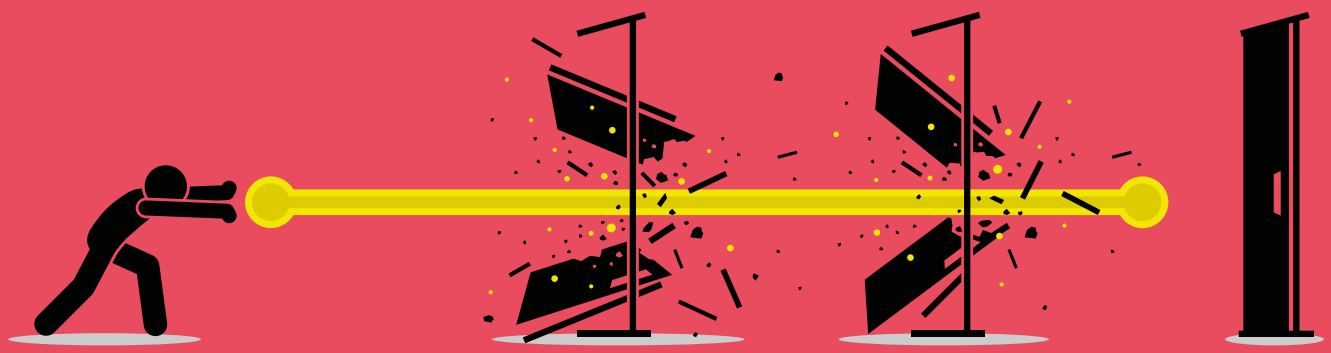
A WORLD OF BARRIERS – THE LATEST ON FIREWALLS IN TRUST LITIGATION



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To misquote the lyrics of the great Edwin Starr – "Firewalls: what are they good for?" It turns out the answer may be much more positive than "Absolutely nothin'".

In recent years a variety of jurisdictions have introduced, tweaked, amended and upgraded their firewall legislation in an effort to promote themselves to potential clients as safe havens where the firewall provisions will act as a comforting harbour against the inclement waves that may batter against the integrity of the trust.

For those unfamiliar with what a firewall might be (in a trust context) it's worth starting with a brief overview of the sorts of challenges that a trust may face in terms of attacks or claims against trust assets. This article does not seek to address specifically the topic of asset protection trusts which are based, generally, upon specific legislative frameworks implemented to meet a particular market demand. Nor do we seek to address the question of fraudulent transfers, the Statute of Elizabeth or insolvency based remedies for creditors.

The biggest risk to some trusts may be commercial pressures arising from within the nature of the business being carried out by companies in the structure giving rise to litigation. For others of a dynastic nature, the settlor may be concerned as to wealth leaking out through spendthrift children or divorce claims from scorned children-in-law. Typical claims may include the following:

- family provision or inheritance claims brought by a spouse, ex-spouse, child or other dependant;
- claims brought based upon community property rules in civil law jurisdictions;
- claims pursued by a trustee in bankruptcy, a receiver or some other insolvency process concerning a settlor or beneficiary's estate; and
- forced heirship claims from the executors or administrators of the estate of a settlor or beneficiary or from apparent heirs themselves.

Many of these claims may trigger considerations of forum, comity, application of international conflict of laws principles and so forth. It will require analysis of the location of the claimant, the assets in question, relevant treaties and international conventions, governing law clauses and so forth. Again, this article does not seek to address any of that in any detail but firewall legislation is an attempt to ensure, in very simple terms, that any claims concerning trust assets are adjudicated under the governing law of that trust.

Taking Guernsey's firewall provisions under the Trusts (Guernsey) Law 2007 (the "Trusts Law") as a good example, section 14 of the Trusts Law states (very comprehensively) as follows:

"Application of Guernsey law to questions of validity.

