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The Trust Offshore

Antony G.D. Duckworth

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The Trust Offshore

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TABLE OF CONTENTS

I.	INTRODUCTION	880
II.	IN THE BEGINNING . . . TAXATION	881
III.	BASIC INGREDIENTS	883
IV.	CONFLICT-OF-LAW RULES	885
V.	THE NEW CLIENT	898
VI.	FORCED HEIRSHIP	900
	A. <i>Introduction</i>	900
	B. <i>France</i>	901
	C. <i>Forms of Attack</i>	905
	D. <i>The Offshore Legislation</i>	907

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VII.	RETAINING CONTROL.....	910
	A. <i>Letter of Wishes</i>	910
	B. <i>The Lucking Clause</i>	910
	C. <i>Reserved Powers</i>	911
	D. <i>Power to Change Trustees</i>	912
	E. <i>A Private Trust Company</i>	913
	F. <i>A Shared Company</i>	914
	G. <i>A Company Without a Trust</i>	915
	H. <i>Purpose Trust</i>	915
VIII.	INVESTMENT	917
IX.	SUPERNUMERARY POWERS	919
X.	CONFIDENTIALITY	927
XI.	UNFAMILIARITY.....	929
XII.	ASSET PROTECTION.....	930
XIII.	PURPOSE TRUSTS	932
	A. <i>England: The Beneficiary Principle and the Requirement of Certainty</i>	932
	B. <i>Offshore Legislation</i>	936
	C. <i>Cayman: The Special Trusts (Alternative Regime) Law, 1997</i>	938
	D. <i>Application to Private Trusts</i>	944
	E. <i>Application in Commercial Situations</i>	948
	1. <i>Holding Special Purpose Vehicles</i>	948
	2. <i>Segregation of Corporate Assets</i>	949
	3. <i>Security for Remote Obligations</i>	950
	4. <i>Security for Non-Pecuniary Obligations in Relation to Property</i> ...	950
XIV.	CONCLUSION.....	951

I. INTRODUCTION

The English trust, transplanted to offshore financial centers, has found a hot-house environment in which law and practice have developed swiftly in recent years—too swiftly for some, not swiftly enough for others. This is the story of a long-established legal mechanism being employed to meet new requirements and conditions, and of governments who understand that their economies depend upon the success of their financial centers. In England, by contrast, the trust has continued to cater largely to domestic requirements and, though there has been some change in these requirements, successive governments have ignored calls for reform.

II. IN THE BEGINNING . . . TAXATION

I was not present at the birth of the offshore financial centers or of their trust business, but I am told that the mother was taxation. Perhaps that is an oversimplification, but I do not doubt that taxation was the major influence. The typical settlor was a taxpayer from one of the major common law countries, and his primary motive for going offshore was tax avoidance. But there were also a few settlers from other places, some motivated by estate planning considerations (the trust allowing them to make property arrangements which could not be made at home), some by fear or distrust of rulers. With the Second World War vividly remembered, the Cold War in progress, widespread exchange controls, and much of the world under socialist, repressive, or untested regimes, the wealthy man (or corporation) might understandably seek to invest in the United States or other "safe" countries, and to hold these investments in a way that would protect them from any rapacious tendencies on the part of his own or neighboring governments. In those days, the Swiss account was the standard answer for fearful individuals, but some thought Switzerland too close to the Iron Curtain. Bermuda and the Bahamas had the geographic advantage and also a flexible legal mechanism by which the client could obtain continuing protection for his family.

As far as I know, tax considerations did not in any of the offshore centers lead to a significant change in trust law. One should not be surprised by that; the trust already had a long history as a tax-avoidance mechanism. It already provided the tax planner with the ability to construct practically any property-holding arrangement of which he could conceive. Of course, taxation did affect trust practice—and still does—but, as tax regimes differ and change, the influence has been mostly of a patchy and transitory nature.

The only pervasive and lasting effect has been the popularity of the discretionary trust in which the trust instrument defines the class of beneficiaries and leaves it to the trustee to decide what, if anything, a beneficiary is to receive, and when. Initially, this held out substantial tax advantages in many tax regimes—because the beneficiary had no quantifiable interest. It was not long before the major common law countries adopted measures to close off that particular tax-avoidance technique, but by then the discretionary trust had endeared itself to the institutions that provide trust services. It was seen as a simple and convenient instrument, easily adaptable to the client's requirements by means of a letter of wishes, an informal document in which the settlor sets out in precatory form his wishes regarding the

exercise of the trustee's distributive discretions. To those unused to this practice it may seem a strange way of doing things, but it certainly provides great flexibility; and that is a highly desirable feature—unless and until it is penalized by the relevant tax regime. No settlor can predict the needs and circumstances of those he wishes to benefit; and there is no reason to suppose that the next fifty years will see any fewer changes than have occurred in the last fifty years in relation to investment, taxation, and the general condition of the world.

On the other hand, the settlor must, of course, be advised that there will probably be no legal recourse if the trustee disregards the letter of wishes. Some settlors are reassured that this is unlikely to occur if a responsible professional trustee has been chosen and, certainly, most professional trustees are only too happy to have guidelines. If anything, their tendency is to give too much regard to the letter of wishes and not enough to other relevant considerations. If the settlor requires greater reassurance, one solution is to provide a watchdog mechanism, perhaps a protector equipped with a power to replace the trustee.² Another more direct solution, but less common, is to give some legal effect to the letter of wishes by providing in the trust deed that the trustee must pay due regard to the letter. The wording of that clause requires care to achieve the right balance between flexibility and reassurance, and such clauses are difficult to standardize (because so much depends on what sort of wishes the settlor wants to express), which may be why they are not more common.

Sometimes the discretionary trust with letter of wishes is used when the settlor is not in fact looking for flexibility and does not really want the trustee to exercise discretion; in these cases, the letter of wishes is specific about the distributions that are to be made, or it calls on the trustee to act on the recommendations of a specified person. Whatever the reason, and sometimes it is simply that the settlor does not want to incur the expense of legal advice, this arrangement is unsatisfactory in several respects, not least that it raises the question of whether the trust deed is a sham. Happily, offshore trustees have become more sensitive in recent years to the question of sham and, indeed, the other dangers of dealing with settlors who do not have adequate legal advice.

In due course, most of the major common law countries adopted measures reducing or eliminating the opportunities for avoiding tax through offshore trusts. In the United States, the opportunities were largely eliminated in the early 1970s;

2. See discussion *infra* Part IX.

Australia and Canada were not far behind; the United Kingdom moved more gradually, but always in the same direction. The result was a substantial decline in the traditional market for offshore trust services. Paradoxically, this untoward development paved the way for the eventual transformation of the offshore trust industry.

III. BASIC INGREDIENTS

The basic ingredients required to make a successful offshore trust center are predictable enough. There must be an adequate legal system, an adequate judicial system, political stability, adequate professional services, good communications, and an absence of significant taxation, exchange controls, or excessive regulation. Looking at the legal system, it is obviously fundamental that it should embrace the trust concept and provide a sufficient body of trust rules. Many of the offshore centers were in the happy position of being British colonies, or former colonies, acquired by settlement. They had simply inherited the entire body of English law, common law, equity, and statute in force at the time of settlement, insofar as applicable to the situation of the colonists and the conditions of an infant colony. In most cases, this reception of English law was confirmed by statute in due course.³ Subsequent English case law is highly persuasive, and decisions of the Privy Council may be binding. As in England, the law of trusts remains uncodified though, as in England, legislation has been enacted for supplementary purposes. Centers in this category include Bermuda, the Bahamas, and the Cayman Islands.

Other centers, such as Cyprus, Mauritius and Nauru, which have had the good fortune to come under British rule or administration, but already had an established system of law, have acquired the trust concept by osmosis, legislation, or both. In some cases, the "trust" may not be exactly the same as the

3. In the Cayman Islands, for example, the Interpretation Law provides at section 40:

All such laws and statutes of England as were, prior to the commencement of 1 George II cap. 1, esteemed, introduced, used, accepted or received as laws in the Islands shall continue to be laws in the Islands save insofar as any such laws or statutes have been, or may be, repealed or amended by any law of the islands.

Interpretation Law (Cayman Islands), § 40.

English conception, but the general approach seems to have been to track England as closely as established local laws permitted.

The Channel Islands are in this category, though it may be noted that they are a constitutional anomaly—certainly not colonies, nor yet part of the United Kingdom. They were part of Normandy when its ruler acquired the English crown in 1066; so perhaps one should regard the United Kingdom as an appendage of the Channel Islands, not vice versa. Curious as the constitutional position may be, even more curious is the fact that from the outset the Channel Islands thrived as offshore trust centers despite lacking what I have described as a basic ingredient—a legal system that embraces the trust concept and provides an adequate body of trust rules.

There is no doubt that the Channel Islands had acquired a “trust” concept by osmosis through long association with England and the English, but the nature and effect of this “trust” had not been defined by the courts. Given the fundamental differences between Norman customary law and English law, particularly in relation to property, it was plain that this “trust” was not the same as that of England. Trust rules were equally undefined, though it was generally expected that the local courts would try to follow English practice insofar as that was consistent with local law and procedure. This may seem to be a rather shaky foundation upon which to build a trust center, but apparently it caused little concern among the London lawyers who helped their clients to choose a trust domicile. Eventually, in 1984, Jersey did adopt comprehensive trust legislation, and five years later Guernsey followed suit.⁴

The Jersey legislation is well worth examination. Not only does it provide a comprehensive system of rules, largely derived from English judge-made principles, it also manages to emulate the effects of equitable ownership; in other words, it provides essentially the same proprietary rights and remedies, including the rule in *Saunders v. Vautier* that allows the beneficiaries, if all in existence and *sui juris*, to terminate the trust and the trust property regardless of any contrary direction in the trust instrument.⁵ However, the Jersey rule is qualified to allow the court to make a contrary order.⁶ No indication is given of the

4. See Trusts Law 1984 (Jersey), consolidated as amended by Trusts (Amendment) Law 1989 (Jersey), Trusts (Amendment No. 2) Law 1991 (Jersey), and Trusts (Amendment No. 3) Law 1996, reprinted in WALTER H. DIAMOND ET AL., 1 INTERNATIONAL TRUST LAWS AND ANALYSIS, JER 101 (1998); The Trusts Law 1989 (Guernsey), reprinted in DIAMOND, *supra*, at GSY 101.

5. See 1 INTERNATIONAL TRUST LAWS A15-24 (Glasson ed., Update 8, May 1997).

6. See *id.*

purpose of this qualification; and perhaps one should not jump to the conclusion that it reflects the American view that the trust should continue if it is necessary for the achievement of a material purpose of the trust. That these proprietary features of the trust do not rest easily on a basis of Norman customary law is indicated by the provision that a trust is invalid if it purports to apply directly to immovable property situated in Jersey.⁷ The Jersey legislation also has a number of innovative features, not borrowed from England, for example a rule limiting the duration of a trust to one hundred years (instead of the English rules against perpetuity),⁸ and a rule making the directors of a corporate trustee liable for breaches of trust.⁹ The Jersey legislation has been copied to a greater or lesser extent by several other offshore centers.

Some countries that inherited English law, as settled colonies, have nonetheless adopted comprehensive legislation codifying most of the rules and principles, even to the extent of adopting a statutory definition of a trust. The Turks and Caicos Islands are an example.¹⁰ Presumably, it was thought that this would attract business by signalling the Islands' enthusiasm for this business and by providing a readable set of rules. I do not know to what extent it has been successful in that respect, but it does seem unwise to jettison the enormous body of case law that has been developed and refined over the years by the courts of England and other trust jurisdictions. No brief code, until it has been thoroughly elucidated by the courts, can match the case law for breadth, depth, or certainty. No doubt the Turks and Caicos courts continue to refer to the old cases, insofar as the new rules permit, so the case law is not abandoned altogether; but the *extent* of its application must be unclear for the time being.

IV. CONFLICT-OF-LAW RULES

One might be forgiven for thinking that another essential ingredient for an offshore trust center is a sufficient body of conflict-of-law rules to deal appropriately with the foreign elements inevitable in the offshore context. All offshore trusts have a foreign element; usually they have many. The settlor comes from elsewhere—presumably, that is what we mean when

7. See *id.* at A15-5.

8. See *id.* at A15-19.

9. See *id.* at A15-24.

10. See, e.g., Trusts Ordinance 1990 (Turks & Caicos), § 3, reprinted in 2 INTERNATIONAL TRUST LAWS, *supra* note 5, at D18-4.

we use the "offshore" epithet to describe a trust. His residence, domicile, and nationality are not necessarily in the same place. The same goes for the beneficiaries. The trust assets, or the underlying investments or operations, are likely to be wholly or partly foreign—and scattered—and they may be held through brokers or other intermediaries who are not necessarily in the same place. A corporate trustee may handle some of its work in the trust domicile and some elsewhere; and there may be co-trustees, protectors, or family committees involved in the administration of the trust. As if all that were not bad enough, these foreign elements are prone to change from time to time. Furthermore, the settlor probably wants, and should be advised to have, a mechanism for changing the trust domicile in case the chosen offshore center ceases to be suitable.

Even in a case in which all the foreign links are with places that have the trust concept, important questions may arise because of differences in, for example, rules on capacity, formalities, perpetuity, alienability, illegality, implied duties, powers and protections of trustees, marital rights, and the protection of creditors. If the trust has links with states that do not have the trust concept, any application of their laws in relation to the trust is likely to have disruptive consequences. Furthermore, most no-trust states have forced heirship, which adds a further dimension of difficulty, usually subjecting lifetime dispositions to claw-back, and also bringing in its train a variety of rules limiting freedom of disposition *inter vivos* that prevent or disrupt many of the features commonly found in trusts—for example, reserved interests, revocable interests, reserved powers of disposition, gifts to spouses, and gifts to unborn persons.¹¹ Finally, as the cherry on top of this unpalatable concoction, conflict-of-law rules vary considerably around the world, so the answer to any given question depends on which court is answering; and in many parts of the world, conflict-of-law rules are not well developed, making it impossible to predict with any assurance how a given court would answer a given question.

The trust planner must suppress feelings of panic and adopt a pragmatic, defensive approach aimed at ensuring validity in the trust domicile and reducing as far as possible the vulnerability of the trust structure to foreign disruption. Few clients will foot the bill to undertake a detailed analysis of the laws of all possibly relevant states; so the planner tries to reduce the risk of a foreign court assuming jurisdiction over a trust question, and he tries to increase the likelihood that, if a foreign court did so, it would apply the law of the trust domicile. If the residual risk still seems

11. See *infra* Part VII.

too high, he tries to reduce the risk that a disruptive foreign judgement could be enforced effectively.

The planner's task may or may not be easy, depending on the circumstances; but it is altogether more difficult if the conflict-of-law rules of the chosen trust domicile are uncertain—for then he must contend with the risk that the courts of the trust domicile might apply a disruptive foreign law. Yet, until relatively recently that was precisely the situation in all the offshore trust centers. Those centers that had *inherited* the English trust could look to England, but the English conflict-of-law rules were, and still are, surprisingly uncertain in relation to trusts. Those centers that had *acquired* a trust concept were in an even more unsatisfactory condition, it being unclear which system of law one should look to in order to find the relevant conflict-of-law principles. Stranger still, this state of affairs caused no great concern in the offshore centers, or in the onshore centers such as London and New York where most of the trust planning was done. Part of the explanation is that in the early days the typical settlor was from a common law country, but, as already noted, that did not actually eliminate risk, in theory or in practice (after all, every gift creates a class of potential attackers, those who would take the property if the gift were set aside). Another part of the explanation is that many trusts were, and are, created without the benefit of professional planning. Those trusts that were planned were usually planned by tax advisers whose focus was, naturally, on the tax considerations. Lawyers in the offshore centers were seldom involved in the planning process, and were not generally asked to advise on the conflict-of-law aspects. In any case, however diligent the planning, there was not much to choose between the different offshore centers—none offered adequate conflict-of-law rules.

At this point of the discussion, it is necessary to survey briefly the English conflict-of-law rules before 1987 when the Hague Convention on the Law Applicable to Trusts and on Their Recognition¹² was incorporated into English law, with minor modifications, by the Recognition of Trusts Act.¹³ In the words of the most influential commentary on this subject, *Dacey and Morris on the Conflict of Laws*:

12. The Hague Convention on the Law Applicable to Trusts and on Their Recognition, *reprinted in* 2 INTERNATIONAL TRUST LAWS, *supra* note 5, at D51-1 [hereinafter *The Hague Convention*].

