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BALANCING THE REQUIREMENTS OF THE TRUST WITH FAIRNESS AND PROBITY

- A PERSPECTIVE FROM THE CAYMAN ISLANDS –

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INTRODUCTION

First, let me begin by welcoming all the delegates to this important conference and by extending my congratulations to Mourant Ozannes and all their sponsors, for their initiative and insight in having brought us together here this morning.

I am appreciative of the opportunity to address you, which I do in the public interest, for what I consider to be two paramount reasons.

First, I think it is important that all of you, the professionals who serve our international client public, should have a clear appreciation of the administration of justice in the Cayman Islands and how it is in turn, that that those of us involved in the Administration, perceive the needs of the client public that you represent and advise.

Occasions like these are also important for a second reason: which is that they offer us opportunities to disabuse the misinformation about the fiscal culture of the Cayman Islands, that which is so freely disseminated by the mainstream media and by overseas fiscal regulators.

While there is little we can do about what in Cayman we call the "John Grisham effect" in the cultural media, we can certainly nonetheless speak to the truth and substance of Cayman's fiscal regulatory position, when the

opportunity is presented to address a sophisticated audience such as yourselves.

This is my hope in speaking to you this morning and, of course, I speak from the point of view of a judge who has for many years been involved in cases, and indeed trust cases, in which the competing fiscal regulatory dynamics have been at play.

Thus, the topic of my talk is: *Balancing the Requirements of the Trust with Fairness and Probity – a perspective from the Cayman Islands Courts.*

[I think I will need about an half hour.]

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BALANCING THE REQUIREMENTS OF THE TRUST WITH FAIRNESS AND PROBITY

– A perspective from the Cayman Islands courts –

1. The past thirty years or so have borne witness to remarkable developments in the financial industry in the Cayman Islands and elsewhere. As individuals become more prosperous and more internationally mobile in the Global Economy, their wealth and succession planning requirements become more complex and sophisticated; and so too do the structures and products which are crafted to meet them.

2. As everyone in this audience will appreciate, intentions of settlors (or grantors) will often be underpinned by many concerns and demands: they may be concerned about the maintenance of confidentiality; or they may have personal security issues or be motivated by a desire to make charitable and philanthropic donations. Often they are driven by forced heirship concerns arising in their home jurisdiction, and a wish to ensure that, whatever shape their plans may take, they are consistent with their religious or spiritual beliefs.

3. While participants in the offshore financial industry understand the need for innovation and flexibility to meet the legitimate diverse objectives of clients, others regard the offshore legislative agenda with suspicion. These detractors have argued, that in their drive to maintain flexibility and utility of the offshore trust; some jurisdictions are obstructing the leading economic powers in their quest to increase and protect their revenue base. Amidst the fall out from the 2008 financial collapse, a consensus seems to have emerged; and this is that there must be a shift in perspective on both sides, both in the way that offshore jurisdictions promote their efforts to strengthen regulation and fiscal transparency, as well as a change in the expectations of those who wish to do business offshore.

4. The utility of the trust is central to the debate and any discussion of these ideas, must begin with recognition to the fact that the concept of the trust is inherently malleable. Its ability to adapt to changing social and economic circumstances without altering its "irreducible core"[1], is central to the notion of what a trust has been from inception.

5. From its history we know that the trust originated as a means of holding property on behalf of landowners who left their homes and families to fight in the Crusades in the 12th and 13th centuries. The Lord Chancellor's court, known as the Court of Chancery in England, then gradually developed a code of central principles which became known as the principles of equity or conscience, upon which disputes about trusts could be adjudicated. The utility of the trust and the infrastructure that developed around it, allowed it to become a useful tool through which members of the aristocracy could facilitate the administration of their estates and inheritance, through the male family line, over several generations.

