H&J FOCUS

HIGGS & JOHNSON COUNSEL & ATTORNEYS-AT-LAW VOLUME 53, ISSUE 2/2009

STAR Trusts of the Cayman Islands

FOCUS on Various Legislation

Grand Cayman Harbour - www.fevisyu.com/georgetown

STAR trusts – or "special" trusts subject to part VIII of the Trusts Law (2007 Revision) of the Cayman Islands to give them their proper designation – have been part of Cayman law and commercial life since October 1997 when the Special Trusts (Alternative Regime) Law 1997 (thus "STAR") came into effect. This article will offer a summary of the principle features of a STAR trust highlighting how it differs from a traditional (or "ordinary") trust and how those differences might be of interest to would-be settlors. It will point out a pitfall to be avoided but it is becoming clearer as each year goes by that STAR trusts are not merely, as a London Silk recently suggested at a well attended Cayman seminar, "really rather clever" but also, as he testified from his own experience of them, are gaining acceptance amongst professionals in Lincoln's Inn – the very people who will make up the next generation of English Chancery judges.

Two Revolutionary Ideas

First, a STAR trust can have as its objects persons, charitable purposes or non-charitable purposes or any combination of these ("the First Idea"). Second, the right of enforcing a STAR trust can be given to someone other than the beneficiaries ("the Second Idea"). What on earth is revolutionary about those ideas? Or what kind of mindset would regard such a trust as a daring and potentially problematic innovation? Until a decade ago no law student could have been marked down for answering: the mindset of just about any Chancery judge sitting in London over the last century or two and any answer which then cited Lord Evershed's judgment in *re Endacott* [1960] Ch 232 (to the effect that valid trusts generally must have beneficiaries capable of enforcing them) would be shaping up for first class honours. In order to understand why, let us look at the First Idea first. Doing so usefully explains how the First and Second Ideas are related.

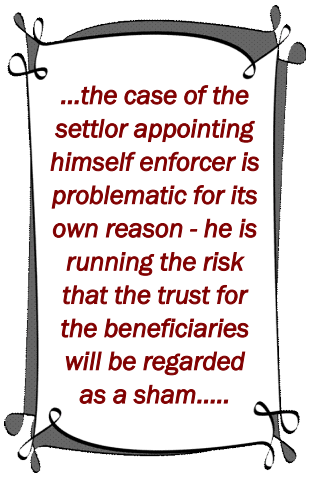
The Problem

In the traditional trust mindset, not merely can a valid charitable trust not be combined with non-charitable objects (because a charitable trust must be *exclusively* charitable) but a non-charitable trust must be for *persons* (beneficiaries) who can enforce the trustee's obligation to deal with the trust property and hold the trustee to account for the manner in which he has done so or wrongly failed to do so ('the Beneficiary Principle"). Charitable trusts are regarded as "public" trusts – they must benefit the public in a recognized way – so there is a sufficient public interest in appointing a public official (the Attorney-General in Cayman or the Charity Commission and, less often, the Attorney-General in England) to hold charity trustees to account and, accordingly, there is someone to enforce trusts for charitable purposes.

But a *purpose* - as such - cannot enforce anything and *non*-charitable purpose trusts ("NCPTs") which do not serve any public benefit

STAR Trusts in the Cayman Islands Continued

such as would justify a public official being put in charge of their enforcement are, it would seem, inherently incapable of enforcement. Now, the argument goes, an obligation that is inherently incapable of enforcement in the here and now is simply not a legal obligation at all and if not, then it cannot be a valid trust because valid trusts inherently just *are* enforceable obligations of a certain sort. That is the problem or, at least, one way of stating it.



The Cayman Solution

How, then, does the STAR legislation resolve the problem? That's where the Second Idea comes in. It breaks the conceptual link between *benefit under* a trust and the *right of enforcement of* the trust. That right is given to the *enforcer* - who may or may not be a beneficiary. This neatly solves the NCPT problem (that is, the lack of enforceability of non-charitable purpose trust) by giving them an enforcer – someone, in short, who has the same rights as the Attorney-General possesses in relation to charitable trusts but paid for privately.

So far, so good: a STAR trust established purely as an NCPT does not seem to fall foul of any public policy which underlies the Beneficiary Principle. A necessary consequence of this solution, however, is that where a STAR trust is established as an NCPT *and* as a trust for persons, the beneficiary *as such* has no right to enforce the trust in any way whether by suing the trustee or claiming that he owns or otherwise has a right to any part of the trust property.

