13/12/2005
Civil



**IN THE GRAND COURT OF THE CAYMAN ISLANDS**

**CAUSE NO: 367 OF 2005**



**BETWEEN** **ATC (CAYMAN) LIMITED ("ATC")** **PLAINTIFF**

**AND** **ROTHSCHILD TRUST CAYMAN LIMITED ("ROTHSCHILD")** **DEFENDANT**

**IN CHAMBERS**
**BEFORE THE HON. CHIEF JUSTICE**
**THE 25th AUGUST, 6TH SPETEMBER, 13TH & 14TH DECEMBER 2005**

Appearances: Mr. Ross McDonough and Mrs. Melanie Crinis of Campbells for ATC.

Ms. Sara Collins of Walkers for Rothschild



# RULING

1. ATC has succeeded Rothschild as trustee of the Makar and Nomad Trusts, two trusts governed by the laws of the Cayman Islands.

2. The matter is before me on ATC's summons which seeks the proper construction of a provision of the Trust Deeds. The issue, in respect of which an impasse has been reached between ATC and Rothschild, concerns the terms and extent of the indemnity to which Rothschild is entitled, in respect of any claim it may yet face as out-going trustee. Rothschild has refused to relinquish the trust assets to ATC unless and until an indemnity, to its satisfaction, in that respect is provided by ATC.

3. There is sought to be negotiated a settlement of the terms of Rothschild's indemnity even while ATC disputes Rothschild's right to retain the assets.

4. Having regard to what ATC describes as a reasonable pre-estimate of any such liabilities which may arise to Rothschild and in respect of which the indemnity should apply, ATC is prepared to undertake to the effect (the exact wording to be resolved) that it will withhold a certain sum of money, and not allow the Trusts funds to be depleted below that amount for a specified period of time to be agreed.

5. On the basis of legal advice, Rothschild say they are unable to agree. The reason is that the undertaking to withhold or retain a specified sum within the Trusts, including not to appoint or distribute that amount to beneficiaries; would operate as an impermissible fetter upon the discretion of ATC as trustee and would thus be repugnant to the settled principle that a trustee of a discretionary trust cannot fetter the future exercise of its discretion. Rothschild are therefore concerned that the undertaking would be deemed invalid.

6. Moreover, this would mean that the power or discretion to distribute the assets could be subsequently exercised at the proper time or times, free from the fetter, not only by ATC, but also any successor trustee to ATC.

7. For these propositions, Ms. Collins, on behalf of Rothschild, relies primarily on the case of ***In Re Gibson's Settlement Trust [1981] CH 179***. That was a case in which, among other things, an undertaking given by trustees that they "will (by a certain date) enter into such deed or agreement as is necessary to cause the sum of £50,000 … to be appointed absolutely" to each of the settlor's two children "contingent only upon each of them attaining the age of 25", was set aside for being invalid as fettering the trustees' discretion.

8. The actual unreported first instance judgment in the case and in which that conclusion was reached, has not been obtained. I am told that being unreported (and it seems only ever provided by way of a résumé of the judgment) it is unavailable.

9. The extraction of that principle which the case decides as cited above, is taken from the reported judgment of Vice Chancellor Megarry given later in respect of the ancillary issues of costs. In it the Vice Chancellor recites with clear approval, what he describes as the earlier decision of the Court. (See pages 182 and 183 of the Report above).

10. The same principle had, however, gained much earlier expression in the case law. For instance, in ***Oceanic Steam Navigation Co. v Sutherberry, [1880] Ch.D. 236,*** it was held that an executor or administrator may grant an underlease of land within his estate, but could not give an option of purchase at a future time. This was explained as based on the principle that he may not fetter the exercise of his discretion vested by his trust for sale, by preventing the sale to anyone else and at the proper sale price to be obtained as at the time of sale in the future.

11. Similarly, in the same year, in ***Palmer v Locke [1880] Ch.D 294,*** it was held that a bond or covenant, by the donee of a limited testamentary power, that he will exercise it in a particular preferential way was entirely void. Both in ***In re Peel [1936] Ch 161 and in In re Gourju's Will Trusts [1943] 1 Ch 24*** there appears the unsurprising exposition of principle, that the trustees of discretionary trusts had no power to retain all or any part of the income and to postpone its

application for so long as they thought fit, but were bound to expend the income as and when they received it for the purposes of their trusts.

