Trustee-beneficiaries: Can they have the cake and eat it too?

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The time of cakeism is at hand, and not just in the field of UK trade negotiations. Many trustees of modern trusts find themselves both owning the trust assets and objects of the powers of appointment; legally holding the cake and with a beneficial interest in its enjoyment too.

While the prospects for trustee-beneficiaries may sound tempting, serious indigestion awaits the unwary. As trustees they are subject to fiduciary duties, including to avoid conflicts between their interests and their duties; yet as beneficiaries they are personally invested in how powers of appointment are exercised. The twin risks of scrutiny and criticism from disgruntled non-trustee beneficiaries are ever present.

What is a trustee-beneficiary to do? What steps can a trustee take properly to appoint to himself or herself a slice of the trust assets? Conversely, how can a non-trustee beneficiary impugn dubious decisions of the trustees? This eBriefing suggests some answers.

The principles

The starting point is the well-known equitable rule that a fiduciary is not entitled to put himself or herself in a position where interest and duty conflict, unless authorised under the trust instrument. This is a prophylactic rule; it exists to discourage fiduciaries from preferring their own interests over those of their beneficiaries: *Bray v Ford* [1896] AC 44. Where trustees have acted in breach of this rule, their purported decision may be voidable at the instance of the prejudiced beneficiary (or possibly void *ab initio*): *Lewin on Trusts* (20th ed.), §46-073.

Authorisation of a conflict between interest and duty may of course be given expressly by the terms of the trust (see, e.g., Step Standard Provisions (2nd ed.), clause 9); alternatively the rule may be impliedly excluded for certain trustee-beneficiaries (e.g. where the settlor has in the trust instrument appointed a beneficiary as one of the original trustees: *Lewin*, §46-079 *et seq*).

Many private trusts will, however, not give such authorisation or provide for such exclusion. Indeed, many older private trusts will contain an express prohibition against a trustee exercising any power in such a way as would result in any of the income or capital being applied for his or her benefit.

Where there is no express or implied authorisation or exclusion of the rule, acute difficulties (or, at the very least, uncertainty) can arise for trustees. This is particularly so when they are proposing to exercise a dispositive power. While a trustee is entitled (subject to his or her usual duty to act in good faith, to consider all relevant but no irrelevant factors, etc.) to be partial in the exercise of powers of appointment and to prefer some beneficiaries over others, this does not necessarily mean that a fiduciary dispositive power can properly be exercised in favour of a person who is both an object of such a power and simultaneously a trustee: *Lewin*, §46-073 and §46-076.

What can trustees practically and pragmatically do to avoid criticism and challenge of any decisions to appoint to a trustee-beneficiary? Below are some possible routes through.

Resolving the issue (1): *"I'll just step out of the room"*

One possible workaround may be for the conflicted trustee-beneficiary simply to sit out the decision-taking process in question. This is only possible if such a mechanism is expressly provided for by the trust instrument. As a matter of general principle, all trustees must act, and decisions must be taken unanimously. A conflicted trustee-beneficiary therefore cannot simply 'leave the room' – and the rest of the trustees cannot properly act without that conflicted trustee-beneficiary joining in the decision – unless the trust instrument allows this.

Some private settlements contain mechanisms for decisions to be taken by majority where one or more trustees is or are conflicted. In this author's experience, private settlements dating from the latter half of the twentieth century sometimes adopt such mechanisms. In these cases, the trust instrument (a) expressly prohibits a trustee from

exercising powers in such a way as would or might result in a distribution being made in his or her favour but (b) also expressly authorises the taking of such a decision by the balance of the non-conflicted trustees.

In more recent settlements, however, this rather cumbersome mechanism has largely given way to standard terms which expressly authorise the taking of a unanimous decision by the trustees, which would or might benefit a conflicted trustee-beneficiary, provided that there is at least one non-conflicted or independent trustee.

Resolving the issue (2): a *pas de deux*?

For those trustees whose trust instruments do not authorise a conflict, restrict the application of the equitable rules, or otherwise provide a mechanism for dealing with a conflict, other solutions must be found. One such solution frequently alighted upon by the trustees themselves – once the existence and consequences of the conflict are appreciated – is to suggest that the conflicted trustee resign and a new non-conflicted trustee be appointed; then, so the thinking goes, the newly constituted group of trustees will be able to take the decision in question untainted by conflict.

In theory this is a perfectly acceptable solution, provided of course that the newly constituted trustee body considers the matter entirely afresh. It is this proviso that causes difficulties in practice. Frequently, the trustees will have decided in principle, before the conflicted trustee has resigned, that they wish to make a distribution that will result in one or more of their number receiving a benefit. It is then only at that stage that the conflict is appreciated and steps are taken to replace the conflicted trustee(s); a new trustee is then appointed and shortly thereafter the trustees again resolve to make exactly the same appointment. The decision-making process can readily appear to the beneficiaries (and possibly to a court in due course) to be something of a stich-up, particularly if the newly appointed trustee is a friend or confidante of the former trustee(s). A two-step, pre-determined arrangement is improper; such a *pas de deux* just won't do.

