RESERVATION OF SETTLOR'S POWERS

Modern attitudes to disposition of wealth and the changing nature of trust instruments have promoted the desire for more reserved powers for settlors in modern trusts. This article first discusses the various factors driving the demand for such reservations, and the benefits from such use, before considering the concerns over the extent of such reservations. With some jurisdictions looking set to amend their trust regimes to accommodate the demand of settlors and to liberalise the allowable degree of such reservations, this article articulates the proper parameters that should be set for such reservations, to ensure that the fundamental concept of trust – under which the trustee is held to strict fiduciary duties towards the beneficial owners – is not prejudiced by such a trend.

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I. Different attitudes towards reserved powers

1 The conventional trust doctrine stipulates that once a settlor transfers property to trustees, the settlor has no rights left in respect of the trust property.[1] Unlike beneficiaries in whom are vested the equitable interests, the settlor does not have any proprietary rights to give him *locus standi* to sue for enforcement.[2]

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1 "Where a trust is created *inter vivos* and the settlor is still alive, it would seem that he cannot maintain a suit to enforce the trust." A Scott, *The Law of Trusts* (Little Brown & Co Law & Business, 3rd Ed, 1967) s 200.1 at p 1643. See *Turner v Turner* [1984] Ch 100.

2 It has been argued that the lack of a proprietary interest in the trust property should not preclude the settlor's standing to enforce the trust. Instead, the issue as to whether the settlor has standing to sue should be determined in analogy with the public law standing doctrine. The settlor would have standing to enforce trusts if "his economic interest in the subject matter of the alleged breach was sufficiently foreseeable at the creation of the trust such that protection of the interest by the grantor can be said to have been intended", or "if the breach violates the grantor's substantial expectations". See John T Gaubatz, "Grantor Enforcement of Trusts: Standing in One Private Law Setting" 62 NCL Rev (1983) 905 at 916.

2 However, attitudes to disposition of wealth, and the use of trusts, have been changing. For the dual reasons of tax and confidentiality, settlors would want to alienate ownership and control of their estates to ensure that they have no interest under the settlement. On the other hand, settlors are not comfortable with the idea of handing over complete or exclusive control to others. The reserved powers for settlors fill these needs.

3 Attitudes towards such reservations differ greatly between jurisdictions. Article 2 of the Hague Trusts Convention[3] clarifies that "the reservation by the settlor of certain rights and powers … [is] not necessarily inconsistent with the existence of a trust". In many onshore trust jurisdictions, there are adverse tax consequences where the settlor is held to have maintained some extent of beneficial interest in property notwithstanding the transfer of it to the trustee.[4] A trust arrangement, in which the settlor retains excessive control over the trust functions, may be held to be a testamentary disposition – the "trust" does not take effect until the settlor dies.

4 The English Trustee Act 2000[5] is silent on the issue of settlor's reserved powers. Although there remains uncertainty as to what is permitted, and what is not, with regard to settlor's reserved powers,[6] the ability of a settlor of an English trust to reserve extensive powers to himself under the terms of the trust is limited. This is due to the doctrine of bare trust. A settlor of a trust to which English law applies, who reserves such extensive powers to himself, does not part with any beneficial interest, but instead creates a bare trust.[7]

5 A bare trust fails to achieve its intended purposes if it contains dispositive or other provisions which are to continue to have effect even after the settlor's death. The trust assets then belong beneficially to those who are entitled to the settlor's estate on his death, and do not pass to the beneficiaries specified in the trust instrument without probate or

3 The Hague Convention on the Law Applicable to Trusts and on Their Recognition; most of the provisions of which have been incorporated into English law: Recognition of Trusts Act 1987 (1997, c 14).

4 For example, see §2038 of the US Internal Revenue Code, which includes within the value of the gross estate (for purpose of calculating the estate tax) all interest in property transferred by an individual who retains the "power to alter, amend, revoke or terminate" enjoyment of the property.

5 Trustee Act 2000 (c 29) (UK).

6 "… there is little guidance as to where the boundary exists between powers being validly reserved and a trust failing on the face of the trust deed itself. This uncertainty invariably places draftsman [*sic*], settlors and trustees in a difficult position."

7 Christopher McKenzie, "Having and Eating the Cake: A Global Survey of Settlor Reserved Power Trusts: Part I" (2007) 5 PCB 336 at 341.

other formality.[8] Any purported disposition of assets held on a bare trust is testamentary. If such a disposition is to be valid, it must comply with the provisions of the relevant law on testamentary dispositions – something which in practice rarely happens.[9]

6 The Trust Ordinance of Hong Kong – which is modelled substantially on the English Trustee Act 1925 – is also silent on the issue of settlor's reserved powers. However, there are signs that things may be about to change in Hong Kong. The Joint Committee on Trust Law Reform, established in 2007, seeks to modernise the trust legislation to facilitate a more effective trust administration through the use of modern investment services, address some of the uncertainties in the common law, and promote the use of Hong Kong's trust law, especially by non-Hong Kong clients. Although the Committee's report will only be published in 2009, it is clear that it seeks to propose several changes to the existing trust regime in Hong Kong, and deal with issues such as settlor's reserved powers.

7 Singapore currently appears to be satisfied with occupying a middle-ground with regard to the extent of permitted settlor's reserved powers. Section 90(5) of the Trustees Act provides that no trust shall be invalid by reason of the settlor reserving to himself any or all "powers of investment" and "asset management functions".[10] The general purpose behind the introduction of s 90 seems to be the desire to give greater recognition to, and satisfy, settlors' intentions[11] – who are more knowledgeable and sophisticated, and demand a more active involvement in investment decisions.[12] The introduction of s 90 was also part of a move by Singapore to modernise its Trustees Act to make it in tune "with current developments in trust law and the application of trusts in financial and business transactions in the commercial world",[13]

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8 Christopher McKenzie, "Having and Eating the Cake: A Global Survey of Settlor Reserved Power Trusts: Part I" (2007) 5 PCB 336 at 341.

9 As Sir John Wilde noted in *Cocke v Cooke* (1866) LR 1 P & D 241 at 243: "It is undoubted law that whatever may be in the form of a duly executed instrument, if the person executing it intends that it shall not take effect until after his death, and it is dependent on his death for its full vigour and effect, it is testamentary." Moreover, even if the disposition does comply with these provisions there remains the need for beneficiaries to establish title through probate or other procedures.

10 Trustees Act (Cap 337, 2005 Rev Ed) s 90(5).

11 *Singapore Parliamentary Debates, Official Report* (19 October 2004) vol 78 at col 852 (Professor S Jayakumar). It is to be noted, however, that it was in the specific context of ss 90(1)–90(3) (recognition of dispositions of movable property by a foreign person into a Singapore trust) that Professor S Jayakumar explained the rationale behind s 90 as "to give certainty to the settlor's intentions".

12 Simon D Trevethick, "Recent Changes to the Trustees Act and Civil Law Act" Singapore Law Gazette (August 2005, vol 1).

13 *Singapore Parliamentary Debates, Official Report* (19 October 2004) vol 78 at col 852 (Professor S Jayakumar).

with a view to enhancing Singapore's position as a leading financial and wealth management centre.

8 Singapore was, however, reluctant to further expand the permissible scope of settlor's reserved powers beyond that already spelt out in s 90(5). Instead, Singapore preferred to determine the issue of further expansion of settlor's reserved powers "much later" when it has the opportunity to study the experiences of other jurisdictions.[14] Thus, Singapore has not as yet authorised the settlor to reserve powers with regard to the *distributive* functions of the trust.

9 On the other hand, the offshore trust jurisdictions, in their desire to attract more wealth capital, have given statutory recognition to a much wider ambit of settlor's reserved powers.[15]

10 This article first discusses the various factors driving the demand for such reservations, and the possible benefits derived from such use, before considering the policy concerns over the extent of settlor's reserved powers. It then articulates the proper parameters that should be set for such reservations.

II. Desire for more reserved powers

11 The changing nature of trust instruments has promoted the desire for more reserved powers for settlors in modern trusts.[16] Trusts are no longer restricted to their traditional functions of holding, protecting and transferring real property. Instead, modern trusts are used as investment tools aimed at enhancing the value of financial assets.

12 The modern forms of trust assets call for the settlor to devolve more options upon the trustee in the dispositive provisions of trusts,

14 *Singapore Parliamentary Debates, Official Report* (19 October 2004) vol 78 at col 852 (Professor S Jayakumar).