13. See PAUL MATTHEWS & TERRY SOWDEN Q.C., *THE JERSEY LAW OF TRUSTS* § 4.6, at 42 (3d ed. 1993).

There is a remarkable dearth of English and Commonwealth authority on what law governs the validity of a trust. This is particularly true in the case of trusts *inter vivos* other than those contained in a marriage settlement. The literature is almost equally sparse. In these circumstances, anything like a systematic exposition would be premature. All that can be done is to call attention to some of the matters which have been the subject of express decision in this complex field.¹⁴

With that introduction, Dicey suggested that the rule for trusts *inter vivos* of movable property is:

The validity, the interpretation and the effect of an *inter vivos* trust of movables are governed by its proper law, that is, in the absence of an express or implied selection of the proper law by the settlor, the system of law with which the trust has its closest and most real connection.¹⁵

So far so good, but Dicey added a number of comments and qualifications, for example:

- (1) "Although there is no express English decision to this effect, there can be no doubt that the settlor could select the proper law, at any rate if the trust has a substantial connection with the chosen law."¹⁶ Not very encouraging; and what in the offshore context amounts to a "substantial" connection?
- (2) "But if there is a strong public policy in the system of law with which the trust has its closest and most real connection, it seems doubtful whether the settlor would be allowed to evade it by selecting some other law."¹⁷ No authority was cited for this proposition, and it was omitted in the next edition.¹⁸ What amounts to a "strong public policy"? And how does one identify the place with the "closest and most real connection"?
- (3) "Although it is desirable that a trust should be treated as a unit and governed by one law irrespective of the situs of the movables contained therein, it does not follow that all questions of validity are governed by the same

14. 2 DICEY & MORRIS ON THE CONFLICT OF LAWS 674 (J.H.C. Morris et al. eds., 10th ed. 1980).

15. *Id.*, rule 120, at 678.

16. *Id.* at 680.

17. *Id.*

18. Compare *id.* with DICEY & MORRIS ON THE CONFLICT OF LAWS (Lawrence Collins et al. eds., 11th ed. 1987).

law.”¹⁹ The extent of that proposition was unclear.

As regards the settlor’s capacity, Dicey suggested, “The capacity of the settlor to create the trust is probably governed by the proper law.”²⁰ That tentative conclusion was reached by analogy with marriage settlement contracts but, even in that rather different area of the law, Dicey acknowledged uncertainty. It was said:

The question of what law governs the capacity of the parties to enter into a marriage settlement contract is a matter of some difficulty and it is necessary to speak with hesitation. On principle capacity should be governed by . . . the proper law of the contract It is sometime said, however, that capacity is governed by the law of the domicile of the party alleged to be incapable.²¹

Dicey then attempts to rationalize the various cases and concludes that capacity is governed by the proper law of the contract, but then adds:

The proper law means, in this connection, the system of law with which the contract is most closely connected, and not the law intended by the parties. As Lord MacNaghten said in *Cooper v. Cooper* ‘it is difficult to suppose that Mrs. Cooper could confer capacity on herself by contemplating a different country as the place where the contract was to be fulfilled’.²²

On questions of administration—for example, as to the powers and duties of the trustees, their liability for breach of trust, their right of indemnity or contribution, their right to remuneration, the question of what is income and what is capital, the question of what are proper trustee investments, and who can appoint a new trustee—Dicey said, “On many of these matters, English and Commonwealth authority is entirely lacking,”²³ but suggested, “As a general rule, questions of administration are governed by the law of the place of administration. The place of administration is likely to be the place where the trustees reside or carry on business, especially if the trustee is a trust corporation.”²⁴

The English rules were also uncertain with regard to the feasibility of changing the proper law of a trust. Dicey made the

19. 2 DICEY & MORRIS, *supra* note 15, at 680.

20. *Id.*

21. *Id.* at 664.

22. *Id.* at 665-66.

23. *Id.* at 683-84.

24. *Id.* at 684.

tentative suggestion that it could be changed under a power in the trust instrument to that effect, but no authority was cited.²⁵

In relation to testamentary trusts of movables, the English rules clearly distinguished the validity of the will from the validity of the trusts it created.²⁶ As regards trusts *inter vivos*, it was unclear whether any equivalent distinction should be drawn. If the trust creation process involved transfers of property to the trustee, it was clear enough that there were transfer issues, but trusts can be, and frequently are, created without any such transfer—either because the settlor is making himself the trustee, or because the property is already in the hands of the intended trustee when the settlor gives his direction to hold on trust. In such cases, should the creation of the trust—that is, the settlor's declaration or his direction to the trustee—be governed by the proper law of the trust without regard, for example, to the law of the place or places where the settled property is situated? The answer appeared to be affirmative.²⁷

All in all, one might say that the indications from England were encouraging but uncertain, and in an offshore trust center one needs clearer answers to these basic questions:

- (1) Does the settlor have complete freedom to choose the proper law of his trust? Or are there some conditions or exceptions?
- (2) Which issues—for example, capacity, validity, effect, administration—are governed by the proper law? And which are governed by, for example, the law of the settlor's domicile, or the law of the places where the settled assets are situate?
- (3) Can the proper law be changed? If so, are there conditions?

In 1987, the English rules were to some extent clarified by the Recognition of Trusts Act (adopting the Hague Convention with minor modifications),²⁸ but large areas of uncertainty remain. The answer to the first of my questions is now clear enough: the settlor's freedom to choose English law to govern his trust is subject to no condition or exception.²⁹

My second question has received a little clarification, but the more difficult parts remain unanswered. The Convention does not deal with capacity, and it does not apply to "preliminary

25. *Id.* at 680.

26. *See id.*, rule 117, at 675.

27. *See generally id.* at 678-81.

28. *See* 1 INTERNATIONAL TRUST LAWS, *supra* note 5, at A1-5.

29. *See* The Hague Convention, *supra* note 12, art. 6.

issues relating to the validity of wills or of other acts by virtue of which assets are transferred to the trustee."³⁰ This establishes a critical distinction between trust issues and "preliminary" issues. The Explanatory Report on the Convention employed the colorful metaphor of a rocket and rocket-launcher.³¹ One difficulty with this distinction is the point, already noted, that a trust can be created without any transfer of property to the trustee.³² The Explanatory Report acknowledged that a trust may be created by declaration, but then simply stated that "[t]he Commission unanimously accepted that the acts by which this change in the capacity in which the assets were held was effectuated must also be envisaged by article 4 and therefore excluded from the Convention's scope."³³ The Explanatory Report did not address the other possibility, that the assets had already been transferred to the trustee before the settlor gave his directions to hold them on trust; but presumably the Commission would have said the same thing—that is, that the validity of the settlor's directions was a matter outside the Convention.

Another difficulty in the rocket/launcher distinction is its application to a case in which the trust is created by a single transaction, a transfer to the trustee to hold upon trust for beneficiaries. How does one separate the preliminary issues from the trust issues? In any case, whatever the launcher may comprise, we are no wiser about the choice of law to govern its various aspects. I am not being critical of the Convention; its objective was to secure for the trust a measure of recognition by no-trust states, not to clarify English conflict-of-law rules.³⁴ For its intended purpose, the rocket/launcher distinction is understandable, clear, and natural; no-trust states are to remain free to object on any grounds to the creation of a trust. They undertake to recognize a trust only if its launch was unobjectionable. But, if the rocket/launcher distinction is pressed into service to clarify English conflict-of-law rules, its virtue in that context is doubtful.

My third question remains uncertain. The Convention provides that it is a matter for the proper law to say whether the proper law can be changed,³⁵ which puts us no closer to knowing what English law, if the proper law, says about that.

30. *Id.*, art. 4.

31. See Explanatory Report by Alfred E. von Overbeck, ¶ 53, *reprinted in* 1 INTERNATIONAL TRUST LAWS, *supra* note 5, at C51-13.

32. See *supra* notes text accompanying notes 26-27.

33. Explanatory Report by Alfred E. von Overbeck, *supra* note 31, ¶ 57.

34. See *id.* ¶ 14.

35. See The Hague Convention, *supra* note 12, art. 10.

Jersey was the first offshore center to take a step towards clarifying its conflict-of-law rules. Its Trusts (Jersey) Law 1984 included several relevant provisions. It was made clear that the settlor could choose Jersey law to be the proper law of his trust, and this freedom was subject to no condition or exception.³⁶ Though there was no statement of the issues governed by the proper law, there was an implication that the proper law governed validity to the exclusion of foreign laws but, seemingly, the settlor's capacity was another matter, probably governed by the law of the settlor's domicile.³⁷ Furthermore, the legislation made it clear that it did not "give validity to any transfer or disposition of property to a trust which would not otherwise be a valid transfer or disposition,"³⁸ an exclusion that seems wide enough to allow a foreign objection to the disposition because of its trust terms. It was made clear that the proper law may be changed from that of Jersey to another country—if the terms of the trust so provide.³⁹ Surprisingly, perhaps, there was no condition as regards the effect of the new law. Overall, one might say that Jersey had taken a step in the right direction, but had not achieved a set of rules that were really sufficient. There is an evident similarity in the Jersey approach and the Convention approach—probably no coincidence, as both were concluded in the same year. Indeed, with Jersey's approval, the United Kingdom has extended the Convention to Jersey, and conforming amendments were made by Jersey in 1991.⁴⁰ Earlier, in 1989, amendments had been made that, among other things, limited the reference to the settlor's domiciliary law on the question of capacity.⁴¹

Next in line were the Turks and Caicos Islands, which adopted the Trusts (Special Provisions) Ordinance in 1985.⁴² The law established a number of special rules to apply to trusts that had an "approved trustee," meaning a Turks and Caicos company meeting certain conditions and approved by the governor.⁴³ One of the special provisions was that any trust with an approved trustee would be governed by the law of the Turks and Caicos Islands and that "the law of any country or territory outside the

36. See Trusts Law 1984 (Jersey), art. 4, reprinted in 2 INTERNATIONAL TRUSTS LAWS, *supra* note 5, at D15-4.

37. See *id.* arts. 4-10.

38. *Id.* art. 55(1)(G).

39. See *id.* art. 37.

40. See Trusts (Amendment No. 2) Law 1991 (Jersey), reprinted in 2 INTERNATIONAL TRUST LAW, *supra* note 5, at D15-19.

41. See Trusts (Amendment) Law 1989 (Jersey), reprinted in 2 INTERNATIONAL TRUSTS LAWS, *supra* note 5, at D15-17.

42. See 1 INTERNATIONAL TRUST LAWS, *supra* note 5, at A18-3.

43. See *id.* at A18-4.

Islands shall not be taken cognisance of in relation to any such trust," except in the case of immovable property.⁴⁴ Another provision was that the capacity to create a trust of movables would be governed by the law of the Turks and Caicos Islands.⁴⁵ The Ordinance made no reference to a distinction between trust issues and "preliminary" or transfer issues, but some such distinction may be inferred; otherwise, a transfer of foreign moveable property would be governed entirely and exclusively by Turks and Caicos law merely because it was a transfer to an "approved trustee." That these rules were not entirely satisfactory seems to have been acknowledged; a new set of rules was incorporated in the Trusts Ordinance 1990.⁴⁶

The Cayman Islands were next with the Trusts (Foreign Element) Law 1987 (TFEL).⁴⁷ This set out to deal with the subject comprehensively and to tackle the "preliminary" issues as well as the trust issues. TFEL established the settlor's complete freedom to choose the proper law of his trust (referred to in the legislation as the "governing law").⁴⁸ It enabled a change of proper law, subject to specified conditions.⁴⁹ In the case of a change to Cayman Islands law, the change must be recognized by the previous governing law; in the case of a change from Cayman Islands law, the new governing law must recognize the validity of the trust and the respective interests of the beneficiaries.⁵⁰ TFEL established that all trust and preliminary issues, including capacity, validity, and administration, are governed by Cayman Islands law without reference to the laws of other jurisdictions;⁵¹ but that rule is subject to a number of exceptions, for example, in relation to testamentary dispositions,⁵² and also dispositions of immovable property.⁵³ Another exception established that foreign laws would be recognized in determining whether the settlor was

44. Trusts (Special Provisions) Ordinance 1985 (Turks & Caicos Islands) § 10, reprinted in 2 INTERNATIONAL TRUST LAWS AND ANALYSIS, *supra* note 4, at TUR 101.

45. *See id.* at § 9.

46. *See generally* The Trust Ordinance 1990 (Turks & Caicos Islands), reprinted in 2 INTERNATIONAL TRUST LAWS, *supra* note 5, at D18-3.

47. *See generally* Trusts (Foreign Element) Law 1987 (Cayman Islands), reprinted in 2 INTERNATIONAL TRUST LAWS, *supra* note 5, at D7-35.

48. *See id.* at § 4.

49. *See id.*

50. *See id.*

51. *See id.* § 5.

52. *See id.* ("This section does not validate any testamentary trust or disposition which is invalid according to the laws of the testator's domicile").

53. *See id.* § 5(a) ("This section does not validate any trust or disposition of immovable property situate in a jurisdiction other than the islands which is invalid according to the laws of such jurisdiction").

the owner of the property he purported to settle or the holder of a power enabling him to do so.⁵⁴ Another important exception established that the new rules did not "affect the recognition of foreign laws prescribing generally (without reference to the existence or terms of the trust) the formalities for the disposition of property."⁵⁵ And, in this connection, the term "formalities" was given an extended definition to mean:

the documentary and other actions required generally by the laws of a relevant jurisdiction for all dispositions of like form concerning property of like nature, without regard to: (a) the fact that the particular disposition is made in trust, (b) the terms of the trust, (c) the circumstances of the parties to the disposition, or (d) any other particular circumstances, but include any special formalities required by reason that the party effecting the disposition is not of full age, is subject to a mental or bodily infirmity or is a corporation.⁵⁶

So the door was left open to the application of foreign laws in relation to transfer issues, including, to a limited extent, the settlor's capacity, but not so as to give effect to any foreign objection to the transfer by reason of it being a transfer in trust or by reason of the terms or circumstances of the particular trust.

The Cayman approach has proved popular in the sense that it has been the model for several other offshore centers.⁵⁷ However, the only learned commentary of which I am aware sounds a critical note. In *Launching the Rocket—Capacity and the Creation of Inter Vivos Transnational Trusts*, Jonathan Harris writes:

The whole effect of the Act is, *prima facie* at least, to give great freedom to a settlor to confer capacity on himself to dispose of property. In so doing, it might be said to value pragmatism more than consistency with conflict of laws principles on capacity and the transfer of property.⁵⁸

Under the circumstances that seems unfair, partly because the English principles were, and are, so unclear, and partly because Harris seems to have overlooked the Cayman exception noted above concerning "formalities" and the admittedly unusual definition of that word.⁵⁹ Harris provides an illuminating discussion of the English rules after 1987 (which confirms the

54. See *id.* § 5.

55. *Id.* § 5(d).

56. *Id.* § 2.

57. See Jonathan Harris, *Launching the Rocket—Capacity and the Creation of Inter Vivos Transnational Trusts*, in 1 INTERNATIONAL TRUST LAWS, *supra* note 5, at C2-23.

58. *Id.* at C2-24.

59. See *supra* notes 55-56 and accompanying text.

great and continuing uncertainty of the English rules and the contradictions of the views expressed by commentators) and he concludes with some suggestions for what the English rules should be:

- 1(a) The capacity of any party to dispose of any property right is governed by the *lex situs* at the time of the purported transfer.
- (b) The capacity of any party to create a trust of any property of which he may, according to rule (a), dispose, is governed by the proper law of the trust.⁶⁰
- 2(a) Whether any proprietary interest has been transferred *inter vivos* from a would-be settlor to a would-be trustee is determined by the *lex situs* at the time of transfer.
- (b) Whether the transfer is effective to transfer *equitable* title to the would-be beneficiary, and thus to form a completely constituted trust, is determined by the proper law of the trust.⁶¹

There is an evident similarity between the Harris approach and the Cayman approach: both give some effect to the *lex situs*, but objections in the *lex situs* that arise from the trust aspects of the transaction are overridden. According to the Harris approach, if the *lex situs* denies the settlor general capacity to dispose of property, that rule is applied;⁶² on the other hand, if the *lex situs* acknowledges general capacity but denies the settlor particular capacity to make this disposition of property, that rule is not applied.⁶³ If the *lex situs* denies that the disposition gave the trustee *any* interest (and it is not clear what this really means in the context of civil law concepts of ownership), that rule is applied; but, if the *lex situs* denies that the right to the property has shifted from the settlor to the beneficiaries, that rule is not applied.⁶⁴ It seems to me that there is a lot to be said for this approach, but it is open to question whether it is more principled than pragmatic. For example, Harris' justification for applying the proper law of the trust to the question of whether equitable title has passed from the settlor to the beneficiaries is in the following passage:

60. See Harris, *supra* note 57, at C2-16.

61. See *id.* at C2-22.

62. See *id.* at C2-16.

63. See *id.*

64. See *id.* at C2-22.

Technically, one could argue that two questions arise as to the passing of property: (i) the transfer of legal title to the trustee; and (ii) the transfer of equitable title to the beneficiary. The latter question arises because, in the words of Sykes and Pryles, 'the trust document may therefore be viewed as a type of equitable conveyance.' Thus, if A purports to transfer property to B to hold on trust for C, the *lex situs* might permit the transfer of property to B, but not accept the validity of the equitable transfer. Accordingly, one could argue that the *lex situs* should apply to both questions. Yet this cannot be correct in principle. Otherwise, it would seem to preclude e.g. the creation in England of a trust of land situated in any country where the passing of equitable ownership is not permitted or recognised, even if English law is stated to be the governing law of the trust. Indeed, it would seem to prevent the creation of a trust, the assets of which are held in a country which does not have any analogous concept to that of equitable ownership.⁶⁵

One can see the force of this argument, but is it principled or pragmatic? The fundamental question for all trust states is whether there can be a trust of property situated in a foreign state that denies the validity of the trust or insists that the effects are not those prescribed by the trust law. If the answer to that were negative, the utility of the trust would be substantially reduced. That seems to be Harris' point. I agree with the point, but I would call it pragmatic. The principled justification is, presumably, that while the trust may be regarded (by common lawyers) as a mechanism for giving property to beneficiaries, it may also be regarded as the creation (and release) of obligations and rights in relation to property. This explanation suggests an analogy with contract and, in that context, the *lex situs* generally does not override the proper law.

