Trust arbitration—is it desirable and does it work?

Lawrence Cohen QC and Joanna Poole*

Abstract

This article looks at and concludes that arbitration of trust disputes is often a more desirable means of resolution than traditional Court proceedings. But does the legal mechanism exist for trust arbitration in the absence of legislation such as that enacted in the Bahamas? The ‘pro’ and ‘con’ factions are remarkably close in their views: it depends on the effect of section 82(2) of the Arbitration Act, 1996. We examine this provision (the equivalent of which applies in most common law jurisdictions) and conclude that probably it does. Finally, we turn to drafting issues and discuss our model clauses.

The desirability of trust arbitrations

In recent years there has been a move towards the use of Alternative Dispute Resolution for the resolution of disputes, not only because of the encouragement of legislation and the courts but also because practitioners and clients have been keen to have a quicker, lower cost, and less adversarial remedy than the court room. In the context of trust disputes, mediation has become an increasingly used method for resolving disputes. However, arbitration still remains unfamiliar territory for many within the trust industry despite the fact that few would now challenge its desirability over the court room.

Advantages of arbitration over litigation

One of the major concerns of trust disputes arising in the context of family settlements is privacy and confidentiality. Perhaps the foremost advantage of arbitration is that it is private and confidential. In contrast, court proceedings bring with them the risk of personal and potentially embarrassing details of the settlor and/or beneficiaries’ lives becoming public knowledge. Court proceedings might also result in professional trustees suffering adverse publicity regarding their trust management and administration skills. Further, in the case of a particularly wealthy settlor or a high value trust fund, proceedings can give rise to security concerns—few settlors wish to advertise the extent of their wealth, its location and the identity of those benefiting from it. Although courts are usually amenable to granting privacy measures such as having hearing taking place in camera or that the court file be sealed, an express application by the parties will be required for such an order and the parties will need to show a genuine need for confidentiality.

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The cost of resolving a trust dispute is likely to be significantly lower if it is submitted to arbitration, thereby enabling beneficiaries with limited funds to seek redress for their grievances, and avoiding depletion of the trust fund through expensive litigation. The reason is two-fold: first, speed is in our experience the best limitation of the opportunity to incur costs—an arbitrator who will accept responsibility for the conduct of an arbitration and ‘drive’ it is to be contrasted with court proceedings where an individual judge rarely has responsibility for anything but the application before him so that ‘driving’ is often left to the parties; secondly, crafting the procedure to the nature dispute avoids unnecessary steps and can often therefore expose and tackle the heart of the dispute spending much less time on ‘unwrapping’ it.

In the case of disputes taking place before courts in offshore jurisdictions, it is frequent to find that each party to the dispute has retained a legal team comprising local attorneys as well as English solicitors and Counsel. This inevitably leads to duplication and increased costs. Overburdened and understaffed courts (both onshore and offshore) also render resolution of the dispute a lengthy process—this not only increases costs, but also the emotional stress of the parties and makes an ongoing relationship between them harder to achieve. All of this can be mitigated with arbitration—there is no necessity for multiple lawyers to be retained by each party and the timetable is in the hands of the arbitrator and the parties and unhindered by court availability, making resolution quicker, and less costly so the ability of the parties to have a relationship going forwards more likely. An arbitrator’s written decision is final and binding with only a limited right to appeal on questions of law unless this is excluded by the parties. Again, this means final determination of the matter is likely to be quicker and less costly than litigation.

Another key characteristic of arbitration is that it enables the parties to select an arbitrator or panel of arbitrators who possesses the requisite skills to determine the matters in issue so as to ensure a very high-quality review. More often than not, trust disputes bring into play complex legal issues, especially where they have an international element. Many offshore jurisdictions are not only overburdened and understaffed but they rely on part-time Judges who may not always possess the necessary experience for determination of particular issues.

Another advantage of arbitration is that parallel proceedings in multiple jurisdictions are avoided since the parties agree to submit the dispute to one neutral tribunal for determination. Questions which often burden litigation such as whether the court is in fact the court first seized or the appropriate forum to determine a particular matter etc simply do not arise with arbitration. Again, this results in quicker resolution at a lower cost.

Enforcement of an arbitral award is also likely to be easier to achieve than enforcement of a court judgment—the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (‘the New York Convention’) provides an extensive regime for the global recognition and enforcement of arbitral awards made in other contracting states. As of 1 September 2011 there were 146 contracting states. Following the coming into force of the convention in Liechtenstein on 5 October 2011, all countries in the European Economic Area are signatories.

