Available assets

Charlotte Conner outlines the challenges when dealing with cases involving trusts

Charlotte Conner is an associate with Dawson Cornwell

'This is an area fraught with difficulty as the court is being asked to deal with assets which are not legally owned by either party to the proceedings.'

The recent Court of Appeal decision in *P v P* [2015] brings into focus key issues that may arise in family proceedings when trusts are involved.

Background

P v P concerned an appeal, brought by the trustees of a discretionary trust, against an order of Mostyn J (reported at first instance as *AB v CB* [2014]). The parties met in 1999, began cohabiting in 2002 and married in February 2003. In 2005, they moved into a farmhouse owned by the husband's parents. In 2009, the husband's parents established a trust in relation to that farmhouse. The husband was the principal beneficiary. Under the terms of the trust, the trustees had the power to transfer the farmhouse to the husband, or raise money from it to apply for his benefit. The parties separated in 2012. Decree nisi was pronounced in 2013. On paper, the husband had virtually no assets and only a modest income. However, his family was described as having 'great wealth' and Mostyn J found that the husband's 'position in terms of financial security was absolutely assured'. He varied the trust, reflecting the sharing principle in relation to the matrimonial home, and the wife was awarded £23,000 absolutely (being the value of her contributions towards the farmhouse) and £134,000 by way of a life interest (equating to half its net value). The trustees appealed and their appeal was dismissed by the Court of Appeal.

Types of trusts

In order to comprehend the approach of the Court of Appeal in *P v P*, it is important to first understand the guiding principles as to how trusts are treated by the court in the context of divorce. This is an area fraught with difficulty as the court is being asked to deal with assets which are not legally owned by either party to the proceedings. The assets are owned by a third party, ie the trustees. To complicate matters further, different types of trust will result in different judicial approaches.

In *BJ v MJ* [2012] Mostyn J set out a comprehensive evaluation of how trusts should be treated, reminding us that a spouse who is a beneficiary to a trust may have either:

- a life interest;
- a fixed interest; or
- a discretionary interest.

Where there is a defined interest by way of a fixed or life interest, and where the parties are the only beneficiaries, generally the trust asset is considered to be in the direct ownership of the beneficiary. Such property is identifiable, thus capable of being valued and included by the court in terms of the division of matrimonial assets. Where a beneficiary has only a discretionary interest, then technically they have no more right to be considered by the trustees than any other potential beneficiary, and therein lies the problem.

Discretionary trusts are where most complications arise. Cipher trusts (also known as 'Dear Me' trusts) are discretionary trusts that essentially serve as a vehicle within which the trustees act wholly on the instructions of the beneficiary, such that the beneficiary has unfettered access to the capital/income. In such circumstances, the court tends to ignore the trust structure altogether, regarding the

property as belonging to the beneficiary in its entirety.

Where there is a bona fide trust, there is a key distinction between nuptial and non-nuptial settlements. Lord Nicholls in *Brooks v Brooks* [1995] defined the test for a nuptial settlement (which was later applied by Mostyn J in *AB v CB*) as being one where the disposition:

> ... must be one which makes some form of continuing provision for both or either parties to a marriage with or without the provision for their children.

Nuptial settlements

Where it is determined that a trust is a nuptial settlement, the question arises as to whether variation is appropriate. In *AB v CB* Mostyn J observed the need to (para 54):

> ... resolve a familiar tension between balancing the right to share matrimonial property... with the fact that there is a trust here and the intention of the trust.

Where a trust is a nuptial settlement, notwithstanding that assets are legally held by trustees and that there may also be other third-party beneficiaries, the assets fall within the court's powers under s24(1)(c), Matrimonial Causes Act 1973 (MCA 1973), ie:

> (1) On granting a decree of divorce, a decree of nullity of marriage or a decree of judicial separation or at any time thereafter (whether in the case of a decree of divorce or of nullity of marriage, before or after the decree is made absolute) the court may make one or more of the following orders, that is to say:
>
> [...]
>
> (c) an order varying for the benefit of the parties to the marriage and of the children of the family or either or any of them any ante-nuptial or post-nuptial settlement (including such a settlement made by will or codicil) made on the parties to the marriage, other than one in the form of a pension arrangement (within the meaning of section 25D below);
>
> (d) an order extinguishing or reducing the interest of either of the parties to the marriage under any such settlement, other than one in the form of a pension arrangement (within the meaning of section 25D below).