A feature of the Harris approach that emerges from the body of his paper is that his suggested rules are to apply equally in a case where there is in fact no transfer of property from the settlor to the trustee.⁶⁶ So, for example, a settlor lacks capacity to declare himself a trustee if the *lex situs* denies his general capacity to dispose of property. The suggestion seems to be that the application of the rule is necessary in order to give the *lex situs* the same effect regardless of the method that the settlor employs to launch his trust. Harris' argument is that otherwise a settlor who lacks dispositive capacity under the *lex situs* can circumvent his incapacity by declaring a trust under which he may then be compelled to transfer the property to the beneficiary.⁶⁷ I am not sure that I see the force in that argument. If and for so long as the *lex situs* denies the settlor's capacity, it

65. *Id.* at C2-17.

66. *See id.* at C2-3 to C2-30.

67. *See id.*

will prevent him transferring to the beneficiary, so that particular trust obligation cannot be performed (if it arises while the settlor is still incapable) unless the *lex situs* provides or recognizes a process by which the property of incapable persons can be transferred. In other words, recognition of the trust does not circumvent the *lex situs*. In any case, I am not sure why one should be shy about the idea that different methods of launching a trust have different effects in terms of the application of foreign laws. At this rate, it will be suggested that the validity of a settlement of cash in State A will to some extent be governed by the law of State B if it was the intention that the trustee would use some of the cash to buy property in State B—the argument being that this was a roundabout method of launching a trust of property in State B. It seems to me that the Convention's distinction between rocket and launcher has been allowed to confuse the issue.

The Cayman approach distinguishes (1) the transfer, if any, to the trustee, from (2) the creation of trust obligations to be performed by the trustee. The creation of trust obligations is a matter for the proper law of the trust. Everything is relatively straightforward if the trust is created in two stages: first, a transfer of property by the settlor to the trustee to hold on the settlor's behalf; second, a direction by the settlor to the trustee to hold upon trust for the beneficiaries. In such cases, TFEL has no application to the first stage, the transfer, and, on English principles, it seems the *lex situs* (and, in the case of intangibles, the constituent law) will govern.⁶⁸ The second stage, the creation of trust obligations, is governed by the proper law of the trust. The difficulty arises in the case where these two stages are combined in one transaction, a transfer to the trustee to hold upon trust for the beneficiaries. The Cayman approach is, in effect, to split the transaction, to approach it as though it had been done in two stages, allowing foreign laws to apply in relation to the first stage (notional transfer to the trustee to hold for the settlor), but not the second. If the settlor chooses to launch his trust by declaring himself to be the trustee, there is no question of a transfer; there is only the creation of trust obligations. That is a matter for the proper law. By whichever method the trust is launched, the ability of the trustee to transfer trust property to beneficiaries, if and when that becomes the trustee's obligation,

68. Admittedly, if the foreign law is not a common law, there may be some difficulty in formulating the question to be referred to the foreign law, and perhaps this is what prompted Harris to express his Rule 2a in terms of "any proprietary interest," though I am not sure that really takes us any further in understanding the English rule.

will be dependent on the laws of the places where the trust property is then situate. Meanwhile, there is a perfectly good trust. The TFEL drafting might be improved, but I still consider that its approach is good.

Not all of the offshore centers have followed the Cayman model. Jersey has been mentioned already.⁶⁹ In 1989, it took a further important step and introduced the rule that

[i]f a person domiciled outside Jersey transfers or disposes of property during his lifetime to a trust—(a) he shall be deemed to have capacity to do so if he is at the time of such transfer or disposition of full age and of sound mind under the law of his domicile.⁷⁰

Jersey, therefore, adheres to the notion that capacity is a matter for the settlor's domicile, even in the case of a trust *inter vivos*, but application of the *lex domicilii* is limited to matters of age and mental faculty. Surprisingly, in my view, there has been no adjustment of the provision that "nothing in this Law shall . . . give validity to any transfer or disposition of property to a trust which would not otherwise be a valid transfer or disposition."⁷¹ This seems to leave the door open to any foreign objection, even if it concerns capacity, and even if it arises precisely because it is a transfer in trust or because of the particular terms of the trust. Possibly Jersey takes the view that these are issues that can and should be avoided in practice by the simple expedient of localizing the property before settlement. The usual method is for the settlor to put his foreign assets into an offshore holding company in exchange for an issue of that company's shares, which he then settles upon the trust. Indeed, this practice is to be recommended unless there is some extraneous objection, for example, untoward tax consequences.

V. THE NEW CLIENT

At the end of Section I, I noted that tax measures adopted by the major common law countries resulted in a substantial decline in the traditional market for offshore trust services.⁷² Initially, this did not cause any great alarm or despondency; the same financial institutions that provided trust services also provided a variety of other financial services, including corporate

69. See *supra* Part IV.

70. Trusts (Amendment) Law 1989 (Jersey), art. 1, reprinted in 2 INTERNATIONAL TRUST LAWS, *supra* note 5, at D15-17.

71. Trusts Law 1984 (Jersey), art. 5(1)(G), 2 INTERNATIONAL TRUST LAWS, *supra* note 5, at D15-16.

72. See *supra* Part I.

management. Overall, business continued to expand. As far as I am aware, institutions did not at first increase significantly their efforts to sell their trust services in new parts of the world. However, in Hong Kong, the prospect of a return to China was developing a substantial demand for trust services; and fairly quickly, the virtues of the trust became widely known in many expatriate Chinese communities. Perhaps this also contributed to the worldwide phenomenon of "private banking," financial institutions making major efforts to seek out and secure the business of wealthy people (in the usual jargon, "high net worth individuals"). Whatever the causes of the phenomenon, there was swift recognition of the fact that trust services were especially important—not that they were more profitable than other kinds of financial service, but that there was no better way to deepen and make secure a relationship with a wealthy client and extend that relationship to his family than by taking on the trusteeship of his family trust. Inevitably, the focus was on no-trust states; wealthy people in the trust states had little use for offshore trust services unless there was a tax advantage to be obtained, and by this time such advantages were scarce in the major common law states. Selling the trust idea in no-trust states was initially difficult, unless the client or his local advisers had encountered it already; but the word soon spread and, of course, the fundamentals were strong: the trust is an excellent estate planning solution in all circumstances unless the relevant tax authorities have decided to penalize its use.

So now the offshore trust industry has a new typical client. The old client came from one of the major common law countries; the new client comes from Latin America, Continental Europe, the Middle East, or the Far East; and he brings with him different objectives, attitudes, and problems. It is these differences, and the keen desire of the financial institutions to accommodate them, that account for most of the changes in offshore trust law and practice.

In the new client's baggage we found, for example:

- (1) forced heirship;
- (2) a desire to retain control over investment and management decisions;
- (3) a propensity for unorthodox investments, and no desire to use the client's home currency as the measure of value and performance;
- (4) a desire for extra protection against the risks of using this alien structure;
- (5) a desire for confidentiality; and

- (6) unfamiliarity with the trust idea—on the part of the client and, often, his trusted advisers.

These are discussed in Sections VI to XI below. As will be seen, the focus shifts from tax planning to trust planning—though obviously tax is still an important consideration.

VI. FORCED HEIRSHIP

A. Introduction

At the outset, few of us realized that forced heirship was a problem. If other legal systems restricted testamentary freedom, surely that was simply another good reason for creating an offshore trust *inter vivos*. Even when we gathered that forced heirship regimes might be hostile to trusts, we were not much concerned. We knew very little about these foreign laws and we did not think it was our business to know about them. It was up to the settlor to take advice in his own country, and most of these settlors were wealthy cosmopolitan individuals attended by plenty of advisers. If we appreciated that the trust might not be recognized in the settlor's own country, this caused mild concern at most. Surely the only thing that really mattered was that the trust should be recognized in the offshore center? Gradually, however, we came to realize that we stand at the point of contact between two fundamentally opposed legal philosophies, and, in consequence, there are real difficulties for the trust planner to solve.

Common law systems impose on parents a duty to care for their children and provide for their financial needs until they are able to provide for themselves. But the child has no further rights in relation to his parents' property. Remoter descendants have no rights at all. There are, of course, intestacy rules; but these rules do not override the testator's wishes if expressed in proper form. By contrast, the general rule in civil law systems is that the bulk of an individual's property must pass on death to his descendants immediately and unconditionally, in equal shares per stirpes, regardless of his wishes or their needs. If there are no descendants, then parents and remoter ascendants take instead. If the differences between the common law and the civil law stopped there, the resulting difficulties would be relatively minor. Nearly all legal systems agree, in relation to movable property at least, that succession is governed by the law of the deceased's own state (though there are differences as to the relevant connecting factor, whether that is nationality, domicile,

or habitual residence). But the differences do not stop there. In most forced heirship regimes, the same policy that restricts testamentary freedom also leads to restrictions on the individual's freedom to dispose of property *inter vivos*. These lifetime restrictions come in a variety of forms, not all of which are obviously related to forced heirship. The civil law approach stops short of saying that property belongs to the family rather than the individual, but it reflects a compromise between individual and family ownership.

By way of illustration, the next subsection outlines the French regime. France has been chosen because it has been so influential on the regimes of other civil law states. First, however, I would like to place this discussion in perspective. The confrontation with forced heirship is not merely a problem for offshore centers or offshore trusts. Forced heirship threatens all trusts, onshore as well as offshore, and all other transactions that have a gratuitous element— gifts, covenants, and even contracts if entered into for less than full value. As a practical matter, the threat may be more worrying for an offshore center, but it extends just the same to all other common law states. Whenever an individual enters into a gratuitous transaction, there is a risk that sooner or later the transaction will be attacked by his heirs or representatives with the argument that the transaction was invalid from the outset or that the heirs have the right to claw-back the gift or claim compensation. The risk exists even though at the time of the transaction the individual has no connection with a civil law system.

B. France

In France, the individual's power of testamentary disposition is limited to a portion of his property, the disposable portion (*quotite disponible*).⁷³ On his death, the rest of his property, the reserved portion (*reserve hereditaire*) devolves without regard to his wishes upon the persons prescribed by law, the forced heirs. The size of the reserved portion depends on whether the individual is survived by descendants or ascendants. If there are none, there is no reserved portion. If there is one living child (or a deceased child with living issue), the reserved portion is one-half of the estate. If there are two such children, the reserved

73. For more discussion of France's laws regarding testamentary dispositions, see generally C. CIV. (France), Book 3, Titles 1-2; EUROPEAN SUCCESSION LAWS (David Hayton ed., Chancery Law Publishing 1998); LAWRENCE: INTERNATIONAL PERSONAL TAX PLANNING ENCYCLOPAEDIA (Butterworths & Co. Publishers 1991).

portion is two-thirds of the estate. If there are more, it is three-quarters of the estate. If there are no children or other descendants, but there are surviving ascendants in both maternal and paternal lines, the reserved portion is one-half of the estate. If there are ascendants in one line only, it is one-quarter of the estate.

The same restriction applies during the lifetime of the individual. In principle, lifetime gifts may be made only from the disposable portion. However, the calculation of the disposable and reserved portions cannot be made until the donor's death and so lifetime gifts are valid for the time being but may have to be reduced or returned on the donor's death. This is the claw-back feature mentioned already.

For the purpose of calculating the disposable and reserved portions and the entitlements of the forced heirs, the actual estate left by the deceased individual is grossed up by the amount of all gifts made in his lifetime. This applies to all gifts, including gifts in trust, however long before the date of death they were made and regardless of whether the motive of the gift was to avoid or adjust the entitlements of the forced heirs. The reserved portion is calculated by reference to this grossed-up amount and hence, the entitlement of each forced heir. If a forced heir has received lifetime gifts, these are charged against his share, and his entitlement is reduced accordingly.

If the actual estate is sufficient to cover the entitlements of the forced heirs, legacies granted by will may be paid from the excess, and lifetime gifts are safe from claw-back. If the actual estate is insufficient to cover the entitlements of the forced heirs, no legacies can be paid, and lifetime gifts are subject to claw-back (*reduction*) in inverse order—that is, the most recent first, in order to make up the deficit.

For example, if an individual died with an actual estate of ten million francs but in his lifetime had made gifts totalling six million francs, the entitlements of the forced heirs would be calculated by reference to a fictitious estate of sixteen million francs. For simplicity we assume there was no surviving spouse. If there were one surviving child, his forced share—the whole of the reserved portion—would be half this amount (eight million francs). Of the actual estate, this would leave two million francs to pay the legacies granted under the individual's will. If the will purported to grant legacies of a greater amount, they would be abated ratably, subject to any contrary direction in the will.

If, in the same example, the individual had been survived by three children instead of one, the reserved portion would be three-quarters of sixteen million francs (twelve million francs), or four million francs per child, a figure in excess of the actual estate. As a result, legatees under the will would receive nothing.

Further, the forced heirs could require reduction of the lifetime gifts in inverse order. Recipients of the more recent gifts would be obliged to compensate the forced heirs to the tune of two million francs, regardless of whether they still held the gifted property.

The recipient of a gift subject to claw-back is not excused by the fact that he has consumed or disposed of the gifted property. If the recipient did dispose of the property and is now impecunious, the forced heirs may challenge the donee, whether he took by gift or by purchase for value, with or without notice, unless the heirs consented to the disposition *inter vivos*.

It seems that the claw-back rules do not generally invalidate the gift; they merely give the forced heirs rights of recovery or compensation. But the validity of the gift presumably could be challenged if it was evasive—if it was made for the purpose of avoiding or adjusting forced heirship rights—or if it breached any of the other rules, noted below, restricting freedom of disposition.

The surviving spouse has no forced heirship rights in French law. Marital property rights are normally fixed by agreement between the spouses at the time of marriage. They may agree, if they wish, upon complete separation of property, but in the absence of agreement to the contrary, the law imposes a community of property regime, giving each spouse an equal interest in property acquired by either of them during the marriage. On death (or divorce) the community is dissolved and the property is divided between the surviving spouse and the estate of the deceased spouse. The heirs and legatees of the deceased spouse participate in the net estate *after* accounting to the surviving spouse for his community share.

The surviving spouse does have one advantage in regard to succession. Subject to certain strict limits, a testator may make provision for his spouse out of the reserved portion of the estate, thus reducing or postponing the interests of the forced heirs.

Ancillary to the forced heirship regime and claw-back, there are other dispositive restrictions whose purpose is to promote or protect the interests of the next generation (and the fisc). Even as regards the disposable portion of his estate, the individual is strictly limited in his ability to create successive interests or confer benefits on future generations. Before the French Revolution, the law was more permissive, to such extent that much of the land was tied up for future generations by means of *fideicommissum*, a concept of Roman law with resemblances to the strict settlement of English law. As a general rule *fideicommissum* is now prohibited, though there are exceptions. For present purposes, the most important exception is that a parent may give property to a child on terms that ownership will

pass on the child's death to the child's children; but this concession applies only if it is a gift to all of the child's children in equal shares regardless of age, sex or other circumstances.

A restriction that relates only to lifetime dispositions is the rule *donner et retenir ne vaut* (to give and keep back is invalid). In general, a gift is ineffective so long as the donor retains possession of, or any freedom of disposition over, the property. Revocable interests or dispositions are generally impossible, but there are exceptions to this rule; and there are occasions when revocation occurs by operation of law, if, for example, a childless donor later has a child. Conditional gifts are also subject to heavy restriction. There are restrictions upon donations or bequests in favor of charitable and other institutions—or, to be exact, there are restrictions upon the capacity of institutions to accept gifts.

There are strict formalities for gifts, even of movable property. For most types of property there must be a notarial *acte*; the donee's acceptance of the gift must be recorded in the *acte*; a full inventory with values must be prepared; and, in the case of real property, the *acte* must be registered at the Bureau des Hypotheques. Lawyers have expended much ingenuity in circumventing the notarization rule, and the French courts have been quite accommodating in this respect.

France's succession rules apply:

- (1) to the movable estate wherever situate of a person who at the time of death was habitually resident in France; and
- (2) to the immovable estate located in France of a person wherever resident.

A rule that has been much criticized in France and elsewhere gives heirs of French nationality special rights. Even if the deceased was not a habitual resident of France and had no immovable property in France, French law will intervene on behalf of any heirs of French nationality, conferring upon them the same forced heirship entitlements as they would have enjoyed if the succession had been governed by French law, and permitting the French heirs to effect recovery of their entitlements against any French property.

To summarize, the clear policy of French law is that the property owned by a person is a fund (*patrimoine*) that should be handed down from one generation to the next, and which should be preserved from the generosity of the owner. This policy is achieved by a combination of (1) succession rules restricting testamentary power to the disposable portion, (2) claw-back of lifetime dispositions if they prove to exceed the disposable portion, (3) very limited legal mechanisms for creating partial

interests in property or for tying it up for successive generations (in other words, no functional equivalent of the trust), (4) a miscellany of other substantive restrictions, and (5) onerous formalities for dispositions.