6. This basic concept of the trust, based on the duties of fidelity and good faith, has proliferated and diversified over hundreds of years, so that we encounter it today in wills, legitimate tax and succession planning, the vesting and holding of property and pensions, as well as in an extraordinarily wide range

[1] ***Armitage v Nurse [1988] Ch 241***, as applied in the Cayman Islands in ***Lemos v Coutts [2003] CILR 281*** **at 403**

of commercial transactions. We have even heard of "*a blind trust*", a North American construct of unique political relevance, where a person in public life, legitimately perceives the need for protection from concerns about conflicts of interests.[2]

7. Indeed, so malleable is the fiduciary nature of the trustee's obligations, for safeguarding the interests of investors or beneficiaries, that John H Langbein, professor of law and legal history at Yale, in his paper "*The Secret Life of the Trust*", estimated in 1977 that:

> *"most of the wealth that is held in trust in the United States is placed there incident to business deals, and not in connection with gratuitous transfers...well over 90% of the money held in trust in the United States is in commercial trusts, as opposed to personal trusts."*[3]

8. Blessed with relative political and economic stability over the last 50 or so years; the British Overseas Territories, sharing as they do an English legal heritage, have played their own part in ensuring that the trust concept keeps pace with the demands of an increasingly sophisticated and diverse commercial world. In the Cayman Islands in the late 1980s and throughout

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[2] See definition of the "Blind Trust" given in "Commonwealth of the Caribbean Trust Law", Kodilinye and Carmichael 2nd Ed. pp225-226; Cavendish Publishing 2007.

[3] 'The Secret Life of the Trust: The Trust as an Instrument of Commerce", Yale Law Journal, Vol 107, page 165, 1907-1998.

the 1990s, we saw amongst other developments, for example, the introduction of reserved powers legislation[4], the presumption of immediate and lifetime effect[5] and the statutory validation of non-charitable purpose trusts[6], commonly known as STAR trusts.

9. In 1989 our Fraudulent Dispositions Law replaced the English Statute of Elizabeth, creating a regime for balancing creditors' rights with legitimate asset protection objectives.

10. And central to this, is the affirmation of the principle that every disposition of property made, with an intent to defraud and at an undervalue, shall be voidable within six years of the disposition at the instance of a creditor prejudiced by it. Under the Bankruptcy Law (1997 Revision), if the settlor of a trust commits an "*act of bankruptcy*" (as per s14 of the Bankruptcy Law) within the Cayman Islands, he may be made bankrupt within six months of the act and transactions at an undervalue can be set aside by the trustee in bankruptcy, if they occurred within a prior period of up to 10 years.

11. I understand you will also be hearing later today, in one of your sessions, about the foreign elements provisions of Cayman's Trusts Law, known as its

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[4] S14 Trusts Law (2011 Revision) introduced 8n 1998 with the Trusts Law (1998 Revision).
[5] S13(1) Trusts Law (2011 Revision) introduced in 1998 in the Trusts Law (1998 Revision).
[6] Part VIII of the Trusts law (2011 Revision), introduced in 1977 by the Special Trusts (alternative Regime) Law 1997.

"firewall" legislation, an innovation which has since its introduction in 1989, found its way into the statute books of many other offshore jurisdictions. It means that in essence, foreign law or a foreign judgment shall not be recognised, enforced or give rise to an estoppel, insofar as it is inconsistent with other provisions of the Cayman Trusts Law (2011 Revision). This in effect, ensures that Cayman Islands law shall govern trusts which are domiciled here; all part of the comprehensive public policy that repudiates any presumption of irregularity behind Cayman trusts.

12. And this is, of course, a policy that does nothing more than preserves the ancient respectability of the Trust concept.

13. To quote Frederic William Maitland, the English jurist and legal historian:

> *"If we were asked what is the greatest and most distinctive achievement performed by Englishmen in the field of jurisprudence, I cannot think that we shall have any better answer to give than this, namely the development from century to century of the trust idea."*[7]

14. It is fair to say, that while the international financial centres have led the way in the evolution of modern trust law in the last 20 or 30 years, some commentators have expressed a concern, that they are in danger of leaving

[7] Collected Papers: *The Collected papers of Frederic William Maitland, ed. Fisher, Cambridge, 1911, 3 vols, at 271.*

the core concept of the trust, as it is recognised in English law, too far behind, in the drive to attract new business and meet the demands of clients. This debate which has been over the movement away from the beneficiary principle and the "irreducible core", to the introduction of STAR and the non-charitable purpose trust, has proven to be as fierce as it is fascinating.