15 For example, both the Bahamian Trustee Act (1998) and the Jersey Trusts Law 2007 expressly provide that a trust would not be invalidated or delayed from taking effect just because the settlor reserves powers to, *inter alia*, revoke or amend the trust instrument: Bahamian Trustee Act 1998 ss 3(2)(a) and 3(2)(c); Trusts (Amendment No 4) (Jersey) Law 2006 Art 9A(2); appoint or dispose of the trust income or capital to anyone: Bahamian Trustee Act 1998 s 3(2)(b); Trusts (Amendment No 4) (Jersey) Law 2006 Art 9A(b); or to appoint or remove any trustee, enforcer, protector or beneficiary: Bahamian Trustee Act 1998 s 3(2)(d); Trusts (Amendment No 4) (Jersey) Law 2006 Art 9A(e).

16 Michael R Houston, "Estate of *Wall v Commissioner*: An Answer to the Problem of Settlor Standing in Trust Law?" (2004–2005) 99 Nw UL Rev 1723 at 1765.

ie, the allocation and distribution of beneficial interests.[17] Extensive discretionary powers vested in the trustee encourage the settlor to reserve some powers over the trust, so that the settlor is able to, for example, alter the investment directions of the trust as economic circumstances depart from those governing the creation of the trust, or to continue to assert the settlor's preferences over asset disbursement to beneficiaries based on the beneficiaries' changing needs.

13 The present-day trustee, in view of his duty to invest, enjoys greater responsibility, and also discretion, in the administration of trusts. These discretionary investment powers are further expanded under legislative regimes[18] which confer upon trustees a default general power of investment.

14 Moreover, the nature of modern trusts creates conflicts of interest. Settlors in modern trusts are more likely to use the trust as a device to manage the investment of various financial securities, with a view to distributing the assets to beneficiaries over time. In contrast, beneficiaries seek to obtain immediate possession of trust assets.[19] The trustee's preservation of trust assets is likely to be in accordance with the settlor's instructions, but against the beneficiaries' preferences.[20]

15 Another conflict of interest arises when trustees who are given wide discretion in investment and distribution decisions are paid based on asset value or trust transactions – prompting trustees to grow the trust value through investments and minimise payments to beneficiaries, or execute more trust transactions than are perhaps necessary.[21] The increased discretion vested in trustees breeds potential grounds for trustee misbehaviour in acting against the trust interests so as to seek maximum compensation from the particular trustee fee structure in operation. This results in an adversarial relationship between the trustees and the beneficiaries. These conflicting trustee motivations in portfolio management and disbursement decisions also contribute to the frustration of a settlor's intentions. The trustees'

17 See John H Langbein, "The Contractarian Basis of the Law of Trusts" (1995) 105 Yale LJ 625 at 638.

18 For example, the English Trustee Act 2001 and the Singapore Trustees Act 2004. Section 4(1) of the Singapore Trustees Act (Cap 337, 2005 Rev Ed) provides that "a trustee may make any kind of investment that he could make if he were absolutely entitled to the trust".

19 See Michael R Houston, "Estate of *Wall v Commissioner*: An Answer to the Problem of Settlor Standing in Trust Law?" (2004–2005) 99 Nw UL Rev 1723 at 1764–1765.

20 Michael R Houston, "Estate of *Wall v Commissioner*: An Answer to the Problem of Settlor Standing in Trust Law?" (2004–2005) 99 Nw UL Rev 1723 at 1765.

21 See Michael R Houston, "Estate of *Wall v Commissioner*: An Answer to the Problem of Settlor Standing in Trust Law?" (2004–2005) 99 Nw UL Rev 1723 at 1740–1741.

decisions may be against the beneficiaries' interests. In such a situation, the intervention of the settlor as a "referee" helps prevent, and resolve, such conflicts between trustees and beneficiaries.[22] Thus, it has been observed that "perhaps a supervisory role for the settlor is nothing more than a natural extension of trust law given the newfound potential for conflicts of interest in modern trusts".[23]

16 Expanding the scope of settlor's reserved powers – thereby assuring the settlor of the trustee's fidelity to his wishes – increases the settlor's willingness to create a trust.[24] A settlor who reserves the power of modification of trust terms is able to continually impose his financial judgment on the future investment directions of the trust assets. This is in contrast to the present legislative regimes in various Commonwealth jurisdictions, where there is no guarantee that the settlor's express intentions indicated in the trust instrument would always be followed.

17 Scholars have also pointed to the emerging trend of trust protectors in offshore trust jurisdictions[25] as a response, and also a remedy, to the settlor's uncertainty about the future.[26] The settlor, by appointing a trusted person as the protector, and granting him the authority to replace trustees, or make modifications to the trust instrument, *etc*, is able to indirectly manoeuvre the performance of the trust according to the settlor's preferences. As a trust protector can be granted the power to appoint his successor, the office of trust protector allows for a lengthier settlor oversight. Bearing the contemporary development of trust protectors in offshore trust jurisdictions in mind, allowing a more permissive scope of settlor's reserved powers would be the straightforward answer to the settlor's preference for greater certainty under the modern trust regime.

18 The settlor's reserved power to remove trustees can also serve to reduce "agency" costs. "Agency costs" refer to the losses suffered by a principal because his agent's interest – and hence incentives to act – diverge from those of the principal. The problem of agency costs[27] –

22 Michael R Houston, "Estate of *Wall v Commissioner*: An Answer to the Problem of Settlor Standing in Trust Law?" (2004–2005) 99 Nw UL Rev 1723 at 1765.

23 Michael R Houston, "Estate of *Wall v Commissioner*: An Answer to the Problem of Settlor Standing in Trust Law?" (2004–2005) 99 Nw UL Rev 1723 at 1765.

24 See Robert H Sitkoff, "An Agency Costs Theory of Trust Law" (2004) 89 Cornell L Rev 621 at 659.

25 Tsun Hang Tey, "Trust Protector" (2008) 20 SAcLJ 273.

26 See Robert H Sitkoff, "An Agency Costs Theory of Trust Law" (2004) 89 Cornell L Rev 621 at 671.

27 The principal can reduce agency costs by monitoring the agent's activities or by bonding the agent. Hence, Jensen and Meckling defined agency costs as the sum of the principal's monitoring expenditures, the principal's bonding expenditures, and the principal's residual loss – the remaining reduction in the principal's welfare as a result of the divergence of the interests of the principal and the agent. See further,

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endemic in the law of trusts – arises as it is difficult for a principal to observe whether the agent is acting on the principal's behalf.[28] Unlike corporate fiduciaries whose behaviour as agents is often subject to market discipline,[29] the typical trustee faces little market pressure in the performance of his duties.[30] The success of a trust critically hinges on the strength of the mechanisms for monitoring trustee performance. This mechanism is normally provided by the fiduciary duties imposed on trustees, which are enforceable by beneficiaries. However, the mechanism of fiduciary duty litigation has several deficiencies.[31] Firstly, the beneficiaries' preferences may not be perfectly aligned with the settlor's. A trustee is unlikely to face any action for breach of fiduciary duty when it takes action with the approval of the beneficiaries, even though the settlor and the beneficiaries may have had divergent preferences. This reduces the value of fiduciary duty litigation as a mechanism for monitoring agency costs.[32] Secondly, fiduciary duty litigation assumes the existence of rational and educated beneficiaries. That is seldom the case. If the settlor had confidence in the financial acumen of the beneficiaries in the first place, practically, he ought to have transferred his assets to the beneficiaries, thus preventing the agency cost problem from ever arising. It is likely that trustees as a

Michael C Jensen & William H Meckling, "Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure" (1976) 3 J Fin Econ 305 at 308.

28 Sitkoff, "An Agency Costs Theory of Trust Law" (2004) 89 Cornell L Rev 621 at 643–646. For an explanation of the lack of certainty in the law as regards whether the settlor or the beneficiary is the trustee's principal, see Sterk, "Trust Protectors, Agency Costs, and Fiduciary Duty" (2006) 27 Cardozo L Rev 2761 at 2762–2763: "[O]n some issues, equivocation about identifying the trustee's principal presents more significant difficulties. Suppose, for instance, the settlor wishes to control trust distributions in ways that the beneficiaries (or some subset of beneficiaries) do not like. Treating the beneficiaries as the trustee's principal is inconsistent with much traditional doctrine, and particularly with the emerging contractarian theory of the trust. But treating the settlor as the principal also creates a significant practical and conceptual problem: the settlor will typically be dead for much of the trust's duration. Practically, the settlor's demise often makes it impossible to determine whether the trustee is faithfully representing the wishes of the dead settlor. Even if the settlor left explicit instructions on some matters, the settlor could not possibly have anticipated all of the decisions a trustee would face. And that problem – the settlor's lack of foresight – becomes more serious as the duration of the trust increases."

