

Judicious Encouragement or Judicial Bullying?

1. Judicious Encouragement: The Concept

Where a beneficiary is absolutely entitled to trust property in possession or reversion, his interest is available as property which can be transferred to his spouse or child under the Matrimonial Causes Act 1973 s 24(1)(a). The position is different where there is a discretionary trust and the court is asked to exercise its power to treat trust capital or income as an available ‘resource’ under the Matrimonial Causes Act 1973 s 25(2)(a). This was considered in *Thomas v Thomas*,¹ where Waite LJ said that:

‘the court will not act in direct invasion of the rights of, or usurp the discretion exercisable by [the trustees]. Nor will it put upon [them] undue pressure to act in a way which will enhance the means of the maintaining spouse. [However, there] will be occasions when it becomes permissible for a judge deliberately to frame his orders in a form which affords judicious encouragement to [trustees] to provide the maintaining spouse with the means to comply with the court’s view of the justice of the case.’

Glidewell LJ agreed and added that:²

‘If on the balance of probability the evidence shows that, if trustees exercised their discretion to release more capital or income to a husband, the interests of the trust or of other beneficiaries would not be appreciably damaged, the court can assume that a genuine request for the exercise of such discretion would probably be met by a favourable response. In that situation if the court decides that it would be reasonable for a husband to seek to persuade trustees to release more capital or income to him to enable him to make proper financial provision for his children and his former wife, the court would not in so deciding be putting improper pressure on the trustees.’

The family courts have made many orders designed to provide the trustees of discretionary trusts with ‘judicious encouragement’.³ The making of such orders differs from a finding that the trust is a sham: the court assumes that the trust is valid, but proceeds on the basis that the trustees have the power to distribute assets to the beneficiary and will in fact exercise that power if an order is made against him that he cannot satisfy out of his own resources because it will be in his interests to spare him the financial embarrassment that would otherwise follow.⁴ The case is also different where there is a ‘nuptial settlement’, i.e. where a trust was made in contemplation of, or during the course of, marriage benefiting one or both parties as husband and wife.⁵ In such cases the court can vary the settlement under the Matrimonial Causes Act 1973 s 24(1)(c).⁶

¹ [1995] 2 FLR 668 [3].

² *Ibid* [33].

³ e.g. *Charman v Charman (No 4)* [2007] 1 FLR 1246 [48]; *B v B* [2010] 2 FLR 867 [75]-[76]; *Whaley v Whaley* [2012] 1 FLR 735 [40]; *RK v RK* [2013] 1 FLR 329 [60].

⁴ *Charman v Charman (No 4)* [2007] 1 FLR 1246 [58]; *Kan Lai Kwan v Poon Lok To Otto* (2014) 17 HKCFAR 414 [37]-[41].

⁵ *Prinsep v Prinsep* [1929] P 225; *Brooks v Brooks* [1996] AC 375; *N v N and F Trust* [2006] 1 FLR 856.

⁶ As in e.g. *P v P* [2015] WTLR 1039; discussion in A Mold and J Hilliard, ‘Dealing with Divorce: Claims for Financial Provision Involving Trusts’ (2014) 20 T&T 906.

2. Some Trust Law Basics

The ‘judicial encouragement’ cases have alarmed trusts practitioners who believe that the courts’ practice amounts to the bullying of trustees to exercise their discretionary dispositive powers in favour of individual beneficiaries, endangering some basic trust law principles. In particular, trustees must take the interests of all the beneficiaries into account when exercising their discretionary dispositive powers, and hold an even hand between them;⁷ they must not bind themselves in advance to exercise a discretionary power in a certain way, as they must exercise their judgment according to the circumstances that exist at the time of the power’s exercise;⁸ and they must consciously exercise their judgment when deciding what to do as it is to their discretion, and no one else’s, ‘that the execution of the trust is confided’.⁹

Beneficiaries are of course entitled to communicate with trustees about their capital and income needs, trustees owe a duty to consider such requests reasonably and in good faith, and in practice trustees normally try and help beneficiaries to the extent that the trust terms permit this and it does not unfairly prejudice the position of other beneficiaries. These principles apply whether or not the beneficiary is also the settlor. As stated in *Re Esteem Settlement*:¹⁰

‘one would expect to find that in the majority of trusts, there had not been a refusal by the trustees of a request by a settlor. This would no doubt be because, in the majority of cases, a settlor would be acting reasonably in the interests of himself and his family. This would be particularly so where there was a small close-knit family and where the settlor could be expected to be fully aware of what was in the interests of his family.’

