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# EQUITABLE COMPENSATION

A perspective gained from the Cayman Islands' case of

***AB Jnr and Madame B v MB and Four others : 2013 (1) CILR* 1.**

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**PRESENTED BY**
**THE HON. ANTHONY SMELLIE**
**CHIEF JUSTICE OF THE CAYMAN ISLANDS**

# Equitable Compensation:

A perspective gained from the Cayman Islands' case of

***AB Jnr and Madame B v MB and Four others : 2013 (1) CILR* 1.**

Could beneficiaries who had received a large distribution of capital in settlement of their interests upon their exit from the trust, who were not seeking to rescind the settlement being no longer able to make restitution in integrum to the trust, nonetheless claim equitable compensation for breach by the trustees of their fiduciary duty of full and frank disclosure in the course of negotiating with them for their exit from the trust?

This question was posed as a problem for the court on the basis of a proposition, which turned out to be quite wrong, that equitable compensation for a breach by the trustees of the fair dealing rule in the course of a transaction with their beneficiaries, would only be available where the beneficiaries could rescind the transaction and restore to the trust the assets which had been transferred out of the trust for their benefit.

A leading textbook states that equity recognizes two different types of compensation claim against trustees, classifying them as "substitutive performance claims" and "reparation claims"[1]

The first class involves claims for a money payment as a substitute where a trustee fails in the performance of his obligations to deliver up trust assets *in specie*. Claims of this sort are "apposite when trust property has been lost or misapplied in an unauthorised transaction, and amount claimed is the objective value of the property which the trustee should have been able to produce when called upon to do so"[2]

[1] See Underhill and Hayton 18TH Ed, Chap.22, p1118 ( adopting Dr Steven Elliott's terminology in "Compensation Claims against Trustees'" (Oxford DPhil thesis, 2002).
[2] Op cit, ibid.

The second class, reparation claims, are described as claims for a money payment to make good the damage caused by a breach of trust, and the amount claimed is measured by reference to the actual loss sustained by the beneficiaries[3].

Having been invited to address you on the subject of equitable compensation, I assumed that your conveners could only have had in mind that I might be able to offer you some worthwhile insight from perspectives gained from the point of view of the Cayman bench.

And so, on that rather modest basis, I have selected a particular case, one that came within the classification of a reparation claim, for my brief talk with you this morning.

The case arose out of a protracted and acrimonious dispute which had for many years embroiled the family of the settlor, a wealthy Saudi Arabian businessman.

The trust was settled as a Cayman Islands trust by the settlor in 1985. It comprised the bulk of his wealth and included, among other things, large shareholdings in well-known sports car and watch making companies, as well as a very valuable art collection.

Shortly after the settlor's death in 1991, his widow Madame B, on behalf of herself and her minor son AB Jnr, the last child of the settlor, challenged the validity of the trust, claiming that its assets belonged to the settlor's estate and so were governed by the laws of France and Switzerland; the jurisdictions respectively where the settlor had been domiciled and head-quartered his business empire.

Her challenge to the validity of the trust gave rise to concerns whether Madame B had forfeited her interests under the trust by operation of the

[3] Op cit, ibid.

“no-contest” clause of the Trust Deed. These concerns, although alerted by the trustees, did not deter her challenge.

A lady of Syrian extraction, Madame B arranged to have herself accredited as a Syrian Diplomat to France and, among other steps taken against the trust, asserted diplomatic immunity in respect of the trust property in Paris where she had lived with the settlor and AB Jnr.

A consequence was that the very valuable art collection belonging to the trust and housed in the Paris property, became inaccessible to the trustees, along with the property itself and the rest of its contents, including important records of the trust companies.

In furtherance of her claim under the settlor’s estate, Madame B also applied to the courts in Paris and Geneva (where the headquarters building was located ) for orders compelling unlimited disclosure of the trust companies’ records.

This move compelled the trustees to apply to the Cayman court for protective orders which were granted and were eventually recognized and enforced by the French and Swiss courts.

The hostile claims against the trust assets persisted nonetheless and so acrimonious and intractable had the dispute become, that a desire to have their interests bought out of the trust - expressed on behalf of herself and AB Jnr - was accepted by the trustees as being not only in their best interests, but also as being in the best interests of all other beneficiaries.

Negotiations commenced between the trustees on the one hand and Madame B and AB Jnr’s court-appointed Guardian on the other.