29 See Bernard S Black, "Agents Watching Agents: The Promise of Institutional Investor Voice" (1992) 39 UCLA L Rev 811 at 856–857.

30 Sitkoff, "An Agency Costs Theory of Trust Law" (2004) 89 Cornell L Rev 621 at 643–646; Melanie B Leslie, "Trusting Trustees: Fiduciary Duties and the Limits of Default Rules" (2005) 94 Geo LJ 67 at 99.

31 Sterk, "Trust Protectors, Agency Costs, and Fiduciary Duty" (2006) 27 Cardozo L Rev 2761 at 2771.

32 Sterk, "Trust Protectors, Agency Costs, and Fiduciary Duty" (2006) 27 Cardozo L Rev 2761 at 2772.

group understand the limited capacity of the beneficiaries.[33] To make matters worse, if the trust beneficiaries are minor, incompetent or financially unsophisticated, they may not be effective monitors[34] of the trustee's performances. This reduces the effectiveness of fiduciary duty litigation as a mechanism for ensuring that the trustee acts in the interests of the settlor. Lastly, trustees recognise that beneficiaries would have to bear certain costs in commencing an action against the trustees for breach of fiduciary duties – the most obvious of which are the litigation costs. Even if the beneficiaries succeed in an action against the trustee for breach of fiduciary duty, they may only be able to recover the litigation costs from the trust estate.[35] This would be a hollow victory since the beneficiaries – as the equitable owners of the trust estate – would in substance be recovering from their own pockets.[36]

19 Academics have suggested that granting the settlor the *locus standi* to enforce the trustee's duties would minimise beneficiaries' supervisory costs by making the threat of litigation more viable as a deterrent against trustee misconduct.[37] It has been suggested that the settlor's reserved power to remove trustees would also provide a "deterrent" to safeguard against trustee misconduct[38] – the exercise of which does not require any proof of trustee misconduct.[39]

III. Onshore trust jurisdictions – Allowable extent

20 The English position is that once the trust has been established, the settlor retains no interest in it, and effectively drops out of the picture.[40] As the settlor does not own the trust property, he does not possess the requisite standing to enforce the trust,[41] or to remove an existing trustee for breach of fiduciary duty.

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33 Sterk, "Trust Protectors, Agency Costs, and Fiduciary Duty" (2006) 27 Cardozo L Rev 2761 at 2772.

34 See Fischel & Langbein, "ERISA's Fundamental Contradiction: The Exclusive Benefit Rule" (1988) 55 U Chi L Rev 1105 at 1114.

35 See *Palmer v Hartford Nat'l Bank & Trust Co* 279 A 2d 726 (Conn 1971) (the beneficiaries recovered from the trust itself the litigation costs they incurred in opposing the proposed sale of trust property at a price far lower than the price the purchaser ultimately paid for it).

36 See *Shriner v Dyer* 462 So 2d 1122 (Fla Dist Ct App 1984).

37 Sitkoff, "An Agency Costs Theory of Trust Law" (2004) 89 Cornell L Rev 621 at 668. See also John T Gaubatz, "Grantor Enforcement of Trusts: Standing in One Private Law Setting" (1984) North Carolina L Rev 905.

38 Michael Houston, "*Estate of Wall v Commissioner*: An Answer to the Problem of Settlor Standing in Trust Law" (2004–2005) NW U L Rev 1723.

39 Michael Houston, "*Estate of Wall v Commissioner*: An Answer to the Problem of Settlor Standing in Trust Law" (2004–2005) NW U L Rev 1723 at 1767.

40 *Re Astor's ST* [1952] Ch 534 at 542, *per* Roxburgh J; *Bradshaw v University College of Wales* [1988] 1 WLR 190 at 194, *per* Hoffman J.

41 *Re Astor's ST* [1952] Ch 534 at 542.

21 While the settlor may choose, at the time the trust is created, to write a letter of wishes to the trustees to express his preferences for the manner in which the trust assets are being administered or disposed of, such a letter, unless it is of binding effect, has no binding legal effect, and the trustees are not obliged to follow such instructions.[42]

22 The settlor is also unable to alter the beneficial entitlements of the trust beneficiaries after the inception of the trust. Once the trust is completely constituted, the settlor has no control over the administration or disposition of the trust assets, except in so far as there is some appropriate provision in the trust instrument which had been set out before the inception. An example would be an express provision reserving to the settlor, the power of revocation.[43] Another example would be a power of appointment over the trust assets. However, insofar as the settlor may wish to reserve a power of appointment, such powers can only be exercised to determine the allocation of the surplus remaining of a trust fund after the beneficiaries have received their defined interests.[44] A third example would be one directing the income to be held on "protective trusts" for the benefit of any particular beneficiary for the period of his life or any lesser period. The interest of a specified beneficiary is made determinable on bankruptcy, attempted alienation or the like, and thereupon a discretionary trust would arise in favour of that beneficiary and certain other persons such as the beneficiary's spouse or issue. The ability of the settlor to "protect" the trust assets through such a mechanism has been statutorily recognised by s 33 of the English Trustee Act 1925.[45]

23 The effect of the English position is this: except where a power of revocation has been expressly reserved by the settlor, while the settlor may be able to establish certain parameters within which the disposition of the trust assets may change, the settlor is "unable" to reserve a power allowing him to – following the inception of the trust – alter the beneficial entitlements of the trust beneficiaries at will. The settlor is "unable" to do so, in the sense that doing so would affect the validity of the trust – the "trust" may be construed as a "sham", or as a testamentary disposition[46] to which the instrument may fail for not having been

42 Tsun Hang Tey, "Letters of Wishes" (2009) 21 SAcLJ 193.

43 Halsbury UK 454. See *Re Flavell, Murray v Flavell* (1883) 25 Ch D 89 at 102–103; *Standing v Bowring* (1885) 31 Ch D 282.

44 *Re Weekes Settlement* [1897] 1 Ch 289. See Pearce & Stevens, *The Law of Trusts and Equitable Obligations* (Butterworths, 3rd Ed) at p 405.

45 See the UK Trustee Act 1925 s 33.

46 Reserving a power of revocation *per se* would not lead the English courts to hold the trust to be a testamentary disposition. *Tompson v Browne* (1835) 3 My & K 32 at 35–36, *per* John Goodwill: "It is very well settled as a matter of English law that an *inter vivos* settlement may reserve extensive interests and powers to the settlor, including a first life interest and an unfettered power of revocation, whilst still

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executed in conformity with the special rules governing execution of wills.

24 With regard to the administration of trust assets, while the effect of the amendments to the English Trustee Act in 2000 is to confer upon the trustee a wide "general" power of investment, the settlor is able to circumscribe this otherwise very wide investment power by stipulating restrictions or exclusions, pertaining to the undertaking of investments, in the trust instrument. Yet again, such directions are only legally binding on the trustee if the instructions had been in place before the inception of the trust. The settlor is unable to otherwise direct the administration of trust assets once the trust comes into operation.

25 The extent of reserved powers in Hong Kong is limited to the power to revoke the trust and the power to appoint surplus trust assets. Similarly, with regard to the disposition of trust assets, a settlor can also stipulate on the instrument binding restrictions[47] to the trustee's exercise of his powers of investment.[48] It is, however, likely that changes will be made to the current trust legislation in order to increase the attractiveness to potential settlors of setting up a trust in Hong Kong. Proposed changes on various parts of the legislation, including the important issue of settlor's reserved powers, are expected to be unveiled in the forthcoming report of the Joint Committee on Trust Law Reform in 2009.

26 The recent amendment to the Singapore Trustees Act[49] allowed a significantly wider scope for the settlor's involvement in the administration of a trust, as compared to the English position. Section 90(5) of the Trustees Act[50] states that "[n]o trust … shall be invalid by reason only of the [settlor] … reserving to himself any or all

being entirely valid as an *inter vivos* disposition. There does, however, have to be some transfer of an equitable interest in the trust property [to someone other than the settlor] (even if it may be defeasible by the settlor exercising a reserved power of appointment or a power of revocation) for a valid *inter vivos* trust to be created." (Referred to in Wolfe D Goodman QC, "Retention of Powers by Settlor" in *The International Trust* (John Glasson) (Jordans 2002) p 531 at p 542.)

47 Section 6 of the Hong Kong Trustee Ordinance provides that the discretionary exercise of a trustee's powers of investment (under s 4 of the Ordinance) shall be subject to any consent or direction with respect to the trust funds as *required by any instrument creating the trust* or by any Ordinance.