There are limited defences under the New York Convention to enforcement, such as the arbitration agreement not being valid under its governing law, or the award dealing with matters outside the scope of the arbitration agreement or on the ground of enforcement being contrary to public policy.

There are limited defences under the New York Convention to enforcement

The obvious advantages of arbitration outlined above, means that few now challenge the desirability or effectiveness of arbitration over litigation—anyone in doubt need look no further than the Thysson litigation. One of the most expensive court room battles the world has ever seen, the litigation concerned the £1.9 billion family fortune of Baron Hans Heinrich Thysson-Bornemisza and saw the Baron at war against his son who he claimed, in Bermudian proceedings, had duped him into agreeing to create a continuity trust to control the family’s empire—with the trust being governed by a supervisory board of which his son was the chairman.2

Legal teams of each of the parties comprised London City firms, a team English Counsel and local Bermudian attorneys—which allegedly saw costs of £500,000 per week. Settlement of the proceedings finally came after a rumored £100 million in legal costs, the airing of the family’s private life across the global media and the stepping down of the judge, Mr Justice Mitchell, following what many believe to have been a dispute with the Bermudian government over pay. The settlement statement released by Baron will ring in the ear of those who have had the misfortune to become embroiled in such disputes—it read3:

The family very much regrets that misunderstandings have led to legal proceedings, which are all dismissed or withdrawn, and also that the family, its members and professionals who have worked with the family, were subjected to adverse media coverage connected with such misunderstandings.

Notwithstanding the clear advantages of arbitration, there remains a degree of reluctance in trust draftsmen to insert mandatory arbitration clauses principally because of the following concerns:

i. whether the arbitration is a binding method of trust dispute resolution;
ii. the supervisory jurisdiction of the court—directions/appointment of trustees etc; and
iii. practical problems such as binding minors and others under a disability.

Do trust arbitration clauses work?

Introduction to the problem—the need for an arbitration agreement

The basis of arbitration is that the parties to a dispute have entered into an arbitration agreement and that the dispute is within the scope of that agreement. In contrast to disputes under ordinary commercial agreements, the relationship between trustees and beneficiaries is not founded on contractual provisions. Even if the settlor and the trustee were to enter into an arbitration agreement in the trust instrument, the beneficiaries will rarely be parties to it, let alone will they have entered into any written contract. So where and how is the arbitration agreement to arise? This is the central theme of this article. We take it in stages: first, by reference to the settlor and the trustee as the immediate parties to the trust instrument and secondly by reference to the interests of the beneficiaries under the trust instrument (whether present, future, contingent, and whether or not under a disability such as being minors or, at most extreme, unborn).

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3. ibid.
4. Defined by s 6 of the Act as an agreement to submit to arbitration present or future disputes (whether they are contractual or not). s 5 provides that the agreement must be in writing or evidenced in writing or made by the exchange of written communications.
The settlor and the trustee as immediate parties to the trust instrument

There can, in our view, be no real doubt that it is possible for a settlor and a trustee to enter into an arbitration agreement as to future disputes which arise between them in relation to a trust. For example, a settlor covenants that he will on x date transfer a particular piece of property to the trustee to be held on the trusts of the trust instrument. We can see no sensible argument as to why disputes as to this covenant should not be the subject of an arbitration agreement. This point leads to the first drafting trap: an agreement between the settlor and the trustee is required. To illustrate the point which we are making, assume that the trust instrument is couched in terms such as I hereby direct that Disputes which shall arise hereafter shall be referred to and determined by arbitration in accordance with the procedure set out below. In our view, this is simply not an agreement. It is an administrative provision in a trust. The contrast is obvious with the following: In consideration of the Trustee agreeing to accept office on the terms of this Trust Instrument and the Settlor agreeing to appoint the Trustee as trustee of these trusts, the Settlor and the Trustee hereby agree that Disputes which shall arise hereafter shall be referred to and determined by arbitration in accordance with the procedure set out below. Our view is that the substance as well as the form of such a provision is one which is an arbitration agreement within the meaning of the Act. Both the Settlor and the Trustee are bound by this clause.

Binding others beyond the immediate parties to the arbitration agreement

In the absence of legislation, only one mechanism has been suggested which might arguably bind beneficiaries to an arbitration agreement to which they are not direct parties. Section 82 of the Act is entitled Minor Definitions. Sub-section (2) provides:

References in this Part to a party to an arbitration agreement include any person claiming under or through a party to the agreement.