This power entitles the court to make outright provision to one party and may even be exercised where the trust is offshore (but generally only if the court is satisfied the order would be implemented).

> ... the central theme... is that it is permissible for the court to invade third party interests within the confines of the trust structure, but only to the extent that fairness so requires...

he added:

> It is acknowledged that in the generality of cases, the court should indeed be slow to do so.

Where a trust is a nuptial settlement, notwithstanding that assets are legally held by trustees and that there may also be other third-party beneficiaries, the assets fall within the court's powers.

Where a legitimate trust is set up during the course of the marriage, this may have been as a result of an agreement between the parties. Baroness Hale in *Miller v Miller; McFarlane v McFarlane* [2006] confirmed that the court will (para 153):

> ... recognise that in a matrimonial property regime which starts with the premise of separate property, there is still some scope for one party to acquire and retain separate property which is not automatically to be shared equally between them.

Variation

Before varying a trust, the court must exercise caution, and s25, MCA 1973 is the starting point: ie the court will have regard to all circumstances. In *Ben Hashem v Ali Shayif* [2009] Munby J (as he then was) stated (para 290) that:

> ... the court's discretion under s24(1)(c) is both unfettered and, in theory, unlimited... [there is] no limit of the form any variation can take...so it is within the court's powers to vary (at one end of the scale) by wholly excluding a beneficiary from a settlement, to (at the other end) transferring some asset or other to a non-beneficiary free from all trust.

Agreeing with the submission of counsel in that case that (para 291):

This highlights the obligation to seek to achieve a fair and objective result, where the trust is not interfered with more than is necessary to 'do justice between the parties'. Munby J recognised that the court ought to be 'very slow to deprive innocent third parties of their rights under the settlement'.

Financial resource

The question remains whether all, or part, of the trust assets can be attributed to the spouse who is the beneficiary of the trust. Wilson LJ in *Charman v Charman* [2006] distilled this question down to whether the trust is a financial 'resource' for the purposes of s25(2)(a), MCA 1973 and (para 13):

> ... whether, if the husband were to request it to advance the whole (or part) of the capital of the trust to him, the trustee would be likely to do so.

This was considered further in *Whaley v Whaley* [2011] by Lewison J, who stated (para 113) that:

> Thus whether a beneficiary under a discretionary trust has a proprietary interest is not relevant. The resource must be one that is 'likely' to be available. This is the origin of the 'likelihood' test. No judge can make a positive finding about the future: the best that can be done is to assess

> likelihood. What is relevant is the likelihood of the trust fund or part of it being made available to him, either by income or capital distribution. If the husband were to ask the trustees to advance him capital, would the trustees be likely to do so... The question is not one of control of resources: it is one of access to them.

Court of Appeal decision in *P v P*

In circumstances where it is held that a trust is not a nuptial settlement, the court has been left with 'judicious encouragement'. In *Thomas v Thomas* [1995], the Court of Appeal agreed that a husband (who was a beneficiary to a discretionary trust) could be ordered to pay a lump sum on the basis that his family would be likely to make sums available.

The position previously adopted and summarised above was reinforced by Black LJ who gave the leading judgment in *P v P*. The basis of the appeal by the trustees in *P v P* was whether the husband had a right to occupy the farmhouse. The trustees asserted that in determining this issue, the judge had exceeded the proper ambit of his discretion. It was argued that (para 30):

> ... the order failed to take account of the needs of the children, the interests of the other beneficiaries under the trust, the intention of the settlor that the property would not be sold, the husband's needs (particularly for housing) and the wife's ability to provide for herself from her own or other assets.