Lawyers and expert valuers were engaged on both sides to advise on the terms of the exit from the trust and on the values to be ascribed to the

assets of the trust for the purposes of the exit settlement. The Cayman court directed that full disclosure of information should be provided by the trustees who were also charged with the responsibility of procuring an "appropriate valuation" for arriving at the "indicative fair value" (market value) of the assets.

As the trust had an expiry period of 80 years and so remoter beneficiaries could come to benefit under it, the trustees determined that the assets to be appointed out for the benefit of Madame B and AB Jnr, should not simply be given over to them but that a new settlement should be created to preserve the expectations of benefit for their descendants. It was agreed that this new trust would be established in Guernsey.

The valuers proceeded with their work and global values for the trust assets were arrived at. The value assessed by the valuers for Madame B and AB Jnr came in at around USD 1.1 billion – some USD 200 million more than the value assessed by the trustees' valuers.

The global values of course included, in particular, the values for the sports car company and the art collection. Citing her sentimental attachment to it, Madame B insisted on having the entire art collection appointed out to the Guernsey trust.

After extensive negotiations, an agreement was reached with the trustees ascribing a global value for the trust assets which reflected the higher values assessed by Madame B's valuers.

An unusual feature of this otherwise fully discretionary family trust, was that beneficial entitlements were specified in terms of fixed percentage shares of the trust assets. Between them, Madame B and AB Jnr had 18.93% (6.38% /12.55%) of the shares and so, after the application by the trustees of what they deemed a "liquidity discount", a value of USD

173 million was ascribed for the appointment out of their shares to the Guernsey Trust, including the sum of USD 92 million ascribed to the value of the art collection.

The approval of the exit settlement by the Cayman court was required on behalf of AB Jnr and all other minor or future unborn beneficiaries and this was given at a hearing on 23 June 1999. In granting its approval, the court accepted the appropriateness of the liquidity discount on the basis that those beneficiaries remaining in the trust would be left with assets which would be much less liquid after the appointment out of USD173 million to the Guernsey trust.

However, undisclosed to the court and to Madame B and AB Jnr's Guardian, was the fact that contemporaneously with the exit negotiations and those court proceedings, the trustees had been engaged in negotiations with a leading car making company (anonymized as "MV") for the sale to it of 40% of the sports car company – a transaction which, on any view, was likely to increase the overall value and liquidity of the trust assets.

This decision not to disclose the imminent MV sale, the trustees came to admit, was quite deliberate. Their position taken after advice from eminent Queen's Counsel, was that disclosure to Madame B, given her history of hostility and challenge to the validity of the trust, would allow her to hold the trust to ransom over the MV sale and potentially even jeopardize that transaction.

Moreover, as in adopting the higher valuation of the assets presented by her valuers, they had satisfied themselves that any increased value to the trust assets to be gained from the MV transaction, would not exceed the difference of USD200 million between the valuations and which they had granted as an uplift from their valuation, to set the values for the

purposes of the exit settlement. Thus, they claimed to have ensured that Madame B and AB Jnr were fairly treated in the global values ascribed to the assets for the purposes of their exit from the trust.

Accordingly, even if there had been a technical breach of their trustees' duty of disclosure, no loss to Madame B or AB Jnr had been caused by the non-disclosure of the MV transaction and so no compensation was payable.

Still moreover, said the trustees – and most to the point of my discussion of this case now – no equitable compensation could be awarded because no sooner had Madame B been able to do so, than she had arranged for the Guernsey trust to sell the art collection in order to realize its ascribed value. She was therefore not to be allowed to rescind the exit settlement, not being able to provide restitution in integrum to the trust. They argued that as equitable compensation is available only "in lieu of recission", there could be no claim.

For that proposition the trustees relied on what was found to be a misunderstanding of dictum of Vice Chancellor Megarry from the famous case of ***Tito v Wadell***[4], to which I must return.

It was clear that the breach of trust claim against the trustees had two distinct aspects. First, the breach of their duty of fidelity owed to Madame B and AB Jnr, their beneficiaries, in failing to disclose the MV transaction which was highly relevant to the value to be ascribed to the assets for the purposes of the exit settlement. Second, the breach of the trustees' own duty to obtain an "appropriate valuation", both as they were otherwise obliged to do and as ordered by the Cayman court.

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[4] Tito v Wadell (No. 2) [1977] Ch. 106

Taken together, these allegations amounted to a claim against the trustees for breach of the fair dealing rule[5], in the context of their dealings with their beneficiaries.