15. But at the end of the debate, what matters most is certainty. And certainty in the application of legal principle and confidence in the infrastructure of the court system here in the Cayman Islands; are key to the continuing success of the jurisdiction. In the same way that confidence in legislative developments such as STAR, is strengthened by mature debate and careful deliberation; the credibility, durability and strength of the trust concept, is further supported by its frequent examination and the application by the Cayman Islands Courts of the principles of equity, and of precedent based case law.

16. This is exemplified most frequently in the Grand Court's inherent jurisdiction to supervise the administration of trusts in the Islands. As it was explained by Lord Walker of Gestingthorpe in the Privy Council case of ***Vadim Schmidt v Rosewood Trust***[8], referring to disclosure of trust information:

[8] [2003] UKPC 26

> *"The more principled and correct approach is to regard the right to seek disclosure of documents as one aspect of the court's inherent jurisdiction to supervise, and if necessary intervene in, the administration of trusts. The right to seek the court's intervention does not depend on entitlement to a fixed and transmissible beneficial interest. The object of a discretion (including a mere power) may also be entitled to protection from a court of equity, although the circumstances in which he may seek protection and the nature of the protection he may expect to obtain, will depend on the Court's discretion."*

17. In furtherance of that supervisory jurisdiction; trustees, beneficiaries, executors, administrators and enforcers alike, have a right to apply to the Grand Court for the determination of a question arising in the administration of an estate or in the execution of a trust.[9]

18. Trustees are also entitled to apply to the court under section 48 of the Trusts Law (2011 Revision) for an opinion, advice or direction, on any question relating to the management or administration of trust assets, such application

[9] GCR Order 85

to be served on all parties with an interest in it. As I described this jurisdiction in my judgment in ***A v Rothschild Trust Cayman Limited***[10]**:**

> *"it is a jurisdiction to which resort has been taken in a number of different circumstances and while its boundaries have never been defined by the court, it has, from the decided cases, clearly come to be regarded as a remedial jurisdiction, for orders to be made as the justice of the case deserves."*

19. Disputes and questions arising in the administration of the trust, can arise from families based and involve assets located, almost anywhere in the world. They can involve highly complex and sensitive issues, as well as significant sums of money and their effective disposal involves a partnership between the local and international legal community, including the judiciary here and abroad and court staff in the Cayman Islands; all to ensure that the cases are run smoothly and cost effectively. Proceedings do not involve only the parties to the dispute. They can involve expert witnesses of law from other jurisdictions; they can involve applications to courts abroad, visits here from overseas by advocates and QC; they can involve valuers, forensic accountants and scientific experts in many fields, from medicine to handwriting and ink dating.

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[10] [2004-05] CILR 485, at 497

20. Every year, the Financial Services Division of the Grand Court deals with between 300 and 400 cases, each of which requires time for judicial reading in, trial, deliberation and writing judgments. In the last 12 months alone, I and two other fellow Judges in the FSD, have been engaged in trying three substantial disputes, each involving several months of judicial attention and a great deal of court staff time. While this unfolded, our other colleagues on the FSD and other divisions of the Grand Court, had to deal with the panoply of other cases which constantly engage the Court. Accurate time estimates from advocates and meticulous scheduling by the Court Listing Officer, play their part in ensuring that everything is dealt with in a timely manner. Occasionally, and with the best will in the world, unforeseen issues do arise and again, with patience, professionalism and the co-operation of everyone involved, the complex cases are absorbed and dealt with, causing the minimum disruption to other cases.

21. Everyone who transacts here, needs to have confidence that their business disputes will be handled professionally, efficiently and cost effectively by the courts, its attorneys and the other professionals who practice here. Despite the obvious strength and durability of the trust concept, to ignore the demands and complexities of trust disputes which inevitably arise, would be

naive. It would also be naive to ignore the more reasonable voices of scepticism.