That is where some see a difficulty. Even Professor (now Justice) David Hayton has written in 2007: "there is a good chance [the English court] will recharacterise the "beneficiaries" as really being mere objects of a non-fiduciary (or personal) power of appointment, so that the beneficial interest remains with the settlor under a resulting trust for him. To oust this problem some beneficiaries must, under the trust instrument, have rights as enforcers." When it is realized that under the STAR legislation, *there is nothing to stop the settlor from being the initial enforcer*, the appearance that the trustee is simply holding the fund to the order to the settlor is even stronger.

It is suggested, however, that the case of the settlor appointing himself enforcer is problematic for its own reason – he is running the risk that the trust for the beneficiaries will be regarded as a sham - that is, as not having been intended to impose any duty on the trustee other than to do what the settlor tells him to do from time to time. That is a pitfall to be avoided. But is there really a problem with divorcing benefit under a trust and the right of its enforcement where persons are also appointed as beneficiaries? *Must* at least one beneficiary be appointed enforcer if the trust is not to "limp" around the world with only one good leg in Cayman? This writer thinks not – at least if it is correct to say, as has been argued, that a STAR trust established purely as an NCPT poses no public policy problem from an English point of view. If that is indeed correct, what difference can it make that the settlor has also identified persons as beneficiaries?

If the alienation of the beneficial interest is good under an exclusively NCPT such that a STAR trust for such purposes would *not* be regarded as a mere trust for the settlor by an English judge, then the very reason which makes that true – the fact that there is someone (other than the settlor, to be on the safe side) to hold the trustee to account – applies as well to the case where the trust also has beneficiaries as its objects or, indeed, has beneficiaries as its exclusive objects. Therefore, the STAR trust should emerge as not merely a rather clever vehicle but one recognised and enforceable in traditional trust jurisdictions.

Legislative Updates in The Bahamas

The Banks and Trust Companies (Temporary Business Continuity Operations) Regulations, 2009

The Central Bank of The Bahamas ("Central Bank") is responsible for the licensing, regulation and supervision of banks and trust companies operating in and from within The Bahamas pursuant to the provisions of the Banks and Trust Companies Regulations Act, 2000 as amended. The Governor of the Central Bank has the authority to exempt any entity from the licensing requirements for banks and trust companies subject to such terms and conditions as the Governor may deem to be appropriate.

...a "side pocket" fund can be created where illiquid assets from an existing identified Bahamian investment fund can be transferred into a new SMART fund...

The Banks and Trust Companies (Temporary Business Continuity Operations) Regulations, 2009 provide such an exemption to foreign banks and trust companies enabling them to establish operations on a temporary basis in The Bahamas where natural disaster or other serious event in their home country disrupts their business operations. The Regulations set out the proposed conditions applicable to the exemption and the relevant testing and maintenance undertaken by or on behalf of the exempt person or entity for the sole purpose of establishing and/ or verifying the effectiveness of the exempt person/ entity's continuity arrangements.

The Investment Funds (SMART Fund) Rules, 2009

The Investment Funds (SMART Fund) Rules, 2009 (the "Rule") which sets down therein the requirements in respect of a new type of SMART Fund, the SMART Fund Model 006, was *Gazetted* and thus became law on February 13th, 2009. A category of investment fund under the Investment Funds Act, 2003 (the "IFA") a SMART Fund provides an element of flexibility as it enables the Securities Commission of The Bahamas (the "Securities Commission") to prescribe the regulatory and reporting requirements for such a fund.

With the SMART Fund Model 006 (the "Fund"), a "side pocket" fund can be created where illiquid assets from an existing identified Bahamian investment fund can be transferred into a new SMART fund, provided however that no more than 30% of the gross assets of the existing identified Bahamian investment fund are invested in the Fund.

A summary of the pertinent features of the Fund are set out below:

INVESTORS: In order to be an investor in the Fund, such person must be a shareholder of the existing identified fund, the illiquid assets of which were transferred to the Fund, and must be a person who qualifies to invest in a professional fund. Further, at least 75% of the shareholders must approve the establishment of the Fund.