Although two of the three trustees were themselves at all material times also beneficiaries of the trust, there was no allegation of a breach by them of the self-dealing rule. The plaintiffs acknowledged that the position of conflict of interests in which they found themselves was one brought about by the wishes of the settlor in appointing them both as trustees and as beneficiaries and by the terms of the trust itself under which they had been appointed. Such a situation will provide an exception to the otherwise strict rule that a fiduciary may not benefit from his dealings with the person to whom he owes fiduciary duties, having acted in breach of those duties.[6]

Nonetheless, the trustees were found to have acted in breach of the strictures of the fair-dealing rule – that which required them not to enter into a transaction with a beneficiary without making full disclosure and ensuring that the transaction with the beneficiary is fair and honest, taking no advantage of the beneficiary[7].

In so deciding, I rejected the trustees' defence of "reliance on legal advice", in respect of which they had cited and sought to rely upon a provision of the trust deed which they said allow them to act in breach of duty owed to beneficiaries where they acted upon legal advice.

It was however, shown and accepted that they had indeed relied upon legal advice, albeit only confirmatory of their own earlier decision to not disclose the MV transaction in the context of the exit negotiations. For

[5] Citing Lewin on Trusts 18th Ed para 20-135, *Tito v Wadell* (above) and In *Re Thompson's Settlement [1986] Ch 99*
[6] The court accepted this proposition, applying *In Re Z Trust 2009 CILR 593* and *Boardman v Phipps [1967] 2 A.C. 46*
[7] Citing again *Tito v Wadell (No 2)* above and *In Re Thompson's Settlement [1986] Ch. 99*

this reason, while there was willful default on the part of the trustees, the breach was found to be a non-fraudulent breach of fiduciary duty.

Nonetheless as a claim for loss can arise from a non-fraudulent breach, it was found to be open to AB Jnr, although not to Madame B, to claim equitable compensation.

This difference of treatment between Madame B and her son came about in the light of further evidence. This revealed that during the course of the exit settlement and before she sold the art collection, she had become aware of the MV transaction. She had received sufficient information about the MV transaction to have allowed her to act but had chosen not to act to rescind the settlement, instead acquiescing in the breach of duty by the trustees by accepting the settlement, alienating the bulk of the art collection (for more than USD 82 million at the time) and so allowing the trustees to act on the basis of the settlement, not only to her detriment as she claimed, but also to the detriment of the trust as a whole. Having waited several years after the settlement in June 1999 before bringing her claim, she was also found to have been estopped and barred by the equitable doctrine of laches, in the sense both of prejudice and delay[8].

No such defences were, however, available to the trustees against AB Jnr's claim. His mother's knowledge, acquiescence and prejudicial delay could not have been attributed either to him or his Guardian ad litem.

Equitable compensation- availability as a remedy

As already mentioned, the jurisdictional objection to equitable compensation as a remedy in the absence of the right to rescind the exit settlement, was rejected as based upon a misunderstanding of Vice

[8] Citing, among other case authorities : P&O Nedlloyd B.V. v Arab Metals Co.[2007] 1 W.L.R. 2288 and Holder v Holder[1968] 1 Ch 353.

Chancellor Megarry's dictum from *Tito v Wadell*[9] where he had stated (by reference to the earlier House of Lords decision in *Nocton v Ashburton*[10]) that:

> *"…in a proper case a claim in compensation in equity (as distinct from damages at common law) lies in lieu of setting aside a transaction.…"*

In *Tito v Wadell*, Megarry VC had in fact found that there was a breach of fiduciary duty on the part of the Crown and that equitable compensation would have been payable to the Banabans of Ocean Islands but for his further finding that such a claim would have been barred in laches, in the final analysis. In so concluding, he followed *Nocton v Ashburton* as settled authority for the proposition that a claim for equitable compensation for loss arising from a breach of fiduciary duty is maintainable as being separate and apart from any other claim- such as for damages or rescission – arising in respect of the transaction to which the breach of duty relates.

The modern case law, since *Nocton v Ashburton*, has provided many examples, a number of which are cited in the judgment[11] and such that there really should have been no debate. As Snell's Equity clearly states the principle[12]:

> *"The circumstances conferring a right to rescind may also give rise to a right to claim damages or equitable compensation. In such cases the right to rescind is independent of, and cumulative with, the right to reparative*

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[9] Op cit, above, at 249.
[10] Above.
[11] London Loans & Savings Co. v Brickenden [1934] 3 DLR 465(on appeal to the Privy Council from the Supreme Court of Canada); Target Holdings Ltd. V Redferns [1996] 1 AC 421 H.L.; Rama v Miller [1996] CLC 186; Swindle v Harrison [1997] 4 All E.R. 705; Longstaff v Birtles [2002]1 W.L.R 470 AND Hurstanger Ltd v. Wilson [2007] 1 W.L.R. 2351.
[12] 32dn Ed., para 20-031.