The claw-back rules are particularly troublesome. French claw-back is:

- (1) unlimited in time (i.e., regardless of how long before death the gift was made);
- (2) not an anti-avoidance rule: it applies regardless of whether the individual was trying to avoid or adjust the rights of his heirs;
- (3) remorseless: it makes no difference that the donee has used, spent or lost the gift. If he cannot return it, he must compensate the heirs;
- (4) unfriendly to trusts, in the sense that it gives no credit for trust interests given to the heirs: they can insist on outright ownership of their inheritance without strings or conditions;
- (5) unpredictable: when an individual makes a disposition in his lifetime, one can only guess what will be his circumstances (personal, familial, and financial) at the time of his death. No gift is entirely free of risk; an English donor may eventually move to France;
- (6) a blot on the title to property: if the donee has parted with the property and is now impecunious, the heirs may be able to trace the property into the hands of whoever now has it, even though acquired by purchase for value; and
- (7) non-waivable: There is nothing that the donor or the donee can do nothing about the claw-back risk. Even if the probable heirs are of full age, they cannot give an effective waiver.

C. *Forms of Attack*

Suppose that an individual creates a trust *inter vivos* and eventually dies under circumstances that subject his succession to Ruritanian law. Suppose it transpires that the actual estate is insufficient to satisfy the rights of the forced heirs under Ruritanian law. Of course, the heirs could obtain a favorable decision from the Ruritanian courts, but let us suppose there is no person or property in Ruritania against which the heirs could enforce their rights. So the heirs decide to commence an action in the trust domicile. There may be several possible claims:

- (1) *Property*: The heirs may claim that their rights under Ruritanian law amounted to a proprietary interest in the settlor's property during his lifetime, an interest that was not overridden by the settlement.
- (2) *Capacity*: The heirs may claim that the settlor, because he had children, lacked capacity to make a disposition of this nature.
- (3) *Validity*: The heirs may claim that the settlement was invalid, perhaps because the settlor's purpose was to avoid or adjust the rights of forced heirs, or because he reserved a beneficial interest for himself and powers of disposition. Or perhaps the objectionable feature was that Ruritanian gift formalities were not observed.
- (4) *Direct enforcement*: The heirs may claim that Ruritanian law gives them claw-back rights that the forum should recognize and enforce. Thus, the trustee and any beneficiaries who have received distributions should return the settled property; if that cannot be done, compensation should be paid.
- (5) *Restitution*: The heirs may claim that the trust beneficiaries have been unjustly enriched at the expense of the heirs.
- (6) *Tort*: The heirs may claim that the trustee and the settlor's advisers who assisted him to create the trust are guilty of interfering with the heirs' rights, so they are liable in damages.

Applying English principles, it does seem improbable that the heirs could succeed in any such claim. Since the early Middle Ages, the English rule has been *nemo est heres viventis*: a living person has no heirs. Nonetheless, as has already been noted, there is a great dearth of judicial authority, and when one looks closely at each of the possible claims and the principles that an English court might apply in relation to it, one does encounter some real issues, at least in relation to a trust in which the settlor's reserved interests and powers are such that the trust may be regarded as a will-substitute. Space does not permit me to embark on a discussion of these issues, but I hope I have said enough to show why the offshore centers saw the need for specific legislation in relation to forced heirship to remove any doubt about where the line should be drawn.

Of course, there are other strategies available to the heirs, other than a frontal attack in the trust domicile. They may be able to obtain satisfaction in the settlor's country if they can find

trust property or trust beneficiaries there. If trust-controlled companies have assets there, it may be possible to pull aside the corporate veil. Another strategy may be to obtain a judgment in the settlor's country and then enforce it in other places where persons or property can be found, perhaps even the trust domicile. On English principles, that may be possible depending upon the circumstances of the particular case, unless the trustee or other defendant can persuade the court that to do so would be offensive to public policy. The main argument would be, presumably, that it is against public policy that all dispositions of property *inter vivos* at less than full value should be blighted by a claw-back risk that cannot be assessed until the disponent's death. Nevertheless, the Hague Convention on Trusts provides a counterargument of sorts. Convention states have acknowledged expressly that a foreign state may withhold recognition of a trust *inter vivos* that eventually interferes with the succession rights of the settlor's heirs. So, can a Convention country say that enforcement of a foreign judgment giving effect to those succession rights is against its public policy? The Hague Convention on Succession, if ratified without reservation, would make matters much worse, for it appears to accept the civil law view that the heirs' claw-back claims with respect to property disposed of by the deceased in his lifetime should be characterized as a matter of *succession*, governed by the law indicated by the Convention.

D. *The Offshore Legislation*

The Cayman Islands were the first to adopt legislation dealing specifically with forced heirship. The Trusts (Foreign Element) Law 1987 has been noted already. Its special provisions, as amended in 1995, read:

Exclusion of Foreign Law

6. Subject to the same provisos as set out in paragraphs (a) to (f) inclusive of section 5, it is expressly declared that no trust governed by the laws of the Islands and no disposition of property to be held upon the trusts thereof is void, voidable, liable to be set aside or defective in any fashion, nor is the capacity of any settlor to be questioned, nor is the trustee or any beneficiary or any other person to be subjected to any liability or deprived of any right, by reason that –

- (a) the laws of any foreign jurisdiction prohibit or do not recognise the concept of a trust; or
- (b) the trust or disposition avoids or defeats rights, claims or interests conferred by foreign law upon any person by reason of a personal relationship to the settlor or by way of heirship rights, or contravenes any rule of foreign law or any foreign judicial or administrative order or action

intended to recognise, protect, enforce or give effect to any such rights, claims or interests.

Heirship rights

6A. An heirship right conferred by foreign law in relation to the property of a living person shall not be recognised as –

- (a) affecting the ownership of immovable property in the Islands or moveable property wherever situate for the purposes of paragraph (a) of section 5 or for any other purpose; or
- (b) constituting an obligation or liability for the purposes of the Fraudulent Dispositions Law, 1989 or for any other purpose.

Foreign Judgments

6B. A foreign judgment shall not be recognised or enforced or give rise to any estoppel insofar as it is inconsistent with section 6 or section 6A.⁷⁴

These provisions have been borrowed in whole or part by many of the other offshore centers, but some have ploughed their own furrow. Jersey, for example, dealt with the subject quite briefly, providing in its 1989 amendment:

If a person domiciled outside Jersey transfers or disposes of property during his lifetime to a trust . . . no rule relating to inheritance or succession (including, but without prejudice to the generality of the foregoing, forced heirship, 'legitime' or similar rights) of the law of his domicile or any other system of law shall affect any such transfer or disposition or otherwise affect the validity of such trust.⁷⁵

Perhaps the legislator took the view that the other possible grounds of attack⁷⁶ were covered by implication or stood no prospect of success in any event. Or perhaps he felt constrained by the fact that Jersey itself has forced heirship.

Obviously, none of this offshore legislation removes the need for care in both the planning and the administration of a trust. The question remains: if the settlor dies in circumstances that subject his succession to a forced heirship regime, will the heirs have a claim against the trust? And, if they do, will they find a court that is sympathetic to their claims and is in a position to enforce its decisions and upset the trust arrangements? Space does not permit a full discussion of planning techniques, but it is worth noting that if, as is nearly always the case, the prospective heirs are beneficiaries of the trust, much can be achieved by

74. Trusts (Foreign Element) (Amendment) Law 1995 (Cayman Islands), reprinted in 2 INTERNATIONAL TRUST LAWS, *supra* note 5, at D7-38.

75. Trusts (Amendment) Law 1989 (Jersey), art. 1, 1 INTERNATIONAL TRUST LAWS, *supra* note 5, at D15-17.

76. See *supra* Part VI.C.

appropriate drafting of the trust instrument. For example, a “no-contest” clause can be included so that, if an heir attacks the trust, he will lose his trust interest; and, if his attack fails, he will end up with nothing. Sometimes provisions of this sort are put on a discretionary footing, so that the trustee is given the decision whether to exclude the heir/beneficiary. The trouble is that this puts the trustee into a difficult position, and the trustee may well be reluctant to act without a direction from the court. The court may also feel some reluctance. After all, the settlor has signalled that an attacking beneficiary should not necessarily be excluded—so what should be the criteria for making this decision? The better approach seems to be to have automatic exclusion, coupled with a power to reinstate a beneficiary who repents and makes good any loss or expense that he has caused.

Another important practical consideration is the accessibility of trust information, the information that an heir would need in order to plan and execute an attack. For example, the heir would want to know in what jurisdictions the trust had investments. Under English principles, it is unclear to what extent the trust instrument may restrict the beneficiaries’ access to trust information, so care is needed.⁷⁷

The Cayman Islands case of *Lemos v. Coutts & Co.* is an illustration of both of these practical points, “no-contest” clauses (in that case discretionary and ultimately ineffectual) and access to information.⁷⁸ *Lemos* taught various useful lessons, not least that a trust is inherently difficult to defend from a forced heirship attack if it has substantial links with the jurisdiction whose laws govern the settlor’s succession—if, for example, assets and operations of the trust or its controlled companies are situate there.⁷⁹ In the end, the dispute was settled. At no stage did the plaintiffs attempt a frontal attack on the trust in the Cayman Islands.

77. Information rights are discussed in more detail in Part X below.

78. [1992-93] C.I.L.R. 460, 481-82, 508 (Cayman Is., Ct. App. 1993). (The plaintiffs were claiming that as beneficiaries they should have access to trust information, but other beneficiaries and the trustee argued, with partial success, that the information should be denied or restricted because it was being sought to facilitate an action brought by the plaintiffs in Greece to set aside the trust or claim claw-back rights).

79. See *id.* at 481-82.

VII. RETAINING CONTROL

It is understandable that many "new clients" are reluctant to surrender all control over the investment and management of the settled assets. Several techniques have been employed for achieving their wishes, not all of them good.

A. *Letter of Wishes*

I have already alluded to the use of non-binding letters of wishes in relation to distribution decisions; they have also been used as a means of giving the settlor de facto influence or control over investment decisions.⁸⁰ Quite simply, the letter of wishes invites the trustee to consult with the settlor before making important decisions. So far so good, but sometimes the letter goes further and indicates that the trustee should act on the settlor's directions; and plainly, that is not good at all. If the trustee acts accordingly, it will be in breach of its fiduciary obligation to make its own decisions. The trustee will have to pay for the settlor's bad decisions, and it will probably not be allowed to offset the profits generated by his good decisions. From the settlor's viewpoint, the arrangement is unsatisfactory because it gives him no effective reassurance; his continued control of investment decisions depends on the trustee's continued willingness to act in breach of its obligations. Worse still, such a letter may constitute powerful evidence that the trust instrument is a sham, that it pretends to give the trustee discretion while the true understanding is that the trustee will do as it is told.

B. *The Lucking Clause*

In memory of the English case, *Re Lucking's Will Trusts*,⁸¹ "Lucking clause" is the name often given to provisions in trust instruments that declare the trustee may leave the management of controlled companies to others and refrain from interference unless there is actual notice of wrongdoing. This clause is sometimes employed when the plan is that the trust will hold all its assets through a holding company, and the settlor or his designees will be appointed as the directors of the company—hence giving him de facto control of operations. Under English principles, such a clause is legitimate, but the trustee needs to

80. See *supra* Part II.

81. [1967] 3 All E.R. 726.

understand its effect. Some trustees make the mistake of thinking that the clause absolves them of their duty to take care in choosing the directors and their duty to supervise the activities of the directors. Of course, it does not.

A more extreme form of Lucking clause is sometimes used, one that purports to exclude the trustee's duties of care and supervision and that actually prohibits the trustee from interference unless there is notice of wrongdoing. Some clauses even purport to prohibit the trustee from seeking information about the company and its operations. The validity and effect of these super-Lucking clauses is open to doubt. Under English principles, the court would surely be most reluctant to accept that neither the trustee nor anyone else who is accountable to the beneficiaries has responsibility for managing the property. One possible conclusion is that the settlor (and other directors of the company) are held to be fiduciaries with responsibilities to the trust's beneficiaries. Another is that the clause is simply invalid as being repugnant to the trust idea; the trustee has a duty to use its powers as shareholder prudently in the interests of the beneficiaries. In any case, it seems that these clauses do not purport to displace the trustee's duty to choose directors with care—indeed, it seems proper to conclude that extra care is required if the directors are to be immune from subsequent supervision or removal. Conceivably, another possible outcome is that the trust is struck down for lack of a genuine intention on the part of the settlor to create an immediate trust for the benefit of anyone other than himself. As far as I am aware, none of these questions has yet been tested in an offshore court.

C. *Reserved Powers*

Plainly, the straightforward technique is for the settlor to reserve appropriate powers in the trust instrument. For example, the trust instrument may reserve a power to issue investment directions and require the trustee to comply with these directions. The power may be exclusive (the trustee may only act as and when directed by the settlor) or non-exclusive (the trustee may act in its own discretion in the absence of contrary directions from the settlor). This is certainly a legitimate approach, but care is still required to ensure that the desired result is achieved. Questions for consideration include:

- (1) Should the settlor hold his power in a fiduciary or non-fiduciary capacity? If an extensive power is held by him in a non-fiduciary capacity,

- particularly if it is held on an exclusive basis, it may cast doubt on the validity of the trust;⁸²
- (2) If the settlor's power is fiduciary, he must act in the interests of the beneficiaries, and he is also subject to other fiduciary obligations—for example, no profit, no conflicting interest or duty, and no delegation. Should these obligations be modified?
 - (3) Should the trustee keep informed or prompt the settlor when decisions are required and react when the settlor's decisions seem inappropriate? These duties will probably be implied unless the trust instrument says otherwise;
 - (4) Will there be a clear dividing line between matters that are the responsibility of the settlor and matters that are the responsibility of the trustee?
 - (5) What is to happen when the settlor dies, or if he becomes incompetent? If the trustee may then find itself with responsibility for an unorthodox collection of investments or other difficult-to-manage property, careful drafting is needed to establish a safe liquidation process;
 - (6) Will the settlor's involvement shift the situs of the trust for tax or other purposes to the settlor's country? Will it undo the purpose for which the settlor wanted an *offshore* trust in the first place?

D. Power to Change Trustees

The settlor may be satisfied with a simple power to change trustees. If he keeps sufficiently informed about the trustee's investment activities, he will have power to intervene effectively. Again, there are questions to be considered, for example, whether the settlor's power should be held in a fiduciary capacity, and whether his choice of new trustees should be restricted by qualification requirements. In general, however, this appears to be a relatively simple and satisfactory solution.

82. For a discussion of such trusts, see *infra* Section X.

E. A Private Trust Company

The settlor incorporates a company to act as the trustee of his trust. Typically, a professional trust company is appointed to manage the private trust company and look after the day-to-day administration of the trust. The settlor can put himself or other persons of his choice onto the board of the private trust company (PTC). This has become a popular solution for large trusts, but, once again, there are several questions that require careful consideration, such as:

- (1) *The sham question*: If the settlor genuinely intends that the PTC will observe its fiduciary obligations at all times, there should be no question of sham; but, if he really means to do as he pleases regardless of fiduciary obligations, the structure will be eminently attackable.
- (2) *The ownership question*: If the settlor owns the shares of the PTC, they will fall into his estate upon death, and perhaps his personal representatives or heirs will interfere with his plans. The usual solutions are:
 - (a) to incorporate the PTC as a company limited by guarantee—then there will be no shares to fall into the settlor's estate, and his membership of the company can simply terminate upon his death; or
 - (b) to establish a charitable trust to own the shares of the PTC. Obviously, there must be a genuine charitable intent, and the trustee of the charitable trust must act bona fide in the interests of charity, not in the interest of the beneficiaries of the underlying trust; or
 - (c) to establish a non-charitable purpose trust to hold the shares of the PTC.⁸³
- (3) *The conflict question*: If the directors of the PTC include beneficiaries, they will inevitably encounter conflicts of interests in administering the trust. Likewise, if the directors include executives of companies owned by the trust, they may have conflicts of interest or duty. Is that acceptable? To some extent, the dangers

83. For a discussion of such trusts, see *infra*. Section XIII.

can be mitigated by, for example, separate boards or committees of the PTC to deal with different aspects of the trust administration.

- (4) *The remedy question:* If the PTC commits a breach of trust, beneficiaries will have no effective remedy—because the PTC will have no substantial assets. They may have a claim against the directors, but if the directors are family members, this may lead to a civil war in the family.

In some situations, professional trustees encourage their clients to establish private trust companies because the intended operations of the trust are such that the professional trustee is reluctant to assume responsibility—perhaps the plan is for the trust to control an active trading or manufacturing business. The professional trustee thinks it would be safer if its involvement were as an administrator of the PTC, rather than as the trustee of the trust. This is true—up to a point. If the professional institution assists in something that it knows or suspects to be a breach of trust, it will still be liable as a constructive trustee.

F. A Shared Company

The property is held and administered by a company in which the trust holds shares which carry a substantial financial interest but little or no voting rights; the settlor holds the other shares which carry full voting rights. Hence, the settlor has control, and he has it outside the trust structure. As the controlling shareholder, he has no fiduciary obligation to the beneficiaries, though the directors have their usual fiduciary obligations to the company. In many cases this is the best solution for the settlor who really does want hands-on control of operations. The main questions for consideration are:

- (1) *The succession question:* Who is to take the controlling interest in the shared company when the settlor dies or becomes incompetent, and how is this transfer of control to be achieved? There are several techniques for putting control into the desired hands, including multiple classes of shares which take voting control successively, the use of guarantee companies, or the use of non-charitable purpose trusts to hold the voting shares and ensure that the right people are appointed as directors of the share company.