What the trustees did in those cases that was implicitly wrong, was the purported fetter upon the exercise of their discretion at the time in the future, when the discretion to distribute income would arise to be exercised.

***In Re T Trust** [2000] CILR 24 at 49,* this Court, by reference to ***In re Gibson*** and other cases; also recognised the same rule referring to "the fundamental principle that it is not open to trustees to seek to fetter in any way, the manner in which they or their successors might exercise powers of appointment in the future. Trustees must be free to take all circumstances into account and to act accordingly at the date they actually do exercise that power".

12. In ***Re Allen Meyrick's Will Trust** [1966] 1 WLR 499,* Justice Buckley presented a comprehensive exposition on the principle that a trustee may not fetter his future exercise of discretion.

13. The case involved a will trust by which the testatrix directed her executors and trustees to hold her residuary estate "upon trust that they may apply the income thereof in their absolute discretion for the maintenance of my ... husband and subject to the exercise of their discretion upon trust, for my two godchildren," R and L; "in equal shares absolutely".

14. Later, the trustees, having made certain payments to the testatrix's husband under the trust, were unable to agree on the extent to which they ought to further apply income of the trust for the benefit of the husband, because he was an undischarged bankrupt.

15. A summons was issued by the trustees asking, among other things, first whether the trust declared by the testatrix was, upon the true construction of the will, a discretionary trust under which the trustees could pay or apply the income to or for the maintenance and benefit of the husband, or for the benefit of R and L or any one or more to the exclusion of the other; or whether it conferred a power on the trustees to pay or apply the income for the maintenance of the husband, subject to which the income ought to be held upon trust for R and L and, secondly; if the answer to the first question was in accordance with the latter alternative, whether the power was capable of being surrendered to the Court, or if not, how the income or the balance of the income ought to be applied or dealt with in the event of trustees failing to agree as to the manner or the extent to which the power ought from time to time to be exercised. Implicit in the first question raised, was the concern whether the trustees had a discretionary power to appoint and distribute the income. In the second question, the implicit concern was whether the trustees could bind the future exercise of such a power by surrendering it to the Court or by getting the Court's directions once and for all, how to exercise it.

16. It was held first; that on a true construction of the will, the trustees had a discretion to apply the income of the trust for the maintenance of the husband and subject to that, the income was to be held on trust for R and L, in equal shares absolutely.

17. That being so, because the proper exercise of a discretionary power to apply income depended essentially on circumstances which might change from time to

time, the Court would not accept a surrender of the obligation to apply income received by the trustees in the future, but that, if the trustees were unable to decide how to exercise the power, they could apply to the Court for directions giving the necessary information as to the circumstances then prevailing. If the donee of the discretionary power cannot himself fetter the exercise of his power in the future, the Court will not purport to do so in his stead.

18. This is in effect, the same principle as that recognised in the earlier cases cited above, although those cases appear not to have been considered. That may not be surprising however, if this case is seen as having been primarily concerned with whether the proposed surrender of discretion to the Court – as distinct from the trustees' own decision having the same effect - would operate as an improper fetter.

19. Against that background, ATC seeks the ruling of the Court whether it might validly enter into the proposed undertaking. This is a matter of construction as distinct from seeking to surrender the exercise of ATC's discretion to the Court in the sense discussed in ***Re Allen Meyrick's Will Trust*** (above). ATC may well, however, in light of the decision at which I have arrived, later apply to the Court pursuant to section 48 of the Trust Law for specific directions for the giving of the undertaking.

ATC construes Clause 6.19 of its respective trust deeds as expressly allowing it to give the undertaking. On the face of that Clause, one is immediately inclined to be sympathetic to ATC's construction, as it appears to address precisely the point in issue:

> "*Power to Indemnify:* *The Trustees are authorised to indemnify and to enter into any indemnity in favour of any former Trustee or other persons in respect of any contingent or prospective liability, including any Tax in respect of the Trust Fund or the income thereof, or otherwise in connection with the trusts created pursuant to this Agreement. The Trustees may, in the exercise of an absolute discretion, apply the whole or any part of the Trust Fund or the income thereof by way of mortgage, pledge or otherwise howsoever as security for such indemnity".*

20. In light of this provision, the question becomes whether an express provision in the trust deed can be taken as overriding the prohibition, to be regarded as settled in the case law, against the fettering of the exercise of a trustee's discretion.