*relief. The claimant may claim rescission or damages or both...".*

It seems that counsel for the trustees had misunderstood the distinction (as clearly set out above from Underhill and Hayton) between a substitutive performance claim and a reparation claim - as a basis for claiming loss arising from a breach of fiduciary duty.

For this they can readily be forgiven, judging from the confusion over the subject identified and sought to be clarified by the leading commentators, as arising from various Commonwealth decisions, including, most eminently that of the House of Lords itself in *Target Holdings v Redferns* (above)[13].

AB Jnr's claim was in no sense one for rescission of the exit settlement and for restitution of his shares to the trust or for an account for misapplication of his shares. Such a claim could, perhaps, have been met by a response that he had benefitted from the exit settlement and could no longer rescind it. Rather, his claim was a more straightforward claim for reparative relief arising from the willful default of his trustees in their breach of the fair dealing rule in the context of the negotiations for his exit from the trust.

Where, as here, the claim was in actuality a reparation claim for money to make good the damage caused by the breach of trust, the same eminent text book writers and commentators explain that questions of causation, like those applicable to common law tort or breach of contract claims, will arise[14].

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[13] See , for instance: "Equity's Place in the Law of Commerce", by Lord Millett, (1998)114 LQR 214 ; Equitable Compensation for Breach of Fiduciary Duty, Prof. Charles Mitchell Current legal Problems (2013) pp1-33.

[14] See, again FNs 1 and 13 above and "Stewardship of Property and Liability to Account" Prof Charles Mitchell, Lecture to the Chancery Bar Ass. Annual Conference 17th January 2014, citing, inter alia Hall v Libertarian Investments Ltd, per lord Millett NPJ sitting in the Hong Kong Final court of Appeal in 2013.

And so, in AB Jnr's case, the question – as implicitly recognized in the judgment - then became one of causation: did the breach result in loss and if so, how was the loss to be identified and compensated?

**The basis for assessing compensation**

The right in AB Jnr to claim equitable compensation for breach of the fair-dealing rule having been established, the question then became on what basis was it to be assessed?

Counsel on behalf of himself and his mother pressed strongly for what they described as the "alternative transaction basis", a hypothetical scenario in which the trustees would have disclosed the MV transaction before concluding the exit settlement, the settlement would then have been postponed for some 6 months to allow the MV transaction to be completed and then the values to be attached to the plaintiff's shares for their exit from the trust would have been increased along with the overall value of the trust fund because of the impact of the MV transaction.

That argument was rejected in favour of a finding that, had the trustees fulfilled their duty of fidelity; proper and timely disclosure of the MV transaction would have been made so as to allow for the appropriate valuation as directed by the court and the exit settlement would have proceeded in the time frame that it did but on the basis of a full and fair assessment of the value of the plaintiffs' shares. In other words "but for" the breach of duty by the trustees, the exit settlement itself would have provided the full amount of what was due to AB Jnr. This was described as the "actual transaction basis" for assessing compensation.

After analysis of the competing expert evidence as to the impact of the MV transaction upon the overall value of the trust fund, among other

matters, the sum of USD7.56 million was arrived at, thereby increasing the value ascribed to the exit settlement from USD173.34 to USD180.90 million.

Although Madame B was estopped from claiming equitable compensation due to her acquiescence in the trustees' breach, had she not acquiesced but challenged and succeeded in setting aside the exit settlement, a counter-claim brought by the other beneficiaries that she had forfeited her shares by operation of the no – contest provisions of the trust, would have been a live issue confronting her.

It was plain, as was also found in the judgment, that her many and persistent challenges to the trust, including as to its very validity, would have operated to forfeit her shares.

That finding perhaps reflected her decision not to have acted to set aside the exit settlement as soon as she had acknowledgement of the MV transaction. Setting aside the exit settlement would not only have revived her interest as a beneficiary of the trust but also the question of whether she had forfeited that interest.

But perhaps the most salutary lesson to have been learnt from the dispute – given its acrimony, length and complexity[15] – was that costs, amounting to more even than the sum of his equitable compensation, were also awarded to AB Jnr.

Hon Anthony Smellie
Chief Justice
The Cayman Islands

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[15] The trial itself ran for nearly three months.