Problems In Attaining Binding Determinations Of Trust Issues By Alternative Dispute Resolution

By David Hayton∗

Introduction: 'Trust Issues'

In dealing with trust issues this paper is not concerned with external disputes that do not involve the beneficiaries but only involve the trustees' rights or liabilities in respect of third parties that arise from the trustees' conduct as trustees e.g. in matters of contract or tort law. This paper is concerned with disputes that involve the beneficiaries, whether such disputes concern the internal trustee-beneficiary relationship or the claims of third parties to impeach the trust (e.g. because designed to defraud the settlor's creditors or divorcing spouse or claimants under legislation like the Inheritance (Provision for Family & Dependants) Act 1975 or because the property of third parties can be traced into the hands of trustees).

In the case of external disputes not involving the beneficiaries the trustees as persons of full capacity have statutory powers to submit to arbitration or otherwise settle (e.g. pursuant to mediation) any claim relating to the trust fund, while express powers to enter into types of contract which, in accordance with industry practice, contain arbitration provisions will confer necessarily implied powers to agree to such provisions as part of the necessary price of the contract.

Where a dispute does involve the beneficiaries it may be that all possible beneficiaries are ascertained and of full capacity so that they can all enter into a contract for arbitration or a contract of compromise (whether arising from arbitration or mediation) so as conclusively to determine all the relevant trust issues. However, beneficiaries are normally not all ascertained and of full capacity, while one beneficiary of full capacity can stand out against any recourse to arbitration (or to any compromise) and insist on a full court hearing unless, exceptionally, he had earlier contracted with fellow beneficiaries of full capacity to have recourse to arbitration or a provision in the trust instrument imposed recourse to arbitration as a condition or burden attached to the benefits passing to the beneficiaries.

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1 Insolvency Act 1986 ss. 339-342, 423-425
2 Matrimonial Causes Act 1973 s.37
3 Section 10
4 Trustee Act 1925 s.15
5 In most USA states a material purpose of the settlor cannot be defeated even by all the beneficiaries unlike the English position: Stephenson v Barclays Bank [1975] 1 WLR 882. Underhill & Hayton, Law of Trusts & Trustees (15th ed) Art. 72
6 See under final heading infra "How to further facilitate arbitration".
ADR: Arbitration and Mediation

Arbitration is a much more formal process than mediation and is regulated by statute which allows the court some limited supervisory or supporting jurisdiction. The arbitrator’s written decision is final and binding (subject to a limited appeal to the court on a question of law, unless excluded by agreement of the parties) and amounts to an ‘arbitration award’ capable of extensive enforcement e.g. under the New York Convention on the Recognition & Enforcement of Foreign Arbitral Awards. However, it is considered that a settlor’s trust instrument cannot normally amount to an ‘arbitration agreement’ capable of leading to an ‘arbitration award’ enforceable internationally, while any domestic legislation purporting to treat a relevant provision in a trust instrument as an ‘arbitration agreement’ leading to an ‘award’ would not have international effect.

Arbitration requires a hearing where each party can produce legally admissible evidence and deal with all alternative arguments that have been raised and can comment on matters where the arbitrator is to rely on his expertise in reaching his decision in judge-like fashion.

In contrast, a mediator is an honest broker trying to facilitate a negotiated settlement whether (i) before proceedings have commenced but the issues and parties are well known or (ii) after service of a statement of case (formerly ‘of claim’) so the issues are clearly defined for the parties to know where they stand or (iii) at any later stage in the lead up to trial. Mediation negotiations are ‘without prejudice’ and confidential, while the mediator can receive information not to be divulged to the other side without consent. Thus, parties do not need to take up bargaining positions far apart from each other: the mediator can ascertain their true lowest figures and ensure that vastly different figures are not put forward as settlement proposals that could well drive the other party to court, believing a settlement to be out of the question. Most mediation agreements allow the mediator to stop the mediation if of the view that a party has no true interest in reaching a settlement or is abusing the mediation process to obtain a sneak preview of the other party’s position or is deliberately misleading the other party or otherwise acting so as to prevent the mediator acting impartially.