22. Indeed, judicial scepticism onshore about offshore structures, has found its expression in a number of different fora: As Mr. Justice Coleridge in the English Family Division put it in 2004, while adjudicating a financial application on divorce:

> *"Sophisticated offshore structures were very familiar to the judiciary trying ancillary relief proceedings and did not impress, intimidate or fool anyone. If clients used such structures to avoid disclosing their true wealth, they could not expect sympathy when it came to the question of paying the costs of the enquiry which inevitably followed:*[11]

23. In the case of ***Charman v Charman*** in the English Court of Appeal in 2007, the Court of Appeal referred to the *"judicious mixture of worldly realism and of respect for the legal effects of trusts, the legal duties of trustees and in the case of offshore trusts, the jurisdictions of the offshore courts"*[12] while at the same time, emphatically confirming that the assets in a Bermudian trust should be treated as matrimonial property on the division of assets on divorce.

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[11] J v V [2004] 1 FLR 1042
[12] [2007] EWCA Civ 503

24. Several examples of scepticism can be found in the courts of the United States, most often in claims brought by the IRS or regulators, or in bankruptcy proceedings and the individuals involved there have not always escaped prison for contempt. In *Federal Trade Commission v Affordable Media LLC*[13],Denyse and Michael Anderson were co-trustees of a Cook Islands trust with a Cook Islands trust company, Aisa Citi Trust Limited. They were committed for contempt by the US District Court, after they claimed they could not repatriate assets back to the US, although they controlled them either directly or indirectly. They were removed as trustees by Aisa Citi who then refused to co-operate but the Andersons remained protectors of the trust. The finding of contempt was made in the context of fraud alleged by the US Federal Trade Commission, in relation to a telemarketing scheme. The court held, not surprisingly, that the impossibility of complying with the repatriation order was "self-created".

25. These are of course examples of what pre-eminent Harvard Professor of Law, Austin Wakeman Scott, in his authoritative treatise on trusts law describes as, the "*darker side of the picture.* [Where] *The trust has often served as a means of evading the law....*"

[13] 179 F 3d 1228 (9TH Circuit Court of Appeals 1999)

He went on to say that: *"It has often been said that a trust is altogether the same that a use was...they have the same parents, fraud and fear; and the same nurse, a court of conscience."*[14]

26. The 'dark' side has regrettably, on occasion, dominated the way in which offshore trusts are perceived and described. The US Senate's investigations produced almost 400 pages in its report entitled "*Tax Haven Abuses: The Enablers, The Tools and Secrecy*"; in conjunction with hearings held on 1 August 2006.[15]

27. Senator Carl Levin, the author of the report, was quoted in the New York Times as saying the law "*should assume that any transaction in a tax haven is a sham*". The report itself concluded broadly that:

    a. Offshore service providers in tax havens use trustees, directors and officers, who comply with client directions when managing offshore trusts or shell corporations established by those clients and do not act independently;

    b. Financial secrecy laws and practices in offshore tax havens make it easy to obscure the economic realities underlying a great number of transactions, with unfair results under US tax and securities laws.

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[14] Austin W Scott & William F Fratcher, The Law of Trusts.

[15] www.hsgac.senate.gov/...report-Aug.2006.p

28. At the G20 Summit in 2009, the then President of France, Nicolas Sarkozy put it bluntly – *"We want to put a stop to tax havens"*.