And as Wilson LJ said in *Charman v Charman*:¹¹

‘A trustee ... will usually be acting entirely properly if, after careful consideration of all relevant circumstances, he resolves in good faith to accede to a request by [a settlor-beneficiary] for the exercise of his power of advancement of capital, whether back to the settlor or to any other beneficiary.’

However, if a settlor, beneficiary or any other person directs trustees to exercise a discretion in a certain way and they act unthinkingly in accordance with his instructions without using their independent judgment, their acts can be set aside.¹²

3. Schrödinger’s Cat

The family courts do not accept that these rules are undermined by orders providing ‘judicious encouragement’. They consider that such orders merely respond to the realities of the situation, tested by asking a ‘simple’ factual question, namely whether, ‘if the [beneficiary] were to request [the trustee] to advance the whole (or part) of the

⁷ *Re Lepine* [1892] 1 Ch 210, 219; *Lloyds Bank plc v Duker* [1987] 1 WLR 1324, 1330-1; *Re Mulligan* [1998] 1 NZLR 481.

⁸ *Re Gibson’s ST* [1981] Ch 179, 182-3.

⁹ *Re Beloved Wilkes’ Charity* (1851) 3 Mac & G 440, 448.

¹⁰ [2004] WTLR 1 [166].

¹¹ [2006] 1 WLR 1053 [12].

¹² *Turner v Turner* [1984] Ch 100.

capital of the trust to him, the trustee would be likely to do so'.¹³ If the answer is yes, then the relevant part of the trust assets is a resource available to the beneficiary that should be taken into account when making an order for ancillary relief.

Matters may not always be straightforward, though. Depending on the settlor's motives in creating the trust, the number of other beneficiaries to whose interests the trustees should pay regard, the value of the trust fund, the value of the beneficiary's other assets, etc, the trustees might only be willing to advance some part of the fund – and in that case the court should only treat this part as an available resource.¹⁴ Another factor in any trustee's decision-making would also be the reasons which the beneficiary had for making his request. And here we run into the problem of Schrödinger's Cat. The courts have said that when asking whether the trustees would advance funds to the beneficiary they can posit a hypothetical situation in which the court has made an order against him that he cannot satisfy out of his other resources. So the question is not 'would you advance funds to the beneficiary to support his general spending needs?' but 'would you advance funds to the beneficiary to prevent him becoming bankrupt as a result of the court order?' Thus in *Charman v Charman (No 4)*,¹⁵ counsel argued that the trust funds should not be regarded as a resource available to the divorcing beneficiary because in practice he had not recently drawn on them, possessing sufficient wealth outside the trust to live on. Sir Mark Potter P responded that 'it is in law a perfectly adequate foundation for the aggregation of trust assets with a party's personal assets for the purposes of [s 25(2)(a)] that they should be likely to be advanced to him or her in the event only of "need"' – and this test was satisfied on the facts of the case because the beneficiary would have a 'need' for trust capital 'in order to assist him to discharge his legal obligations [created by the ancillary relief order].'¹⁶

It is problematic for the court to insert itself into an investigation of the trustees' likely actions if the effect of this is to alter the outcome. Cases can easily be imagined in which trustees might consider a beneficiary's imminent bankruptcy to be a more pressing concern than the future spending needs of other beneficiaries, although they would not subordinate these beneficiaries' needs to the beneficiary's wish to buy a new house or take a holiday. In *Thomas v Thomas*,¹⁷ Waite LJ said that the courts should not cross the line between 'judicious encouragement' and 'improper pressure', but as Andrew Mold and Jonathan Hilliard have written:¹⁸

'if the evidence is that the trust assets would not in the ordinary course (without the Court's order) be made available to the divorcing beneficiary in the foreseeable future, then it does seem to amount to improper pressure to engineer that likelihood purely by making an ancillary relief award. In that case, the Court's order would not merely be a trigger or 'encouragement' but rather an attempt to force the trustees to do that which they would not otherwise anticipate doing.'