Problems with Incapacitated & Unascertained Beneficiaries

In order for the interests of incapacitated or unascertained beneficiaries to be affected by any dispute resolution process they need to be duly represented. However, unascertained (e.g. unborn) beneficiaries cannot be represented by a representative until legal proceedings have commenced and the court has appointed a ‘representative’ for that class of person. Crucially, the

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7 See under final heading infra "How to further facilitate arbitration".
8 Civil Procedure Rules 1998 Sch 1 RSC Ord 15 r.13
representative cannot agree to a binding settlement without the court approving it as 'for the benefit of the absent persons.'

Children and mental patients must have a 'litigation friend' to conduct proceedings whether as claimant or defendant: until there is a litigation friend no party may take any step in the proceedings except for a competent claimant issuing and serving a claim form. A person may become a litigation friend by filing a certificate of suitability that he can fairly and competently conduct proceedings on behalf of the child or patient, and has no interest adverse to that of the child or patient, and, where the child or patient is a claimant, undertakes to pay any costs ordered to be paid in relation to the proceedings. The court has power to replace such litigation friend, while it also has power in the first place to appoint a litigation friend on the application of a person seeking such appointment or of a claimant. Crucially, no settlement of a claim can be valid without the approval of the court. It is envisaged that in some cases agreement may be reached for settlement of a claim before proceedings are begun (and so before there is any litigation friend). In such a case where the sole purpose of proceedings on that claim is to obtain the court's approval to a settlement a simplified originating summons style procedure under rule 8 of the Civil Procedure Rules must be used rather than the normal rule 7 procedure via a claim form and defence.

It seems that the court can authorise a representative or litigation friend to enter into an arbitration agreement with the other parties to resolve legal proceedings so as to take advantage of the Arbitration Act but that, otherwise, the representative or litigation friend cannot do so. Of course, any compromise of the arbitration will need to be approved by the court.

Mitigating Litigation Problems

The English approach is to try to save ultimately heavy costs by the use of pre-action Protocols designed to narrow issues and to lead to compromises before legal proceedings are commenced. A Trust Law Committee Working Party has just finished a draft Protocol for trust issues designed to encourage the use of mediation at any stage but particularly at an early stage if possible. The idea is that a representative or litigation friend could be appointed by the court before legal proceedings are commenced so as to have proper status from the outset in trying to influence a compromise. Such person could then also consent on behalf of the incapacitated or unascertained beneficiary to the mediator approaching the Inland Revenue where its view will have a bearing on the proposed mediated compromise, tax matters often having a bearing on settlement of trust disputes.

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9 Ibid r.13(4)
10 Civil Procedure Rule 21
11 Rule 21.10
12 Rule 21.10(2)
13 RSC Ord 15r.13(3)
14 CPR 21.10(1)
15 CPR 21.10(1) and (2)
Provision will need to be made for how the costs of the mediation are to be dealt with so as not to deter persons from acting as representative or litigation friend.

The Working Party considers that mediated compromises should still require the court's approval (i) to protect incapacitated and unascertained beneficiaries from any lack of skill and experience on the part of their advisers which might lead to an inadequate settlement for such beneficiaries (ii) to ensure that lawyers receive only their proper costs and fees (neither overcharging nor recommending an unfavourable settlement influenced by an attractive costs offer) and (iii) to enable the other parties to obtain a valid discharge from the beneficiaries' claims.

Costs would be saved, of course, if the court did not have to be put fully in the picture in order to approve a compromise because the representative or litigation friend had full power to enter into a compromise and give a valid discharge from their beneficiaries' claims to the other parties. However, the price so to oust the jurisdiction of the court would need to be a requirement for the representative or litigation friend to have sufficient skill and experience to ensure that their beneficiaries obtain an adequate compromise and that the lawyers involved received only their proper costs and fees. Just as a court approval would not bind the beneficiaries if obtained by fraud or non-disclosure of material facts so would be the position for approval given by a representative or litigation friend. The requirement could be 15 years practice in the trust field as a solicitor or barrister.