29. Although the bipartisan bill, entitled "Stop Tax Haven Abuse Act has not passed into law in the United States, Senator Levin has continued his campaign for greater transparency in financial transactions which have their root in offshore jurisdictions. In a statement to Congress on 18 July this year, Senator Levin restated his support for a "Stop Tax Haven Abuse Act", stating:

> *"There is indeed no free lunch here. In 2006 our Subcommittee on Investigations estimated that the tax havens cost the Treasury in the neighbourhood of $100 billion a year, and though we have had some successes in the battle against tax havens since then, tax dodgers and tax avoiders have continued to exploit every offshore loophole and tax haven they can find."*[16]

30. In the same statement by Senator Levin, he went on to demonstrate what has become an increasingly common tendency to unite the international anti-money-laundering and anti-terrorism efforts, with what he refers to as "resisting tax haven abuses". Earlier this year, the House of Representatives

[16]From a press release reproduced on Senator Levin's website at www.levin.senate.gov/newsroom.

stripped a provision of the CUT Loopholes Act[17] which had already been passed by the Senate which, according to Senator Levin "*would have given the Justice Department the same tools to combat tax haven abuses, that they now have to combat money laundering*."

31. The OECD has also thrown its weight behind transparency and exchange of information for fiscal purposes, establishing a Global Forum (of which the Cayman Islands is a member), tasked with ensuring the implementation of an international standard in tax information exchange and co-operation. Since its establishment in 2009, Tax Information Exchange Agreements between, nations have proliferated and phase two of the peer reviews undertaken by the Global Forum, is underway.

32. This is the current context in which the judiciary of the Cayman Islands, as part of their inherent supervisory jurisdiction over the administration of trusts domiciled here, must achieve what has been described by one local commentator as a "*fine balance*"[18]. A fine balance between on the one hand, individuals who may wish to protect their assets legitimately or who may seek to minimize their tax bills in compliance with their local tax laws, and on the other; creditors, including government revenue agencies, who wish to

[17] Described as the "Special Measures" provisions: see footnote 16 above.
[18] Sara Collins, 'A fine Balance', Cayman Financial Review, August 2007

recover debts or revenues owed to them and of course, the obligation to co-operate in the fight against international crime.

33. The current context in which we operate, also has implications for the further development of the law of private client confidentiality. This concept of confidentiality of course had its genesis in English law. In a paper I wrote which was published in Jersey and Guernsey Law Review in February this year, I described it thus:

> *"Duties of confidentiality, as part and parcel of the duties of loyalty and good faith, are necessary incidents of a fiduciary relationship, a relationship established by duties which come from the wellspring of equity; from the obligations, policed by the courts of equity, to hold identified property for the benefit of others. These obligations, forming part of the moral code which governs fiduciaries, are the hallmarks of personal relationships of "trust and confidence", underpinned by the solemn obligation of the professional and entrusted person to respect the privacy of those whose interests he must protect. This is an idea with deep roots in the common law of both England and the United States of America."*[19]

[19] 'A New World of Trust Litigation: A Cayman Perspective', Jersey & Gu8ernsey Law Review, February 2012.

34. This is another example of the "balancing exercise" which the court has to undertake in the exercise of its supervisory discretion. Again in *Schmidt v Rosewood*, the Privy Council described it this way:

> *"Especially where there are issues as to personal or commercial confidentiality, the court may have to balance the competing interests of different beneficiaries, the trustees themselves, and third parties. Disclosure may have to be limited and safeguards may have to be put in place.*
>
> *Evaluation of the claims of a beneficiary ...may have to be an important part of the balancing exercise which the court has to perform on the materials before it."*

35. I cannot continue my discussion of the duty of confidentiality in the trust context, without mention of the Cayman Islands Confidential Relationships (Preservation) Law, most recently revised in 2009; and the proposed Data Protection Bill 2012[20]; currently going through the process of public consultation. The data Protection Bill has been drafted with the aim of achieving European Commission recognition of the Cayman Islands' data protection regime, while balancing the expectations of personal privacy with the new international standards on financial transparency.

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[20] Available from the Law Reform Commission.

36. But even before the introduction of a data protection statute, the established case law of the Cayman Islands, belied the myth of the existence of absolute secrecy or confidentiality. While the CR(P)L has at its heart the principle of the maintenance of confidentiality of a principal's financial affairs, the statute makes provision for numerous exceptions, consistent with the Islands' international obligations. These relate to:

a. The investigation of criminal offences here and abroad;

b. regulatory matters through the auspices of the Cayman Islands Monetary Authority, the Financial Secretary or the Governor;

c. the vindication of rights in civil proceedings whether here or abroad; and

d. information provided under a request made through the Tax Information Authority established under the Law passed in 2009, specifically to enable the implementation of the Islands' tax information exchange agreements.

