both of these conclusions are supported by the decisions in *Steele v. Paz Ltd.*, *supra*, and *Re Freiburg Trust [2004]* 6 IPRLR 1078 (Jersey RC). As I indicated earlier, a deed of settlement may be so constructed as to show clearly that a Protector is not to have fiduciary obligations and may act purely for his own benefit. The deed under consideration here contains no hint of this. The nature and extent of the authority conferred upon the Protector, together with the provisions exempting him from liability for negligence and providing for indemnification and remuneration for his time, demonstrate that this settlor intended the Protector to act in a fiduciary capacity.

What, then, can be said of the beneficiaries' right to nominate a Protector?

The trustee is a fiduciary. If the beneficiaries (or some of them) had been given the right to remove the trustee and appoint another instead (which they were not), their exercise of that right of nomination would be subject to the control of the court. The Circle Trust Deed instead gives this critical authority to the Protector. The Protector himself is a fiduciary; his decisions regarding removal and appointment of trustees are therefore reviewable in this court. However, if the argument advanced by the first, third, fourth, and sixth defendants is accepted, the exercise by the beneficiaries of their right to nominate a Protector is not reviewable. Any decision they might have taken (hypothetically) to remove a trustee and substitute another one would be reviewable, but a decision to remove or appoint a Protector (who can himself remove and appoint

trustees) is not. Why should the beneficiaries be less accountable to each other and to the court in the latter case than in the former? There is some irony in the fact that, by inserting a Protector into the trust's structure and giving to him, rather than to the beneficiaries, the power to remove and appoint trustees, the settlor (on one view of the issue) has transformed the right of nomination from an accountable to an unaccountable exercise of power.

The trustee of the Circle Trust administers and executes its terms. The Protector selects the trustee. The law recognizes that the selection of a trustee by beneficiaries must be done in good faith. The selected trustee cannot be manifestly unsuitable for the task – in other words, the selection decision cannot be clearly irrational. Can it then be conceded that a majority of the beneficiaries may act in bad faith with impunity, or may make a decision which is clearly irrational, when selecting the person with the power to select the trustee? I think the answer must be "no."

The settlor is taken to have known and understood the applicable law at the date of execution of his deed. He would have known that, if he had given to the beneficiaries the right to remove and appoint trustees, their decisions in that regard would be amenable to court review. The addition of a Protector to the trust's structure was intended to enhance and supplement the other protections enjoyed by the beneficiaries. Would the settlor, then, have intended by the same act to remove the accountability to each other and to the trust which the beneficiaries would have had if they could remove and appoint trustees directly? The law requires the power to remove and appoint trustees, even when

exercised by beneficiaries, to be exercised in good faith for the benefit of the trust as a whole. In my view, where a Protector is given the right to do that, the right of nomination of the Protector must equally be exercised in good faith for the benefit of the trust and all of the beneficiaries. I am satisfied that the right of nomination accorded to these beneficiaries in the Circle Trust Deed imposes upon them a fiduciary obligation which is reviewable in this court upon an allegation of irrationality, absence of good faith or impropriety of purpose.

The sixth Defendant, in particular, concedes and emphasises that the decision and actions of the Protector are reviewable because he is a fiduciary. This, he argues, is enough; there is no reason to add an additional layer of supervision by allowing a review of the process by which he was elected to office. I confess that I find unappealing this assertion that *ex post facto* control is all that is needed. For example, let us consider a hypothetical case in which a majority of the beneficiaries choose to elect as Protector a person whom they are certain will do nothing whatsoever to fulfil his mandate. Such a decision, in my view is irrational. However, if *ex post facto* control of the Protector is the only sort available, the minority beneficiaries are without a remedy until some considerable time has passed. Assuming the Protector makes no announcement of his intended inactivity, no step could be taken to remove him until the minority are able to demonstrate that circumstances have arisen requiring his attention but he has refused to act. By that time, the trust assets may have been diminished in circumstances where an effective Protector could have prevented that. It is eminently more sensible, in my view, to permit a review

of the appointment process itself on the relatively narrow grounds of irrationality, absence of good faith, and improper purpose.

My answer to question two is "yes."

If the answer to issue two is "no", whether the appointment of the sixth Defendant on 11th June, 2004 was valid and effective."

Because of my answer to question number two, this question requires no answer.

Dated this 28th day of July, 2006

Henderson, J.

Henderson, J.
Judge of the Grand Court