Avoiding Recourse to the Court

Can one not avoid having the court appoint a representative or litigation friend so as to authorise recourse to arbitration or to approve a compromise? What if the settlor's trust deed provides a mechanism for the appointment of a 'virtual representative' or 'virtual representatives' to make decisions that bind the incapacitated or unascertained beneficiaries that they represent, whether a decision to agree to arbitration or a decision to agree a compromise?

A good case can be made\textsuperscript{17} that arbitration does not amount to court proceedings, so that the settlor would not be ousting the jurisdiction of the court\textsuperscript{18} relating to representatives and litigation friends where matters are resolved by an arbitrator after hearing virtual representatives or their lawyers but before legal proceedings had been commenced by service of a statement of case. The involvement of the virtual representatives should satisfy the requirements of natural justice and due process so the court should leave well alone. However, a compromise agreed to by virtual representatives whether pre- or post-legal proceedings\textsuperscript{19}, would oust the need for there to be representatives,

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\textsuperscript{16} RSC Ord 15r.13(4)
\textsuperscript{17} See L.Cohen & M Staff, 'The Arbitration of Trust Disputes' (1999) 4 J.Int.Trust & Corp. Pl.203 at 222-223
\textsuperscript{18} See Re Raven [1915] 1 Ch 673, Re Wynn [1952] Ch 271, but on matters of fact or mixed law and fact the court's jurisdiction can be ousted.
\textsuperscript{19} CPR 21.10(1) and (2), RSC Ord 15 r.13(4)
\end{flushright}
or litigation friends to agree a compromise needing the approval of the court if to be binding on all parties; so such virtual representatives’ compromise should be of no effect unless they become appointed a litigation friend or representative by the court and the court approves their compromise.

How to Further Facilitate Mediation

Resolution of a dispute in accordance with a solution proposed by a mediator requires persons of full capacity capable of signing an agreement that will bind the incapacitated and unascertained beneficiaries on whose behalf they sign. Currently, for England and UK Dependencies such persons need to be appointed by the court and the agreed compromise must be approved by the court. In the USA virtual representation clauses in trust instruments buttressed by legislation (e.g. in New York and in Washington) are permitted to enable virtual representatives bind the interests of those whom they represent without the need for any court approval.

Thus the trust instrument (or statute) could provide as follows:

(i) If an interest in an estate or trust has been given to persons who compose a certain class upon the happening of a certain event, those living persons of full capacity who would constitute the class if the event had happened on the day the parties to the dispute agreed a resolution thereof shall act as virtual representatives for all members of the class and shall be the only required parties to the dispute with respect to the interest;

(ii) If an interest in an estate or trust has been given to a living person, and the same interest or a share therein is to pass to that person’s surviving spouse or to persons who are or may be the distributees, heirs, issue or other kindred of that person upon the happening of a future event, such living person if of full capacity shall act as a virtual representative for all such persons and shall be the only required party to the dispute with respect to the interests of such other persons;

(iii) Except as provided in (ii) above, if an interest in an estate or trust is to be given to a person, a class of persons, or both upon the happening of any future event, and the same interest or a share thereof is to pass to another person, class of persons, or both upon the happening of an additional future event, the living person or persons who could take the interest upon the happening of the first event shall act as virtual representatives for all such other persons;

30 American case law allows ouster of the court's jurisdiction on matters of law as well as fact and mixed fact and law.

21 Significantly it seems that uncertainties as to the effectiveness of virtual representation clauses led to statutes dealing with the matter eg Washington Revised Code 11.96.110, New York Surr Ct Proc Act section 315.

and shall be the only required parties to the dispute with respect to the interests of such other persons;

(iv) Notwithstanding (i), (ii) and (iii) above, if a person acting as virtual representative has a conflict of interest involving the interest of a person he or she is representing, he or she shall not act as virtual representative of such person who instead will be represented by a special legally qualified representative appointed in writing by [the protector or the President/Chair of a relevant organisation or by the court if statute confers jurisdiction for such an appointment on the court, people not being able to impose obligations on courts]. The special representative may be appointed for more than one person or class of persons if the interests of such persons or class are not in conflict. The special representative has authority to enter into a binding agreement on behalf of the person or persons he or she is representing and is the only required party to the dispute with respect to the interests of such person or persons.

