

No contest clauses: a Cayman perspective

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It is common for those establishing trusts to take steps to ensure their hard work is not undone by beneficiaries litigating future grievances. One of the tools in a trust advisor's arsenal is a provision which can disincentivise challenge and mitigate litigation risk arising from estate planning. That provision is known as a no contest clause.

What is a no contest clause?

A no contest clause is a provision sometimes seen in discretionary trusts and wills. It discourages or prevents beneficiaries from seeking to contest the terms of the relevant trust deed or, in some cases, challenging actions by a relevant fiduciary. Provisions of this nature need to be approached with care, both when drafting and when exercising relevant exclusion powers. Ousting the jurisdiction of the Court by threatening the removal of benefit as a deterrent to parties litigating grievances can be considered contrary to public policy and, at its extreme, a contempt of Court.

How does a no contest work?

In circumstances where an instrument contains a no contest clause, the usual consequence for beneficiaries taking any of the actions triggering the provision is automatic exclusion from benefit. Exclusion usually takes effect either through:

1. an automatic exclusion provision (with consequential provisions reallocating the now excluded beneficiary's interest), or
2. a requirement for positive action by a fiduciary to exclude the belligerent beneficiary

Many consider a no contest clause to have a more fearsome bark than bite. That is, the effect of the existence of a no contest clause may sufficiently disincentivise challenge to avoid the initial cost of litigating the construction and effect of the provision, before the challenging party can commence proceedings to address their underlying grievance.

What does a no contest clause look like?

The below example from *AN v Barclays Private Bank and Trust (Cayman) Limited & others* [2006 CILR 367] was considered in depth by the Cayman Court.

"Exclusion from Benefit:

"Whosoever contests the validity of this deed and the trust created under it, of the provisions of any conveyance of property by any person or persons to the trustee to form and be held as part of the trust fund and of the decisions of the trustee and / or of the protection committee shall cease to be a beneficiary of any of these trusts and shall be excluded from any benefits, direct or indirect, deriving from the trust fund."

Is a no contest clause effective in the Cayman Islands?

No contest clauses were examined extensively by former Chief Justice Smellie in *AN v Barclays*. The no contest clause above sought to prevent a beneficiary from challenging:

- the validity of the trust
- transfers of property into the trust
- decisions by the trustee or protection committee

The sanction for non-compliance was exclusion from benefit.

The Court held that no contest clauses are effective if they satisfy the ordinary rules of construction. The clause must be construed strictly and in accordance with cases which have dealt with the construction of similar provisions in testamentary dispositions. Among other things, the Court found that the existence of the statutory STAR trust regime and the primacy with which the Court has considered the common law principle of freedom of disposition reinforce that no contest clauses are fundamentally compatible with local public policy considerations.

As to construction, the Court will have regard to the following principles.

Uncertainty

In order to be valid, a condition resulting in the loss of benefit must be drafted so that the person affected, or the Court, is able to determine from the outset, precisely and distinctly the exact event or conditionality which if satisfied would purportedly result in the loss of benefit (the exclusion "trigger" mechanism).

Circumstances in which the provisions were held to lack certainty or where insufficient evidence had been adduced which proved that the conditions had been satisfied, including provisions where

exclusion from benefit was triggered should a beneficiary not receive an English education, and not be raised guided by the principles of the Protestant religion, according to the rites of the Church of England.

The Court considered that the construction of the conditionality relating to challenges to (i) the validity of the trust and (ii) the validity of transfers onto trust, to be sufficiently clear under the relevant rules of construction and should therefore be upheld.

However, the Court spent considerable time analysing the effect of the third condition, namely challenges to the decisions of the trustee and / or the protection committee which was less certain. In particular, the Court explained that under settled trust principles, as evidenced in the rule in *In re Londonderry's Settlement* [1965], it would be unlikely for a beneficiary to understand the decision for an exercise of a trustee's discretion which was subject to challenge. This is because a beneficiary isn't entitled to the material upon which a trustee's exercise of powers is based and is therefore left to interpret and possibly challenge a decision from the resulting trustee action. As a result, the Court had reservations that a no contest clause preventing **contests** of trustee **decisions** may be regarded as sufficiently uncertain as to be invalid.

Those reservations were compounded when considering the nature of a potential challenge to a trustee's decision. Should the provision prevent a beneficiary from challenging a decision made in bad faith contrary to the irreducible core of duties owed by a trustee? If the trustee exercised powers for improper purpose or otherwise contrary to the powers granted to it under the trust deed, would a challenge to such an exercise be caught by the no contest clause? The Court held that construed literally, such a challenge is meant to trigger forfeiture and would be too uncertain to be enforced.

Additional factors

The Court also considered additional factors, repugnancy and ouster of the Court's discretion.

A repugnant condition is one which attempts to make the enjoyment of a vested gift contrary to the principles of law affecting the gift. Conditions which are repugnant to the estate to which they apply are absolutely void.

Provisions which purport to oust the jurisdiction of the Court without providing a suitable alternative dispute resolution mechanism are similarly invalid on the basis that the Court's jurisdiction can never wholly be ousted.

| Considerations when drafting a no contest clause

As a result of the judicial consideration of the purpose and effect of no contest clauses, private wealth practitioners should exercise considerable care when drafting them to increase the likelihood that the provisions will be upheld. In particular, practitioners should:

1. ensure that the condition triggering the no contest clause, as well as the consequences arising from the provision are clearly drafted. Common law rules of construction are such that a condition of defeasance or forfeiture must be strictly construed, and may be set aside on the basis of uncertainty, repugnancy and ouster of the court's jurisdiction being contrary to public policy
2. if removing dispute resolution mechanism through recourse to the Courts, ensure there are comprehensive internal dispute resolution mechanisms, like arbitration, such that the provision does not fall foul of the limitation regarding ouster

Ultimately, if a client has real concerns regarding future "attacks" on their carefully established trust by trust beneficiaries, another structuring solution would be the use of a STAR trust.

The Cayman Islands STAR trust separates the traditional enforcement rights of a beneficiary, preventing a beneficiary having any direct enforcement rights against the trustee (or the enforcer). In a STAR trust the only party with enforcement rights is the "Enforcer" (a statutory office, mandated pursuant to the STAR legislation). Practically speaking, the effect of this legislation is that no beneficiary would be able to directly challenge any aspect of a STAR trust created for their benefit. A STAR trust deed does not need to contain a no contest clause as the trust itself could be considered a "no contest trust".

Ogier's top-tier Trust Advisory Group is well placed to provide more information on private wealth structuring generally, and the applicability of no contest provisions in particular. Find out more about our [Trusts Advisory Group](#).

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Key Contacts



Jordan Constable

Senior Associate

Cayman Islands

E: jordan.constable@ogier.com

T: +1 345 815 1808



Gregory Haddow

Associate

Cayman Islands

British Virgin Islands

E: gregory.haddow@ogier.com

T: +1 345 815 1824

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