

PROTECTORS AND TRUST DISPUTES

Speech

by

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**OPC TRUST LAW CONFERENCE
BC HILTON HOTEL
NASSAU, BAHAMAS
24th OCTOBER, 2011**

INTRODUCTORY MATTERS

- What's in a name? Getting some definitional stuff out of the way: Client says :
"We have a trust but it doesn't have a Protector, only an Advisory Committee that has power to hire and fire the trustees, and power to move the trust to another country; that sort of thing". Call it what you will, the "Advisory Committee" is, in point of Bahamian law, the Protector : ref. the Trustee Act 1998, S.2:

"Protector" means any person appointed as such pursuant to the terms of the trust instrument, including any persons designated as advisers, surrogates, nominators or as a committee or by any other name having such functions and duties as may be prescribed by the trust instrument or other deed or document effecting their appointment, but excluding persons holding trust property".

- There are several things in this definition that need to be emphasized:
 1. Whether or not a trust does indeed have a Protector is not to be determined by whether some person is described as such in the trust instrument but rather according to the "functions and duties" ascribed to the relevant person.
 2. Although the office of Protector is given statutory recognition by the Trustee Act, the Protector is entirely the creature of the particular trust under which he serves (except possibly for exceptional cases where the court, in the exercise of its inherent jurisdiction, appoints a Protector (post)).

3. The powers of the Protector are contained exclusively in the relevant trust instrument (S.81 of the T Act makes this clear). There are no inherent powers that attach to a protectorship as is the case, for example, with a trusteeship.
 4. No person can serve concurrently as both trustee and protector. (Note, however, that there is no prohibition against a beneficiary or any other person, including the settlor, serving as Protector).
- For the purposes of our discussion today, we can accept as a working definition that a Protector is someone who is not a trustee but who nonetheless has certain functions and duties to perform in relation to the particular trust under which he has been appointed. I think we can safely qualify that by saying that the “functions and duties” contemplated by the statutory definition to which I just referred must be of some importance, i.e they must rise above the purely administrative or menial (e.g. if a named person is tasked by the trust instrument to keep the minutes of trust meetings, that note-taker, although exercising a “function” under the trust does not thereby become a Protector.
 - A caveat before we proceed further : be wary of generalizations. Protectors come in all different shapes and sizes just as the trusts under which they serve come in all different shapes and sizes. A contextual, case-by-case, approach is therefore required as opposed to a monolithic, one-size-fits-all approach.
 - A second related caveat is that although the jurisprudence of the offshore legal world is helping to develop a better understanding of the various roles of trust protectors and the varying standards of accountability that should attach to these various roles, it is important to bear in mind that there is significant variation among the statutory regimes of offshore jurisdictions on the subject of trust protectors. Accordingly, one must take care not to assume that a case

from, say, Jersey or the Cayman Islands, is necessarily "good law" in The Bahamas, or vice versa. Instead, account must be taken of differences in statutory regimes and the impact that these differences may have on the way a particular question is judicially treated in one jurisdiction as opposed to another.

- Having said that, I will be citing cases from other jurisdictions that enunciate principles that are, in my view, generally – I repeat, generally - applicable under Bahamian trust law as well. To that extent, the foreign cases that I will be citing should be of persuasive effect in dealing with comparable situations here in The Bahamas.

In the course of my presentation, there are a number of questions that will be touched on along the way:

10 KEY QUESTIONS

1. In examining the relevant trust instrument and the trust structure as a whole, what do the powers of the Protector, in their totality, tell us about his intended role in the trust structure?
2. Drilling further down, are the Protector's powers under the trust personal or fiduciary or perhaps a mixed bag of both? This question lies at the very heart of my subject because whether or not a court will interfere with the exercise or non-exercise of a Protector's power will usually be dictated by whether the power in question is fiduciary or personal. (Will focus on the essential differences between personal and fiduciary powers very shortly).
3. To what extent does the answer to the question whether a Protector's power is personal or fiduciary turn on whether the Protector in a given case is also a beneficiary and/or the settlor of the trust, or, say, a spouse of the settlor as opposed to, say, a professional or institutional protector?