However, persons with apparent coincident interests as members of a class of beneficiaries may have conflicting interests e.g. 21 and 19 year old grandsons may want to settle the dispute quickly to obtain cash to meet debts or purchase fast cars, while infant and unborn grandsons would want to settle the dispute for a larger sum of money even if this takes longer, or such two grandsons may want the family company owned by the trust to be sold off, although 16 and 14 year old grandsons may be very interested in going into the family business, so that the company should not be sold.

In the Matter of the Estate of Herbert Silver Deceased Judges Nathan and Sobell held that the income interest of a life tenant and the contingent remainder interest in capital of his unborn children (who would take the capital if the life tenant predeceased his mother, although he would take the capital if he survived his mother) led to a conflict of interest that precluded the life tenant from being virtual representative of his unborn children in proceedings to remove a trustee. The life tenant was irritated that the trustee preferred paying high salaries to officers of a controlled company, rather than pay high dividends, and refused to exercise a power to invade capital to benefit the income beneficiary.

The court stated:

'Virtual representation is a doctrine which permits one who is a party (the "representor") to represent the interests of persons or classes of persons (the "representees") who otherwise would be necessary parties, without serving them with process or making them actual parties. The whole theory underlying the doctrine is similarity of economic interests. It is presumed that the representor in pursuing his own economic self-interest will necessarily protect the rights of the representees having the same

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23 Re Hooker’s Settlement [1955] Ch 55.
24 340 N.Y.S. 2d 335 (1973)
interest. The doctrine was recognised by the courts long before the adoption of the statute [Surrogate Court Probate Act section 315]. There is no question of the constitutionality of the statute under due process standards. Like the guardian *ad litem* statute, it provides for all necessary safeguards of notice and opportunity, albeit by the representor instead of by the guardian. The sole problem is representation by one party of another party and the possibility inherent in such representation of resulting conflict of interest - a consequence never present where representation is by a guardian *ad litem*. Basic to the conflict problem is that the court is required to reach a decision at the threshold. If it makes an error of law in interpreting the statute, it never acquires jurisdiction over the representees. Its decree will be subject to direct or collateral attack (O'Donoghue v Boles 159 N.Y. 87, 100).

Even if the court rightly concludes that the statute authorises virtual representation, there is never any absolute assurance that the decree will not be vulnerable. If the decree results in an advantage to the representor vis-à-vis the representee this is *prima facie* proof of either inadequacy of representation or conflict of interest (Matter of Willis, 6 Misc 2d 218). In short, virtual representation never assures the same finality as does representation by a guardian *ad litem*. Section 315 is drafted to assure adequacy of representation and to prevent conflict of interest.... Recognising that in some proceedings the safeguards will not adequately protect the representees, subdivision 5 gives the court absolute discretion to require service of process upon the contingent remaindermen, if adults, or to appoint a guardian *ad litem* if persons under disability [the court going on to conclude that a guardian *ad litem* may be appointed for unborns "under authority inherent in the court" and that the "decisions do establish that courts are extremely cautious in allowing virtual representation. Justifiably so if finality is the goal"].

Thus, to avoid the lengthy, complex, virtual representation clauses like (i), (ii) and (iii) above and the problems of one party being virtual representative for other parties with a possible lack of finality, it seems best to provide in the trust instrument only for appointment of an independent special representative (not already being a party to the dispute) for such incapacitated, unborn or unascertained beneficiary or class of beneficiaries, except that the special representatives can represent more than one person or class of persons if no conflict of interest arises. To avoid conflicts of interest, the trustees should not be appointors of special representatives but some independent person like a protector (if there is one and if not affected by a conflict of interest) or, better, the head of some relevant organisation. Provision will need to be made for payment of the special representative, who ought to be an experienced qualified lawyer (or, perhaps, just someone with extensive trust experience), and for the trust instrument to provide protection against later claims by disgruntled representees e.g. "Any agreement signed by a special representative shall conclusively bind the persons represented by such representative and the
This exercise of trying to draft effective virtual representation clauses in trust instruments reveals how more straightforward it would be if statute not only provided for virtual representation in trying to settle all disputes, but further provided that if potential conflicts of interest precluded virtual representation of particular beneficiaries, then the court could appoint a special representative with full authority to enter into an agreement binding his beneficiaries, and who would then be discharged from all responsibility as in the Revised Code of Washington 11.96.