4. Illustrative Cases

Many cases will not be like this, of course. In many cases, the trustees would be likely to agree to any reasonable request by the beneficiary, and the court's conclusion that

¹³ *Charman v Charman* [2007] 1 WLR 1053 [12].

¹⁴ As in e.g. *X v X* [2016] EWHC 1995 (Fam) [62].

¹⁵ [2007] 1 FLR 1246.

¹⁶ *Ibid* [53].

¹⁷ [1995] 2 FLR 668 [3].

¹⁸ Mold and Hilliard (n 6) 928.

the trust funds are an available resource is then more obviously justified. It is instructive to consider some cases where orders for judicious encouragement have been made.

In *Browne v Browne*,¹⁹ the wife was the principal beneficiary of Jersey and Liechtenstein settlements, and on divorce the husband obtained a lump sum award that the wife could not meet out of her free estate. Butler-Sloss LJ thought it a relevant consideration that:²⁰

‘prior to the divorce ... every application by the wife for funds for herself and for her husband for any of the pursuits that they wished to engage in, pleasure as well as the buying of property, was met and the sums asked for were advanced at the request of the wife.’

Likewise, in *Charman v Charman (No 4)*²¹ the husband was ordered to pay the wife a lump sum award calculated as a percentage of all the marital assets including those of a discretionary trust. Sir Mark Potter P concluded that the trust fund was an ‘available resource’ because the husband was the settlor of the trust and the trust assets were the fruit of his work, and he had written several letters of wishes indicating that he wished to have access to the trust assets; although no distributions had recently been made to him, this was because he had had no immediate need for money and wished to avoid tax liability.²²

In *Whaley v Whaley*,²³ the husband was ordered to pay the wife a lump sum calculated on the basis that the marital assets included property held by the trustees of two trusts established by the husband’s father for his children and remoter issue. The husband was a beneficiary of one trust, and the trustees of the other had a power to add him to the class of beneficiaries subject to the approval of trust protectors. Significant factors identified by Black LJ and Lewison J included:²⁴ the settlor had wanted the husband and his brothers each to have a separate fund over which they exerted power and three earmarked funds had been created within one trust which the settlor had been content for them to deploy as they wished; the trustees of this settlement had been empowered to ‘ignore entirely’ the interests of other beneficiaries if they wished to favour one particular beneficiary; the trustees/protectors had routinely acceded to the husband’s requests on past occasions, showing that they ‘could be expected to comply absolutely’ with his future requests respecting both trusts ‘notwithstanding that in the case of [one] the advancement of capital would require the additional step of the husband first being added as one of the beneficiaries’.

Finally, in *Kan Lai Kwan v Poon Lok To Otto*,²⁵ the husband settled a majority stake in his company on a discretionary trust for himself, his wife and their three children, two of whom died without issue. On the divorce, the entire trust fund was treated as a financial resource available to the husband. Ribeiro PJ identified many facts justifying this conclusion, including:²⁶ the husband had the power to replace the trustee (and the court cursorily rejected the husband’s argument that this should be ignored because the power was fiduciary); a letter of wishes provided that the trustee should

¹⁹ [1989] 1 FLR 291.

²⁰ Ibid 293.

²¹ [2007] 1 FLR 1246.

²² Ibid [47] and [52]. At [55] he also noted that the husband had the power to replace the trustee without deciding the relevance of this, given that the power was fiduciary.

²³ [2012] 1 FLR 735.

²⁴ Ibid [41], [51], [54] and [116].

²⁵ (2014) 17 HKCFAR 414.