- (2) *The remedy question:* If the person or persons with the controlling interest in the company act in a manner contrary to the interests of the beneficiaries, they will probably have no effective remedy. This may be of concern to the settlor if his plan is that someone else, other than the trustee, is to step into his shoes as the controlling shareholder.
- (3) *The incentive question:* If it is the settlor's plan that someone else will step into his shoes as controlling shareholder, there may need to be some financial incentive.

G. *A Company Without a Trust*

A trust is not the only legal mechanism for creating successive interests. A company can be used instead. One simple technique is to have the shares held in joint names so that on the settlor's death they pass by survivorship. Another technique is to have several classes of shares with special rights that subsist only during the first holder's lifetime. For those whose plans are fairly simple, this may be a good solution—if there are no tax objections. There are lots of variations on this theme, especially in those offshore centers which have the concept of a company limited by guarantee, as distinct from a company limited by shares. The virtue of a guarantee company is that a person's membership can simply expire on his death (or other specified events); there is no share to fall into his estate. The main limit on all corporate solutions is the fact that a person cannot be admitted to membership of the company and so cannot be given enforceable rights, if he is not yet in existence and ascertained. Whatever the constitution of the company may say about admitting such persons to membership in due course, the current members may decide to change the constitution.

H. *Purpose Trust*

Much of the difficulty in accommodating retentive settlors turns around the point that, in an ordinary trust, the trust property must be managed in the interests of the beneficiaries. The purpose of the trust is necessarily to benefit the beneficiaries. It is not easy to reconcile that necessary purpose with the settlor's desire for control unless it is an agreeable solution for all concerned that the settlor assume fiduciary obligations and disabilities. If that is not agreeable, care is needed. Purpose

trusts offer a radical alternative solution.⁸⁴ The point is that the purpose of the trust need not be necessarily and simply to benefit the beneficiaries, so the door is opened to all sorts of interesting possibilities.

While some of us have devoted considerable efforts to finding effective control mechanisms, some have simply ignored the paperwork and the legal niceties. In the Jersey case of *Abdel Rahman v. Chase Bank*,⁸⁵ the only defect in the paperwork (on which no Jersey lawyer had been asked to advise) was that it offended a particular Jersey rule, now abolished, known as *donner et retenir ne vaut*.⁸⁶ On that ground the trust was struck down. Additionally, however, it appeared that both the trustee and the settlor had continued to behave as though the settlor remained the sole beneficial owner of the trust property. The catalogue of errors makes grim reading. Not surprisingly, the Jersey court decided that the trust was a sham. This certainly caught the attention of professional trustees in all the offshore centers, and has had a salutary effect in tightening up their practices. Indeed, I believe there has in some quarters been an over reaction, probably because there is, or was, fairly widespread confusion about what "sham" really means. A good many learned articles have been written and conference presentations made, on this subject; and I am optimistic that the confusion is abating.

Some offshore centers have enacted legislation intended to remove or reduce the risk that a trust may be held invalid if the settlor reserves excessive powers or interests. The Cook Islands International Trusts Act 1984 provided a long list of powers and declared that no international trust or disposition would be void on their account.⁸⁷ So far as English principles are concerned, it may be doubted whether such provisions really address the problem. The reservation of powers, dispositive or administrative, is not of itself hazardous to the validity of a trust, except that validity may be in question if the settlor reserves to himself exclusive power to make management and investment decisions *and* makes it clear that he accepts no fiduciary obligations in that respect. Be that as it may, similar rules have been adopted by Nevis and the Cayman Islands. The Cayman Islands' Trusts (Amendment) (Immediate Effect and Reserved Powers) Law 1998 does also address a related but different problem, where the drafting of a trust instrument leads to doubt whether, quite apart from all the settlor's reserved powers, there is an immediate trust

84. For a discussion of such trusts, see *infra* Section XIII.

85. [1991] J.L.R. 103.

86. See Part VI.B.

87. See International Trusts Act 1984 (Cook Islands), *reprinted in* 1 INTERNATIONAL TRUST LAWS, *supra* note 5, at D8-3.

for the benefit of anyone other than the settlor himself. Not infrequently, the drafting of trust instruments is less clear in this respect than it should be. The Cayman legislation establishes a rebuttable presumption that an immediate trust was intended.

VIII. INVESTMENT

Trustee investment rules vary in detail among the offshore centers, but in most of them the basic principles are those developed by the English courts. In England, the leading case was heard a little more than one hundred years ago, and considering the radical changes that have taken place since then, the principles have held up remarkably well.⁸⁸ One might say the same of Justice Putnam's even more antique statement.⁸⁹ Nonetheless, the principles or their application have fallen behind economic and market developments. In the offshore context, the old principles suffer some additional deficiencies. In particular:

- (1) Frequently, the "new client" does not regard the preservation of capital as the paramount objective. He wants a more aggressive investment policy.
- (2) The requirement of care and skill, that of "the ordinary prudent man of business," makes even less sense in an offshore context. In which region of the world should one seek the hypothetical man of business? Even if one went to the most sophisticated region, one would hardly expect to find an ordinary man of business who was competent to run a large international portfolio of investments. The principle against delegation is diametrically opposed to the requirement of prudence. Dealing with markets around the globe, delegation is essential.
- (3) The admonition to preserve capital is meaningless without an agreed base currency or some other yardstick to measure value. Indeed, no investment strategy can sensibly be devised without knowing how to measure success or failure. In an onshore trust, the yardstick will generally be the domestic currency, even if the

88. *Learoyd v. Whiteley*, (1897) 12 App. Cas. 727.

89. *Harvard College v. Amory*, 9 Pick. (26 Mass.) 446 (1831).

trust is intended to have foreign investments. In an offshore trust it is most unlikely that anyone would consider the domestic currency to be the appropriate yardstick. The old rules provide no answer. If the beneficiaries live in one country, it may be argued that the currency of that country is the relevant yardstick—because that is where the beneficiaries are most likely to use the trust distributions. But in many cases, this would run directly counter to the settlor's actual intentions; many settlors see their trusts as a way of protecting themselves and their families from the uncertainties of their own countries' economies. If obliged to specify a single currency as the yardstick, most settlors would probably choose the U.S. dollar—but only because of *current* economic conditions. Even in the short term one can foresee the Euro becoming an alternative choice. My impression is that most settlors, taxed with this question, prefer not to tie their trust to any single yardstick. So how is one to measure success?

On the other hand, the English principles have the redeeming feature that the trust instrument is competent to establish its own investment regime. It would be nice now to report that offshore trusts do establish satisfactory investment regimes, but this would not be entirely accurate. The practice does seem to be improving, but slowly. One still finds plenty of trust instruments which do little more in this respect than provide a long catalogue of investments and transactions upon which the trustee is authorized to embark.

Surprisingly, perhaps, there seems to be no interesting offshore legislation on this subject. Many centers are still operating on the basis of a "legal list" of authorized investments—rendered irrelevant by almost every trust instrument. As far as I know, no center has followed the Prudent Investor Rule adopted by the American Restatement (Third) of Trusts⁹⁰ or the proposals of law reform bodies in the other major trust jurisdictions. Perhaps there would be more offshore interest in the law concerning trustee investment, and in the investment provisions of trust instruments, if more offshore trustees were sued for failing to discharge their investment duties; but there has been surprisingly little litigation of that sort. Part of the explanation

90. RESTATEMENT (THIRD) OF TRUSTS (Prudent Investor Rule) §§ 227-29 (1992).

may be that in many offshore trusts it is not the plan that the trustee have full management responsibility over a portfolio of investments. If there is to be a portfolio of investments, its management is often entrusted to one or more investment houses in onshore centers, though in recent years the offshore institutions have made headway in winning this business. Often, as already noted, the settlor himself wishes to make the decisions, at least with regard to policy. Often the trust is intended to hold particular investments or property.

IX. SUPERNUMERARY POWERS

Understandably, the "new client" often has misgivings about putting substantial assets into an unfamiliar structure administered by an unfamiliar institution in an unfamiliar land. Reservation of control by the settlor may be problematic for extraneous reasons; in any case, the trust is usually meant to continue for a significant period after the settlor dies or becomes incapacitated. So it is now usual to find that powers of one sort or another are given to persons who are neither the settlor nor the trustee. The labels vary, but "protector" and "management committee" are both popular. My generic label for these power-holders is "supernumeraries," and I refer to their powers as "supernumerary powers".

Supernumerary powers vary greatly. Sometimes the supernumerary is peripheral to the trust administration, sometimes he is so central that the trustee is little more than a custodian. Among the supernumerary powers that I have encountered are powers:

- (1) to appoint or remove trustees;
- (2) to approve the trustee's remuneration;
- (3) to approve self-dealing by trustees;
- (4) to make or approve investment or administrative decisions;
- (5) to make or approve amendments to the administrative terms of the trust;
- (6) to make or approve distribution decisions;
- (7) to make or approve additions to or exclusions from the class of beneficiaries;
- (8) to veto the settlor's exercise of reserved powers;
- (9) to determine whether the settlor is suffering a disability or other misfortune such that his reserved powers should be terminated or suspended;

- (10) to veto the exercise of beneficiaries' rights, for example, the right to trust accounts or information;
- (11) to give or obtain tax advice for the trust;
- (12) to undertake regular reviews of the trust administration;
- (13) to nominate auditors;
- (14) to approve the trustee's accounts;
- (15) to release the trustees from liability for breach of trust;
- (16) to settle questions or disputes concerning the administration of the trust;
- (17) to enforce the trust by legal proceedings;
- (18) to change the governing law of the trust;
- (19) to trigger or cancel flight arrangements (Castro clauses);
- (20) to terminate the trust by triggering the final vesting provision.

I should note immediately that in relation to some of these powers, there is considerable doubt whether the law permits them. For example, it seems doubtful whether a supernumerary can be empowered to release the trustee from liability, and if that is permissible, one suspects that the effect may be to shift the beneficiary's claim from the trustee to the supernumerary. As for appointing a supernumerary to settle questions or disputes concerning the administration of the trust, it is in general impossible to oust the jurisdiction of the court. Other powers whose feasibility may be questionable are the power to enforce the trust by legal proceedings and the power to veto the exercise of beneficiaries' rights.

The variety in supernumerary powers reflects the variety in the motives for having a supernumerary. For example, the motive may be:

- (1) as a precaution against the trustee becoming unsuitable;
- (2) as a precaution against the chosen trust center becoming unsuitable;
- (3) as a reassurance that the trustee will pay due regard to a non-binding letter of wishes;
- (4) as a means of ensuring that someone knowledgeable about the settlor's family is involved in making distribution decisions;
- (5) as a mechanism for keeping the tax planning of the trust up to date;
- (6) to provide effective liaison between the trustee and the beneficiaries;

- (7) to enable beneficiaries to participate in some fashion in the trust administration;
- (8) to enable the trust to pursue an investment policy which the trustee regards as unduly hazardous or difficult;
- (9) to enable the trust to carry out some collateral purpose of the settlor, "collateral" in the sense that it is not just a matter of conferring financial benefit on the beneficiaries;
- (10) to provide a façade behind which the settlor may exercise control over the trust administration;
- (11) to enable the appearance of an offshore trust with an offshore trustee while the de facto trust administration is conducted onshore.

Again, there are some unmeritorious items in the list—the last two mentioned—but, happily, their incidence seems to be declining.

The real and continuing problem with supernumerary powers is that they are seldom drafted adequately. The power itself is usually set out in sufficient detail, as are the conditions and formalities for its exercise; but there is rarely sufficient indication of the duties and disabilities that accompany the power. It is, or was, supposed by many that if the trust instrument were silent, the protector could do as he pleased. Several cases have helped to dispel that unfortunate misconception, but we still do not have an authoritative statement of the rules or principles by which the duties and disabilities of a supernumerary may be identified. There has been some legislation, but in my view it is of little assistance largely because if it says anything at all about duties and disabilities, it suggests that the same rule applies to all supernumeraries regardless of the nature of their powers and regardless of the purposes for which their powers were given to them. Surely, the first thing that needs to be recognized in dealing with supernumerary powers is that the consequences differ from case to case. One cannot even say that the consequences of a given power will be the same in every case. Take the power to appoint and remove trustees, and consider four cases:

Case 1: The power is given to the income beneficiary, and his choice is restricted to licensed trust corporations. Suppose the evidence indicates that the settlor gave this power to the beneficiary so that he could protect his own interests in the trust. One hopes a court would conclude that the beneficiary had no duty in relation to the power, though the

power could not be used for an extraneous purpose, for example, to find a trustee willing to commit breaches of trust in the beneficiary's favor.

Case 2: The power is given to a committee of beneficiaries, and there is no restriction on their choice. Suppose the evidence indicates that the committee was meant to protect the family as a whole. One hopes a court would conclude that the power was held in a fiduciary capacity.

Case 3: The power is given to a non-beneficiary protector. Suppose the evidence indicates that this was meant to give beneficiaries a cheaper and more satisfactory remedy than going to court. Again, one hopes the conclusion is that the power is held in a fiduciary capacity; in this case it appears that the supernumerary has a passive role, to react appropriately if and when a beneficiary suggests that the trustee should be replaced.

Case 4: The power is given to a professional protector. Suppose the evidence indicates that the protector was meant to keep a continuing eye on the trust administration and to replace the trustee if for any reason that was in the interests of the beneficiaries. In this case one hopes the supernumerary has a fiduciary duty and must play an active supervisory role—that is, do what he was appointed to do.

These few cases illustrate the point that the duties and disabilities of a supernumerary depend on the circumstances and are not determined simply by reference to the nature of his power, or whether he is a beneficiary.

In the Belize Trusts Act 1992, it is provided:

- (1) The terms of a trust may provide for the office of protector of the trust.
- (2) The protector shall have the following powers –
 - (a) (unless the terms of the trust shall otherwise provide) the power to remove a trustee and to appoint a new or additional trustee;
 - (b) such further powers as are conferred on the protector by the terms of the trust or of this Act.
- (3) The protector of a trust may also be a settlor, a trustee or a beneficiary of the trust.
- (4) In the exercise of his office, the protector shall not be accounted or regarded as a trustee.

- (5) Subject to the terms of the trust, in the exercise of his office a protector shall owe a fiduciary duty to the beneficiaries of the trust or to the purpose for which the trust is created.⁹¹

This seems to raise a number of questions. Why should a power to replace the trustee be implied? What is meant by the proposition in paragraph (4) that the protector "shall not be accounted or regarded as a trustee"? Unless he holds the trust property, that seems obvious. Why should one presume that the protector has a fiduciary duty? What does that duty actually entail: for example, should the protector keep an eye on the trust administration and act on his own initiative, or should he intervene only if asked to do so by a beneficiary? What is meant by a duty "to the purpose for which the trust is created," and who can enforce such a duty?

In the Bahamas Trustee Act 1998, it is provided:

- (1) A trust instrument may contain provisions by virtue of which the exercise by the trustees of any of their powers and discretions shall be subject to the previous consent of the settlor or of some other person as protector, and if so provided in the trust instrument the trustees shall not be liable for any loss caused by their actions if the previous consent was given and they acted in good faith.
- (2) The trust instrument may confer on the settlor or on any protector any powers including (without limitation) power to do any one or more of the following –
 - (a) determine the law of which jurisdiction shall be the proper law of the trust;
 - (b) change the forum of administration of the trust;
 - (c) remove trustees;
 - (d) appoint new or additional trustees;
 - (e) exclude any beneficiary as a beneficiary of the trust;
 - (f) add any person (including the settlor and any private or charitable trust or foundation) as a beneficiary of the trust in addition to any existing beneficiary of the trust;
 - (g) give or withhold consent to specified actions of the trustee either conditionally or unconditionally; and
 - (g) release any of the protectors' powers.
- (3) A person exercising any one or more of the powers set forth in paragraphs (a) to (h) of subsection (2) shall not by virtue only of such exercise be deemed to be a trustee and, unless otherwise provided in the trust instrument, is not liable to the beneficiaries for the bona fide exercise of the power.⁹²

Again, there seem to be a number of questions. What does paragraph (1) mean in terms of the trustee's liability or

91. Trusts Act 1992 (Belize), Part 3 § 16, *reprinted in 2 INTERNATIONAL TRUST LAWS*, *supra* note 5, at D4-13.

92. Trust Act 1998 (Bahamas), § 81 *reprinted in 2 INTERNATIONAL TRUST LAWS*, *supra* note 5, at D3-60.

accountability? Plainly, the trustee cannot properly act without the prescribed consent—and there was no need for a statutory provision to say that. The idea seems to be that if the consent has been given, the trustee's liability or accountability is diminished to some extent. The trustee is to be liable only if it did not act in good faith. So does this mean that the trustee is exonerated from its duty to act with care or skill? It seems to elevate a simple consent provision in a trust instrument to something more; care may be needed to ensure there are no unexpected tax consequences. Paragraph (2) has the merit that it does not seek to imply any powers. Paragraph (3) seems similar to the Belize provisions, stating that the protector is not a trustee but implying a duty of good faith. So I have the same questions or criticisms as for the Belize provisions. Furthermore, in a matter for which the protector's consent is required and given, the net effect appears to be that no one, neither the trustee nor the protector, has any duty of care or skill.