We observe that, at first sight, a beneficiary of a trust appears to be a person claiming under or through either the Settlor or the Trustee in relation to the trust itself and the duties imposed by it. We will look at this a little more below but, for the present, we need to stick with and explain the most material of the provisions of the part of the Act to which this section 82(2) is referring—section 9 and section 86(2). Section 9 provides as follows:

9(1) A party to an arbitration agreement against whom legal proceedings are brought (whether by way of claim or counterclaim) in respect of a matter which under the agreement is to be referred to arbitration may (upon notice to the other parties to the proceedings) apply to the court in which the proceedings have been brought to stay the proceedings so far as they concern that matter.

(4) On an application under this section the court shall grant a stay unless satisfied that the arbitration agreement is null and void, inoperative, or incapable of being performed.

Putting these provisions together, their effect appears to be:

i. If proceedings are brought against a party to an arbitration agreement against another in respect

5. We are assuming a wide definition of Disputes for this purpose.
6. ibid—we will continue to use the term Disputes in this fashion.
7. The provisions of Section 9 set out above apply to an arbitration agreement which is not a domestic arbitration agreement. In the case of a domestic arbitration agreement, s 9 is modified by s 86(2) so that there is a discretion to refuse to stay of legal proceedings on the basis that there are other sufficient grounds for not requiring the parties to abide by the arbitration agreement. The rather cumbersome definition in s 85 means that where one or more of the parties is ‘foreign’, the agreement will not be domestic. We have used ‘foreign’ to indicate in the case of an individual that she is a national or resident of a country other than the UK. In the case of a corporation, ‘foreign’ indicates incorporation or the central management and control being outside the UK. In the case of offshore trusts, we think it is unlikely that many will be domestic within the local equivalent of this provision. This article does not investigate the full implications which are, broadly, that a domestic arbitration agreement will be outside the scope of the New York Convention and the granting of a stay will be discretionary but with the party opposing the stay bearing the onus of showing why it should not be granted.
of something which is within the scope of the agreement, he may apply for a stay.

ii. The stay must be granted unless the clause is ineffective.

If a beneficiary of a trust containing an arbitration agreement brings the proceedings, can a Defendant such as the trustee or another beneficiary apply for a stay? The Act tells us that a party to an arbitration agreement includes *any person claiming under or through a party to the agreement* which seems to point firmly to the beneficiary being bound. The real question is whether a beneficiary is truly such a person.

**Is a beneficiary of a trust a person claiming under or through a party to an arbitration agreement?**

At first sight, at least, the words *claiming under or through* seem apt to describe the claim of a beneficiary to or in respect of his beneficial interest. It is difficult to explain where a beneficiary gets his interest from if it is not derivatively either from the settlor or the trustee, ie the two parties to the arbitration agreement. But it has been fairly observed that the words of the Act were most definitely not written specifically with trust beneficiaries in mind rather than being generally directed. Whereas there would be no doubt that these words would cover an assignee of a party to an arbitration agreement, what we have to ask ourselves is whether there is some reason that the words ought to be construed in such a way as to exclude beneficiaries of trusts from their ambit. For the purpose of developing the argument, let us assume that there might be a difference between

i. a trust arbitration clause which is widely drawn and, on its face, is intended by the settlor and the trustee to bring within its scope a dispute of exactly the kind which has arisen (eg a dispute between beneficiaries and the trustee as to the exercise of a trustee’s powers and discretions) and

ii. a much narrower and less explicit clause as to the scope of the intended arbitration agreement.

In the case of the wide scope clause, we can see no possible reason of policy or principle of statutory construction which ought to limit the scope of the words of section 82(2). If the scope were to be limited, the result would be to defeat both the intention of the settlor and the basis on which the trustee agreed to accept office. ‘Perverse’ is the word which we think describes a beneficiary who is able to exempt himself from the terms of the trust, including those as how disputes should be resolved.

In the case of the narrower scope clause, what seems to us to matter is not section 82(2). It is the pure issue of construction of the trust’s arbitration agreement. If the dispute is within the scope of the agreement, the analysis is exactly the same as the wide scope clause—the intention of the settlor and the trustee will be defeated if a beneficiary is allowed to avoid the arbitration agreement. If, however, the dispute is not within the scope of the arbitration agreement, there will be no arbitration and, again, the settlor’s intention will be respected.