²⁶ Ibid [60]-[91].

consult with the husband before exercising powers and in practice the trustee always did so; the trustee made frequent distributions to the husband after the company declared dividends following a decision of the company board controlled by the husband and not by the trustee which played a passive role in the company management; and nothing in the trust deed prevented the trustee appointing the whole or part of the capital or income to a single beneficiary to the exclusion of all the others. The court also rejected the trustee's statement that it would regard one-third of the trust fund as having been earmarked for the couple's surviving daughter.

These examples collectively give a clear picture of the circumstances in which the courts are most likely to find that assets held on discretionary trust are a resource available to a divorcing beneficiary, viz where the trust has been settled by a spouse who is also a beneficiary, whose wishes relating to the trust assets the trustees are bound to consider, and whose requests they invariably grant in practice. This suggests, conversely, that the situation in which the courts are least likely to make such a finding are: where the divorcing beneficiary was not the settlor of the trust, where he has little or no legal or de facto control over the trustees' decision-making, and where there are other beneficiaries in whose favour the trustees have often exercised an independent discretion to distribute funds. Additional factors increasing the likelihood of the court making such a finding include: beneficiaries other than the divorcing beneficiary have pressing needs which the trustees wish to meet; and/or the trust assets are illiquid, e.g. because they are shares in a private company, selling which would damage the interests of other beneficiaries.

Facts of the latter kind were present in *A v A*,²⁷ where the husband's interests under various trusts were held not to be an available resource for the purposes of an ancillary relief order. Munby J identified several reasons for this:²⁸ there was no history of distributions to the husband, who was only one of several family beneficiaries of trusts set up by the husband's father for the benefit of all his descendants; the trust assets were a majority shareholding in a company and it would be inappropriate at the present stage of the company's trading history for the trustees to sell shares with a consequent watering down of their control of the company and deleterious tax consequences; and doing so would adversely affect the husband's son by his first marriage who was also a beneficiary and who had 'a particularly pressing call on the trustees' discretion' because he was also managing director of the company.

Consider, also, *Quan v Bray*,²⁹ where a charitable trust for the protection of tigers in South China was established by the husband and wife, where the trust funds had invariably been applied to that purpose, and where Bodey J concluded that they should not be regarded as a resource available to the husband. Although the husband's father had the power as trust protector to vary the terms of the trust by adding him to the class of beneficiaries, the judge did not accept the wife's argument that this power was likely to be used for the husband's benefit, and concluded that the trust assets were available for the Chinese tiger project only.

5. Helping the Courts with their Enquiries

If trustees are asked a hypothetical question by a court as to how they would exercise their dispositive powers, were a beneficiary to make a request for funds to satisfy an ancillary relief order, and they refuse to answer, this creates a significant risk that the court will conclude in the absence of contrary evidence that the trustees would indeed

²⁷ [2007] 2 FLR 467.

²⁸ Ibid [92]-[100].

²⁹ [2017] EWCA Civ 405.

distribute trust assets to the beneficiary. This occurred in *Charman v Charman (No 4)*.³⁰ Compare *A v A*,³¹ where the trustees were represented and where the court accepted their statement that they would decline the husband's request because they would have wished to protect the interests of the husband's son who was another beneficiary.

In *Re B Trust*,³² Henderson J held in the Cayman Islands Grand Court that it would be improper for trustees to say how they might exercise their discretion following a court order, as that would fetter their discretion and establish an expectation in the minds of the parties that the trustees might not be able to fulfil if circumstances changed in the interim. That was a very purist view of the trustees' duties, but not one likely to appeal to the Family Court, not least because it is open to trustees to caveat their statements. Bodey J made this point in *X v X*, where he said that:³³

'[A] trustee cannot ... now commit himself, nor be expected to do so, as to any particular course of action at any future point in time. ... On the other hand, the proper approach to "resources" ... does require the court to make an assessment of likelihood. ... Obviously the questions addressed to [the trustee are] entirely hypothetical. Obviously everything would depend on all the circumstances at the time of the husband's assumed request ... All that is a given.'