14. (1) Subject to the terms of the trust, all questions arising in relation to a Guernsey trust or any disposition of property to or upon such a trust, including (without limitation) questions as to –

(a) the capacity of the settlor,

(b) the validity, interpretation or effect of the trust or disposition or any variation or termination thereof,

(c) the administration of the trust, whether it is conducted in Guernsey or elsewhere, including (without limitation) questions as to the functions, appointment and removal of trustees and enforcers,

(d) the existence and extent of any functions in respect of the trust, including (without limitation) powers of variation, revocation and appointment, and the validity of the exercise of any such function,

(e) the distribution of the trust property,

are to be determined according to the law of Guernsey without reference to the law of any other jurisdiction.

For these purposes "the law of Guernsey" does not include the Guernsey rules of private international law, except those set out in this section."

There are then carve outs to respect, for example, the law governing the disposition of an asset into a trust which is not owned by the settlor. Section 3 of the firewall provisions goes on:

Section 4 makes plain that no foreign judgment outside of Guernsey shall be recognised or enforced if it is inconsistent with the Trusts Law or the Royal Court, "for the purposes of protecting the interests of the beneficiaries or in the interests of the proper administration of the trust, so orders".

"(3) No Guernsey trust, and no disposition of property to or upon such a trust, is void, voidable, liable to be set aside, invalid or subject to any implied condition, nor is the capacity of any settlor, trustee, enforcer, trust official or beneficiary to be questioned, nor is any settlor, trustee, enforcer, trust official, beneficiary or third party to be subjected to any obligation or liability or deprived of any right, claim or interest, by reason that –

(a) the laws of any other jurisdiction prohibit or do not recognise the concept of a trust, or

(b) the trust or disposition –

(i) avoids or defeats or potentially avoids or defeats rights, claims, interests, obligations or liabilities conferred or imposed by the law of any other jurisdiction on any person –

(A) by reason of a personal relationship to a settlor or any beneficiary, or

(B) by way of foreign heirship rights, or

(ii) contravenes or potentially contravenes any rule of law, judgment, order or action of any other jurisdiction intended to recognise, protect, enforce or give effect to any such rights, claims, interests, obligations or liabilities."

Guernsey is far from being alone with having enacted firewall provisions – similar sections are found in Bermuda, Cayman and Jersey. It is fair to note that each jurisdiction's firewall has drawn upon, and is heavily influenced by, the others. The essence of each and their intent is, though, broadly the same. For that reason any case law where firewall provisions have been tested or put under the judicial microscope is usually very informative to guide the wary practitioner as to the effect of these firewalls – as we all know, the legislative intent behind these bulwarks may not always survive the siege engines of litigation. There has not been a myriad of cases worldwide on the topic, but a recent judgment from Cayman illustrates, positively, how firewalls may stand up to robust examination.

Geneva Trust Company (GTC) SA v IDF and MF (Grand Court of the Cayman Islands, FSD 248 of 2017, Kawaley J, 21 December 2020)

The Honourable Justice Kawaley, sitting in the Financial Services Division of the Grand Court of the Cayman Islands, described this case in the following way:

"The present application may be described as a tale of two representatives (the Guardian and the Trustee) and two jurisdictions (Italy and the Cayman Islands). Minor roles are played by MF, the 2nd Defendant, and Switzerland. The Guardian acting on behalf of the elderly settlor and beneficiary of the Stingray Trust ("the Trust") seeks to establish the invalidity of the Trust. The Trustee seeks to uphold the validity of the Trust."

After setting the stage in his characteristically colourful manner, Kawaley J addressed the issues of:

(i) whether section 90 of the Cayman Trusts Law (2020 Revision) (now the Trusts Act) (the "Firewall Provision") provides that all questions relating to, inter alia, the validity of a Cayman Islands trust can only be adjudicated by the Cayman Islands courts;

(ii) whether a forum clause in a Cayman Islands law governed trust deed constitutes an exclusive jurisdiction clause; and

(iii) whether, therefore, proceedings brought in the Cayman Islands to determine the validity of the Trust should be permitted to proceed notwithstanding that proceedings in Italy dealing with the same subject matter were well advanced (the "Italian Proceedings").