A further general criticism of this and other offshore legislation on the subject of protectors is that it all tends to distract attention from the true path, the first step of which is or should be an inquiry into the purpose for which the particular power was granted (or reserved) in the particular case. It is that step which allows one to apply the "fraud on the power" doctrine and determine whether the power has been exercised for an improper purpose; it is that same first step which leads one towards discovering whether the protector was intended by the settlor to have a duty of some sort to exercise the power or consider its exercise. To be more precise, it appears that a sensible way to approach the duty question is to ask:

- (1) Did the settlor grant the power in order that some purpose of the settlor should be achieved? Or was it to enable the protector to serve his own interests or purposes?
- (2) If to serve a purpose of the settlor, what did the settlor expect the protector to do for that purpose?
- (3) To what extent, if any, did the settlor mean this to be a matter of obligation enforceable by the court?
- (4) Is it the kind of obligation which the court is willing and able to enforce?

I must admit that there is to my knowledge no case in which a court has put this forward in so many words as the proper approach, but it does seem to be consistent with the reported decisions. Several of these concern offshore trusts; in fact, nearly all the major offshore trust centers have had at least one

supernumerary power case. The main Cayman Islands contribution was *In the Matter of the Z Trust*.⁹³ A management committee was empowered to give the trustee directions concerning the principal asset of the trust, the shares of a holding company, which in turn held some valuable minority positions in family companies.⁹⁴ Initially, the committee consisted of the settlor's daughter (who was to become the principal income beneficiary), one other beneficiary and one non-beneficiary.⁹⁵ Eventually, the non-beneficiary was replaced by another beneficiary.⁹⁶ The dispute concerned a power to vary the trust "with the unanimous written consent of the grantor and the management committee."⁹⁷ That power of variation had been exercised to give the grantor's daughter access to capital in addition to her income interest.⁹⁸ Other beneficiaries eventually claimed that this variation (and the ensuing capital distributions) was improper.⁹⁹ The claimants argued that the power of variation was held, by the committee at least, in a fiduciary capacity, and so it could not be validly exercised for the benefit of anyone serving on the committee.¹⁰⁰ The court decided as a matter of construction of that particular trust instrument that the power of variation was not held in a fiduciary capacity.¹⁰¹ Even if it had been, the court decided that this was not a case of a fiduciary putting herself into a position where her interests conflicted with her duty; the Grantor had put her into that position.¹⁰² The decision itself turned, of course, on the particular facts of the case, but a number of general points emerge from the judgment of Judge Smellie:

- (1) The judge observed, "Much time was taken in the arguments with the cases which examine the nature of powers, cases which were all helpful in their own ways as guidance, but without, as one might expect, being conclusive The nature of powers may be as varied as the circumstances

93. [1997] C.I.L.R. 248, 248-50 (Cayman Is., Grant Ct. 1997).

94. *See id.* at 259-60.

95. *See id.* at 254.

96. *See id.* at 254-55.

97. *Id.* at 258-59.

98. *See id.* at 254-55.

99. *See id.* at 255.

100. *See id.* at 259.

101. *See id.* at 272.

102. *See id.* at 293.

- of the settlements under which they are given.”¹⁰³
- (2) The committee’s power to give investment directions was admitted by all parties to be fiduciary, in some sense, but it did not follow that the Committee’s power of variation was fiduciary.
 - (3) The judge accepted that a power may be accompanied by a “qualified fiduciary duty.”¹⁰⁴ In this case the committee effectively controlled not only investment decisions, but also the dividend policy of the holding company, thus determining how much of the company’s earnings became trust income to which the grantor’s daughter would then be entitled. She could hardly have a duty to exercise that control for the benefit of anyone but herself.

Perhaps the most important points emerging from this case were, first, that in identifying the duties and disabilities of supernumeraries, the court is seeking out the intention of the settlor in granting the power in question.¹⁰⁵ It is not an exercise in finding the appropriate pigeonhole or category of power and then searching the authorities to find the consequences that go with that category. Second, the task of identifying the settlor’s intention can be a difficult one if the trust instrument merely describes the power.¹⁰⁶ So the draftsman of a supernumerary power should take care to indicate, at the least, the purpose for which the power is granted. It may not be sufficient to say that it is “fiduciary” or “non-fiduciary,” because in some situations neither epithet answers adequately the questions that need to be answered.

In these respects, it seems doubtful whether there is much that the legislator can usefully do—except to avoid giving confusing signals. However, it would be helpful to have some statutory guidance on:

- (1) Whether a fiduciary protector has the same access to the court as a trustee for advice, direction, protection, and exoneration;

103. *Id.* at 256.

104. *Id.* at 260-61.

105. *See id.* at 257.

106. *See id.* at 267-68.

- (2) Whether and in which circumstances the court has jurisdiction to appoint or remove a fiduciary protector;
- (3) Whether and in which circumstances a protector has standing to bring an action for the enforcement of a trust.

X. CONFIDENTIALITY

It is unfashionable now to talk of confidentiality in polite terms. The politically correct view seems to be that anyone who wishes his affairs to be confidential must be a drug-runner or a money-launderer. However, most settlors and most beneficiaries are interested in confidentiality, and they cannot all be villains. Indeed, unless the money has already been well-laundered, it seems improbable that an intelligent villain would choose a trust, a structure in which (usually) a government-regulated financial institution assumes a duty to know what is going on. The fact is that in most parts of the world, people regard their financial affairs as private. In some parts of the world, there are special concerns, for example, fear of kidnapping. None of that has much to do with the development of trust law and practice offshore; for us, the interesting confidentiality issues are those that arise in cases where the settlor does not want his beneficiaries to have full access to trust information for the time being. Many settlors are concerned that their children or grandchildren should not be discouraged from education and careers by knowledge of a large trust waiting to line their pockets. Settlor who are concerned by the risk of a forced heirship attack may wish to deprive beneficiaries of access to sensitive information, such as the location of trust assets, until the risk has disappeared.

English case law does not provide clear guidance in this respect, but it seems that some trust instruments may go beyond what is permissible. Thus far, there have been few illuminating offshore cases. The Cayman Islands case of *Lemos v. Coutts*, already mentioned, did confirm that a beneficiary's right to trust accounts and information is not an absolute right.¹⁰⁷ If, as that case shows, there are circumstances in which the court would agree that access should be denied or qualified in the interests of the beneficiaries as a whole, it is presumably legitimate for the

107. [1992-93] C.I.L.R. at 518; see also *infra* Part VII.

trust instrument to confer on a trustee a corresponding discretion, subject to any contrary direction of the court. Another Cayman Islands case, *Re Ojeh Trust*,¹⁰⁸ confirmed the application of the principles laid down by an English court in *Butt v. Kelson*,¹⁰⁹ qualifying the beneficiary's right of access to information concerning a controlled company.

The recent Bahamian legislation, the Trustee Act 1998,¹¹⁰ tackles the main issues in a rather lengthy section that may be summarized as follows:

- (1) A trustee must take reasonable steps to notify each beneficiary who has a vested interest. If there are no such beneficiaries, the trustee must take reasonable steps to ensure that at least one person who is capable of enforcing the trust is aware of its existence and general nature.
- (2) The foregoing rules are qualified by the proviso that no information is to be given if the trustee in its absolute discretion considers it would not be in the best interests of the beneficiary to receive the information.
- (3) There are corresponding rules regarding the disclosure of trust documents and financial statements.
- (4) In disclosing trust documents or financial statements to a beneficiary the trustee must, if other beneficiaries so request, or if the trustee considers it to be in their interests, take all reasonable steps to exclude information concerning the other beneficiaries and their interests.
- (5) Certain categories of documents are put beyond reach of the beneficiaries. Indeed, they are put beyond the reach of the court and the discovery process. The documents in question are described as follows:
 - (a) any memorandum or letter of wishes issued by the settlor or any other person to the trustees, or any other document recording any wishes of the settlor;
 - (b) any document disclosing any deliberations of the trustees as to the manner in which the trustees should exercise any discretion

108. [1992-93] C.I.L.R. 348, 362-63 (Cayman Is., Grand Ct. 1993).

109. [1952] Ch. 197.

110. See *supra* note 92 and accompanying text.

- of theirs or disclosing the reasons for any particular exercise of any such discretion or the material upon which such reasons were or might have been based; or
- (c) any other document relating to the exercise or proposed exercise of any discretion of the trustees (including legal advice obtained by them in connection with the exercise by them of any discretion).¹¹¹

Item 5 does seem rather radical. If a beneficiary has made a case that the trustee has exercised a discretion improperly, why should there not be discovery of the relevant documents? The thrust of this new rule seems to be to protect the trustee by reducing its accountability—regardless of whether the settlor wanted to do so. It is hard to see the justification for this. Certainly, it has nothing to do with the desire of some settlors to restrict or delay beneficiaries' access to trust information.

In the Cayman Islands, there has not yet been any statutory adjustment applicable to ordinary trusts, but the new STAR regime does allow a settlor to create a trust for beneficiaries on terms which give them as much or as little (or no) access to trust information and documents as the settlor wants.¹¹² Every STAR trust must have at least one effective enforcer, but non-beneficiaries can be appointed as the enforcers. In practice, it is unlikely that a settlor would want to create a trust on terms that the beneficiaries would never have enforceable rights; but, for example, the settlor might decide that his children should be informed of the trust and acquire enforceable rights only when they had reached a certain age. Meanwhile, of course, someone else (beneficiary or non-beneficiary) must have rights or duties of enforcement. STAR does not affect the rules of discovery applicable to an action against the trustee.

XI. UNFAMILIARITY

The "new client" tends to be wholly unfamiliar with the trust concept. That would not be a problem if he came equipped with a knowledgeable legal adviser. Unfortunately, in many parts of the world the idea that one should do nothing without legal advice has not yet taken hold. If the "new client" seeks advice, he does not necessarily go to a lawyer, let alone a lawyer who knows

111. See generally Trustee Act 1998 (Bahamas), *supra* note 92.

112. See *infra* Section XIII.C.

about trusts. He is as likely to rely upon his trusted *financial* adviser. Professional trustees recognize the danger of this. If they cannot steer the client into the hands of a suitable lawyer, they may try to steer him towards one of their own standard documents. Many professional trustees have developed several standard documents, nicely packaged with explanatory materials, instruction sheets, "due diligence" forms, and the like—all designed to make trust creation as simple as possible. These packages are useful not only for dealing with the inadequately advised client but also for marketing purposes—marketing personnel not always knowing as much about trusts as perhaps they should. This packaging practice is good in some respects, but it tends to an attitude that estate planning is a matter of choosing between financial products. Of course, plenty of trusts are properly planned, tailored to the particular client's needs and circumstances, but plenty are not. On the bright side, this practice has led to some commendably short and understandable documents, though occasionally treading perilously close to the line between trust and agency. Sometimes the explanatory material in the package is less commendable, suggesting that in its drafting the marketing personnel gained the upper hand over the technicians.

XII. ASSET PROTECTION

In the early 1980s, a client of a different kind began to appear in offshore trust centers—the American professional or businessman looking for a more effective way of protecting himself and his family from creditors. The virtues of an offshore trust for this purpose were being advocated strongly by several American law firms. Most of the offshore centers then had rules inherited or copied from England: bankruptcy rules, applicable for the most part only to debtors who reside or conduct business within the jurisdiction and fraudulent conveyance rules, applicable generally. The fraudulent conveyance rules were generally those of the Statute of Elizabeth 1571, which provided, in brief, that all conveyances and dispositions of property made with the intention of "delaying, hindering or defrauding" creditors would be "clearly and utterly void, frustrate and of none effect."¹¹³ English cases of some antiquity suggested that the rule applied to future creditors as well as existing creditors. So, for example, a settlement might be set aside if made in contemplation of the settlor entering a hazardous business.

113. Statute of Elizabeth, 13 Eliz. 1 (1571) (Eng.).

However, the extent of application of the rule in relation to future creditors had not been clearly established; it seemed evident that a line had to be drawn somewhere. It would surely be unreasonable to set aside every trust in which it could be established that the settlor recognised that one advantage of creating a settlement would be to protect his family from the risk of his own insolvency, even though on any sensible appreciation that risk was remote.

Many, but not all, of the offshore centers adopted legislation. In some cases it seems they were merely trying to clarify the rules; in other cases they were plainly seeking to attract "asset protection" business by making it more difficult for creditors to attack trusts. The Cook Islands' legislation appears to be the most extreme. For example:

- (1) It must be proved "beyond reasonable doubt" that the principal intent of the settlement was to defraud the plaintiff creditor and that the settlement rendered the settlor insolvent.
- (2) There is deemed to be no fraudulent intent if the settlement was made before the creditor's cause of action accrued or more than two years after it accrued.
- (3) A foreign judgment will not be enforced if it is inconsistent with these provisions.¹¹⁴

The Cayman Islands' Fraudulent Dispositions Law represents a more moderate approach.¹¹⁵ It draws the bright line between obligations that "exist" at the time of the settlement and those that do not "exist" until later. In that respect, the new rule is more favorable to settlors than the old rule, though, as already noted, it was unclear to what extent the old rule protected future creditors. In other respects, the new rule seems to maintain the status quo; there is no special burden of proof, no time limit (apart from the six-year limitation period), and no change to the rules regarding the enforcement of foreign judgments. The precise meaning of "exist" in this context has yet to be established.

From the outset, most financial institutions have been nervous of asset protection trusts, and rightly so. Their efficacy is generally in great doubt—not least because an American

114. See International Trusts Act 1984 § 13B & 13D (Cook Islands) *reprinted in* 2 INTERNATIONAL TRUST LAWS, *supra* note 5, D8-3.

115. See generally Fraudulent Dispositions Law of 1989 (Cayman Islands), *reprinted in* 2 INTERNATIONAL TRUST LAWS, *supra* note 5, at D7.40.

bankruptcy court will presumably deal quite roughly with a settlement that it considers to be fraudulent of creditors. So unless the settlement is consistent with the applicable state law, effective asset protection presumably requires the relocation of the settlor, the settled property, and the beneficiaries to a place where American court orders would not be enforced. Furthermore, a financial institution that assists in this arrangement or acts as trustee exposes itself to a risk of civil liability even in the offshore center (if it transpires that the settlor broke the local rules). Indeed, if the settlor can be brought within the scope of the local bankruptcy rules—for example, because he committed an act of bankruptcy in the offshore center—there may be a question of criminal liability. Assuming that there may also be a question of criminal liability in the United States, that may well be an extraditable offence so far as the offshore center is concerned. Many financial institutions will not take on asset protection business at all; others require satisfactory legal opinions in the offshore center and in the United States. The result seems to be that, while many enquiries are received about the formation of asset protection trusts, they seldom come to fruition. I am perplexed by the reports one hears of billions of dollars salted away by Americans in asset protection trusts. If true, most of these trusts must be administered by some very adventurous or ill-informed financial institutions.

XIII. PURPOSE TRUSTS

A. *England: The Beneficiary Principle and the Requirement of Certainty*

In England and most other common law jurisdictions, it is generally accepted that a trust for purposes is void unless the purposes are charitable.¹¹⁶ The explanation is that there is no one to enforce the trust, no one who can bring the trustee before the court to compel performance.¹¹⁷ In *Leahy v. Attorney-General for New South Wales*,¹¹⁸ it was said in the Privy Council:

A gift can be made to persons (including a corporation) but it cannot be made to a purpose or to an object; so, also, a trust may be created for the benefit of persons as *cestuis que trustent* but not for a purpose or object unless the purpose or object be charitable.

116. See 1 INTERNATIONAL TRUST LAWS, *supra* note 5, at B4-3.

117. See *id.*

118. [1959] 2 All E.R. 300 (P.C.).

For a purpose or object cannot sue, but, if it be charitable, the Attorney-General can sue to enforce it.¹¹⁹

This is the “beneficiary principle,” and it sounds straightforward enough, almost obvious, until one reflects that in many purpose trusts there are beneficiaries, persons intended to benefit. Consider a trust for the education of the settlor’s grandchildren, a trust to elect A to some public office, a trust to provide recreational facilities for the employees of a company, a trust to improve the treatment of a particular disease, or a trust to expose immorality in government. In all these examples, the trust is presumably intended to benefit persons, though not by giving them cash or property. So why does the law deny the beneficiaries of a purpose trust the right to bring the trustee before the court for an order compelling the trustee to perform the trust? Where exactly is the critical dividing line between person trusts (valid) and purpose trusts (invalid unless charitable)? The English cases do not provide a clear answer to either question, but one commentator has described the critical dividing line in the following terms:

It must, it is submitted, be a question of construction in every case whether the trust is for the benefit of a class of individuals, the specified manner of their enjoyment . . . being secondary; or whether the specified mode of enjoyment is the essence of the gift, the indirect benefit to individuals being secondary. If the trust is of the first kind, it is a valid trust for the benefit of the specified class who may, if unanimous, terminate the trust and call for the trust property. If the trust is of the second kind . . . it is an invalid purpose trust.¹²⁰

Not an easy test to apply!

Underlying this suggested dividing line seems to be a strictly proprietary conception of the trust, that it is a mechanism for giving property to others. The beneficiaries of a person trust have standing to bring the trustee before the court because they are the beneficial owners of the property; they are enforcing rights which equity regards as proprietary interests. The beneficiaries of a purpose trust are not beneficial owners, their intended rights are not regarded as proprietary interests, so they have no standing—even though it may be perfectly clear from the trust instrument that they were meant to have enforceable rights.

This view of the trust is open to debate. At the least it is subject to exceptions. English courts do recognize and enforce trusts in several situations where the plaintiff is clearly not the

119. *Id.* at 307.