37. The treatment by the Cayman courts of applications for disclosure has been consistent over many decades and illustrates the manner in which the jurisprudential "*balancing exercise'* has been undertaken. It is plain however, that there is amply scope for issues of conflict of laws to arise in the future, as they have occasionally in the past, particularly in view of the

stated intention of regulators outside the Cayman Islands to assert their jurisdiction over disputes relating to, amongst other structures, Cayman Islands trusts.

38. A stark example arose in the case of ***Re H***[21]. There a trustee of a Cayman Islands discretionary trust, long settled by the settlor for the benefit of his family, was the subject of a Grand Jury subpoena. The trustee's father, the settlor of the trust, was subject to a Grand Jury investigation in Pennsylvania, due to alleged breaches of the Bankruptcy Code there. The trustee was subpoenaed by the Grand Jury to give evidence about the nature, location and extent of the trust assets. A challenge brought in the Cayman Islands to the validity of the trust by the Pennsylvania trustee-in-bankruptcy, was at that time subject to separate proceedings in the Cayman court, and although the settlor did not object to disclosure, the trust companies in the structure did not consent. At the heart of the Pennsylvania action was the presumption that the settlor remained owner of the trust assets, despite them having been settled on trust long before his bankruptcy.

39. In that judgment, I held:

> *"If validly constituted, the trust must be regarded as holding property independently of its settlor. The pivotal issue of*

[21] [1996] CILR 37

validity remains to be decided...as a matter of Cayman law which governs the trust. While that pivotal issue remains to be decided...it would be contrary to public policy and an unwarranted negation of the applicant's duty of confidentiality owed as trustee, to direct that he should give into evidence confidential information in foreign criminal proceedings which, as a matter of Cayman law, may yet come to be regarded as misconceived."

40. Directions for disclosure were refused and the action in the Pennsylvania courts against the assets in the Cayman Islands trust, was eventually discontinued.

41. In ***Re Ansbacher (Cayman) Limited***[22] 2001, I said this:

"While the confidential information about the affairs of persons doing business in and from the Islands is required to be protected, the protection afforded by the law is not absolute. Disclosure will be allowed, where it is appropriate to ensure that justice is done in disputes between persons and where the enforcement of the criminal law and the administration of

[22] [2001] CILR 214

justice – whether here or overseas – requires that disclosure be allowed.

...The disclosure of confidential information has been allowed and directed by this court in numerous cases, involving many different countries and many different legal issues and circumstances..."

"One principle has, however, always remained constant here, as it has in all countries which share our common law heritage (and this is that):

The law is not premised upon any presumption of wrongdoing.

...It follows that this court must stand ready the more so to reject any request for disclosure which may proceed upon a presumption that the mere fact of doing business with a Cayman financial institution, points to some reproachable objective such as tax evasion. Further, that the Cayman court will not direct the giving in evidence of confidential information without some assurance as to the limitations on its use or, for that matter, abuse."

42. And so it is that I believe, our courts will continue to strive to maintain the proper balance.

43. In closing, I would like to end this talk on a positive note by reaffirming that, in my view, the trust concept remains and will remain a legitimate and important estate and succession planning tool, in the panoply of options available in the world of international finance. The process of innovation in the development of the trust concept, has had its foundation in careful attention by the local judiciary to statutory advancements. These have been construed in the context of the longstanding and fundamental legal principles which breathe life into the trust concept. The success of the offshore trust industry, growing as it has from its roots in English law, has depended on the willingness of the English courts and those in the leading offshore jurisdictions, to develop common law and equity to ensure that those who might seek to exploit the "*dark side*" of the trust concept, will soon discover that they are most unwelcomed and will find no haven in our jurisdictions.

I thank you for your attention and hope that you have an informative and enjoyable conference.

Hon. Anthony Smellie
Chief Justice

October 5 2012