In proceedings for variation of a nuptial trust, or proceedings where an allegation of sham is made, offshore trustees may wish to say nothing to avoid the English court drawing the conclusion that they have submitted to its jurisdiction.³⁴ Whether or not that is a necessary precaution, submission to jurisdiction should not be an issue where the only question is whether an order should be made against a beneficiary that 'encourages' trustees to distribute funds to him. Such an order would be made against the beneficiary alone and could not be executed against the trustees.³⁵

If trustees answer the court's question, and say that they would not grant a beneficiary's request for money, it will obviously depend on all the facts whether the court believes them. Courts are aware that trustees may collude with dominant settlor/beneficiaries to give a false picture of the trust affairs,³⁶ and even where there is no question of that, courts may still make findings on the evidence that are inconsistent with the trustees' view of the situation. Nevertheless, trustees can legitimately say that they would have to consider the request in the light of their duty to act in the interests of all the beneficiaries. And depending on the circumstances, it may be that they could legitimately conclude that certain assets should be made available to the beneficiary and/or that certain assets should not, e.g. because the trustees would wish to preserve these to meet the needs of other beneficiaries and/or because the trust assets are illiquid and realizing them would unfairly damage the interests of other beneficiaries.

As noted already, an answer of this kind was given in *A v A*,³⁷ where Munby J accepted the trustees' statement that they 'would require considerable persuasion before they complied ... with a request which had the effect of significantly undermining

³⁰ [2007] 1 FLR 1246; see too *B v B* [2010] 2 FLR 887 [77]; *BJ v MJ* [2012] 1 FLR 667 [18].

³¹ [2007] 2 FLR 467.

³² (2012) 14 ITEL 557 [42].

³³ [2016] EWHC 1995 (Fam) [62].

³⁴ *BJ v MJ* [2012] 1 FLR 667 [20]-[21], discussing *Mubarak v Mubarak* [2009] 1 FLR 664 [67]; see also M Birt, 'Trusts and Divorce Courts: An Offshore Perspective' (2009) 13 J&G 6.

³⁵ *A v A* [2007] 2 FLR 467 [95].

³⁶ *R v R* [2009] 2 FLR 1083 [64]-[65]; *Whaley v Whaley* [2012] 1 FLR 735 [51] and [117]; *Joy v Joy-Morancho* [2016] 1 FLR 815 [169]-[170].

³⁷ [2007] 2 FLR 467 [97].

[the son's] position.' However a similar answer was rejected in *Kan Lai Kwan v Poon Lok To Otto*,³⁸ where the trustee stated that 'in so far as [the wife] seeks to have 50% of the shares held under the Trust transferred to her, the Trustee has obvious concerns that this will not be in the interests of the beneficial class as a whole' and that if an order applying judicious encouragement were made against the husband, the trustee would be unwilling to distribute one-third of the fund because it would wish to preserve this for the parties' surviving daughter. Hence, the trustee argued, the court should not make an award based on the premise that the whole fund was a resource available to the husband. Ribeiro PJ dismissed this, holding that the trustee was confused about the question it had to answer: it had improperly focused its submissions on the award which the court should make against the husband when it should have been addressing 'the likelihood of its acceding to a hypothetical request by [the husband] to advance to him the whole or part of the capital or income of the trust'.³⁹

This criticism was misplaced. It was legitimate for the trustee to say it would be willing to distribute part of the fund but not to distribute all of it because this would prejudice the daughter's position.⁴⁰ The court may not have believed this statement, given the history of the trust and the trustee's relationship with the husband, and given that in his letter of wishes the husband had said that he only wanted one-third of the trust fund to be reserved to his daughter after his death. However, the trustee was not confused about the question it had to answer, which it correctly understood to be whether it would distribute funds to the husband to help him satisfy an ancillary relief order – as Sir Mark Potter P had held in *Charman v Charman (No 4)*.⁴¹