120. P.J. Millett Q.C., *The Quistclose Trust: Who Can Enforce It?*, 101 L.Q.R. 269, 282 (1985).

holder of a proprietary interest. One obvious example is the trust for charitable purposes. There is no pretence that the Crown or the Attorney-General is the beneficial owner of property devoted to charity. Another example is the familiar discretionary trust. A member of the beneficial class has a right of due administration but no proprietary interest.¹²¹ In these situations, the English trust is therefore a matter of obligation, not property—an obligation of the trustee that the courts will enforce by proprietary remedies as well as personal remedies.

One might think that this undermines the beneficiary principle described above, that the English courts should recognize and enforce purpose trusts so long as they have beneficiaries, persons intended to have a right to the benefit of the trust, regardless of whether the right amounts to a proprietary interest. Indeed, this view seems to have been taken in *Re Denley's Trust Deed*,¹²² where the judge said:

The beneficiary principle . . . is confined to purpose or object trusts which are abstract or impersonal. The objection is not that the trust is for a purpose or object per se, but that there is no beneficiary or cestui que trust. . . . Where, then, the trust, though expressed as a purpose, is directly or indirectly for the benefit of an individual or individuals, it seems to me that it is in general outside the mischief of the beneficiary principle. . . . I think that there may be a purpose or object trust, the carrying out of which would benefit an individual or individuals, where that benefit is so indirect or intangible or which is otherwise so framed as not to give those persons any locus standi to apply to the court to enforce the trust, in which case the beneficiary principle would, as it seems to me, apply to invalidate the trust, quite apart from any question of uncertainty or perpetuity.¹²³

However, this view has received criticism as well as support.¹²⁴ So the English situation is uncertain. The beneficiary principle is undoubtedly a feature of English law, but its extent is unclear. It certainly strikes down trusts for impersonal purposes, though exceptions have been made, for example, for trusts to maintain animals and graves.¹²⁵ It also strikes down trusts for abstract purposes—where the benefit to persons is too indirect (for example, a trust to develop a better alphabet)—unless charitable.

121. See UNDERHILL & HAYTON, *LAW OF TRUSTS AND TRUSTEES* 40 (15th ed. 1995).

122. [1968] 3 All E.R. 65 (Ch.).

123. *Id.* at 69.

124. See e.g. *Re Lipinski's Will Trusts*, [1977] 1 All E.R. 33 (Ch. D.); *Re Northern Developments Holdings Ltd.*, (Oct. 6, 1978 (Ch. D.), unreported but described in *Carreras Rothmans v. Freeman Mathews*, [1985] 1 All E.R. 155, 166-67); *Re Grant's Will Trusts*, [1979] 3 All E.R. 359 (Ch. D.).

125. For a list of such cases, see *Astor's Settlement Trusts*, [1952] 1 All E.R. 1067 (Ch. D.).

Beyond that, the application of the beneficiary principle is debatable. If the trust is to benefit persons in some indirect manner, but it is uncertain which persons may benefit, the trust is definitely bad (unless charitable); however, it is not clear whether this is a consequence of the beneficiary principle or the well-known requirement that the objects of a trust must be certain. Indeed, the requirement of certainty is, under English principles, another major obstacle to the creation of purpose trusts.

Under English principles, a trust must be expressed in such a way that (1) whatever the trustee may do with the property, the court will be able to say with certainty whether this was proper or improper, and (2) the court itself can, if need be, execute the trust.¹²⁶ Under the first limb of this rule, any conceptual uncertainty in the purpose will be fatal to the trust. For example, a trust for the education of persons of a given description will presumably fail (unless charitable) because the word "education" is conceptually uncertain—does it, for example, include technical training or visits abroad to improve one's fluency in a foreign language—and it will fail doubly if the description of the beneficial class is such that one cannot say of every postulant whether he is within it. As for the second limb of the rule, the important point is that the court is unwilling to decide non-justiciable questions.¹²⁷ The extent of non-justiciability is in some doubt following *McPhail v. Douulton*,¹²⁸ but it seems safe to say that if the trust is so framed that, though the bounds of the trustee's discretion are well marked, the decision will involve an arbitrary choice, or one based on personal preference, the trust will fail the test and be void. There must be a criterion, expressed or implied, to guide the exercise of discretion. Again, an exception is made for charity; in charity cases, the court will settle a scheme of administration.

To satisfy this certainty requirement, the draftsman of a non-charitable purpose trust must take the greatest care.

Though for these reasons it is, to say the least, difficult to create a non-charitable purpose trust under English law, England is a party to the Hague Convention on the Law Applicable to Trusts and on Their Recognition, and the Convention has been incorporated into English law by the Recognition of Trusts Act 1987.¹²⁹ The Convention's definition of a trust includes trusts for

126. See generally *Morice v. The Bishop of Durham* [1803-13] All E.R. 451 (1805).

127. See UNDERHILL & HAYTON, *supra* note 121, at 73.

128. [1970] 2 All E.R. 228, 247.

129. See 1 INTERNATIONAL TRUST LAWS, *supra* note 5, at A1-5.

purposes, and there is no suggestion that these purposes need be charitable.¹³⁰ Indeed, such a condition would be problematic since the concept of charity varies from one jurisdiction to another. In consequence, an English court is bound to recognize a foreign non-charitable purpose trust unless one of the specific Convention exceptions applies—for example, the particular trust is “manifestly incompatible” with English public policy (*ordre public*).¹³¹

It has been suggested by one English commentator that any non-charitable purpose trust is offensive to English public policy because the beneficiary principle is a matter of public policy.¹³² If so, England is at liberty, despite the Convention, to withhold recognition of foreign purpose trusts unless they conform to the English idea of charity. However, I find it very difficult to imagine an English court taking such a chauvinistic view of an international agreement whose obvious purpose is to require all participating countries to recognize foreign trusts even though they could not be created under domestic law. Furthermore, in the various English cases dealing with attempts to create English trusts for non-charitable purposes, there is nothing to suggest that the idea is in any way harmful to the public weal. Such attempts have failed for the technical reason that there would be no one to enforce the trust. It may be noted that there is no English objection to the creation of a company to carry out non-charitable purposes. So if the foreign jurisdiction has solved the technical problem by providing an enforcement mechanism, I cannot see why an English court should find the idea in the least bit offensive.

It should be added that there are plenty of countries that have not ratified the Convention. To what extent they would recognize non-charitable purpose trusts is unclear but, of course, many of them are no-trust countries that give limited recognition to any kind of trust, whether for persons or for purposes.

B. Offshore Legislation

In recent years, most of the offshore centers have enacted legislation enabling the creation of non-charitable purpose trusts.¹³³ Nauru was the first in the field in 1972, but the idea did not really take off until Bermuda’s legislation in 1989, which

130. See The Hague Convention, art. 2, reprinted in 2 INTERNATIONAL TRUST LAWS, *supra* note 5, at D51-1.

131. See UNDERHILL & HAYTON, *supra* note 121, art. 11.

132. See Paul Matthews, *Star: Big Bang or Red Dwarf?* 12 TOLLEY’S TRUST LAW INT’L 98, 99 (1998).

133. See 1 INTERNATIONAL TRUST LAWS, *supra* note 5, at A24-14.

has been the model for several of the other offshore centers.¹³⁴ Not all have followed Bermuda. Belize and Jersey, for example, have gone their own ways. To confuse the picture further, Bermuda has recently modified its legislation—time will tell whether other Bermuda-style centers follow suit.

Though this legislation varies in style and substance, the fundamentals are similar. The enforceability problem that underlies the beneficiary principle is overcome by saying that a non-charitable purpose trust can be enforced at the suit of anyone who has been appointed as an enforcer by or pursuant to the trust instrument; settlors have a free hand in choosing whom they will appoint as enforcers.

The other major stumbling block, the English requirement that the objects of a trust be certain, has received surprisingly little attention. In some cases the legislation says nothing at all on this subject; in some it is provided that the purposes must be "specific, reasonable and possible"¹³⁵ or "certain, reasonable and possible;" under Bermuda's recent modification, the purposes must be "sufficiently certain to allow the trust to be carried out."¹³⁶ To what extent these various formulations depart from the English rule is presently unclear. It will be interesting to see what the courts decide.

Another common feature of all this offshore legislation is that it grafts the new rules for non-charitable purpose trusts onto the existing body of trust law, leaving unaltered the old rules regarding person trusts and charitable purpose trusts. The snag with this approach is that the distinction between person trusts and purpose trusts remains critical—and obscure, as noted earlier.¹³⁷ One set of rules governs person trusts, different rules govern charitable purpose trusts (as in England), and a third set of rules governs non-charitable purpose trusts. So when a question arises concerning, for example, the validity of the trust, the question of who has standing to enforce the trust, the question of whether those who would benefit from the trust have any enforceable rights, or the question of whether the court has jurisdiction to effect or approve a variation of trust, there is a

134. See Foreign Trusts, Estates and Wills Act 1972 (Rep. Of Nauru), reprinted in 2 INTERNATIONAL TRUST LAWS, *supra* note 5, at D26-11; Trusts (Special Provisions) Act 1989 (Bermuda), reprinted in 2 INTERNATIONAL TRUST LAWS, *supra* note 5, at D5-28.

135. See *e.g.* Trusts (Special Provisions) Act, 1980 (Bermuda) § (1)(a), reprinted in 1 LEWIS D. SOLOMAN & LEWIS J. SARET, ASSET PROTECTION STRATEGIES: TAX AND LEGAL ASPECTS, 1999-1 Cum. Supp. at 416.

136. Trusts (Special Provisions) Amendment Act 1998 (Bermuda) § 2, reprinted in 2 INTERNATIONAL TRUST LAWS, *supra* note 5, at D5-38.

137. See *supra* note 120 and accompanying text.

preliminary question: is this a person trust, a charitable purpose trust, or a non-charitable purpose trust? This preliminary question may very well be difficult and expensive to resolve. The situation is likely to be even more difficult if the trust instrument subjects property to mixed person/purpose trusts. In some regimes, it seems the answer to this last point is that you cannot have a mixed person/purpose trust.

C. Cayman: *The Special Trusts (Alternative Regime) Law, 1997*

The Cayman Islands have adopted a different approach. The Special Trusts (Alternative Regime) Law (STAR) establishes an alternative trust regime under which trusts of all kinds can be created, not just non-charitable purpose trusts.¹³⁸ STAR applies to a trust if, and only if, the trust instrument so provides.¹³⁹ Trusts subject to STAR are referred to in the legislation as "special trusts,"¹⁴⁰ but will be referred to in this paper as STAR trusts. If the trust instrument does not invoke STAR, it is an ordinary trust governed by the ordinary trust principles inherited from England.¹⁴¹

STAR provides that the law relating to STAR trusts is the same in every respect as the law relating to ordinary trusts, save as provided in the legislation.¹⁴² The main differences are:

- (1) *Objects*: The objects of a STAR trust may be persons or purposes or both. The purposes may be charitable or non-charitable.¹⁴³
- (2) *Enforcement*: Those persons, if any, who would derive a benefit or advantage, directly or indirectly, from the execution of a STAR trust (defined as "beneficiaries") do not, as such, have standing to enforce the trust; nor do they have an enforceable right to the trust property.¹⁴⁴ The only persons who have standing to enforce a STAR trust are those beneficiaries or non-beneficiaries who are given the right or duty of enforcement by the trust instrument.¹⁴⁵ STAR

138. See Special Trusts (Alternative Regime) Law 1997 (Cayman Islands), reprinted in 2 INTERNATIONAL TRUST LAWS, *supra* note 5, at D7-49.

139. See *id.* § 3.

140. *Id.* § 2.

141. See *id.* § 3.

142. See *id.* § 5.

143. See *id.* § 6.

144. See *id.* § 7.

145. See *id.*

refers to these persons as "enforcers."¹⁴⁶ In certain circumstances, the court may appoint an enforcer.¹⁴⁷

- (3) *Uncertainty*: A STAR trust is not rendered void by uncertainty as to its objects or mode of execution.¹⁴⁸ The trust instrument may empower the trustee or others to resolve any such uncertainty; the court has jurisdiction to resolve uncertainty by reforming the trust, by settling a plan for its administration, or in any other way which the court deems appropriate.¹⁴⁹ However, if the general intent of the trust cannot be found from the admissible evidence as a matter of probability, the court may declare the trust void.¹⁵⁰
- (4) *Variation*: The court has *cy pres* jurisdiction to deal with supervening impossibility, illegality or obsolescence.¹⁵¹
- (5) *Perpetuity*: The various rules against perpetuities do not apply to STAR trusts.¹⁵²
- (6) *Testamentary delegation*: STAR trusts may be created inter vivos or by will. The rule against testamentary delegation does not apply.¹⁵³
- (7) *Trustees*: At least one of the trustees must be a trust company duly licensed in the Cayman Islands.¹⁵⁴

STAR treats the trust as a matter of obligation, not property.¹⁵⁵ The obligation is annexed to the trust property in the sense that (1) it is an obligation to do something with the trust property, and (2) it is enforceable against the trustee and third parties by proprietary as well as personal remedies.¹⁵⁶ It is directly comparable to an English trust for charitable purposes.¹⁵⁷ The enforcers of a STAR trust perform the same

146. *Id.*

147. *See id.*

148. *See id.* § 10.

149. *See id.*

150. *See id.*

151. *See id.* § 11.

152. *See* 1 INTERNATIONAL TRUST LAWS, *supra* note 5, at A7-29.

153. *See* Special Trusts (Alternative Regime) Law 1997 (Cayman Islands), *supra* note 138, § 3.

154. *See id.* § 12.

155. *See* 1 INTERNATIONAL TRUST LAWS, *supra* note 5, at A7-30.

156. *See id.*

157. *See id.*

function as the Attorney General in relation to an English charitable trust. In fact, one might say that STAR takes the English idea of an obligation trust to its logical conclusion. What English law permits in limited circumstances, STAR permits in all circumstances. The Attorney General is retired, and the creator of the trust can choose whom he pleases to be enforcers.¹⁵⁸

The same rules apply whether the STAR trust is for persons or purposes or both.¹⁵⁹ Indeed the person/purpose distinction ceases to have any significance. Even if the trust obligation is to make distributions to persons, and even if the trust instrument appoints those persons as enforcers, the trust is still a matter of the trustee's obligation, not the beneficiaries' property. In an ordinary (English) trust, the beneficiaries can put an end to the trust under the rule in *Saunders v. Vautier*—because they are the beneficial owners. But STAR states expressly that the beneficiaries, as such, have no right to the trust property.¹⁶⁰ Qua enforcers, they can compel performance of the trust obligation, but they have no authority to put an end to the trust. Indeed, even if all the enforcers and the trustee wanted to put an end to the trust, they could not properly do so. A trustee or enforcer who acts with the intention of defeating the trust is guilty of theft. STAR gives an enforcer proprietary remedies to recover misapplied property from third parties, but it is clearly stated that these remedies are given to the enforcer on behalf of the trust.¹⁶¹

Thus, STAR is a mechanism by which obligations of any kind (if they are lawful and not contrary to public policy) may be annexed to property. Standing to enforce the trust obligation can be given to whomever the trust creator chooses, whether or not beneficially interested.

An English commentator has posed the question whether, if none of the persons who stand to benefit directly or indirectly from a STAR trust are appointed as enforcers, an English court might take the view as regards any English property that the settlor remains the beneficial owner on the basis of a resulting trust.¹⁶² Of course, such a situation is highly unlikely. Unless there are compelling extraneous reasons, such as taxation, the settlor will surely want the intended beneficiaries to have rights of

158. See *id.* at A7-33.

159. See *id.*

160. See Special Trusts (Alternative Regime) Law 1997 (Cayman Islands), *supra* note 138, at § 7.

161. See *id.* § 9.

162. See David Hayton, *Preface* to ANTONY DUCKWORTH, STAR TRUSTS: THE SPECIAL TRUSTS (ALTERNATIVE REGIME) LAW 1997 CAYMAN ISLANDS, 2ND GENERATION OF PURPOSE TRUSTS AND MORE 1998.

enforcement sooner or later. Furthermore, even if the beneficiaries are excluded from enforcement, the question can be avoided by holding English assets through an appropriate offshore holding company—and, of course, most offshore trusts operate through holding companies in any event. So the question is somewhat academic, but I find it difficult to see how an English court could possibly reach the conclusion suggested—unless the particular trust was for some reason so offensive to English law or public policy that the court refused to recognize it at all. If the STAR trust is recognized, and the question is whether its effect is to leave the settlor as the beneficial owner, the answer is perfectly obvious—no! One could only regard the settlor as the beneficial owner on the basis of a resulting trust if the trustee had a duty to hand over the trust property to him or in accordance with his directions; STAR makes it quite clear that this is not so. Indeed, if the trustee did hand back the trust property to the settlor, the property would be recoverable at the suit of any enforcer; the trustee would be liable to reinstate the trust fund; any enforcer or other person involved in the misapplication would also be liable, if he knew it was a misapplication; and the trustee would be guilty of theft and punishable accordingly. Hardly the symptoms of a resulting trust!

So who does have beneficial ownership of property held in a STAR trust? The answer is exactly the same as in an English trust for charitable purposes. There is no beneficial owner. The trustee has the full ownership of the trust property, to the exclusion of the settlor or anyone else, subject to fiduciary duties which the court will enforce at the suit of any enforcer. Since under domestic English principles such a property arrangement is feasible (a trust for charitable purposes and in certain other situations), there is no reason to suppose that an English court would have difficulty in recognizing this as the effect of a STAR trust.