4. To what extent does the answer to the question whether the Protector's powers are personal or fiduciary also turn on whether the powers in question are included in the suite of powers prescribed by S 81 (2) of the Trustee Act?
5. To what extent does the answer to the question whether the Protector's powers are personal or fiduciary turn on internal characterizations of the Protector's role and powers in the trust instrument itself. In other words, where the Protector's powers are declared by the trust instrument to be personal and not fiduciary, or vice versa, how much effect does that have on the question as to whether the powers are indeed fiduciary or not.
6. To what extent does the answer to the question whether the Protector's powers are personal or fiduciary turn on how extensive and important those powers are in the overall scheme of the trust?
7. Where the powers of the Protector are indeed found to be personal does it follow that the Protector is not subject to any kind of judicial oversight or accountability to the Beneficiaries?
8. Where the powers of the Protector, on the other hand, are found to be fiduciary, to what extent will the Protector be accountable for the way he exercises – or fails to exercise – those powers.
9. What can trustees do - and what duties may they be under - where they feel that a Protector is acting in breach of his duties or in a manner harmful to the trust?
10. What can the courts do to remediate such a situation and, in particular, can a court remove or neutralize a Protector and appoint a new Protector?

THE 10 KEY QUESTIONS DISTILLED INTO 3

- Although I have posed 10 separate questions, you will be pleased to know that I do not propose to deal with them, one by one, because they can, in

fact, be distilled into just three lines of inquiry for the purposes of my presentation today:

- 1. How do we determine whether the Protector's powers are personal or fiduciary under a particular trust?**
- 2. How does the Protector's accountability vary depending on the answer to that question?**
- 3. What should the Trustee do, and what can the courts do, where the Protector has acted, or is threatening to act, in a manner harmful to the Trust?**

1. Determining whether the Protector's powers are personal or fiduciary under the particular trust in question:

- We should remind ourselves of the essential distinction between a personal power and a fiduciary power: a personal power can be exercised selfishly, even whimsically because no duty is owed by the power-holder to anyone. As long as the personal power is exercised within the parameters laid down in the trust instrument the power-holder is not accountable to anyone. A fiduciary power, on the other hand, carries with it the burden of accountability. This is so because under trust law, fiduciary powers encapsulate an implied duty to exercise the power in good faith, for the purposes for which the power was intended, and to do so rationally and in the interests of the beneficiaries as a whole and not in the interests of the power-holder or any other person.
- So how does one determine whether a power is fiduciary or personal in the context of a particular trust?

- A natural starting point is to identify just who the Protector is in relational terms. If, for example, he is the settlor himself or the spouse of the settlor or one of the beneficiaries, there will be something of an initial suspicion – I would not put it any higher than that for the moment – that the Protector may not be intended to be a fiduciary at all; that instead it is intended that his powers should be personal. On the other hand, if the Protector is an independent professional or an institutional Protector, the initial suspicion – again I would not put it any higher than that for the moment - will be that the Protector is intended to be a fiduciary.
- But frankly this is an overly simplistic and, to a certain extent, a misleading way to begin because one really cannot get very far with this approach without considering - in conjunction with the question of who the Protector is - the question of why he was appointed in the first place, and why he was armed with the relevant powers in the first place. Was it to better equip him to protect and promote his own interests as settlor and/or beneficiary, or was it to equip him to act more broadly in the interests of the trust generally, that is to say, in the interests of the beneficiaries as a whole. If it is the former, i.e. the powers have been given to the Protector to enable him to better secure his own interests as a beneficiary, then, all other things being equal, the powers will likely be characterized as personal, while in the latter case, they will be likely be characterized as fiduciary. (All this, however, is subject to what I will have to say shortly regarding S. 81 of the Trustee Act).
- Happily, there is a not inconsiderable body of offshore trust case law on this whole question as to whether, in a given context, a power is personal or fiduciary. In fact, one of the leading cases is a case out of The Bahamas (cited in all the major English trust law books) : Rawson Trust and Perlman (SC of Bahamas no. 194 of 1989, decided 25 April 1990, per (Neville) Smith J ("the Perlman case")). (Note that it pre-dates the Trustee Act (1998).

