

A RECEIVER CANNOT BE ENTRUSTED TO REVOKE A TRUST A Case Note on a Recent Decision of the Grand Court of the Cayman Islands

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Background

What is the nature of a settlor's reserved power of revocation in the context of a revocable trust? Put another way, does the power to revoke a trust fall within that, often times murky, concept of property? According to a recent judgment of the Chief Justice of the Grand Court of the Cayman Islands, a settlor's power of revocation in a Cayman Islands trust is just that, a power: not property. It is believed that this is the first time the issue has been judicially considered.

In *TMSF v Merrill Lynch Bank and Trust Company (Cayman) Limited and others* (26 June 2009) Smellie C.J. had to consider whether a judgment creditor was entitled to an order for the appointment of receivers by way of equitable execution, in order to force the judgment debtor to exercise his reserved power as settlor of two Cayman Islands trusts; to revoke those trusts and apply the proceeds in partial satisfaction of the judgment debt. The judgment debt which was sought to be enforced was a Turkish judgment enforced in the Cayman Islands at common law by way of action and summary judgment.

The Law of Trusts

Section 14 of The Trusts Law (2007 Revision) of the Cayman Islands provides for a number of powers to be reserved to or granted by the settlor of a Cayman Islands trust. The first in the list of such powers is “any power to revoke, vary or amend the trust instrument or any trusts or powers arising thereunder in whole or in part.” Similar provisions appear in the trust legislation of other offshore or popular trust jurisdictions.

The reservation by a settlor of a power of revocation enables the trust structure to be used in a flexible way for different purposes. For example, it enables the trust to qualify as a grantor trust for US tax purposes¹. It can be used to make provision for a disabled relative or child with the ability, should such person predecease the settlor, for the settlor to take back the trust monies previously settled, or, more generally, to provide a ‘living will’ or to avoid probate.

However, the flexibility of reserved powers also carries with it potential consequences. The trust fund will ordinarily be considered to remain under the control of and so “belong” to the settlor for tax purposes whether during his lifetime or upon his death. Should he become bankrupt, it is likely that a trustee in bankruptcy will be able to exercise the reserved power so as to make any remaining trust assets available to the bankrupt estate. Section 100 of the Bankruptcy Law (1999 Revision) of the Cayman Islands provides that the property of the debtor vesting in the trustee in bankruptcy for purposes of division among his creditors includes “the capacity to exercise and to take proceedings for exercising all such powers in and over, or in respect of property as might have been exercised by the debtor for his own benefit at the commencement of the bankruptcy”.²

¹ Kessler & Pursall *Drafting Cayman Islands Trusts* p.246

² Section 283(4) of the Insolvency Act 1986 of England and Wales is in similar terms.

The Judgment

As the issue had not previously been considered by the Grand Court, it was necessary for the Court to approach it from first principles. In a careful and scholarly analysis, Smellie C.J. determined that a receiver could not be appointed over a settlor's power of revocation. His judgment is an important decision on the nature and extent of reserved powers which is of relevance to other trust jurisdictions permitting similar wide ranging reserved powers.

In order to justify the appointment of a receiver, it was argued on behalf of the judgment creditor that the power of revocation was in the nature of property, specifically a chose in action, over which a receivership by way of equitable execution could be made, notwithstanding that such a chose in action would not be available for legal execution.³ It was therefore necessary for the Court to consider whether this argument was correct.

The scope of the remedy of receivership by way of equitable execution was recently considered in some detail by the English Court of Appeal in *Masri v Consolidated Contractors International SAL*.⁴ Lawrence Collins L.J. examined the historical development of the remedy since 1873 and concluded that *"there is no reason why in 2008 the court should not exercise a power to appoint a receiver by way of equitable execution over future receipts from a defined asset. There is no longer a rule, if there ever was one, that an order can only be made in relation to property which is presently amenable to legal execution. There is no firm foundation in authority for a rule that the remedy is not available in relation to future debts."*⁵

This conclusion would justify the appointment of a receiver over any future appointments by the trustees of capital or income to the settlor as beneficiary, or to the whole of the trust monies in the event that the settlor were himself to exercise his power of revocation. However, as Smellie C.J. observed, it is not authority for the proposition that a receivership may be appointed over a power of revocation of a trust, so as to bring about its revocation and the reversioning of its assets in the settlor, in circumstances where the settlor has evinced no intention to do so himself.

The Chief Justice started his analysis by examining the longstanding and fundamental distinction between "a power" and "property" as epitomized in the judgment of Fry LJ in *Re Armstrong ex p. Gilchrist* (1886) 17 QBD 521, 531-532 where he said:

"No two ideas can well be more distinct the one from the other than those of "property" and "power" ... A "power" is an individual personal capacity of the donee of the power to do something. That it may result in property being vested in him is immaterial; the general nature of the power does not make it property. The power of a person to appoint an estate to himself is, in my judgment, no more his "property" than the power to write a book or to sing a song. The exercise of any of these three powers may result in property, but in no sense which the law recognises are they "property"."

He continued to consider all of the subsequent cases and concluded that absent statutory provision there was no authority which would equate a power of revocation or a general power of appointment with "property". All of the subsequent cases in which a "power" was treated as being equivalent of "property" were cases where statute had provided an extended meaning of property so as to include in the definition of property, for the purposes of the particular statute, the capacity to exercise a power in or over or in respect of property. The various statutory provisions which provided for an extended meaning, in particular legislation governing bankruptcy and wills, were considered by the Chief Justice and he concluded *"the lesson from ... a comparison of the statutory provisions against the background of the history of the common law is simple and compelling: in the light of the well established common law rule that distinguishes power from property, where the law intends to equate them it has been necessary to create express statutory exceptions to the common law rule."*

³ The supposed restriction to choses in action available for legal execution was demonstrated to be ill-founded by *Bourne v Colodense* [1985] I.C.R. 291; *Maclaine Watson & Co Ltd v International Tin Council* [1988] Ch. 1 (affirmed [1989] Ch 253 (CA)); *Soinco v Novokuznetsk Aluminium* [1998] QB 406; *O'Connell v An Bord Pleanala* [2007] IEHC 79.

⁴ [2008] EWCA Civ 303

⁵ Paragraph 184

The Impact of the Decision

The decision of Smellie C.J. is to be welcomed by trusts practitioners not only because it is a useful modern analysis of the continuing distinction between powers and property, but also because it upholds the settled concept of trusts. The judgment recognises that the existence of settlors' reserved powers should not expose trust assets to attack, save where the legislature has determined that it is appropriate and in the public interest to do so, as in the case of bankruptcy. In the words of Smellie C.J.: to do so "*would be to set aside the settled common law principles which have distinguished powers from the property they affect for hundreds of years and would strike at the very heart of the trust concept.*"

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Together, they appeared on behalf of the successful Settlor in this case.

This article is not intended to be a substitute for legal advice or a legal opinion. It deals in broad terms only and is intended to merely provide a brief overview and give general information.

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