OFFERING MEMORANDUM: A term sheet, which is essentially a short form offering memorandum, is required for the Fund which term sheet is required to contain therein certain prescribed information. A subscription agreement is not mandatory but if the Fund was to have a subscription agreement, it would have to contain therein certain confirmations as prescribed by the Rule.

CONSTITUTIVE DOCUMENTS: The constitutive documents shall provide, inter alia, that only shareholders of the existing identified Bahamian investment fund may become shareholders of the Fund and further that no new subscribers are permitted.

ADMINISTRATOR: An administrator which is licensed as such under the IFA is not required and instead, the operators of the fund can adminster the Fund.

AUDITS: There is no requirement for the Fund to be audited annually and instead, a performance report or management account will have to be filed every six months with the Securities Commission and also provided to each shareholder of record every six months.

Legislative Updates from The Bahamas Continued

Real Property Tax Cap

In December of 2002 amendments to the Real Property Tax Act ("the Act") placed a $35,000.00 maximum annual tax ("the Cap") on all owner occupied homes under the Act. As the introduction of the Cap further strengthened the real property market in the Bahamas, it was praised by many real property professionals and home owners alike.

...many have fought the case for its re-introduction by arguing the impact of its removal on the competitive regional market.

The Cap however was short lived and by June of 2008 the Act was amended again and the provision that introduced the Cap was removed, leaving Real Property Taxes on that part of all owner occupied residences valued over $5,000,000.00 to be assessed at an annual rate of three-quarters (3/4%) of one per centum.

Since the removal of the Cap in June of 2008 many have fought the case for its re-introduction by arguing the impact of its removal on the competitive regional market. It was based on these arguments, made public in most part by the Bahamas Real Estate Association that the announcement of the 2009-2010 Budget Communication, in the House of Assembly was highly anticipated.

So where is the Cap now? The Cap is still missing. It was not stated to be re-introduced or re-implemented in the Act by the Minister of Finance the Rt. Honorable Hubert A. Ingraham, P.M. in his 2009/2010 Budget Communication. It was however, stated in respect to Real Property Tax rates that owner occupied properties will be assessed using the following new rates:-

$1 to $250,000.00 – rate "Exempt"

$250,000.00 to $7,500,000.00 – rate "1%"

$7,500.000.00 and up – rate "1/4%"

The resulting fact being that once the Act is amended to insert these new rates a small percentage of home owners will see a welcome change to their bills from what they had seen over the past twelve months. Whether that amendment to introduce these new rates will be made retroactive to the date of the Budget Communication, May 27th, 2009 remains to be seen.

Partner Honoured as one of Legal's First in Florida

Dr. Earl A. Cash (pictured) was honoured at the Legacy Gala in Orlando, Florida during the annual Florida Bar Convention with over 250 other attorneys at the unveiling of the publication "Florida's First Black Lawyers (1869 – 1979)". This chronicles the successes and challenges they faced while practicing law in Florida.

Dr. Cash noted, "I am gratified to be a part of this distinguished group of Florida attorneys. My years at the University of Miami School of Law and the bonds forged with fellow members of the chapter of the then Black American Law Students Association have had an indelible imprint on my legal career. However far we might have come, we will never be able to forget those challenging beginnings and the invaluable support provided us by such Association and, especially, the late Professor Robert Waters."

Dr. Earl Cash worked in the Appellate Division of the Public Defenders Office in Miami, Florida and in April, 1979 was admitted to the Florida Bar. He was called to the Bahamas Bar in 1982 and spent the 1990s as a temporary Stipendiary and Circuit Magistrate for Night Court in the Bahamas, and served as a member of the Disciplinary Tribunal of the Bahamas Bar and the Ethics Committee of the Bahamas Bar Association. Specializing in Trusts and Estates, he is a member of the Society of Trust and Estate Practitioners (STEP) and an occasional delegate at IBC's Annual International Trust and Tax Planning Conference. He was named a pre-eminent adviser in Euromoney's *Guide to the World's Leading Trusts and Estates Lawyers* (2009).