To complicate matters further, the Trustee had already challenged jurisdiction in the Italian Proceedings; had already submitted to the jurisdiction in the Italian Proceedings; and had already obtained Beddoe relief in the Grand Court permitting it to substantively defend the Italian Proceedings.

It is perhaps unsurprising, given these circumstances, that Kawaley J found that:

(i) the Firewall Provision does not require all matters which must be determined under Cayman Islands law to be determined exclusively by the Grand Court of the Cayman Islands;

(ii) the forum clause was not an exclusive jurisdiction clause;

(iii) Italy was the most appropriate forum; and therefore

(iv) the Cayman proceedings commenced by the Trustee to uphold the validity of the Trust should be stayed in favour of the Italian Proceedings commenced by the Guardian to establish the invalidity of the Trust.

This decision is the first comprehensive analysis of the Firewall Provision in the Cayman Grand Court - earlier decisions had only expressed tentative conclusions on whether section 90 confers exclusive jurisdiction on the Cayman Islands courts in respect of Cayman Islands law governed trusts. After considering the statutory framework, the wording of section 90 itself and a survey of all of the cases that had considered previously the Firewall Provision, Kawaley J concluded that the plain and ordinary meaning of the Firewall Provision is to require certain matters in respect of Cayman Islands trusts to be determined as a matter of Cayman law (therefore either to be determined by the Cayman Islands courts or by a foreign court applying Cayman Islands law). In other words, the Firewall Provision is a governing law provision, not an exclusive jurisdiction provision. This analysis, in our view, is very likely to apply to similar firewall provisions including, for example, those in Guernsey's Trust Law.

Whilst Kawaley J's interpretation of the Firewall Provision is relatively uncontroversial, his Lordship's conclusion that the forum of administration clause is not an exclusive jurisdiction clause is at first blush difficult to reconcile with the Judge's own decision in the same court one year earlier: HSBC International Trustee Limited v Tan Poh Lee & Others FSD 175 of 2019, 16 October 2019 ("HSBC"), in which he held that the same forum of administration clause was an exclusive jurisdiction clause.

The clause in question in both cases was "The courts of the Cayman Islands shall be the forum for administration of this Trust." In circumstances where the wording of the clause could not be prayed in aid of a different outcome, Kawaley J manoeuvred deftly his decision in HSBC by distinguishing the status of the claimant in this case (the putative settlor – so a "stranger" to the trust) from the status of the claimant in HSBC (a beneficiary) and concluding that "the forum for administration clause is not an exclusive jurisdiction clause enforceable against a party suing in the capacity of a stranger to the Trust". It would appear, therefore, that in the Cayman Islands at least, a forum of administration clause of this type will confer exclusive jurisdiction in respect of claims by beneficiaries, but not in respect of claims by "strangers". This may come as a surprise to trustees and settlors who thought that the Cayman Islands offered protection from creditors and other "strangers" who may choose to attack their trust arrangements.

Mr Hagen QC when dealing with the forum non conveniens point submitted that it was "blindingly obvious" that this Court should not assume jurisdiction. He was relying, as I understood it, in large part on the history of the various proceedings and where things now stood. I find that it is plain and obvious that the proposed application by the Trustee for an anti-suit injunction is unarguable, being first actively advanced nearly five years after the validity of the Trust was first challenged in foreign proceedings and over a year after the Trustee submitted to the jurisdiction on the merits of the Milan Proceedings". In short, delay defeats equity.

In what is arguably an excellent illustration of the adage "hard cases make bad law", the real rationale for the Judge's decision in this case is perhaps explained concisely in this paragraph from the judgment:

The deft judicial gymnastics Kawaley J deployed in distinguishing the prior apparently inconsistent case in Tan Poh Lee as to exclusivity may not be required in other jurisdictions, but this case will certainly assist those faced in future with tackling firewalls wheresoever they may have been erected. Future claimants may find they continue to be, with concluding due credit to Mr Starr, "nothin' but a heartbreaker".