Although such Codes provide normally for virtual representation by beneficiaries with interests coincident to the interests of the representees, it seems simpler if there were legislation providing a short summary process whereby the Court or, perhaps, the Chair of particular organisations could appoint special representatives whose acts would conclusively bind their representees and who would be immune from suit by their representees unless they had acted dishonestly. Thus such representatives (appointable before or after service of legal proceedings) could effectively agree to a mediated compromise binding their incapacitated or unascertained beneficiaries or to an arbitration leading to an internationally enforceable arbitration award.

How to Further Facilitate Arbitration

While one cannot force mediation upon those who do not want to mediate, can the settlor by his trust deed force arbitration upon the trustees and the beneficiaries to resolve disputes between them? After all, in this day and age and in the light of the safeguards in the Arbitration Act 1996 the court surely will not view an arbitration clause in a trust deed as an attempt to oust its jurisdiction or as repugnant to the rights created by the settlor where it concerns the administration or execution of a trust.25

In the ordinary case, however, the Trust Law Committee Working Party considered that an arbitration clause in a trust deed would not amount to an arbitration agreement or contract within the Arbitration Act 1996. The basis of a trust is the unilateral transfer27 of assets to a person prepared to accept the office of trustee with the benefits and burdens attaching to such office. It is a beneficial incident of such office, for example, that the trustee can debit the trust fund with the expenses and fees incurred in performance of the office, and it is not a contract between the settlor and the trustee that enables the trustee so to debit the trust fund.

25 See L.Cohen & M Staff op.cit. note 17 supra
26 Despite the contrary view of L.Cohen & M Staff supra
27 Normally the trustee will agree with the settlor to accept assets as trustee. However, if land or shares are registered in T’s name without his knowledge or property is left by will to T without his knowledge, T can disclaim the trust, but the settlor’s declaration of trust of the particular assets created a valid trust which will not fail for lack of a trustee: he or his personal representative will become trustee: Mallott v Wilson [1903] 2 Ch 494
However, if a settlor (on behalf of himself and the beneficiaries deriving their interests through him) in his trust deed expressly contracts with the trustee (on behalf of itself and its successors in title) in consideration of undertaking the office of trustee (for the benefit of the trustee, the settlor and the beneficiaries) that any dispute between the trustee and the beneficiaries shall be referred to arbitration by an arbitrator appointed by the [head of a specified organisation] this should amount to an arbitration agreement or contract. By taking the benefit of the trust deed the beneficiaries and the trustee and their successors as beneficiaries and trustee all become parties to the arbitration agreement and bound by it. Thus, the trustee would be able to stay any action by the beneficiaries against it and vice versa.

If no legal proceedings had been commenced it seems likely, as already seen, that the provisions for representatives or litigation friends for unascertained or incapacitated beneficiaries would be inapplicable, so that no question of ouster of jurisdiction of the court would arise if the trust deed provided a mechanism for appointment of virtual representatives or even if the arbitrator appointed persons to be virtual representatives. The involvement of these virtual representatives should satisfy the requirements of natural justice and of due process, so that the arbitration award should then be unimpeachable.

There is thus scope to incorporate into new inter vivos trusts an arbitration clause along the lines suggested in the penultimate paragraph. However, the virtual representation aspects dealt with in the last paragraph are untested. This would not matter if the law were changed (as earlier suggested) to allow special representatives appointed by the Court or by the Chair of specified organisations to bind their unascertained or incapacitated beneficiaries without the need for any court approval. Indeed, this would facilitate mediation, so that there would be likely to be less recourse to the more formalistic and cumbersome arbitration process.

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28 Also s.82(2) Arbitration Act 1996 provides that a party to an arbitration agreement includes any person claiming ‘under or through’ a party to the agreement.