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H&J Proud Sponsor of 8th Annual Texaco Speech Competition

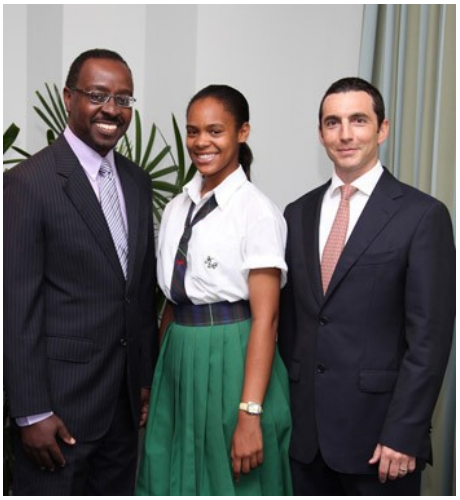
Higgs & Johnson is a proud sponsor of the 8th Annual Texaco Speech Contest and awards a cash prize to the 3rd place winner. The firm has been a sponsor of the competition for the past several years and values the importance of such competitions to the youth of the nation.

Introduced in 2002, The Texaco Safety Speech Contest is considered the premier speech competition in The Bahamas. It is a "by invitation" event which provides a platform for the best young speakers from around The Bahamas to compete for over $20,000 in scholarships and other prizes. The topic is always safety related, and participants are allowed up to seven minutes to share their views. This year's topic was *"Texaco and Road Safety – A Winning Combination".*

The 3rd place winner, Ms. Nicole Cartwright, is an eleventh grader at Kingsway Academy. She is presently studying for the Bahamas General Certificate of Secondary Education (B.G.C.S.E) exams and wishes to pursue a Bachelor's degree in Accounting. Her personal motto is, '*whatsoever thy hand findeth to do, do it with all your might.'*

According to Partner, Mr. Oscar N. Johnson Jr, "Higgs & Johnson remains committed to this program, despite the current economic situation, because it provides support to such outstanding scholars and impacts the community positively. Not only are students allowed an opportunity to showcase their talents whilst educating others on road safety but they are also rewarded with scholarship monies towards a college education which is vital to the success of an individual".

Higgs & Johnson congratulates Ms. Cartwright and wishes her much success on achieving her future goals.



(L-R) Oscar Johnson (Partner), Nicole Cartwright (3rd place winner) and Paul Davis (Attorney)

Tara Archer, Partner (seated 3rd from left) represents H&J at the reception to announce the semi-finalists (standing).

Higgs Johnson Truman Bodden & Co Donates to the Lions Club

(L-R) John Delaney - Global Managing Partner, Higgs & Johnson; Vicki Chatfield - Business Development Executive, Higgs Johnson Truman Bodden & Co; Lion Adrian Neblet - Sight & Diabetes Chairperson and; Chris Narborough - Country Managing Partner, Higgs Johnson Truman Bodden & Co.

Higgs Johnson Truman Bodden & Co gladly donated to the Lions Club of Grand Cayman to mark their annual event 'White Cane Week 2009'. During this week, Lions around the world draw attention to the many challenges caused by vision impairment impacting society today.

Partner, Gina M. Berry, has been a member of the Lions movement for 24 years and is herself a Past President of the Lions Club of Tropical Gardens. She commented, "We certainly value the work of the Lions & Leos in our community. The Lions Club of Grand Cayman is particularly well known for its excellent work in the area of sight screening and conservation. As such, we felt it only fitting to support this worthy cause and make a donation to the Club's 'Annual White Cane Week 2009'. The firm believes, just like the Lions, that it is our duty to positively impact lives in the Cayman Islands".

Higgs Johnson Truman Bodden & Co is committed to embracing its corporate responsibility by supporting the excellent work of the Lions & Leo Clubs of Grand Cayman.

Partners Present at the STEP Caribbean Conference

Heather L. Thompson

Ms. Thompson... elaborated on the trustee's lien over trust property, indemnity and indemnity insurance.

Christel Sands-Feaste

Higgs & Johnson partners Ms. Heather L. Thompson and Mrs. Christel Sands-Feaste gladly accepted the offer by STEP (The Society of Trust & Estate Parishioners) to speak at the 11th Annual Caribbean Conference, held May 4 – 6, 2009, under the theme 'Leading in Turbulent Times'.

Ms. Thompson was one of four expert panelists for the breakout session 'Transfer of Trustees: Lessons from the Experts'. She elaborated on the trustee's lien over trust property, indemnity and indemnity insurance. Ms. Thompson noted, "During my presentation, I focused on the fact that trustees often overlook the existence of the lien and also, on the practical difficulties, expense and delays which may be encountered when chains of indemnities are used."

