

XXIV Old Buildings' Stephen Moverley Smith QC on the impact of a ruling over the powers of a trust's settlor

Power and property – a Privy Council ruling grapples with the extent of settlors' rights

In an uncertain world it is perhaps not surprising that there is an increasing enthusiasm among the newly rich to settle their wealth in offshore asset protection trusts. There is, however, a reluctance to surrender possession and control of their assets to trustees, of whom they are likely to have had no previous experience.

To address this issue, the trust industry has devised the strategy of reserving powers to the settlor of the trust, in particular the power to direct to whom the trust assets should be distributed and a power to revoke the trust so that the trust assets re-vest in the settlor.

The wisdom of this approach has now been seriously called into question in light of the recent Privy Council decision of *TMSF v Merrill Lynch* [2011] UKPC 17, an appeal from the Cayman Islands.

TMSF, the regulator of Turkish banks, had obtained judgment for \$30m (£19m) in Turkey against a Turkish individual, Mr Demirel, in relation to a massive bank fraud. Demirel had established in Turkey two discretionary trusts, whose trustees were Merrill Lynch. In relation to each trust he had reserved to himself an absolute power of revocation. The trustees held shares in some Cayman companies, which in turn held nearly \$30m in cash. Summary judgment proceedings were successfully brought by TMSF in Cayman based on the Turkish judgment.

The issue for TMSF was how to enforce that Cayman judgment against the trusts. No sham argument was available, but what of the powers of revocation? The obvious route appeared to be to seek an order that Demirel exercise the powers and collapse the trusts. However, while the statutory jurisdiction permitted an injunction to be granted whenever it was 'just and convenient', that course also appeared unavailable in light of the 2003 decision of Justice Wilson in *Field v Field* [2003] that a creditor was restricted to established



methods to enforce a judgment, which could not be bypassed by granting a freestanding injunction.

TMSF accordingly turned to receivership by way of equitable execution as a possible solution, but there were two significant difficulties. First, was a power the type of interest over which a receiver could be appointed? Second, if, in theory, a receiver could be appointed, was that something the court could properly do? There was no precedent for any such appointment. Indeed, it appeared that the question had never been considered by the courts before, whether in the Cayman Islands or elsewhere.

At the centre of the debate in relation to the first of these questions was the proposition that a receiver could only be appointed over property, and a power was not property. Traditionally, a distinction has been drawn between a 'power', which is viewed as the ability to do something, and 'property', which is what you may get when the power has been exercised.

In *TMSF* at first instance, the court had concluded that, where

it was desirable to treat powers as property, express provision was made to achieve this result by legislation. Powers were not otherwise property: absent legislation, the court had no jurisdiction. The Court of Appeal failed to engage on the point, but in the Privy Council the issue was considered in some depth. For Lord Collins, who gave the judgment of the Privy Council, there was no absolute rule: for some purposes a power was not property, for other purposes the holder of a general power could be regarded for all practical purposes as the owner. In the context of *TMSF*'s application he had no difficulty in accepting that an unfettered power of revocation granted a right that was tantamount to ownership of the underlying trust assets.

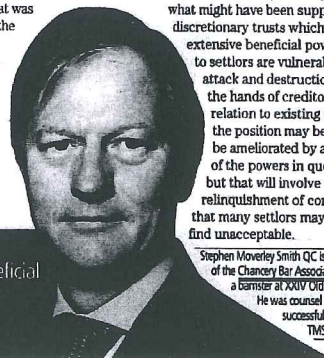
As to whether or not a receiver could be appointed over such an interest, Lord Collins had considered the matter before while sitting in the English Court of Appeal in *Masri v Consolidated Contractors International (UK) Ltd* in

2009. There, he had concluded that the overriding consideration was the demands of justice and that the jurisdiction to appoint receivers by way of equitable execution could accordingly be developed incrementally, to apply old principles to new situations. Applying that approach, Lord Collins concluded that such incremental development extended to appointing receivers over an asset that was only tantamount to property.

As to the second question, whether the court should make an order, this raised a pure question of policy. The Court of Appeal had concluded that as a matter of policy no order should be made in the absence of legislation. Lord Collins took a different view. For him, the question was not whether powers should be considered to be a species of property, but whether the interests of justice required that an order should be made. Having previously determined that there was no jurisdictional bar to making such an order it was perhaps unsurprising that the conclusion he reached was that justice required that receivers should be appointed to make effective the judgment of Cayman court.

What the decision in *TMSF* establishes is that, contrary to what might have been supposed, discretionary trusts which reserve extensive beneficial powers to settlors are vulnerable to attack and destruction at the hands of creditors. In relation to existing trusts, the position may be able to be ameliorated by a release of the powers in question, but that will involve a relinquishment of control that many settlors may well find unacceptable.

Stephen Moverley Smith QC is a member of the Chancery Bar Association and a barrister at XXIV Old Buildings. He was counsel for the successful appellant, TMSF.



Contrary to what might have been supposed, discretionary trusts which reserve extensive beneficial powers to settlors are vulnerable to attack and destruction at the hands of creditors

Stephen Moverley Smith QC, XXIV Old Buildings

www.legalweek.com

Legal Week 6 October 2011 15