48 Under the Hong Kong Trustee Ordinance, however, the trustee does not have a wide "general" power of investment as his English counterpart does. Instead, s 4 of the Hong Kong Trustee Ordinance states that a trustee may only invest in (a) any investment specified in the Second Schedule, and (b) in any other investment (including deposits in a bank outside Hong Kong) which may be authorised by the court on summary application for that process made in chambers.

49 Trustees (Amendment) Act (Act 45 of 2004).

50 Cap 337, 2005 Rev Ed

powers of investment or asset management functions under the trust …". The rationale of this legislative change is probably to satisfy the preferences of "more knowledgeable and sophisticated" settlors who demand a more active involvement in investment decisions.[51] Even so, it is to be noted that Singapore still does not recognise the validity of trusts under which the settlors reserve powers to directly affect the interests of the beneficiaries, whether by changing their trust entitlements or through the removal or addition of trust beneficiaries.

IV. Liberalising onslaught from offshore trust jurisdictions

27 The offshore trust jurisdictions have passed legislation which recognise a very broad permissible scope of settlor's reserved powers. They can be broken into three broad categories: (a) powers allowing the settlor to be involved in the trust operation; (b) powers allowing the settlor to affect directly the beneficiaries' interests; and (c) exemption against liability for fiduciary breach for trustees as long as the trustees accede to the instructions of the settlor.

A. Settlor's involvement in trust operation

28 The legislation passed in the offshore trust jurisdictions does not specifically elaborate on the trustee's *locus standi* to sue for enforcement. In circumstances where the settlor has not reserved to himself any portion of the beneficial interest in the trust assets, the offshore trust legislation generally does not state that the settlor would nevertheless possess the right to enforce the trusts. Instead, the offshore trust legislation focuses on the settlor-trustee relationship, *ie*, the correlative rights and obligations between the settlor and the trustee.

29 The impetus of such an offshore legislative trend was the introduction of ss 12A and 12B of the Cayman Islands' Trust (Amendment) (Immediate Effect and Reserved Powers) Law 1998. This law – now incorporated into Part III of the Cayman Islands' Trusts Law – was specifically designed to assist with the structuring of trusts for high networth settlors where their continued involvement in managing speculative or high risk underlying trust assets was deemed to be important.[52] The purpose of the amendment was to clarify several issues, including an issue which has plagued the international trust industry for many years – what powers can be reserved by the settlor

51 Simon D Trevethick, "Recent Changes to the Trustees Act and Civil Law Act" Singapore Law Gazette (August 2005, vol 1).

52 Justin Appleyard, "Cayman Islands" in *Trusts in Prime Jurisdictions* (Alon Kaplan ed) (London Globe Business Pub, 2006) at p 120.

without incurring the risk of the court deeming the arrangement an agency rather than a trust.[53]

30 The amendment creates a rebuttable statutory presumption that any trust instrument which is not expressed to be a will, testament or codicil, would have immediate effect.[54] The amendment also lists a number of specific powers, the reservation or grant of any or all of which will not invalidate the trust or affect the presumption of lifetime effect, such as the power to revoke, vary or amend the trust instrument, the power of appointment of income or capital; and the power to appoint, add or remove any trustee, protector or beneficiary, *etc*.[55] The amendment further provides that a trustee who complies with a valid exercise of any of the reserved powers will not be in breach of trust.[56] These two amending provisions have been subsumed as ss 13 and 14 of the Cayman Islands Trust Law (2001 Revision), which provide as follows:

> **Section 13(1)**
>
> In construing the terms of any instrument stipulating the trusts and powers in and over the property, if the instrument is not expressed to be a will, testament or codicil and is not expressed to take effect only upon the death of the settlor, it shall be presumed that all such trusts (and in particular the duty of the trustees to the beneficiaries to

53 Walkers, "Cayman Islands: Reserved Powers" at <http://www.mondaq.com/article.asp?articleid=60496> (accessed 20 September 2008).

54 See the Cayman Islands' Trusts Law (revised 2001, as amended by the Special Trusts (Alternative Regime) Law 1997) s 13(1):

> In construing the terms of any instrument stipulating the trusts and powers in and over the property, if the instrument is not expressed to be a will, testament or codicil and is not expressed to take effect only upon the death of the settlor, it shall be presumed that all such trusts (and in particular the duty of the trustees to the beneficiaries to administer the trust in accordance with its terms) and powers were intended by the settlor to take immediate effect upon the property being identified and vested in the trustee, save as otherwise expressly, or by necessary implication, provided in the instrument.
>
> Subsection (1) shall apply notwithstanding–
>
> that the trust may have been created in order to avoid the application upon the settlor's death of laws relating to wills, probate or succession; that during the lifetime of the settlor, beneficiaries of the trust may not be ascertainable; that beneficial interests may only vest in remainder or may remain contingent or subject to defeasance by the exercise of reserved powers or otherwise; or that the settlor may be one of the trustees.
>
> Subsection (1) does not apply in the case of a declaration by a person constituting himself the sole trustee of a property to which he was beneficially entitled.

55 Cayman Islands' Trusts Law (revised 2001, as amended by the Special Trusts (Alternative Regime) Law 1997) s 14(1).

56 Cayman Islands' Trusts Law (revised 2001, as amended by the Special Trusts (Alternative Regime) Law 1997) s 15.

> administer the trust in accordance with its terms) and powers were intended by the settlor to take immediate effect upon the property being identified and vested in the trustee, save as otherwise expressly, or by necessary implication, provided in the instrument.
>
> **Section 14**
>
> The reservation or grant by a settlor of a trust of:
>
> (a) any power to revoke, vary or amend the trust instrument or any trusts or powers arising thereunder in whole or in part;
>
> (b) a general or special power to appoint either income or capital of the trust property;
>
> (c) any limited beneficial interest in the trust property;
>
> (d) a power to act as a director or officer of any company wholly or partly owned by the trust;
>
> (e) a power to give binding directions to the trustee in connection with the purchase, holding or sale of the trust property;
>
> (f) a power to appoint, add or remove any trustee, protector or beneficiary;
>
> (g) a power to change the governing law and the forum for administration of the change; or
>
> (h) a power to restrict the exercise of any powers or discretion of the trustee by requiring that they shall only be exercisable with the consent of the settlor or any other person specified in the trust instrument,
>
> shall not invalidate the trust or affect the presumption [of immediate effect] under section 13(1).

31 The rationale was to introduce a measure of certainty for settlors as to the extent of powers that the settlor could reserve, without the court saying that the settlor had not intended to create an *inter vivos* trust and that the instrument was testamentary.[57] This increased affirmation for the validity of a trust instrument – under which the settlor was able to retain a great degree of control – was welcome news for potential settlors who wished to take advantage of the "no tax" regime[58] in the Cayman Islands. Given that a large proportion of individuals who choose to set up offshore trusts are high networth

57 See Grant Stein, "The Legal Realities of Reserved Powers Trusts" (21 February 2005) at <http://www.walkers.com.ky/library.php?op=search&pub_id=114&category=Articles> (accessed 31 July 2009). See also, Anthony Duckworth, "Trends and Developments" in *Trusts and Trustees* (Oxford Journals, Oxford University Press, 2007) vol 13 (No 1) at p 3.

58 There is no direct taxation in the Cayman Islands and the only taxes levied are stamp duties. See Justin Appleyard, "Cayman Islands" in *Trusts in Prime Jurisdictions* (Alon Kaplan ed) (London Globe Business Pub, 2006) p 113 at p 114.

individuals who can well afford the higher fees[59] involved in the creation of such trusts, the higher degree of settlor control as permitted by the Cayman Islands Trusts Law 1998 was also attuned to these individuals' preferences to stay involved – even after the trust inception – with the management of speculative or high risk underlying trust assets.[60]

32 The legislative "revolution" in the Cayman Islands on the scope of settlor's reserved powers was paralleled by the Bahamian legislation in 1998. The powers granted to the settlor in the two legislative enactments are similar. Section 3(2) of the Bahamian Trustee Act 1998 similarly allows the settlor to reserve a power to amend the trust provisions, give directions to trustees in connection with the exercise of any of their powers or discretions, or require that the trustee seek the settlor's consent before making any decisions. The Bahamian settlor, like his counterpart in the Cayman Islands, maintains a high level of involvement in the operation of the trust.

33 Another offshore trust jurisdiction which has followed in the liberalising stance is Jersey. The Trusts (Amendment No 4) Jersey Law was introduced in 2006 to amend the Trust (Jersey) Law 1984. Article 9A of the Trusts (Jersey) Law now permits the same broad spread of settlor's reserved powers.

