BREAKING UP THE BUSINESS

"NO DYNASTY LASTS BEYOND THE LIFESPAN OF THREE GENERATIONS"

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Trustees frequently hold trading businesses settled upon discretionary trusts on the basis that the business should be a "dynastic" asset which benefits future generations of a family in perpetuity. Noble as this intention may be, as generations pass, trustees frequently find themselves interposed between family branches which increasingly diverging views. But if one family branch runs out of patience and wants to break up / restructure the trust and divide the business, where does that leave the trustee?

A ticking clock?

The philosopher Ibn Khaldun said "no dynasty lasts beyond the lifespan of three generations" and trustees might do well to keep this at the back of their minds.

Over progressive generations, the beneficial class of a trust typically expands and is populated by individuals partly or wholly removed from the settlor and/or the operations of the business and with an entirely different outlook. This increases the potential for diverging views amongst beneficiaries and the issue of restructuring or refocussing a trust to reflect the needs of the next generation is often a question of "when" not "if" (with COVID-19 having put succession in sharper focus for many families).

A disgruntled family branch or member is likely to want to achieve economic and legal separation whilst preserving their interest in trophy (income producing) trading assets. However, dynastic businesses may not be readily capable of division. They are often businesses that have survived based upon a combination of reputation, stable culture, long-term financial planning, economies of scale and contribution by key family members.

Where one family branch seeks to divide a dynastic business (to the horror of another family branch) the trustee is not only caught in the middle of a family dispute, it is also likely in the cross-hairs for claims by whichever family branch fails to get their way. How does a trustee proceed whereby they are "damned if they do and damned if they don't"?

This question puts the core duty of a trustee to exercise its discretion and dispositive powers for the benefit of the beneficiaries as a whole in sharp relief. It also requires a trustee to engage with complex commercial issues in connection with the business.

Duty under pressure

In broad terms, a discretionary trust means what it says; discretion is vested in the trustee alone and no one beneficiary, however senior, can dictate to the trustee what to do, nor can any group or even a majority of beneficiaries do so. In this context the trustee has a duty to consider exercising the powers they have in the interests of the beneficiaries as a whole and come to a good faith conclusion on that question. In doing so they must take into account only relevant considerations and reach a decision open to a reasonable body of trustees.

This backdrop, in principle, means a trustee can break up a dynastic business, assuming this decision could be said to be within the scope of a decision made by a reasonable body of trustees.

However, there are tensions that invariably arise from this point that are common across wider trust disputes (e.g. the relevance and weight that should be placed upon a settlor's letter of wishes, to what extent a trustee has or should have consulted with beneficiaries or to what extent a trustee has taken into account relevant considerations). This said, despite these pitfalls, a trustee that adopts a well-planned approach to their decision making at an early stage is more likely to make decisions that are reasonable, rational and defensible.

Decision making for trustees in respect of trading businesses is often necessarily more difficult by the fact that it was often never intended that the trustees would involve themselves directly in the business. Rather, in many cases, businesses are settled into trust with the intention of optimising tax, asset-protection and/or succession planning.

This is particularly relevant for trustees protected by an anti-interference (anti-Bartlett) clause which, broadly, absolves the trustee of a duty to involve themselves in the operations of a business. Notwithstanding a trustee's duty to monitor the business (which merits an entirely separate discussion) for better or for worse many trustees may have relatively limited information.

"Lifting the hood"

Trustees are bound to make proper enquiries and not simply to act on the information to hand. It is likely that a trustee will need to delve into the operations of the business in more detail. As part of a duty to inform themselves, the trustee should seek expert advice as necessary (e.g. valuation, corporate finance, legal or tax advice).

Unlike other more "static" trust assets (e.g. an investment portfolio or property) a trading business is a 'living and breathing' entity. In parallel with investigating the business 'as usual' it may well be relevant to understand how the family / beneficiary dispute itself might impact the business (e.g. could this trigger key persons to leave the business, might it impact reputation/valuation, will it affect recruitment of external talent, will it drain management time?).

The extent to which a trustee discharges its duty of consideration in investigating the business is notably, a decision in itself. A trustee is not expected to continue seeking more information indefinitely and therefore will need to take a proportionate approach.

Adopting a practical / tactical approach

Looking forward, it is likely that a substantive decision to divide a business is a "momentous" one and therefore appropriate for blessing by the court pursuant to a category 2 Public Trustee v Cooper application (another subject that merits a discussion in itself). Whilst a dispute is at an early stage, it is worth a trustee bearing in mind that any such application will necessarily require full and frank disclosure to the court. It may therefore be prudent for a trustee to ensure that its strategy and documentation is progressed with full and frank disclosure in mind.

In parallel, a trustee might consider managing its documents and recording its decisions at an early stage in a way which is mindful of the potential for disclosure orders made against it in the future. Hostile beneficiaries may use ancillary claims to exert pressure upon the trustee to act in a particular way or to force disclosure of documents or reasons for its decisions which the trustee would not otherwise choose to disclose.

On reflection

Whilst there is often no easy answer to trustees facing the break-up of a business, trustees can improve their position by adopting a considered strategy and taking proportionate action at an early stage. In this way their decisions are more likely to be reasonable, rational and defensible. Notably, the court's role is to assess whether or not the decision is one that a reasonable trustee might take rather than a decision it would take.

Stepping back, societal trends provide an interesting backdrop for these potential disputes. Global wealth generated since the Second World War is unprecedented [1] and we are in the midst of the third post-war generation. It the title to this article is right, a number of dynastic businesses and their trustees could be in for a turbulent ride.

1 https://ourworldindata.org/grapher/gdp-per-capita-maddison-2020