- In the Perlman case, there were three Protectors and they were all beneficiaries of the trust as well. It was held that their powers as Protectors were personal and not fiduciary. The powers were held to be personal because they had been conferred upon the Protectors so that they could better protect their own interests as beneficiaries. More specifically, it was held that the powers in question had been given to the Protectors-cum-beneficiaries to ensure that they would not be personally prejudiced in the exercise of the trustee's wide discretionary dispositive powers. Since that was the purpose for which the powers had been granted, it necessarily precluded any fiduciary duty that might be owed to the beneficial class as a whole.
- To much the same effect is Sociedad Franciera Sofimeca v Kleinwort Benson (Jersey) Trustees Ltd -Royal Court of Jersey 13 July 1992, where it was held that the protectors had been armed with the powers in question so that they could better look after their own interests as beneficiaries.
- Similarly, in Re Z 1997 CILR 242 (Grand Ct Cayman, per Smellie J) where there was a committee of protectors, two of whom were beneficiaries, including the Settlor's daughter, it was held that as far as the specific power at issue was concerned, viz. the power of amendment which the Settlor's daughter had exercised for her own benefit, it was personal and not fiduciary. It had been given to her under the trust deed by her father, the settlor, with a view to enabling her to put her own interests as beneficiary over the interests of the other beneficiaries. As in the Perlman case, this pointed to a personal rather than a fiduciary power.
- However, where the power in question is, by its very nature, unrelated to the dispositive provisions of the trust such that it cannot be plausibly argued that the power must have been designed to assist the Protector in protecting his own interests as a beneficiary, the courts will be far more readily inclined to hold that

the power is fiduciary, even where the power-holder is also a beneficiary.

- This was recently demonstrated in the Cayman Islands in Re Circle Trust, HSBC Int'l Trustee Ltd v. Wong [2007] 9 ITELR 676 (per Henderson, J) where it was held that since the power to appoint trustees is, by its very nature, fiduciary and since it was the Protector who had the power to appoint trustees under the trust, the power, in turn, to appoint the protectors (which was the particular power in question) should be viewed as intrinsically fiduciary as well.
- It is useful to set out the principle that the learned judge enunciated in that regard:

"The law requires the power to remove and appoint trustees, even when exercised by beneficiaries, to be exercised in good faith for the benefit of the trust as a whole. In my view where a protector is given the right to do that, the right of nomination of the protector must equally be exercised in good faith for the benefit of the trust and all the beneficiaries.....and is reviewable upon an allegation of irrationality, absence of good faith or impropriety of purpose"
(emphasis supplied).

- A similar judicial approach has been taken in relation to other powers commonly vested in Protectors, irrespective of whether the Protectors in question are beneficiaries or not. Indeed, if the power in question is, by its very nature, presumably intended to serve the interests of the beneficiaries as a whole, it will be difficult to argue that it can ever be a personal power.
- For example, the power to appoint trustees has long been considered under English law to be intrinsically and inescapably fiduciary, at least in the limited sense that the power holder cannot exercise it for his own benefit (which is

perhaps just another way of saying that it can only be exercised for the benefit of others : Re Skeats Settlement 1889 42 Ch D 522.

- Similarly, the power to change the situs of a trust has recently been held to be intrinsically fiduciary in the sense that the power-holder is bound to exercise it in good faith and for a proper purpose: Re Bird Charitable Trust [2008] JLR 1 (the trust of lottery proceeds case).
- So in the final analysis, it may well be that whether a Protector's power is fiduciary or personal depends as much – perhaps even more - on the intrinsic character of the power in question rather than on considerations of who the Protector is or the subjective purpose for which the power was conferred upon him.
- ...which brings me to the eight specific powers set out in S 81 of our Act, namely the :
 - (1) power to change the governing law of the trust;
 - (2) the power to change the forum for the administration of the trust;
 - (3) the power to remove trustees;
 - (4) the power to appoint new or additional trustees;
 - (5) the power to exclude beneficiaries;
 - (6) the power to add beneficiaries (including the settlor);
 - (7) the power to give or withhold consent to specific actions of the trustee; and
 - (8) the power to release any of the Protector's powers.
- S. 81 (3) says that where the Protector (or the settlor, for that matter) is given any one or more of these powers (collectively "the S.81 powers"), firstly,

he does not thereby become a trustee but secondly, and of greater relevance to this discussion, he is "*not liable to the beneficiaries for the bona fide exercise of the power*".

