

# In the matter of the Piedmont Trust and Riviera Trust: the role of Protectors in trustee decision

Insights - 25/10/2021

## Introduction

The trustees of two trusts, the Piedmont Trust (**the P Trust**) and the Riviera Trust (**the R Trust**), approached the Royal Court to seek its approval regarding the distribution of assets upon the termination of the trusts. However, before the Court could make a determination on whether approval should be granted, the Court was required to consider three issues of notable interest: firstly, whether the trustees were disqualified from making their decision because of a conflict of interest and whether this conflict should require them to surrender their discretion to the Court; secondly, the significance that should be attached to letters of wishes by the trustees; and lastly the role to be played by the protector of the trusts in matters and decisions relating to the trusts.

## Facts

Both trusts were created at the instigation of the father of three adult children (his daughter and his two sons), and were settled by relatives of the family. The two sons each have three adult children (**the Adult Beneficiaries**) who, with their fathers, reside in the US, and the daughter has one minor child who she resides with in the UK. The father, his three children and the grandchildren constituted the beneficiaries of both trusts. In April 2020, the father passed away.

In respect of the P Trust, the settlor issued three letters of wishes - the first two of which were substantially the same and stated that the intention of the trust was to make provision for the father's grandchildren, and that while the father was alive, distributions should only be made at his request. However, following his passing, his desire was that the trust should be divided into three parts, one in respect of each of the father's children. As to the one-third attributable to each son, the settlor wished for that part to be distributed equally among that son's respective children. The last third attributable to the daughter was to be distributed to any children she may have before a specified date, failing which her portion would be distributed to her at specified ages. The second letter expressed broadly similar wishes as the first letter. However, the third letter differed in that by this stage, the father and the daughter had fallen out and the letter expressed the wish that

upon his death, the trust fund should be divided into two equal parts - one half being for the children of the elder son and the second half for the children of the younger son.

In respect of the R Trust, the settlor issued only one letter of wishes in which the settlor expressed wishes in similar terms to those in the third letter in respect of the P Trust.

In 2018, following protracted litigation, the daughter requested the trustees to terminate both trusts and make a distribution equally between the three branches of the family. This request was supported by reference to the risk of adverse tax consequences should the settlor of the P Trust die and the level of hostility and breakdown in relations that existed between the family members.

Widespread consultation was held between the trustees and the beneficiaries during which the Adult Beneficiaries put forward a proposal for the distribution which was followed by a separate proposal compiled by the trustees. Protector consent was required for any distributions. The protector was not willing to consent to the trustee's proposal and as a result the trustees were compelled to revisit the matter afresh. This resulted in a further proposal being put forward by the trustees in January 2021 (**the Proposed Distribution**) which gained the consent of the protector, and it was this proposal which formed the subject matter of the approval sought from the Court.

Initially the trustees made it clear that they were approaching the matter in two stages. In stage 1, they were seeking the Court's approval to the percentage split between the various beneficiaries as set out in the Proposed Distribution. Thereafter, in stage 2 the trustees would work with individual beneficiaries to consider the tax position of each beneficiary and the best way in which that beneficiary's distribution should be made, ie directly to a beneficiary, to a trust for the benefit of that beneficiary or in some other manner. However, the Court was not happy to bless an appointment in circumstances where the trustees had not at that time taken tax advice on the effect of the proposed appointments and were not therefore aware of the exact tax position. This is an interesting point and highlights that trustees need to have relevant and up to date tax advice before approaching the Court for a blessing of a proposed course of action.

The application was therefore adjourned to allow the trustees to obtain relevant US and UK tax advice, which was received in May 2021. Following receipt of this advice, the trustees decided to maintain their decision as set out in the Proposed Distribution and the protector maintained its consent to the trustees' decision.

However, during the proceedings a number of issues were raised:

## Decision

Ultimately the Court dismissed the challenges raised by the father's children and found that the decision of the trustees to make the Proposed Distribution should be approved, on the basis that it was a decision which reasonable trustees, properly instructed, could have reached.

## Discussion

Of notable significance arising from the Court's judgement was its consideration and findings in respect of the three challenges raised by the father's children.