Nor did the trustees act improperly in stating their position, as was confirmed in subsequent litigation in Jersey, brought by the wife after the trustee had decided to distribute sufficient funds to the husband to enable him to comply with the ancillary relief order and to exclude the wife as a beneficiary thereafter. These decisions were confirmed in *Representation of Otto Poon Trust*,⁴² where the Bailiff, Sir Michael Birt, reviewed the trustee's conduct in having argued in the divorce proceedings that only two-thirds of the fund should be treated as a resource available to the husband.⁴³

'This Court specifically gave permission to the trustee to participate in the divorce proceeding in order that it could put forward all arguments which could be put in favour of the beneficiaries of the Trust (other than the husband and the wife) in order to safeguard the interests of those beneficiaries ... It is entirely consistent with that duty that the trustee should be putting forward arguments which emphasised the interests of [the daughter] as the other beneficiary and which therefore suggested that not all of the trust assets should be regarded as a resource available to the husband. Speaking more generally, we expect that in many cases where a trustee intervenes in divorce proceedings in order to protect the interests of beneficiaries other than a husband and a wife, the trustee's arguments will end up being in practice more supportive of whichever spouse is seeking to argue that the trust assets are not a resource available to one or other of the parties. Such an approach does not suggest that a trustee is behaving in an incorrect or unduly partisan approach; on the contrary it suggests that a

³⁸ (2014) 17 HKCFAR 414.

³⁹ Ibid [52]-[56].

⁴⁰ See n 14 and text.

⁴¹ [2007] 1 FLR 1246 [53].

⁴² [2014] JRC 254A, affirmed [2015] JCA 109.

⁴³ [2014] JRC 254A [36]-[37].

trustee is doing what it should do, namely highlighting the interests of the beneficiaries other than the spouses.’

6. Toughing It Out?

If an order for ancillary relief is made against a beneficiary who cannot afford to pay without resort to the trust, and who therefore asks for a distribution, the trustees may legitimately take the beneficiary’s circumstances into account when deciding whether to accede to his request. There is longstanding authority for the rule that trustees may advance capital to enable a beneficiary to pay off a creditor.⁴⁴ Moreover, if the trustees believe in good faith that the payment is in the beneficiary’s best interests, the exercise of their power to distribute funds to the beneficiary will not constitute a fraud on the power, although they know that the funds will end up in the hands of another person who is not a beneficiary.⁴⁵

The position of the trustees can be contrasted with the position of a wealthy family member who has made gifts of property to a divorcing spouse in the past and who has the resources to make further gifts in the future. If he chooses not to do so, even if his choice appears unreasonable, then that is his prerogative; but the trustees must give reasonable consideration to requests for funds from their beneficiaries.⁴⁶ It was said in *Whaley v Whaley*⁴⁷ that the need to rescue the beneficiary from the bad consequences of non-compliance with an ancillary relief order would commonly be ‘decisive’ for trustees. In all cases, however, the trustees must weigh up the size and nature of the trust fund and the interests of all the beneficiaries when deciding what to do, and it is not impossible that in light of this review they might conclude that they will not grant the beneficiary’s request, e.g. because there are in fact insufficient funds available (contrary to the court’s expectations) and/or because this would unfairly prejudice the other beneficiaries.⁴⁸

Whether trustees will reach that conclusion in many situations may be doubted, however, given that their choice will often lie between the immediate imperative of rescuing the requesting beneficiary from bankruptcy and the future financial benefit of other beneficiaries. And this is the reason why many trusts lawyers view the family courts’ development of this jurisdiction as judicial bullying.

⁴⁴ *Lowther v Bentinck* (1874) LR 19 Eq 166.

⁴⁵ *Re Turner’s Settled Estates* (1884) 28 Ch D 205; *Kain v Hutton* [2007] NZCA 199 [108]-[113].

⁴⁶ *TL v ML* [2006] 1 FLR 1263 [88].

⁴⁷ [2012] 1 FLR 735 [41].

⁴⁸ *A v A* [2007] 2 FLR 467 [97]; *Re the A and B Trusts* [2007] JRC 138.