- Now, if the Protector is not liable for the bona fide exercise of any of the S. 81 powers, it should follow that he will indeed be liable where he has not exercised his powers bona fide. And if indeed that is the standard that is being statutorily enshrined, should it not follow that the S. 81 powers are all and each of them inescapably fiduciary in the sense that they import a duty to act in good faith which, as we have already observed, is a hallmark of a fiduciary power but essentially alien to the concept of a personal power.

- But if that indeed is what S. 81 is saying, it creates obvious problems. For example, if, as in the Perlman case (which, I repeat, was decided before S. 81 was enacted), powers are given to Protectors-cum-beneficiaries so that they can better protect their own interests as beneficiaries, how is that to be squared with what appears now to be a universal "good faith" requirement for all eight of the S. 81 powers?

- In particular, if S. 81 is to be taken on its face, the good faith requirement would now attach to Perlman-type power arrangements which involve power #7 - the power to give or withhold consent to actions proposed by the Trustees. But where the settlor has, by the express terms of the trust instrument, given a Protector-cum-beneficiary the power to withhold his consent to proposed distributions by the trustees as a means by which the Protector-cum-beneficiary can ensure that his own interests as beneficiary are not prejudiced, shouldn't the requirement of good faith be a complete non-starter in such a context?

- It is true that S. 81 speaks of the Protector not being liable for the bona

bona fide exercise of any of the S. 81 powers "*unless otherwise provided in the trust instrument*" but I would submit that this does not give the Protector a way out. Instead all it means is that the trust instrument can, if so desired, hold the Protector liable for even the bona fide exercise of his powers where, for example, the Protector, in exercising one of the S. 81 powers, does so in good faith but negligently. If the settlor wants to hold the Protector to that higher standard of accountability, S. 81 gives him license to do so. That is all that the words "*unless otherwise provided in the trust instrument*" really mean, not that the good faith requirement can be jettisoned altogether.

- I do not propose to dwell any further on this particular question save to say that judicial elucidation (or, alternatively, legislative clarification) of S. 81 is required in order to settle the question as to whether any of the S.81 powers can indeed be purely personal powers or whether they are all now inescapably fiduciary, at least in the limited sense of importing a duty to act in good faith, for the breach of which the Protector may be liable. This clarification is especially needed for powers 5, 6 and 7 (power to exclude beneficiaries; power to add beneficiaries; and power to give or withhold consent to trustee actions).
- Given the cloud of uncertainty over S. 81, it also means that declaratory statements in the trust instrument to the effect that Protector's powers are personal and not fiduciary are to be taken with a huge grain of salt, especially if the powers in question are within the suite of powers set out in S. 81. But quite apart from that, such declaratory statements are not decisive in any event. They are certainly of some value in that they indicate what the settlor's intentions are but if the Protector's powers are such that they must have been intended to be exercised in the best interests of the trust as a whole, e.g. (1) the power to change the governing law; (2) the power to change the situs; (3) the power to remove trustees; and (4) the power to appoint new or additional trustees – i.e the first four of the eight powers include in the suite of powers

under S. 81 – it is difficult to see how the settlor’s characterization of these powers as personal could would make them so. Instead, they would seem by their very nature to be intrinsically fiduciary. It is likely, therefore, that they would be so construed by the court

- There are just two other points that need to be made on this whole question of whether a power is fiduciary or personal:

(1) There is something of a natural tendency on the part of most courts to come down on the side of holding a Protector’s powers to be fiduciary rather than personal in cases where the arguments for and against are more or less evenly balanced. This natural bias is reflected in a very recent case out of Jersey: Centre Trustees (CI) v. Pabst (2009) JRC 109 where there were two conflicting clauses in the trust instrument, one suggesting that the relevant powers of the Protector were personal, the other clause suggesting that the powers were fiduciary. The arguments were finely balanced but the court resolved the conflict by choosing the clause that made the powers fiduciary.

(2) Secondly, and finally under this head, there will also be something of a natural tendency for a court to hold the Protector’s powers to be fiduciary and not personal where a whole lot of power has been concentrated in the Protector under the trust instrument. As was suggested in Steele v Paz (Isle of Man) 1993-1995 Manx LR 102 , where *“the most important”* powers of the Trustee are controlled, or subject to the consent or veto of the Protector, courts will more readily incline to the view that the Protector’s powers are fiduciary and not personal.