Resignation may lead to other problems. Trustees must be alive to the risk of judicial criticism if the resignation of one or more trustees will lead to additional administrative burdens or expense on the trust fund or otherwise prejudice the interests of the beneficiaries. Thus in *Public Trustee v Cooper* [2001] WTLR 901 Hart J observed (*obiter*) that the resignation of a trustee:

"...will not always provide a practical or sensible solution. The trustee concerned may represent an important source of information or advice to his co-trustees or have a significant relationship to some or all of the beneficiaries such that his or her departure as a trustee will be potentially harmful to the interests of the trust estate or its beneficiaries."

Resignation may be a solution, but if there are decisions which need to be made quickly and/or if the matters relating to the trust are especially complex such that it would take a long time for a new trustee to get to grips with matters, this is unlikely to be the best way forward.

Resolving the issue (3): next stop, Chancery Lane

The difficulties arising from the existence of conflict amongst the trustees may be resolved by approaching the court for directions. Most usually this will take the form of a blessing application to the Chancery Division under the High Court's inherent jurisdiction as explained in *Public Trustee v Cooper*. The trustees must give full and frank disclosure, which will of course include an explanation of the existence and nature of the conflict which has necessitated the application. Where the trust instrument authorises the taking of decisions by the non-conflicted trustees only, the proposed distribution is usually structured in such a way that the conflicted trustee will sit out most of the transactional steps, although he or she will of course be joined as a party to any blessing application.

Either the court will sanction the taking of the decision (in which case the trustees will be protected from future criticism) or it will not (in which case the trustees will at least know that they are at risk if they proceed in any event).

It is important to remember, however, that while courts are generally sympathetic to the realities faced by trustees and their need in many cases to seek the comfort of judicial blessing, the size of the trust fund and the issues at stake ought to justify the expense of full-blown High Court litigation. No doubt if the trust fund is limited and/or the issues to be decided modest in nature a costly application to court for blessing may be criticised. Trustees of more modest trusts may need to consider other alternatives.

Resolving the issue (4): variations to the trust or possible retrospective sanction?

Other options potentially available to trustees would be to apply to court for a variation (under the Variation of Trusts Act 1958) or for the conferral of additional powers (under the Trustee Act 1925, s. 57) to permit conflicts of interest. It is quite common to see in VTA applications where the trustees seek a new perpetuity period of 125 years a simultaneous proposal to adopt new standard administrative provisions, including provisions limiting the application of equitable rule prohibiting conflicts of interest and duty. Such applications of course present their own hurdles in satisfying the court that departures from general equitable principles ought to be permitted.

A further possibility is that the trustees might simply take the decision in any event. They might do so for any number of reasons: perhaps they are ignorant of the implications of the conflict; perhaps they are unwilling to incur disproportionate costs for a modest trust fund; or perhaps they are just willing to run the risk of future criticism. If they do proceed in this manner, can they obtain the court's sanction *ex post facto*?

Although the matter is not free from doubt, *Lewin* suggests that the court has jurisdiction to give retrospective approval: *Lewin*, §46-069. While that may be so, the author wonders how likely it would be for approval to be given, at least in circumstances where a beneficiary has in fact intimated criticism of the decision. There is little difference in practice between the court's giving approval and dismissing a claim for breach of trust. A claim for breach of trust may be preferable for the trust as a whole: in such a claim the trustees and the complaining beneficiary are the parties principally at risk of costs if they lose; in an application for directions the trust will very likely be bearing all parties' costs. Perhaps though, if the trust is a modest one or the risks of future criticism at the time of the decision were considered very remote, a court might be willing to adopt a pragmatic and sympathetic approach given the difficult position the trustees find themselves in.

Tips for disgruntled beneficiaries

What about the beneficiaries of trusts who see trustees distributing trust assets to trustee-beneficiaries? What can they do?

It is important to remember that just because a trustee-beneficiary has received a distribution it is not necessarily wrongful. The rule against conflict of interest and duty has been described as *"riddled with exceptions"*: *Lewin*, §46-078. Additionally, where

a trustee is an object of the power which is then exercised wholly or partly in the trustee-beneficiary's favour, it is not for the trustee to prove positively that the power was exercised properly; it is for the challenging beneficiary to prove that the power was exercised improperly: *Lewin*, §46-073.

Whether a power was exercised rationally, properly and for a proper purpose is of course a highly fact dependent question. There will be some cases in which the exercise of the power looks very fishy; there will be others where the decision is far less obviously improper. The beneficiary may not have easy access to trust papers and the burden is always on the complaining party to prove the wrongdoing.

At the very least, however, beneficiaries are usually well advised to press their trustees for an explanation. Any information disclosed may reveal whether a claim for breach of trust has legs; on the other hand, a blanket refusal to provide information may look defensive and create a presentational and costs risk for the trustees in any subsequent litigation.

Conclusion

The exercise of a fiduciary power of appointment in favour of a trustee-beneficiary can be fraught with risk: criticism and challenge may ensue. While there are potential ways of dealing with such conflict prospectively (and possibly retrospectively), the options can be limited, cumbersome and/or expensive. Care is required and the trustees will generally be wise to seek legal advice. In short, while trustee-beneficiaries may be able to have the cake and eat it too, they must be alive to the risks attendant with doing so. If they are not, they might find themselves in something of a sticky situation.

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