21. If there is a fetter at all to be apprehended in this case, it would in effect be a fetter, by exercise of that plain, express administrative or managerial power, upon the exercise in the future of dispositive powers; however transitory the fetter and however relatively minor the consequential diminution in the amount of trust funds to be available for distribution to beneficiaries while the fetter is in place.

22. None of the cases I have seen is directly on point.

23. The authors of ***Thomas on Powers*** ***(1st Edition Sweet & Maxwell, 1998, London)*** at page 307, paragraphs 6-126, express the following views, it seems with due hesitancy, given the absence of any case authority to the contrary or directly on point:

"The application of the principle (or prohibition against fettering their discretion) may be excluded or restricted by an express provision (although, unlike express provisions authorising the release of powers, this is perhaps neither common nor always easy to draft). Moreover, it must be doubtful whether fetters and restriction of all kinds are prohibited, irrespective of the circumstances. Thus, on a sale or purchase of land by trustees, are they prohibited (in the absence of express provision to the contrary) from entering into a covenant which restricts their future use of either retained land or the land thus purchased?"

24. However hesitant the view, it is one which I think accords with the modern realities of trust administration. It addresses the kind of eventuality properly anticipated by the draftsman of Clause 6.19 of the present Deeds, as likely to arise and to be provided for in the often complex management and administration of valuable trusts.

In ***Underhill and Hayton, Law of Trust and Trustees 16th Edition***, 690 – 691 f.n. 17 where the authors discuss the prohibition against fettering; there is nonetheless the recognition that [(by virtue of express provisions)] "Trustees now have much wider powers than previously when grants of options were impermissible as fettering trustees' functions".

25. The present impasse has had an unfortunate impact upon the proper management of the Trusts. The assertion by Rothschild of their lien over the assets pending satisfaction of their claim to a special form of indemnity, has, at the very least,

impeded the timely and smooth transfer of the assets to ATC, and may even have hampered proper administration and investment in the meantime. I make no observations one way or the other at this juncture, as to the propriety or otherwise of Rothschild seeking to act in that way. However, it is appropriate to note in passing, that it can seldom, if ever, be appropriate for a trustee to exert undue pressure to secure its own entitlements, to the detriment of its beneficiaries; by withholding the entire or very large portions of the trust fund.

26. That stated, it is clearly settled principle none the less, that the beneficial entitlements under a trust are subject to the right of indemnity to which a retiring trustee is entitled and to the lien which that trustee will have over the assets in his possession for satisfaction of that indemnity. It seems also, that the retiring trustee is entitled to an amount in satisfaction of his lien (subject of course to there being no debt owed to the trust, for example, in respect of some unrelated breach of trust) even in priority to the interests of the beneficiaries. See ***Re Griffiths** [1904] 1 Ch.D. 807, **Octavo Investments Proprietary Limited v Knight** [1999] 144 CLR 360 (Australian High Court)* and ***Chief Commissioner of Stamp Duties v Buckhe** [1998 72 ALJR 242 (Australian High Court).*

27. In light of all the foregoing principles and factors, the inclusion of Clause 6.19 in the Deeds cannot be regarded as other than prudent drafting. It is in everyone's interest that when there is to be succession of trustees, the process of transition takes place without undue detriment to the trusts. In providing as it does for the indemnity of a former trustee, that proper process of transition is what Clause 6. 19 seeks to vouchsafe.

28. I am therefore unable to accept that the principle of ***In Re Gibson***, (more fully developed and articulated in the earlier case law discussed above,) must be taken and applied as suggested by Rothschild, so as to defeat the plain words and intent of Clause 6.19 of the respective Trust Deeds. Those provisions expressly vest the Trustee with the power to indemnify a former trustee against liabilities and in the exercise of an absolute discretion, to give the whole or any part of the Trust Fund or income by way of a pledge or otherwise howsoever as security for such indemnity.

29. The exercise of that power with the bona fide intention to meet obligations owed to a former trustee, is not to be regarded as an improper or impermissible fetter upon the exercise in the future by the trustee of its discretionary dispositive powers under the Trusts.

GRAND COURT - CAYMAN ISLANDS

Hon. Anthony Smellie
Chief Justice

13TH December 2005