2. The differing consequences depending on whether the power is personal or fiduciary

- Having addressed the first line of inquiry as I have, I can now dispose of the remaining two rather quickly. I therefore now turn to the question of the divergent consequences that generally flow depending on whether the relevant powers of the Protector are personal or fiduciary.
- Firstly, where the power of the Protector in question is, on its true construction, purely personal, it does not follow that the Protector is completely off the hook and necessarily beyond the pale of judicial scrutiny. Instead, the Protector remains accountable for the exercise of the personal power within the boundaries permitted by the trust instrument. If he purports to exercise the personal power outside or in excess of those boundaries, it can be challenged and set aside by the court.
- Take, for example, the case of a Protector who is also the settlor and a beneficiary. Let us suppose that he is vested with a personal power (leaving S. 81 aside for the moment) to add beneficiaries but only from among a class limited to his spouse and issue. If despite those boundaries, the Protector were to appoint his mistress as a beneficiary, the appointment of the mistress would be set aside for the asking on the simple ground that the Protector had no power to appoint her to begin with. This vitiating factor would transcend and indeed pre-empt any question that might arise as to whether the power was fiduciary or personal. The exercise of the power would simply be invalid.
- However apart from such “fraud on the power” type cases, personal powers are usually always beyond the reach of judicial correction. They can be exercised by the power-holder as the proverbial spirit moves him, and there is nothing a court or anyone else can do about it. Since a duty is owed to no one, there is no one who can legitimately complain.

- In the case of fiduciary powers, on the other hand, it is a completely different story. Fiduciary protectors, like trustees, are subject to the full range of supervision by the courts in the exercise of their inherent jurisdiction over trusts.
- As to how that jurisdiction is exercised in cases where Protectors abuse or misuse their fiduciary powers is, however, best addressed in the context of the third and final line of inquiry to which I now turn.

3. Acting to protect the trust from the harmful actions of the Protector.

- What if the Trustees find themselves in one or more of the following predicaments (illustrative but by no means exhaustive):

 - The Protector, having the power to do so, fires the trustees and appoints as successor trustee a company that is actually owned and controlled by the Protector? What can and should the Trustees do?
 - The Protector, again having power to do so, fires the trustees and appoints as successor trustee an individual who knows absolutely nothing about trusts but whose claim to fame is that he is the Settlor's best friend and robot? What can and should the trustees do?
 - The Protector-cum-settlor, again having power to do so, purports to change the governing law of the trust to a jurisdiction whose laws give comparatively weak protection to beneficiaries but maximal control to the settlor, even to the extent of enabling him to revoke the trust and reclaim the assets, a power he would not otherwise have under the trust instrument itself? What can and should the Trustees do?
 - The Protector, again having power to do so, gives notice that the trust will terminate in a week's time. This premature termination of the trust will trigger capital distributions that will be hugely beneficial to the Settlor from a tax standpoint but hugely disadvantageous to the

beneficiaries. What can and should the trustees do?

- The Protector, whose consent is required under the trust instrument for just about everything, irrationally refuses to give his consent to a re-structuring of the investment portfolio, a move that is both necessary and urgent if the trust fund is to avoid complete collapse. What can and should the Trustees do?

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- The answer is the same in all five examples : the Trustees can and should seek the directions of the court on an urgent basis, utilizing, at least at first instance, the summary procedure under S. 77 of the Trustee Act. In appropriate cases, however, full-blown court action by the trustees may be necessary with a view to having the relevant acts of the Protector declared invalid and of no effect, while obtaining injunctive relief to prevent all pending acts from being carried into effect in the meantime.
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 - In each of the examples, the breach of duty on the part of the Protector is both obvious and egregious so the Trustees need have no fear about incurring any exposure in taking an aggressively pro-active approach against the Protector.
 - Indeed, in the scenarios just given, the Trustees, regardless of how robust their exculpatory clauses may seem, might well be putting themselves at grave risk of action by the beneficiaries for damages for breach of fiduciary duty if they, the trustees, were to do nothing to stand in the way of the Protector or, worse still, if they were to co-operate with the Protector in carrying his actions into effect. If, as a result, the beneficiaries were to sustain losses, the trustees could well find themselves liable to pay.
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 - It cannot be emphasized enough that as part-and-parcel of its inherent supervisory jurisdiction over trusts, the court can always inquire into

whether a Protector's fiduciary powers have been exercised in good faith, within the boundaries permitted by the trust deed, and not for any self-serving or extraneous purpose.