34 The impact of such statutorily-sanctioned reserved powers is decisive.[61] For example, Art 9A(1) of the Trusts (Jersey) Law[62] provides that the reservation by the settlor of a power to "give binding directions to the trustee in connection with the purchase, retention, sale, management, lending, pledging or charging of the trust property, or the exercise of any powers or rights arising from such property" would not affect the validity of the trust, or delay its taking effect. Similarly, s 14(b) of the Cayman Islands' Trusts Law stipulates that the reservation by the settlor of "a power to give binding directions as to the trustee in connection with the purchase, holding or sale of the trust property" would not invalidate the trust, or affect the presumption that the trust takes immediate effect.

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59 Attorneys specialising in offshore trusts typically charge as much as US$18,500 to set up a trust and several thousand dollars each year for maintenance of the trust. See Eric Henzy, "Offshore and Other Shore Asset Protection Trusts" Vanderbilt Journal of Transnational Law, vol 32, 739 at 740.

60 Justin Appleyard, "Cayman Islands" in *Trusts in Prime Jurisdictions* (Alon Kaplan ed) (London Globe Business Pub, 2006) p 113 at p 120.

61 Donovan Waters, "Reaching for The Sky: Taking Trust Laws to the Limit" in *Extending the Boundaries of Trusts and Similar Ring-Fenced Funds* (D Hayton ed) (Kluwer Law International, 2002) p 243 at p 272.

62 As amended in 2006.

35 With regard to the modification of trust terms, it is to be observed that offshore settlors are entitled to unilaterally amend trust provisions. For example, Art 9A(1)(a) of the Trusts (Jersey) Law[63] provides that a power reserved by a settlor to "revoke, vary or amend the terms of a trust or any trusts or powers arising wholly or partly under it" would not affect the validity of a trust. Section 12B(1)(a) of the Cayman Islands Trusts Law runs to the same effect. So do s 3(2)(c) of the Bahamian Trustee Act 1998[64] and s 13C of the Cooks Islands' International Trust Act.[65]

36 The offshore settlor's unfettered right to effect modification of trust terms stands in clear contrast to the onshore trust jurisdictions, in which trust modification is initiated by beneficiaries and the greatest involvement of the settlor is as far as the relevance of his intentions under the "material purpose" doctrine[66] in the US. For example, with regard to the termination of a trust, the general rule is that all parties in interest may terminate the trust, but not if the continuance of the trust is necessary to carry out a material purpose of the trust.[67]

B. Settlor's powers to affect directly the beneficiaries' interests

37 In many offshore trust jurisdictions, the settlor also possesses an unfettered right to add or remove trustees and beneficiaries. For example, s 86(2) of the British Virgin Islands Trust Ordinance[68] recognises the validity of a trust which confers on the settlor or some other person, protector or otherwise, the powers to, *inter alia*, remove or

63 As amended in 2006.

64 A combined reading of ss 3(1) and 3(2) of the Bahamian Trustee Act 1998 provides that where the settlor reserves any powers to "revoke the trust" or to "amend the trust or the trust instrument", that reservation of power "shall not invalidate a trust or the trust instrument or cause a trust created inter vivos to be a testamentary trust or disposition or the trust instrument creating it to be a testamentary document".

65 Section 13C of the Cook Islands' International Trusts Act 1984 affirms that "international trusts" governed under that legislation "shall not be declared void or be affected in any way" just because the settlor retains, possesses or acquires, a power to, *inter alia*, (a) revoke the trust instrument, (b) dispose of trust property or (c) amend the trust or instrument.

66 Section 411(b) of the US Uniform Trust Code states that: "A noncharitable irrevocable trust may be terminated upon consent of all of the beneficiaries if the court concludes that continuance of the trust is not necessary to achieve any material purpose of the trust. A noncharitable irrevocable trust may be modified upon consent of all of the beneficiaries if the court concludes that modification is not inconsistent with a material purpose of the trust."

67 *Rust v Rust* 176 F 2d 66, 85 US App DC 191 at 192; *Shelton v King* 229 US 90, 33 S Ct 686, 57 L Ed 1086; *McDonald v Fulton Trust Co* 71 App DC 36, 107 F 2d 237.

68 As unofficially consolidated in *International Trust Laws*, looseleaf, vol 2 (J Glasson ed) ("Source Material", Jordans, England) at D6-40.

appoint new trustees, or to exclude or include new trust beneficiaries. Section 2(d) of the Bahamian Trustee Act 1998 provides that the "retention, possession or acquisition" by the settlor of "any powers to appoint, add or remove any trustees, protectors or beneficiaries" would not invalidate a trust, or cause a trust created *inter vivos* to be a testamentary trust of disposition. Section 12B(1) of the Cayman Islands Trusts (Amendment) (Immediate Effect and Reserved Powers) Law 1998 provides that the reservation or grant by a settlor of "a power to appoint, add or remove any trustee, protector or beneficiary" would not invalidate the trust, or affect the presumption of immediate interest.

38 It is argued that allowing a settlor to reserve an unfettered right to dismiss trustees should not raise any policy concerns of "repugnancy" to the trust model. The change in appointment of the trustees would not remove the fiduciary safeguard of the obligation of any incumbent trustee to always act in good faith and in the best interests of the beneficiaries. The US Tax Court decision in *Estate of Wall v Commissioner*[69] rightly held that a reservation of power by the settlor to remove and re-appoint trustees would not *per se* result in the settlor being treated as the "beneficial owner" of the trust assets. Here, the settlor had reserved powers to "remove the trustee on written notice and appoint a successor (t)rustee", on the condition that such successor trustee must be a trust corporation and be "completely independent" from the settlor.[70] The Tax Court held that the settlor's reserved powers here would not be tantamount to reservation of a power to alter, amend, revoke or terminate the *enjoyment* of the property (by the beneficiaries), such as to attract the undesirable tax consequences under s 2036(a) or 2038(a)(1).[71] The court emphasised that under existing trust law, "[t]he

69 (1993) 101 TC 300.

70 (1993) 101 TC 300 at 302.

71 Section 2036(a) of the Internal Revenue Code states that:

> The value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death -
>
> (1) the possession or enjoyment of, or the right to the income from, the property, or
>
> (2) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom.

Section 2038(a)(1) of the Internal Revenue Code states that:

> In general, the value of the gross estate shall include the value of all property
>
> (1) Transfers after June 22, 1936
>
> To the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, where the

(*cont'd on the next page*)

trustee has a duty to administer the trust in the sole interest of the beneficiary, to act impartially if there are multiple beneficiaries, and to exercise powers exclusively for the benefit of the beneficiaries".[72] The court was convinced that the existence of this fiduciary obligation of loyalty would act as a safeguard against any temptation by the trustee, in response to the "threat" of being removed by the settlor, to take any action that would detract from the beneficial enjoyment of trust property.[73] In the first place, many settlors express a desire to reserve the power to re-appoint new trustees for reasons that in no way derogate from the beneficiaries' interests, such as where there has been a significant change in the status or management of the originally-appointed trustee company which renders it unsuitable to carry out the trust objectives.[74]

39 In the context of the addition or removal of beneficiaries, however, it is argued that an unfettered reserved right by the settlor to do so – as allowed by the legislation of these offshore trust jurisdictions – is not advisable. This extremely liberal offshore position entitles the settlor to tinker around with the beneficial entitlements at will, therefore subjugating the beneficiaries' interests to his whims. [75]

40 A direct derogation of the beneficiaries' interest could also arise where the offshore settlor exercises a reserved power to revoke the trust. As with the addition or removal of trustees or beneficiaries, the settlor under offshore trust law can generally do this at will.

C. Exemption against liability

41 Some offshore trust legislation, like that of the British Virgin Islands and Dubai, go further in absolving the trustee from all fiduciary duties as long as the trustee has acted with the consent of the settlor, or some other person such as the protector. These legislative regimes allow the settlor to grant a blanket exemption against liability for fiduciary breach for trustees as long as the trustees accede to the instructions of

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enjoyment thereof was subject at the date of his death to any change through the exercise of a power (in whatever capacity exercisable) by the decedent alone or by the decedent in conjunction with any other person (without regard to when or from what source the decedent acquired such power), to alter, amend, revoke, or terminate, or where any such power is relinquished during the 3 year period ending on the date of the decedent's death.

72 (1993) 101 TC 300 at 312.

73 (1993) 101 TC 300 at 312.