The trustees also submitted that Mostyn J was wrong for (para 31):

> ... proceeding on the basis that the husband's family would satisfy the order so as to avoid the farmhouse being sold, or at least placing improper pressure on them to do so.

In refusing this appeal, Black LJ referred (at para 40) to *Thomas*, in which Waite LJ stated that 'the discretionary powers conferred on the court by the amended ss23-25a of the Matrimonial Causes Act to redistribute the assets of spouses are almost limitless' and that 'the court must be equipped... to penetrate outer forms and to get to the heart of ownership'.

Black LJ said that (para 59):

> ... the judge did not *require* the family to put up the money, he merely gave them the option to do so, recognising that they may not do so and the farmhouse may have to be sold.

Dealing with trustees

Having confirmed that the court does have the ability to disregard a trust structure, the question then becomes whether the trustees will benefit their beneficiary if requested to do so and what to do if the trustees refuse to engage? Moylan J in *B v B (Ancillary Relief)* [2010] raised concerns on this point (para 77), saying:

> ... there must be an increased risk that the court will obtain or might obtain the wrong picture in the absence of all the information.

In *BJ v MJ*, Mostyn J affirmed this stance, stating (paras 18-21) that:

> ... if trustees do not voluntarily participate... and give proper disclosure then they can hardly complain if robust findings are made about the realities of control and the likelihood of benefit.

In *DR v GR* [2013] Mostyn J did not accept that in order to vary settlements, trustees should automatically be joined to the proceedings. He considered that notice of the application to the trustees was sufficient (Family Procedure Rules 2010 9.13). Thereafter, the trustees can decide whether to participate or seek to intervene. Mostyn J was clear that if trustees had been properly served then 'any variation order will be valid and binding on them' (para 22).

As evidenced by *Mubarak v Mubarik* [2008], overseas trustees may not wish to submit to the jurisdiction of the English court, but rather may wait for judgment before determining whether or not to comply or deal with enforcement proceedings.

In *BJ v MJ*, Mostyn J considered that once the likelihood of a future benefit had been determined, and the resources available established, these should be divided in accordance with the familiar 'distributive principles of needs, sharing and compensation'. He concluded that where there is a nuptial trust, and an effective order for variation can be made, the court must be satisfied that the order will be enforced. Alternatively, where there are sufficient assets outside of the trust, but it is within the court's powers to be able to make an award out of the non-trust assets by offsetting, this might provide the court with the mechanism to award the overwhelming majority of non-trust assets to the non-beneficiary (to the appropriate degree). Leaving the beneficiary to collect from the trustees means the court does not need to 'judiciously encourage' trustees to make assets available but instead leaves the trustees to provide for their own beneficiary.

Conclusion

P v P, and the previous authorities, remind us that when considering trust assets, the first step is to establish the type of structure holding the assets. If it falls within the court's powers to vary the trust the issue then becomes whether it is appropriate in the circumstances to do so and, if so, how to ensure that the existing interests of any innocent third parties and the parties' respective needs are fully considered. Overall, the court will have to be satisfied that what it achieves, either by way of a variation or otherwise, is fair and reasonable, coupled with the likelihood of whether its orders can actually be enforced. Not an easy task and an area which no doubt will continue to be challenged. ■

AB v CB
[2014] EWHC 2998 (Fam)
B v B (Ancillary Relief)
[2010] WTLR 1689
BJ v MJ
[2012] WTLR 395
Ben Hashem v Ali Shayif
WTLR(w) 2009-10
Brooks v Brooks
[1995] UKHL 19
Charman v Charman
[2006] WTLR 1
DR v GR & ors
[2013] WTLR 1123
Miller v Miller; McFarlane v McFarlane
[2006] UKHL 24
Mubarak v Mubarik
[2008] JRC 136
P v P
[2015] WTLR 1039
Thomas v Thomas
[1995] EWCA Civ 51
Whaley v Whaley
[2011] WTLR 1267