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- There are a goodly number of reported cases from offshore jurisdictions that demonstrate how accessible the courts are to trustees who have cause for complaint against Protectors.
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- See e.g. *Re Papadimiriou* [2004] WTLR 1141 (Isle of Man) : trustees went to court to oppose the appointment by the Protector of additional trustees. The Trustees were unsuccessful (on the ground that the Protector had not acted improperly at all but instead had been motivated by a genuine desire to counterbalance the original trustees (note : the trust involved two reciprocally hostile families). Notwithstanding the result, there was no question that the court had ample jurisdiction to inquire into the propriety of the Protector's actions and, if need be, to rescind or reverse those actions.
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- To much the same effect, see the Guernsey case of *Praphulbala Virani v. Guerney Int'l Trustees and Tim Bennett* [2004] 6 ITEL 1007 : the trustees went to court in an unsuccessful attempt to have Protector's decision removing them overturned. Again there was no question that the court had jurisdiction to reverse the Protector's decision and would have done so had the circumstances so warranted.
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- See also the much criticized decision of Meerabux J in the Bermuda case of *Re Star 1 & 2 (Revised) Trusts Von Knieriem v Bermuda Trust Co and Grosvenor Trust Co.*, unrep. July 1994 ("the Star Trust case") where the Protector, having the power to change trustees, purported to remove the trustee because the trustee had refused to play ball with the settlor.

Specifically, the trustees had refused to help block the settlor's removal from the board of directors of the underlying company in the trust structure. As a result of the trustee's uncooperative attitude, the Protector removed the trustees. The trustees, for their part, marched off to court to question whether the Protector had acted properly in exercising its power to remove them as trustees. The court upheld the removal of the trustees on the highly dubious ground that the Protector only had a "limited" fiduciary duty not to benefit himself and as he had clearly not done so, the trustees had not been removed in breach of any fiduciary duty owed by the Protector. (Note : apart from the fact that reasoning of the judgment is deeply flawed, I would submit that this case would not, in any event, be good law in Bahamas having regard to the good faith requirement imposed by S.81 of the T Act. The outcome in The Bahamas would therefore likely be quite different. A Protector who, as in the Star Trust case, removes a trustee simply because the trustee refuses to do the settlor's bidding, and for no other reason, will probably thereby fail to rise to the "good faith" requirement that attaches to the exercise of a power of this kind under S 81).

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- Does Court have power to remove a Protector and appoint a new one?
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- Yes: ref. Centre Trustees (CI) v. Pabst (ante) where the Protector was removed on conflict-of-interest grounds at the suit of trustees; see also Re Papadimitriou (2004) WTLR 1141 (Isle of Man) where the court acknowledged that it had power to remove the Protector but that on the facts it was not a proper case in which to do so.
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- Where the court is loathe to take the extreme step of removing a Protector, other effective remedies are nonetheless available. For example, the court can suspend the powers of Protector so as to give the

trustees a free hand to act: see e.g. Re M Settlement (2009) JRC 140 where the Settlor-Protector, a debt-ridden alcoholic, was irrationally withholding his consent to terminating distributions to the children. The court ordered that the Protector's power to withhold consent would be suspended thereby freeing the trustees to make the terminating distributions to the children without any hindrance.

- - Regarding the jurisdiction to appoint a new Protector, ref. Steele v. Paz (ante) where the court, acting on analogy to its inherent jurisdiction to appoint trustees and by reference to the maxim that a trust will not fail for want of a trustee, appointed a protector - but note that in this case the appointment of a protector was regarded as critical to the continued efficacy of the trust.
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 - Ref. also Underhill & Hayton, Law of Trusts & Trustees (18th ed. 2010) where the learned editors indicate that "it appears"... that a court has an inherent jurisdiction to appoint a protector if it is deemed critical to the operation of the trust. (*Quaere* whether the jurisdiction to appoint a Protector can or should extend beyond this exceptional kind of case.
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