74 David Harris, "No Such Thing as a Sham Trust?" [2004] PCB (March/April) 95 at 97.

75 See Makoto Arai, "The Law of Trusts and the Development of Trust Business in Japan" in *Modern International Developments in Trust Law* (D Hayton ed) (Kluwer, 1999) p 63 at p 87.

the settlor, or the protector. For example, s 86(1) of the British Virgin Islands Trustee Ordinance provides that:

> An instrument creating a trust may contain provision by virtue of which the exercise by the trustees of any powers and discretions shall be subject to the previous consent of the settlor or some other person, whether named as protector, nominator, committee or any other name and if so provided in the instrument creating the trust the trustees shall not be liable for any loss caused by their actions if the previous consent was given.

42 Section 86(3) then goes on to provide that this person "is not liable to the beneficiaries for the bona fide exercise of the power".

43 A similar provision can be found in Art 68(1) of the Dubai International Financial Centre Law:[76]

> A trust instrument may contain provisions by virtue of which the exercise by the trustees of any of their powers shall be subject to the previous consent of the settlor or 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 he acted in good faith.

44 The British Virgin Islands provision results effectively in the abdication of the trustee's fiduciary duties owed to the beneficiaries, while the Dubai provision shrinks the "irreducible core" of trustee obligations to merely cover the obligation of good faith, ignoring the trustee's other fiduciary duty to act in the best interests of trust beneficiaries.

45 It is doubtful whether in such scenarios, the trustee remains as a "fiduciary" in any sense of the word; or has instead effectively become a mere agent for the settlor or protector.[77]

46 Worse, the beneficiaries' interests in offshore trusts are further detracted from due to the developments which take away the right of trust enforcement from the beneficiaries. Under the Special Trusts (Alternative Regime) (STAR Trust) regime in the Cayman Islands, a settlor may create a trust under which trust beneficiaries do not have the right to enforce trust terms, to bring action against the trustee or to assert rights to the trust property. Instead, the *locus standi* for

76 Dubai International Financial Centre Law (No 11 of 2005) Art 68(1).

77 See Maurizio Lupoi, *Trusts: A Comparative Study* (Cambridge University Press, 1st Ed, 2000) at p 258. He suggests that with the assent of the protector removing the trustee's responsibilities for their actions, the trustee's role is arguably reversed and he becomes, in substance, a mere "agent" for the settlor.

enforcement of trust performance is given to a trust enforcer – a role which the settlor may reserve to himself, or grant to another.[78]

47 Where the enforcer does not owe fiduciary duties towards the beneficiaries,[79] the enforcer's failure, or negligence to enforce trust performance, is not met with any sanction. In such a scenario, the trustees' "fiduciary obligations" become nothing more than a farce – there is effectively no existing safeguard to prevent the trustees from acting to the detriment of the beneficiaries' interests.

48 The traditional concept of the English trust, under which the trustee is held to strict fiduciary duties towards the beneficial owners of the trust property, has been prejudiced by this onslaught of offshore legislation "designed" to increase the attractiveness of these offshore centres to their clients.

V. Serious concerns and sham

49 Before articulating the threshold of the permissible scope of settlor's reserved powers, the reason why the onshore trust jurisdictions remain reluctant in following the offshore trust jurisdictions in embracing a more extensive scope of settlor's reserved powers will now be explored. There are perhaps two main concerns. Firstly, the "trust" arrangement may constitute merely a *façade*, *ie*, a "sham", to further the transferor's deceitful purposes of evading his personal creditors, matrimonial or other claims. Secondly, albeit not clearly articulated by the courts, an extensive scope of settlor's reserved powers could be injurious to the beneficiaries' interests.

A. Sham

50 A sham trust is formed where the settlor and the trustee execute acts or documents in a manner which is "*intended* by them to give to third parties or to the court the appearance of creating between the parties legal rights and obligations different from the actual legal rights and obligations (if any) which the parties intended to create".[80] It must

78 Cayman Islands Trusts Law (revised 2001, as amended by the Special Trusts (Alternative Regime) Law 1997) ss 100(1) and 100(2). The settlor is therefore free to choose an enforcer whom the settlor knows will fully comply with the settlor's preferences.

79 Section 101(1) of the Cayman Islands Trusts Law (revised 2001, as amended by the Special Trusts (Alternative Regime) Law 1997) explains that the enforcer's standing to enforce a special trust may be granted or reserved as a right or as a duty.

80 *Snook v London and West Riding Investments Ltd* [1967] 2 QB 786 at 802, *per* Lord Diplock.

be shown that *both*[81] the settlor and the trustee had intended, from the inception of the "trust" arrangement involving the assets claimed, that the transfer of legal title would be merely a *façade* concealing the actual arrangements between the parties. The court would generally infer the existence of such an intention from the conduct of the settlor and the trustee following the inception of the trust.

51 Serving only to weave a deceitful front so as to allow the settlor to evade his creditors or to avoid family succession[82] or matrimonial claims,[83] and no other useful purpose at all, a sham trust arrangement would be a clear-cut scenario in which there is no reason to regard the "trust" arrangement as valid.[84] For example, in *Rahman v Chase Bank*,[85] the evidence showed that from the date which the settlor purported to constitute the settlement, the settlor had exercised "dominion and control" over the trustee in the management and administration of the settlement. The settlor unilaterally effected capital distributions to himself or others as gifts or loans, and made or disposed of investments without any knowledge of, or reference to, the trustees. The settlor effectively treated the trust assets as his own and the trustee, his agent or nominee. From the settlor's actual dominion over the trust funds, the Royal Court of Jersey inferred that the parties had never intended to establish a genuine trust arrangement, and that the settlor had merely pretended to do so in order to avoid the fetters of the Jersey legislation on his testamentary dispositions.

52 Similarly, in *Minwalla v Minwalla*,[86] the settlor, following the creation of the "trust", was able to withdraw, and move around, trust funds as if they were his own, and the trustees made no attempt to restrain such utilisation even where they were cognisant.[87] The court inferred that the settlor "never had the slightest intention of respecting even the formalities of the trust and corporate structures that had been

81 The bulk of judicial authority confirms that a trust deed would not be held to be a sham unless *both* the settlor and the trustee had the *common intention* that the true position should be otherwise than as set out in the trust deed. It is not sufficient for the settlor alone to have such an intention. See, for example, *Grupo Torras SA v Al Sabah (re Esteem Settlement)* [2003] JLR 188.

82 *Rahman v Chase Bank (CI) Trust Co* [1991] JLR 103.

83 *Rahman v Chase Bank (CI) Trust Co* [1991] JLR 103; *Minwalla v Minwalla* [2004] EWHC 2823.

84 S Bright, "Beyond Sham and into Pretence" (1991) 11 OJLS 136 at 140; B McFarlene & E Simpson, "Tacking Avoidance" in *Rationalising Property, Equity and Trusts* (J Getzler ed) (London 2003) p 135 at p 139; Matthew Conaglen, "Sham Trusts" (2008) CLJ 176 at 184; Gerraint Thomas, "Shams, Revocable Trusts and Retention of Control" in *The International Trust* (John Glasson and Gerraint Thomas eds) (Jordans, 2nd Ed, 2006) at p 589.

85 *Rahman v Chase Bank (CI) Trust Co* [1991] JLR 103.

86 *Minwalla v. Minwalla* [2004] EWHC 2823 at [57].

87 *Minwalla v. Minwalla* [2004] EWHC 2823 at [56].

set up at his direction". From the outset, the settlor's intention was to retain control of the trust assets. In creating the settlement, the settlor's purpose was "only to set up a screen to shield his resources from other claims or unwelcome scrutiny and investigation".

53 In certain circumstances, a trust over which the settlor has reserved extensive controls cannot be said to constitute a sham trust. Nevertheless, there remain grounds upon which the court should set aside the trust, and regard the settlor as the true owner of the trust assets. An example of such circumstances is where the trustee does not share in the settlor's deceitful intention. In *Midland Bank v Wyatt*,[88] the trustee had merely gone along with the "shammer" not "either knowing or caring" about the effect of the sham "trust" deed that the trustee was signing. The judge held that it was not a "necessary requirement" to establish a common intention, between the trustee and the settlor, that the declaration of trust signed by them was merely a *façade*, and not intended to take effect or be acted upon. However, this rule is inconsistent with the bulk of judicial authority.