Compared with the purpose trust regimes of other offshore centers, STAR has a number of significant features:

- (1) *The problem of uncertainty*: It has already been noted that the English requirement of certainty is an obstacle to the creation of purpose trusts. STAR deals with this in the same way as the English rules for charitable trusts—by giving the court jurisdiction to resolve the uncertainty.¹⁶³ Furthermore, STAR allows the trust instrument

163. See Special Trusts (Alternative Regime) Law 1997 (Cayman Islands), *supra* note 138, § 10.

- to establish its own procedure for resolving uncertainty without recourse to the court.¹⁶⁴
- (2) *The problem of obsolescence*: It is in the nature of a purpose trust that in time circumstances may change such that continued adherence to the terms of the trust would not achieve the settlor's original intent. There are also the dangers of supervening impossibility or illegality. Again STAR solves the problem in the same way as the English rules for charitable trusts—by giving the court a *cy pres* jurisdiction.¹⁶⁵
 - (3) *Rights and duties of enforcers*: STAR deals comprehensively with the status of enforcers.¹⁶⁶ In particular, the settlor has a choice whether to impose a duty of enforcement.¹⁶⁷ If, for example, he is giving a beneficiary standing to enforce, he may well decide that the beneficiary should have a right to enforce but no duty to do so. On the other hand, if he is appointing a non-beneficiary to be an enforcer, he will probably want to impose a duty. If none of the enforcers is a beneficiary, and none has a duty to enforce, the trustee must apply to the court for the appointment of another enforcer.¹⁶⁸ STAR also provides for the rights of enforcers, but the trust instrument may add to, or exclude, the statutory rights. A non-obligatory enforcer is given the same rights as a beneficiary of an ordinary trust; an obligatory enforcer is given the same rights and protections as a trustee.
 - (4) *Powers*: STAR deals with powers as well as trusts. Given the current vogue for giving powers to protectors, management committees and other supernumeraries, it is important for a purpose trust regime to provide for the enforcement of the associated duties, if any.
 - (5) *Remedies*: STAR makes it clear that there are proprietary remedies for breach of trust.¹⁶⁹ Otherwise, there would be a danger that a purpose trust might be analyzed, domestically or

164. *See id.*

165. *See id.* § 11.

166. *See id.* §§ 7-9.

167. *See id.* § 8.

168. *See id.* § 7.

169. *See id.*

abroad, to be an obligation that binds the trustee but does not encumber the trust property so as to make it recoverable from an innocent third party, or to obtain priority over the trustee's general creditors.

- (6) *Final disposition*: Some purpose trust regimes limit the duration of a purpose trust and require that the trust instrument provide for the final disposition of the property at the end of the permitted term. Presumably, the final disposition is governed by ordinary trust principles; the final disponent presumably has the same rights as the beneficiary of an ordinary trust. This complication is avoided by STAR. STAR trusts are exempted from the rule against perpetuities.¹⁷⁰ If the settlor chooses to limit the duration of the trust, his final disposition is governed by the STAR rules.
- (7) *Mixed trusts*: One of the most important practical features of the STAR regime is that a trust may be created which is partly for persons and partly for purposes. For example, a settlor may put his trading venture in trust with the objects of (1) continuing the business in accordance with a business plan, and (2) distributing dividends and other proceeds among his family. As has been noted, some other purpose trust regimes do not permit mixed trusts; in order to have the benefit of the purpose trust rules, the trust must be exclusively for purposes. Some regimes do permit mixed trusts, but then the trust is subject to two sets of rules, one set governing the purpose elements of the trust, the other set governing the person elements—and, perhaps, a third set if some of the purposes are charitable—that may lead to confusion and dispute over matters on which the rules differ. STAR provides a single set of rules applicable to all parts of a mixed trust.¹⁷¹
- (8) *The Person/Purpose Distinction*: As already noted, other offshore centres that have enacted purpose trust rules now have three differing sets

170. See *id.* § 9.

171. See *id.*

of rules, one applicable to person trusts, one to charitable purpose trusts, and one to non-charitable purpose trusts. So when an issue comes before the court it may be necessary to decide a preliminary question: what kind of trust is this? STAR reduces this preliminary issue to child's play. Quite simply, the STAR rules apply if the trust instrument contains a declaration to that effect.¹⁷²

D. *Application to Private Trusts*

Obviously, STAR is useful for those who want to set up non-charitable purpose trusts—so long as the purposes are lawful and not contrary to public policy. The STAR legislation makes no attempt to define the public policy exception. English case law gives some guidance but settlors should beware, especially if their trusts might continue for a long time.

Less obviously, STAR offers some additional planning possibilities for charitable trusts. In particular, the Attorney General does not have responsibility for STAR trusts even if they are for charitable purposes. Of course, this will not suit those who like the idea of official enforcement—and they can obtain that by using an ordinary Cayman trust for charitable purposes. Others may feel that they can establish more effective review and enforcement mechanisms of their own. STAR enables them to do so. Another advantage is that under STAR there is no need to wonder about whether the trust qualifies as exclusively charitable. Under English law, that is critical to the validity of the trust; the law reports show only too clearly how many pitfalls there are for the uninformed or unwary.¹⁷³ Care is needed not only in drafting the purpose clause but also, for example, in any provision that creates a power to vary the trust or change the governing law. STAR provides a primrose path around all these traps.

Perhaps the most interesting STAR applications, however, are in relation to person trusts. STAR gives planners a great deal of additional flexibility. Arrangements that are difficult or impossible under the ordinary trust regime are made easy by STAR:

- (1) *A trust for persons can have purposes, too.* As noted earlier, a settlor may want to put his

172. See *id.* § 3.

173. See DOUGLAS H. McMULLEN ET AL., *TUDOR ON CHARITIES* (6TH ED. 1967).

business into a trust on terms which require the continuance of the business as well as providing that the family are to take the income generated by it. Under the ordinary trust regime, this is a difficult proposition. According to English principles the interests of the beneficiaries are paramount, and they—or the court on their behalf—may override any directions the settlor has given about retaining the business. Under STAR one simply provides that continuance of the business is one of the objects of the trust. The beneficiaries cannot override that. To give another example, suppose that the client holds a block of shares in a closely held corporation and wants to put these shares into trust for his family on terms which ensure that the shares will be voted in some particular way, perhaps to keep himself or a specified person on the board of the corporation. Again this is quite difficult to achieve under the ordinary trust regime because the trustee must, and the court will, treat the interests of the beneficiaries as paramount. It is easy under STAR.

- (2) *The settlor's investment objectives can be expressed as objects of the trust and, if so, they cannot be overridden.* As already noted, in an ordinary trust the interests of the beneficiaries are paramount. The court may override the settlor's investment rules in the interests of the beneficiaries. If the trustee blindly follows the investment rules in the trust instrument without regard to the interests of beneficiaries, it is probably at risk; it may be argued that the trustee should have applied to the court for authority to depart from those rules. In any case a beneficiary can apply to the court. Under STAR, the interests of the beneficiaries are not necessarily paramount—it all depends on what are the stated objects of the trust.
- (3) *The beneficiaries do not have to form a certain class.* It is well known that an ordinary trust is void if its objects (beneficiaries) are uncertain. So for example, if the settlor gives his trustee a power or duty to make distributions among the settlor's "relatives and friends," this fails the certainty test and is void. But, it would be valid

under STAR. STAR is more forgiving to the draftsman and allows settlors to give wider discretions.

- (4) *The beneficiaries, if any, do not necessarily have enforceable rights.* Under the ordinary trust regime, a beneficiary necessarily has certain core rights, and these cannot be removed by the trust instrument. The precise extent of these core rights is not clearly established, but they certainly include the right to bring an action against the trustee for the enforcement of the trust. Under STAR, it is up to the settlor to say in the trust instrument whether beneficiaries are to have the right of enforcement and in what circumstances. Another core feature of the ordinary trust is that beneficiaries have a right to call on the trustee for an accounting and to demand access to trust documents and information. This is not an absolute right, and moreover, it seems that it may to some extent be qualified by the trust instrument. But, a trust provision that purports to deny this right altogether is likely to be struck down as repugnant to the trust, or worse still, it may invalidate the whole trust. STAR makes it plain that it is up to the settlor to decide what rights the beneficiaries are to enjoy in this respect and generally. So, for example, STAR accommodates the settlor who thinks it would be bad for his children to know that there is a substantial trust for their benefit until they are well established in their careers.
- (5) *The terms of the trust may provide that a beneficiary loses his rights of enforcement and information in specified circumstances.* This STAR feature may be highly significant in cases where the settlor is concerned that beneficiaries may fall into the hands of creditors or greedy spouses. It may also be highly significant in forced heirship planning: to prevent an heir putting on his beneficiary's hat to obtain the trust information and documents that he needs in order to plan and execute his attack on the trust. Furthermore, the heir can be prevented from using a trumped-up (or genuine) charge of bias or mismanagement to obtain an injunction from the

court inhibiting the trustee's ability to take defensive measures.

- (6) *The rule in Saunders v. Vautier does not apply.* In an ordinary trust, a provision that distribution of an interest vested in possession will be postponed until the beneficiary reaches an age greater than majority, is generally ineffectual. The beneficiary can call for his property. The same principle means that, whatever the trust instrument may say, the beneficiaries can terminate the trust if they are all of a mind to do so—assuming that all of the beneficiaries are in existence and sui juris. Under STAR, even if beneficiaries have been given unqualified rights of enforcement, they cannot override the terms of the trust.
- (7) *Trusts can be protected from costly embroilment in family disputes.* If a substantial part of a family's wealth is in a trust, it may well form the battleground for any family dispute; this sometimes happens even when the dispute is in reality about something different. Trust litigation tends to be particularly time-consuming and expensive—largely because the interests of so many people are affected, and especially when the interests of minors and unborn persons must be represented. For this reason alone, a wealthy settlor may wish to consider limiting the ability of individual beneficiaries to embroil the trust in major litigation. Under the ordinary trust regime he has no effective way of doing so. Under STAR he can tailor the enforcement provisions as he pleases. For example, he may provide that an action can only be commenced by a certain minimum number of beneficiaries, or he can establish a committee of beneficiaries or others to keep an eye on the trust administration and to decide by majority vote whether or not to take legal action.
- (8) *People or institutions who are not beneficiaries can be given the right or duty to enforce the trust.* Under ordinary trust principles it is doubtful whether a protector or other supernumerary can be given standing to bring an action against the trustee for the enforcement of the trust—unless

he happens to be a beneficiary. In some cases, particularly if the beneficiaries are young or financially unsophisticated, the settlor may want the protector to act as enforcer, to keep an eye on the trust administration and take appropriate action if the trustee has mishandled it. Under STAR this is easy.

- (9) *A trust may be perpetual.* The rule against perpetuities does not apply to STAR trusts. However, this feature needs to be treated with some care. If it is arguable that the objects of a trust are contrary to public policy, its duration may well affect the court's decision. Idiosyncratic objects may be acceptable for a short period but not a long one.

E. *Application in Commercial Situations*

On the commercial side, it seems there should be plenty of applications for a mechanism which allows obligations of all kinds to be annexed to property—protected by all the tried and tested remedies, personal and proprietary, that English law has developed for breach of trust. Some particular applications are suggested below.

1. Holding Special Purpose Vehicles

It has become common for the shares of special purpose vehicles (SPVs) to be held in charitable or non-charitable purpose trusts. In a number of financing and securities situations, a corporate vehicle is required, but it is inappropriate for one reason or another that it should be owned by any of the participants. A structure is required that insures the vehicle will remain in being and will act in the appropriate manner or, at least, refrain from acting in an inappropriate manner.

Charitable purpose trusts are a popular solution, but care must be taken to establish that there is a genuine charitable intent. In other words, the trust may be attacked as a sham if charitable distributions are not made. Furthermore, the trustee must of course act in the interests of charity rather than in the interests of the parties to the transactions in which the SPV is involved. So care is needed to make sure that a situation cannot arise in which the trustee may feel compelled to act in a disruptive manner. Another feature of the charity solution is that the Attorney General may intervene on behalf of charity.

Another popular solution has been the non-charitable purpose trust. In some cases the object of the trust is simply "to hold the shares of XYZ Limited." If it is put as simply as that, there must be an argument that this does not qualify as a purpose trust. The argument is that the trust instrument must answer the question, "For what object or purpose is the trust property held?"—and it is no answer to say, "To hold the property." The obvious solution seems to be to expand the purpose clause of the trust to state in appropriate terms that the shares of XYZ Limited are to be held in order to facilitate the proposed transactions. However, that may give rise to a further difficulty because it could then be argued that the trust has beneficiaries, namely the other parties to the proposed transactions, and the trust may be categorized as an ordinary person trust. The difficulty in that outcome is that the beneficiaries would then be regarded as the beneficial owners of the shares of the SPV—which is precisely what they were seeking to avoid in the first place. So it seems that the draftsman must tread delicately in order to avoid these two pitfalls.

With a STAR trust, the situation is simpler. The object clause must set out a real purpose—presumably that of facilitating the proposed transactions—but there is no difficulty or danger in a purpose beneficial to persons. STAR encompasses trusts for persons, purposes, or both. Even if the other parties to the proposed transaction are made enforcers (which is optional) they should not be regarded as beneficial owners of the SPV. The rule in *Saunders v. Vautier* does not apply, so even if all the enforcers acted in concert, they could not lay hands on the shares of the SPV. They can only compel the trustee to administer the trust properly—or recover misapplied property for and on behalf of the trust.

2. Segregation of Corporate Assets

Suppose it is proposed to create several investment funds within a single corporate vehicle. The difficulty is that all the assets of the company are available to meet all its creditors. So investors in one fund take the risk that another fund cannot meet its liabilities—or that the company incurs liabilities in excess of its general assets. STAR provides a mechanism by which this risk can be eliminated. The subscriptions for each fund are held by the custodian in trust to be invested in accordance with the investment manager's directions and to be applied in paying or reimbursing the expenses and liabilities of the company referable to the fund, including liabilities in respect of the company's shares of the relevant class.

Another situation in which segregation may be required is that of the rent-a-captive. Clients want, in effect, to have their own captive insurance companies, but the rent-a-captive structure offers economies of scale and the benefit of the rent-a-captive host's own capital base. Of course the client does not want its captive's assets to be available to the creditors of other captives within the same host. In some offshore jurisdictions, Cayman included, the companies legislation has been modified to permit "cell" companies for this purpose. STAR provides an alternative solution.

Deferred variable annuities are a popular insurance product, and this may be another situation in which STAR provides the most effective method of segregation—to ensure that the investment portfolio attributable to one annuity contract is insulated from liabilities on other annuity contracts or other business of the insurer. However, the suitability of the STAR solution, and the terms of the STAR trust, will depend very much on the relevant tax laws.

3. Security for Remote Obligations

Suppose that A requires effective reinsurance that B will meet an obligation to C in relation to property, or that B will use a particular fund to pay C. One way of giving A security for this remote obligation would be for B to put the property or fund in a STAR trust with the purpose of discharging B's obligation to C, and returning the residue to B. A is appointed as one of the enforcers of the trust. Perhaps A's reason for requiring this reinsurance is that, if B does not perform, A will have to do so, or will suffer some other loss or disadvantage; or this may be a Quistclose situation in which A is lending B the money to pay B's debt to C. It appears that the analysis and effect of a Quistclose trust are still open to argument under English principles. STAR provides a mechanism under which the rights of all parties—the lender, borrower, and borrower's creditors—can be established without doubt.

4. Security for Non-Pecuniary Obligations in Relation to Property

Suppose that X has agreed with Y to apply property in a particular way, but Y wants effective reinsurance that the property will be so applied. X could put the property into a STAR trust—to make the application and return the residue, or resulting assets, to X. Y would be appointed as an enforcer and so could ensure due execution of the trust. If the trustee misapplied the property, Y would have (on behalf of the trust) personal remedies against the trustee (subject to any exculpatory

provisions of the trust instrument) and also a proprietary tracing remedy against X or whomever received the misapplication (unless a bona fide purchaser). If a third party participated dishonestly in the misapplication, there would also be a personal remedy against him on the so-called "constructive trust" basis. So the STAR trust gives Y several additional remedies that it would not have under a purely contractual arrangement with X—and it also secures Y against the risk of X becoming insolvent before the intended application has been completed.

As I hope these examples show, STAR holds out a number of interesting commercial possibilities which deserve investigation. In fact, it was thought to be such a powerful mechanism with so many possible applications that it is for the moment restricted by the rule that at least one of the trustees of a STAR trust must be a trust company licensed in the Cayman Islands. So in any STAR structure such an institution must be involved, as custodial at least. This does not prevent the involvement of others in the trust administration. Provision is made in STAR to relax this rule by regulation.

XIV. CONCLUSION

From this highly selective review, I think it will be apparent that the offshore centers have worked hard to develop both law and practice to meet prevailing conditions. So far as legislation is concerned, there has naturally been some tension between market requirements, actual or perceived, on one hand, and more sober policy considerations on the other. As I have been involved in the process, I should leave it to others to say whether the right balance has been struck. So far as practice is concerned, I hope the discussion is of interest, but I doubt if there is any single feature that can be described as original. We apply old ideas in new situations.

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