### **The trustees' conflict of interest**

It was argued by the daughter that the trustees received tax advice which stated that following the notification of major changes to the UK tax law with effect from April 2018, the trustees ought to have undertaken or proposed planning which would have reduced or even eliminated the daughter's UK tax liability. However, the trustees did not do so and consequently the daughter and her child incurred UK tax. Therefore there was a potential claim by the daughter and her child against the trustees for the unnecessary UK tax and as a result of this, the trustees were left stuck between a rock and a hard place - if the trustees were to gross up distributions to compensate the UK beneficiaries, the trustees may be left open to a claim by the non-UK beneficiaries for a breach of trust to the extent of the amount of the grossing up. The daughter therefore contended that the trustees therefore had a direct personal interest in the decision as to whether to gross up the distributions to the UK resident beneficiaries, because such decision would enable them to choose the likely plaintiff in any claim against them.

The Court found that this was not a case where the trustees should be required to surrender their discretion because of a conflict. Ultimately, it was observed that the trustees could not be placed in a position of conflict where they were not aware of the competing interests at the time of making their decision. At the time of deciding the Proposed Distribution in January 2021, the trustees were not aware of a possible claim against them by the sons or Adult Beneficiaries if they were to gross up the distributions to the UK beneficiaries as it was only on receipt of the tax advice in May 2021 that the trustees became aware of the adverse UK tax consequences and the relating claim by the non-UK beneficiaries.

### **The Letters of Wishes**

The daughter further contended that the trustees paid insufficient regard to the letters of wishes and particularly the first two letters of wishes delivered in respect of the P Trust and the sole

letter of wishes regarding the R Trust.

However, the Court confirmed that the correct position regarding letters of wishes was that they are a relevant consideration and trustees are bound to take them into consideration pursuant to their duty to take relevant matters into account, but that such letters are not binding on the trustees. If the letters were to be binding, this would only serve to displace the independence of the trustees. The Court also dismissed the contention that before a trustee may depart from the intentions set out in such a letter, there must be 'objectively justifiable grounds' for such departure. Finally, the Court clarified that whilst a letter of wishes may not be binding, a trustee is not permitted to 'ignore' the wishes of settlor as this would be inconsistent with its duty to take relevant matters into account. Instead, the Court noted that the correct position is that a trustee is free 'to depart from' a letter of wishes if the circumstances so permit.

This is important guidance for trustees on the weight to be attributed to a letter of wishes and, fundamentally, that a trustee can depart from the terms of a letter of wishes if there are cogent reasons to do so.

### **The role of the protector**

Finally, the sons and the Adult Beneficiaries raised concerns as to the extent of the role of the protector in the context of providing its consent in relation to a discretionary decision made by the trustees, namely:

The Court found that in order for a protector to fulfil its fiduciary duties owed to the beneficiaries, he must have access to such documents and information as are reasonably necessary for him to do so. To the extent that it is the trustees in possession of such information, it is their duty to supply the information to the protector which duty is enforceable by the Court on application by the protector.

In relation to the role of the protector, the Court confirmed that the paramount duty of a protector is to act in good faith in the best interests of the beneficiaries. In doing so, the protector was required to exercise its own judgement. If a protector was to have a limited role of review in respect of a trustee's decision, the protector's role would be the same as the Court's which would in effect render the protector's role almost redundant. The Court found that, depending on the circumstances, a protector may have wider ranging powers which may well include the entitlement to veto a decision of the trustee which is rational, provided that such veto would remain in the interests of the beneficiaries. However, this power is distinguishable in the context of consenting to a decision of a trustee. It is for the trustee to make a decision in the first place as

to distributions or in relation to the exercise of any discretionary power conferred on the trustee. It is not the duty of the protector to take that decision himself or to force the trustee into making the decision which the protector would make if he were the trustee by stating that he will only consent to a particular decision. That would be to exceed his proper role and to use the power given to him otherwise than for its intended purpose. A protector may often find that he should consent to a discretionary decision of a trustee on the basis that it is for the benefit of one or more of the beneficiaries even though, if he had been the trustee, he might have made a different decision which he thought to be even more beneficial.

Following the hearing, the Court was referred to the judgement of the Supreme Court of Bermuda in *Re X Trusts* [2021] Sc (Bva) 72 Civ. wherein the Court was asked to consider substantially the same issue, namely, did the consent provisions in the trust deed confer an independent decision-making discretion on the protectors (the Wider View) or merely a discretion to ensure that the trustee's substantive decision was a valid and rational one (the Narrower View), the latter approach being preferred by the Bermuda Court. However, the Royal Court differed from the view of the Bermuda Court and confirmed its initial judgement on the issue - the protector's role is more correctly characterised by the approach set out in the Wider View, being that the protector's role extends beyond a limited assessment of rationality.

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