54 Earlier on, Lord Diplock, in the seminal case of *Snook v London and West Riding Investments Ltd*, had stated that for a settlement to be a "sham", "all the parties thereto must have a common intention that the acts or documents are not to create the legal rights or obligations which they give the appearance of creating".[89] The later decisions in *Grupo Torras v Al Sabah (re Esteem Settlement)* ("*Re Esteem Settlement*"),[90] *Mackinnon v Regent Trust Co Ltd*,[91] *Minwalla v Minwalla*[92] and *Shalson v Russo*[93] also asserted the unanimous rule that for a sham settlement to be found, there must be mutuality of intention between the settlor and the trustee that the settlement would be a sham. In view of the consequence that a "sham" trust would be void *ab initio*[94] – such that the trustee would be forced to give up "trust" assets – it would seem more consistent with this harsh consequence that the trustee had in the first place acted unconscionably by sharing in the settlor's deceitful intention.[95]

88 [1995] 1 FLR 696 at 699–670.

89 *Snook v London and West Riding Investments Ltd* [1967] 2 QB 786 at 802.

90 [2003] JLR 188 (Jersey Royal Court).

91 [2005] JCA 066 (Jersey Court of Appeal).

92 [2004] EWHC 2823 (Family Division).

93 [2003] EWHC 1637 (Chancery Division).

94 *Midland Bank v Wyatt* [1995] 1 FLR 696 at 707. See also *National Westminster Bank v Jones* [2001] BCLC 98.

95 Gerraint Thomas supports the proposition that mutuality of intention should be a requisite element of a sham trust: "[P]roving a sham intent on the part of the transferee may be essential in order to recover the property, *ie* to ensure that the transferee is not able to take advantage of his unconscionable conduct." Gerraint Thomas, "Shams, Revocable Trusts and Retention of Control" in *The International Trust* (John Glasson and Gerraint Thomas eds) (Jordans, 2nd Ed, 2006) at p 600.

55 If we take the position that the trustee must have shared in the "sham" intention before a settlement can be set aside for being a "sham" trust, what of the situation where the trustee is merely negligent, *ie*, not "knowing" the legal effect of what he or she was signing? *Ex hypothesi* the trust would be perfectly valid. It is submitted that this is an unjust result. The state of affairs reached is the same whether or not the trustee has shared in the "sham" intention – in both scenarios the settlor attempts to retain his *de facto* ownership of the trust assets while evading the third-party claims on these assets at the same time. This is precisely the unjust consequence, *ie*, an abuse of the trust mechanism, that should be avoided; and this consequence should be avoided whether or not the trustee has shared in the settlor's sham intention. The departure of the decision in *Midland Bank v Wyatt*[96] from Lord Diplock's emphasis in *Snook v London and West Riding Investments Ltd*[97] on the requirement of mutuality of intention may be seen as a conscious desire by the Chancery Division to avoid what was perceived to be an unconscionable outcome.

B. Donor et retenir ne vaut

56 Another set of circumstances where no "sham" trust can be said to exist is where *both* the settlor and the trustee had not wittingly set out to create a *façade* to mask the true legal obligations existing between them, but were simply ignorant of the legal effect on the validity of the "trust" if the settlor were to reserve extensive powers of control over the trust. Excluding the situations where the trust parties can be regarded as lacking an intention to create what is objectively classifiable as a "trust" – (for example, where the settlor is ignorant and does not transfer legal title over to the trustee to create a valid trust), there exist other circumstances where the parties have honestly intended to create a trust (the three "certainties" of trust creation being fulfilled) – where there is no *sham* intention involved – but the settlor reserves to himself an extraordinary amount of control over the trust. Such situations would be, for example, where the settlor reserves the unilateral decision to appoint trust capital or income to himself,[98] or where the settlor demands that the trustee only act with regard to the settlor's individual interests.[99] Even though there is no "sham" intention in these circumstances, the settlor's extensive reserved powers results in the same undesirable consequence of the settlor being able to retain effective control of the trust assets, yet at the same time evading claims from personal creditors or other parties for those assets.

96 [1995] 1 FLR 696.
97 [1967] 2 QB 786.
98 See *Rahman v Chase Bank (CI) Trust Co* [1991] JLR 103 (to be discussed below).
99 See *Rahman v Chase Bank (CI) Trust Co* [1991] JLR 103 (to be discussed below).

57 There is clear judicial authority suggesting that even where the trust parties have no "sham" intentions, the settlor may have reserved such an extensive scope of powers to himself that the court may effectively deem the settlor as the beneficial owner of the trust assets. *Rahman v Chase Bank (CI) Trust Co*[100] involved a trust settlement under which a trust corporation was appointed as trustee to hold the trust fund and income upon such trusts as the settlor (deceased) should appoint in his lifetime, allegedly with the trustee's consent. Two clauses in the trust instrument stood out: (a) under cl 4(1), the settlor could in any 12-month period appoint one-third of the capital of the trust fund to himself, without the consent of the trustee; and (b) cl 10 empowered the trustees with the absolute discretion to "pay, transfer or apply" part or the whole of the trust capital fund to the settlor, in so doing, the trustees "*shall* have regard exclusively to the interests of the settlor". The Jersey Royal Court held that the only capable construction of the trust settlement was that the settlor could effectively get back all the trust funds if he wanted to. The settlor's powers contained in the settlement, particularly those contained in cll 4(1) and 10, were held to have breached the maxim of "*donner et retenir ne vaut*" because the settlor retained such powers as to enable him, whether directly or indirectly, to "substantially or wholly to revoke or otherwise terminate the settlement for his own absolute benefit". The court went on to infer – from evidence showing that the settlor was able to effect distributions of capital to himself or others as gifts and loans, or to make and dispose of investments without the trustee's consent – that the settlor and trustee had, from the outset, intended for the settlement to be a sham. The Jersey Royal Court concluded that "even if the court were wrong on the construction of the settlement and the impact of the maxim *donner et retenir*, the settlement would still be invalid [because it is a 'sham']". It is clear from the Jersey Royal Court's decision that the "sham" doctrine, though related, is quite separate from the wider idea of whether the settlor has retained an over-extensive amount of powers to himself.

58 Similarly, the English decision in *Shalson v Russo* shows that a "sham" intention is not the only ground upon which the court would invalidate a trust arrangement. In *Shalson v Russo*, the Chancery Court discarded the claim that the settlement was a sham because the trustee, having intended the settlement to be a genuine trust, was not a knowing party to the "sham" intentions of the settlor.[101] The court then moved on to deal with the "wider" claim as to whether the trustees had merely acted on the settlor's instructions such that the settlor must be regarded as the true owner of the settlement.[102] The court considered this claim, but refuted it because the evidence showed that the trustee did not

100 *Rahman v Chase Bank (CI) Trust Co* [1991] JLR 103.
101 See *Shalson v Russo* [2003] EWHC 1637 at [188]–[191] and [215]–[218].
102 *Shalson v Russo* [2003] EWHC 1637 at [192].

simply respond on demand to every request from the settlor, but exercised independent control over the trust assets. On some occasions, the trustee even requested the reversal of an unauthorised transaction which the settlor had entered into.[103]

59 Contrary opinion exists which argues that a claim asserting that the settlor has retained "substantial and effective control" over the trust does not exist separately from the "sham" doctrine. David Hayton[104] takes the decision of *Re Esteem Settlement* to represent the dichotomy of a "sham" trust and a valid trust, *ie*, that "there is no half-way house of 'quasi-sham' where the veil of the true trust can be pierced so that the trust assets can be regarded as beneficially owned by the settlor". However it may be too quick to draw such a rigid conclusion from the decision in *Re Esteem Settlement*, which did not totally dismiss the possibility of a claim that the settlor could be considered as the beneficial owner because the settlor had "substantial or effective control" of the settlement.[105] The reluctance of the Jersey Royal Court in giving full recognition to this alternative claim stemmed from the court's opinion that "trustees who allow a third party such as a settlor to assume substantial and effective control would have abdicated [the trustees'] fiduciary duties and would be in breach of trust", and therefore the whole issue would be sufficiently remedied by setting aside the transactions which were entered into "because of a breach by the trustees of their fiduciary duties".[106] However, the availability of a remedy for a fiduciary breach is questionable. For example, where the settlor expressly reserves a power to revoke one-third of the trust for the benefit of himself, and the trustee obliges even though such revocation would obviously be detrimental to beneficiaries' interests, can the trustee really be held to a breach of trust for following the settlor's express directions? Where the settlor then provides in the trust instrument that the trustee shall be indemnified against all personal liability so long as the trustee accedes to the settlor's directions, the answer would be a clear "no".

60 The suggestion – that the need for a "wider" ground to invalidate a trust settlement, quite aside from the unique situation where both the settlor and the trustee share a "sham" intention to put up a *façade* – is justifiable. The invalidation of the trust should depend upon an objective appraisal of the situation, *ie*, whether the settlor is able to retain effective control of the "trust" assets and avoid claims from the settlor's creditors at the same time. Basing invalidation of the trust

103 See *Shalson v Russo* [2003] EWHC 1637 at [193]–[208], where the court laid out in great detail some of the dealings which the settlor and the trustee had made with the trust assets.