Mrs. Sands-Feaste presented on 'Trust Contributions: How should these be treated – as loans, investments or otherwise?' She considered the pros and cons of each method and examined the issues that can arise from the various forms of treatment. Ms. Sands-Feaste noted, "It is always a pleasure to speak at the STEP Caribbean Conference. This is undoubtedly one of the largest gatherings of trust professionals from around the world hosted in this region".

Higgs & Johnson saw this as a valuable opportunity to showcase The Bahamas. Ms. Thompson also spoke at the STEP Canada conference this June on Asset Protection Trusts in The Bahamas.

Newest Associate Admitted to the Cayman Islands Bar

Pictured L-R: Raymond Davern (Associate) & Philip Boni (Partner)

Raymond Davern was admitted to practise as an attorney-at-law in the Cayman Islands by the Honourable Justice Quin on the application of Higgs Johnson Truman Bodden & Co.

Philip Boni, Partner stated, "We are thrilled to have Raymond join our Litigation and Corporate Teams. Raymond's superlative academic background and expert knowledge especially his expertise in the law of trusts will be an asset to our firm. All the Partners of Higgs Johnson Truman Bodden & Co join with me in welcoming Raymond to the firm and wish him success in his career with us".

Case Report: Radmacher v Granatino [2009]

Introduction

The case of *Radmacher v Granatino* [2009] EWCA Civ 649 involves the divorce of a wealthy German heiress from her French husband and the question of the enforcement by the Courts of England and Wales of an agreement drafted and signed by the couple in Germany three months prior to their nuptials. Had the couple divorced in Germany or France, there would have been no question as to the validity of the pre-nuptial agreement. However, the couple chose to divorce in the United Kingdom where the validity of such agreements is unclear. The Court of Appeal held that judges exercising their wide discretion to achieve fairness in ancillary relief proceedings were able to place great weight on the terms of any pre-nuptial contract properly negotiated and "not vitiated by any abuse or manifest unfairness".

The result of the Privy Council's ruling was to validate, in certain circumstances, post-nuptial agreements...

This case follows hot on the heals of a landmark Privy Council decision in *Macleod v Macleod* [2009] 1 All ER 851 where an American couple, resident in the Isle of Man, had signed a series of agreements, one on the day of their marriage and several following, that purported to dictate the division of assets should they divorce. As in *Radmacher*, the Court had to grapple with the enforceability of an agreement, freely reached between the parties, contemplating the possible breakdown of their marriage and dictating the subsequent division of assets. Unlike *Radmacher*, the agreement considered in *Macleod* was signed **after** the couple had already been married. Crucially, and in some circles unexpectedly, the Privy Council in *Macleod* upheld the long-held English precedent that while pre-nuptial agreements are one of several factors to be considered by the Court in the event of a divorce, they are not decisive and, indeed, the strict enforcement of such continues to offend public policy. Baroness Hale, handing down the lead judgment, remarked that,

> The Board takes the view that it is not open to them to reverse the long standing rule that ante-nuptial agreements are contrary to public policy and thus not valid or binding in the contractual sense. The Board has been referred to the position in other parts of the common law world. It is clear that they all adopted the rule established in the 19th century cases. It is also clear that most of them have changed that rule, and provided for ante-nuptial agreements to be valid in certain circumstances. But with the exception of the United States of America, including Florida, this has been done by legislation rather than judicial decision.

The result of the Privy Council's ruling was to validate, in certain circumstances, post-nuptial agreements but to explicitly leave the validation of pre-nuptial agreements to the legislature for consideration. It is upon this legal landscape that the Court of Appeal considered the case of *Radmacher v Granatino*.

Background

Ms. Radmacher (the "Wife"), an heiress to a substantial fortune made in the paper industry, met Mr. Granatino (the "Husband"), at the time a successful investment banker, in London in 1997 and married him the following year. Prior to their nuptials the parties agreed and entered into a pre-nuptial contract which, broadly, provided that neither party would obtain an interest in any property brought into the marriage by the other and that in the event of a divorce neither would claim against the property or income of the other. Of this arrangement Wilson LJ remarks that though the agreement is now viewed as benefitting Ms Radmacher, "it may be that in 1998, when the husband seemed to have been launched upon a successful career in the City, it [the agreement] was reasonably seen also to have a *possibly* preclusive effect on claims by the wife against him if certain circumstances eventuated."