104 David J Hayton, "Shams, Piercing Veils, Remedial Constructive Trusts and Tracing" (2004) JLR (February) 6.

105 *Grupo Torras v Al Sabah (re Esteem Settlement)* [2003] JLR 188 at [124].

106 *Grupo Torras v Al Sabah (re Esteem Settlement)* [2003] JLR 188 at [103]–[104].

merely on the sole ground of the parties' subjective intentions would risk being under-inclusive, failing to capture several circumstances where the same undesirable consequences perpetuate without there being a common "sham" intention.

61 In *Rahman v Chase Bank (CI) Trust Co*,[107] the maxim "*donner et retenir ne vaut*"[108] was held to apply because the settlor could (a) under cl 4(1) of the instrument, directly revoke a substantial proportion of the trust capital by calling within any 12-month period for the trustee to appoint one-third of the trust capital to the settlor, and (b) under cl 10, direct the trustee to ignore the interests of other beneficiaries, but to

107 [1991] JLR 103.

108 This maxim would not remain applicable in Jersey today with the subsequent enactment of the Trusts (Amendment No 4) (Jersey) Law 2006 which amends the Trusts (Jersey) Law 1984. Article 9(5) of the Trusts (Jersey) Law 1984 (as amended) stipulates that "[t]he rule *donner et retenir ne vaut* shall not apply to any question concerning the validity, effect or administration of a trust, or a transfer or other disposition of property to a trust". However, the fact that this maxim may have been legislatively abrogated does not detract from the proposition that in common law, there is a "wider" test, quite independent of the "sham" argument, which the courts apply in invalidating a trust which is deemed to empower the settlors with an excessive scope of reserved powers. Article 9A of the Amended Trusts (Jersey) Law 1984 provides:

> (1) The reservation or grant by a settlor of a trust of–
>
> (a) any beneficial interest in the trust property; or
>
> (b) any of the powers mentioned in paragraph (2),
>
> shall not affect the validity of the trust nor delay the trust taking effect.
>
> (2) The powers are –
>
> (a) to revoke, vary or amend the terms of a trust or any trusts or powers arising wholly or partly under it;
>
> (b) to advance, appoint, pay or apply income or capital of the trust property or to give directions for the making of such advancement, appointment, payment or application;
>
> (c) to act as, or give binding directions as to the appointment or removal of, a director or officer of any corporation wholly or partly owned by the trust;
>
> (d) to give binding directions to the trustee in connection with the purchase, retention, sale, management, lending, pledging or charging of the trust property or the exercise of any powers or rights arising from such property;
>
> (e) to appoint or remove any trustee, enforcer, protector or beneficiary;
>
> (f) to appoint or remove an investment manager or investment adviser;
>
> (g) to change the proper law of the trust;
>
> (h) to restrict the exercise of any powers or discretions of a trustee by requiring that they shall only be exercisable with the consent of the settlor or any other person specified in the terms of the trust.
>
> (3) Where a power mentioned in paragraph (2) has been reserved or granted by the settlor, a trustee who acts in accordance with the exercise of the power is not acting in breach of trust.

have regard only exclusively to the settlor's interests, in the exercise of the trustee's power to appoint the trust capital to the settlor. In both situations, the trustee would be in no position to exercise any discretion to refuse the settlor's demands.

62 Conversely, the opposite decisions reached in *Re Esteem* and *Shalson v Russo* can be explained by the ability of the trustees, under the trust terms, to maintain their discretion to execute their trust duties in good faith and in the interests of all beneficiaries. In *Re Esteem*, the Jersey Royal Court held that the trustees (and hence indirectly, the trust assets) would not be under the "substantive or effective control" of the settlor "even if [the trustees] decide to go along with the settlor's request", subject to the caveat that the trustees had "genuinely exercise[d] their discretion in good faith".[109] Looking at the evidence presented in court, the court found that the trustees had not simply gone along with the settlor's requests without applying their minds to the matter in question. The trustees had in fact exercised "*bona fide* discretion".[110]

63 Similarly in *Shalson v Russo*, the court refused to "pierce the veil", and refused to consider the settlor as the true owner of the assets, because there was evidence that the trustees had applied an "independent mind" on whether certain dispositive requests by the settlor could be done. The trustees "were not simply going along with what [the settlor] wanted" and had on several occasions, actively required the reversal of unauthorised trust transactions which the settlor had entered into without the trustees' consent.[111]

64 It is suggested that the test of whether the settlor retains "substantive and effective control"[112] of the trust assets – such that the settlor remains the beneficial owner of the trust assets – would be whether the trust instrument precludes the trustee's fiduciary duty to act in good faith and in the beneficiaries' best interests. Where the trust instrument effectively precludes this "irreducible core"[113] of trustee

109 *Grupo Torras v Al Sabah (re Esteem Settlement)* [2003] JLR 188 at [123].

110 *Grupo Torras v Al Sabah (re Esteem Settlement)* [2003] JLR 188 at [123].

111 *Shalson v Russo* [2003] EWHC 1637 at [195]–[197].

112 The term "substantive and effective control" is not a recognised legal term of art (see Julian Clyde-Smith, "The Settlor/Trustee Relationship – Some Sense at Last" (2004) JLR (February) 94). However, the claim that the settlor remains as the beneficial owner of the trust assets because the settlor retains "substantive" or "effective" control has been raised in several cases. See *Rahman v Chase Bank (CI) Trust Co* [1991] JLR 103, *Grupo Torras v Al Sabah (re Esteem Settlement)* [2003] JLR 188 and *Shalson v Russo* [2003] EWHC 1637.

113 See D Hayton, "The Irreducible Core Content of Trusteeship" in *Trends in Contemporary Trust Law* (A J Oakley ed.) (Claredon, Oxford, 1996) at p 47. Although the content of this irreducible core is still debated among academic scholars, there is judicial authority that it is "sufficient" that this core consists of

(*cont'd on the next page*)

duties, the law would hesitate from holding that the transferee was acting as a trustee and, correspondingly, from holding that there was a trust created.

65 It is argued that the threshold of the permissible scope of settlor's reserved powers is that powers can be reserved to such an extent that they do not preclude the trustee's fiduciary duty to act in good faith and in the beneficiaries' best interests. The invalidation of the trust should depend upon an objective appraisal of the situation, *ie*, whether the settlor is able to retain effective control of the "trust" assets and avoid claims from the settlor's creditors at the same time.

VI. Conclusion

66 The impetus of the Cayman Islands 1998 Trusts Law has initiated a legislative trend among the offshore trust jurisdictions to empower settlors with the ability to reserve a wide scope of trust powers. There are good reasons why a settlor would want to reserve powers over the trust, and several benefits can be reaped from allowing such a trust model, allowing for a more extensive degree of settlor control. However, this has to be balanced against the fundamental concept of trust.

67 The legislation in some offshore trust jurisdictions, like the British Virgin Islands and Dubai, go even further in absolving the trustee from all fiduciary duties as long as the trustee has acted with the consent of the settlor, or some other person such as the protector. The traditional concept of trust, under which the trustee is held to strict fiduciary duties towards the beneficial owners of the trust property, has been prejudiced by this onslaught of offshore legislation structured to enhance the attractiveness of these offshore centres. The resultant "trust" structure resembles more a kind of agency arrangement between the settlor and the trustee, rather than an independent property management regime for the benefit of the beneficiaries. The focus of the "trust" model is no longer on the beneficiaries, but rather on the preferences of the settlor. This begets the question of why the offshore settlor is able to have his cake and eat it too. The settlor is able, through parting with the legal ownership of his assets, to enjoy some degree of protection – which varies across different jurisdictions – by keeping these assets away from his creditors. On the other hand, even though the settlor no longer possesses "legal" title to those assets, he maintains the ability, at any one time, to appoint trust income or capital to himself without the need to consider the interests of the beneficiaries. Another

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the duty to perform the trusts "honestly and in good faith for the benefit of the beneficiaries". *Armitage v Nurse* [1998] Ch 241 at 253–254, *per* Millett LJ.

associated characteristic of such a "trust" model is the settlor's freedom to detract, at will, from the beneficiaries' entitlements.

68 This article argues that the preclusion of the trustee's fiduciary duty to act in good faith and in the beneficiaries' best interests (in the most extreme example, through the settlor's immunisation of trustee liability for his breach of this fiduciary duty) is a step which breaches the threshold of the permissible scope of settlor's reserved powers, and the parameters of what constitute a trust arrangement.