The marriage began to break down in or about 2003 when the husband, having become disillusioned with life in the financial sector, embarked on a Doctorate

Case Report: Radmacher v Granatino [2009] Continued

of Philosophy at Oxford. The husband had by this time amassed savings of approximately $500,000 which he was using to pay for his family's needs and his studies. The wife had benefited immensely from her inheritance and had also contributed to the family purse. At the time of the break down of the marriage the couple had two children who continued to reside with the wife. Throughout the marriage the family's standard of living had been extremely comfortable.

The matter was heard at first instance before Baron J who was willing to take the pre-nuptial agreement into consideration as a factor but looked at several other factors in determining how the assets should be divided. Baron J found that, with respect to the agreement,

Any provision that seeks to oust the jurisdiction of the court will always be void but severable.

- The Husband had received no independent legal advice;
- It deprives the Husband of all claims to the '*furthest permissible extent*', even in a situation of want that was manifestly unfair;
- There was no disclosure by the Wife;
- There were no negotiations;
- Two children have been born during the marriage.

Baron J concluded that while the agreement was flawed, the Husband did enter into it willingly and completely understood the repercussions. The learned judge opined that the Husband's decision to enter into the agreement should affect any award. Baron J then found in favour of the husband and awarded him, *inter alia*, a payment of £5,560,000.00.

The Appeal

The wife appealed Baron J's ruling. Thorpe LJ, providing the lead judgment in the Court of Appeal, held that he disagreed with Baroness Hale's view in *Macleod* of current policy towards pre-nuptial agreements. Indeed he states that, "Due respect for adult autonomy suggests that, subject of course to proper safeguards, a carefully fashioned contract should be available as an alternative to the stress, anxieties and expense of a submission to the width of the judicial discretion."

The primary reasons he gives for holding this belief are:-

- Any provision that seeks to oust the jurisdiction of the court will always be void but severable.
- Any contract will be voidable if breaching proper safeguards or vitiated under general principles of the law of contract.
- Any contract would be subject to the review of a judge exercising his duty under s.25 [of the Matrimonial Causes Act 1973] if asserted to be manifestly unfair to one of the contracting parties

He also further offers in support of this belief that,

- In so far as the rule that such contracts are void survives, it seems to me to be increasingly unrealistic. It reflects the laws and morals of earlier generations. It does not sufficiently recognise the rights of autonomous adults to govern their future financial relationship by agreement in an age when marriage is not generally regarded as a sacrament and divorce is a statistical commonplace.
- As a society we should be seeking to reduce and not to maintain rules of law that divide us from the majority of the member states of Europe.
- Europe apart, we are in danger of isolation in the wider common law world if we do not give greater force and effect to ante-nuptial contracts."

As such, Thorpe LJ found that, even though Baron J acknowledged that the husband's signing of the agreement ought to limit the amount of his reward, the learned judge failed to properly exercise her discretion by not actually limiting the defendant's

Case Report: Radmacher v Granatino [2009] Continued

award because of the agreement. The decision of the Court was unanimous. The award was varied with any funds provided to the husband given to him as father and only until the youngest child would achieve a certain age.

For his part, Rix LJ agreed with Thorpe LJ and further held that "the pre-nuptial agreement made by the parties should be given decisive weight…" when the court exercises its wide discretion in such matters.

Since the decisions of UK Courts are highly persuasive in the Bahamas, it is arguable that this case opens the door in this jurisdiction…

Conclusion

Going forward Thorpe LJ suggests that, "… pending the report of the Law Commission, in future cases broadly in line with the present case on the facts, the judge should give due weight to the marital property regime into which the parties freely entered.

This is not to apply foreign law, nor is it to give effect to a contract foreign to English tradition. It is, in my judgment, a legitimate exercise of the very wide discretion that is conferred on the judges to achieve fairness between the parties to the ancillary relief proceedings." The "due weight" that Thorpe LJ suggests be applied is further described by Rix LJ as being "decisive weight".

Since the decisions of UK Courts are highly persuasive in The Bahamas, it is arguable that this case opens the door in this jurisdiction to the recognition of pre-nuptial agreements. However, as this case is likely to be heard before the House of Lords early next year, there may be more to come. Stay tuned! Of course, it is always open to The Bahamas Parliament to legislate the validity of prenuptial agreements.