**What of minors and unborn beneficiaries?**

One objection frequently advanced against trust arbitration is that there is no mechanism as in litigation to provide for the interests of minors and unborns to be represented. Equally, how can an arbitration be compromised without the assistance of the Court in this situation? These are real and fair questions but they are not insuperable and explain the increasingly sophisticated trust arbitration clauses which are in use. There is no reason why a well thought out trust arbitration agreement cannot provide effectively for all of these issues. A settlor cannot only decide what interests he gives to a beneficiary but he can also ‘legislate’ in the trust instrument for how it can be ‘varied’ and who is able to give consent on behalf of a beneficiary even if unascertained or under a disability. The starting point is to provide that the trustees have power to represent and bind all beneficiaries,
even if under a disability—this is no different from what the Civil Procedure Rules provide. In the case of a hostile claim against the trustees or, if in their opinion it is desirable for beneficiaries to have independent representation, a person (often the Protector unless there is a conflict) is to take on that role. Costs incurred will be payable from the trust fund and the powers should always include power to compromise and bind. It is difficult to advance any reason of principle why a settlor is not free to impose terms of this kind. Of course it may be cumbersome in terms of drafting and legislation is probably better, but this is not even difficult to achieve.

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Are there some claims which cannot be arbitrated?

The theoretical answer to this question is undoubtedly ‘yes’ but this probably obscures the practical answer which is to the opposite effect. An example of a provision which is in the exclusive jurisdiction of the Court is the statutory power of removal of a trustee and appointment of another in his place. That statutory power is not given to an arbitrator but to the Court. Why this is purely theoretical is that there is no obvious problem in an arbitration agreement giving to the arbitrator the power to remove a trustee and appoint another—such a power is very frequently conferred on an individual other than an arbitrator and is exercisable on a purely discretionary basis or, sometimes, if certain conditions exist. The power of an arbitrator to remove and replace a trustee is no different in character from this. Again it is perfectly true that it is cumbersome to have to provide details such as this but it is by no means difficult to do so.

The desirability of legislation

Although our view is that trust arbitration agreements are desirable, legislation would be a much more convenient facilitator to trust arbitration. Any element of uncertainty would be eliminated and clauses could be very much shorter than at present. Equally, trust arbitration agreements can only be introduced into new trusts rather than existing ones.

Model clauses

The form of any clause adopted must, of course, be closely integrated into the language and form of the trust instrument. We have appended the guide which has been in use by one of us for a number of years which draws together the route map for successfully drafting a clause.

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#### Table 1 Trust Arbitration Clauses: Guide to Features of Model Clause

<table>
<thead>
<tr>
<th>Drafting Points</th>
<th>Comment</th>
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<tbody>
<tr>
<td><strong>Draft as an agreement and not a direction</strong></td>
<td>An agreement to arbitrate is invariably necessary; Form matters in deciding substance (NB contrary argument that this is form over substance – however, for professional trustees, remuneration and terms of appointment are both negotiated and are the subject of agreement – arbitration should be similar)</td>
</tr>
<tr>
<td>eg In consideration of the Settlor agreeing to enter into this Deed settling the Trust Property and appointing the Trustee and the Protector on the terms herein contained and of the Trustee and the Protector agreeing to accept office, it is hereby agreed that Disputes shall be referred . . . .</td>
<td></td>
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<tr>
<td>Cf drafting such as I hereby direct that Disputes shall be referred . . . .</td>
<td>Use John Wood’s classification of different types of dispute but note- “Disputes” with outsiders concerning trust property (eg complaining of negligent management by investment managers) ought to be outside definition although power should be given to trustees to submit these disputes to ADR</td>
</tr>
<tr>
<td><strong>Definition of Disputes must be wide enough with sufficient specificity for contemplated problems: Checklist:</strong></td>
<td></td>
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<tr>
<td>Interpretation of Trust Instrument? (perhaps therefore determining who is beneficiary and on what terms)</td>
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<tr>
<td>Breach of Trust? (should Trustee’s liability be arbitrated?)</td>
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<tr>
<td>Administration and Control of Trustee’s management and discretions? (NB close interface with Court’s discretionary ability to give directions which cannot be ousted)</td>
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<tr>
<td>Removal/Replacement of Trustee/Protector (A worthwhile power but not capable of excluding Court’s powers)</td>
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<tr>
<td><strong>The type of arbitration:</strong></td>
<td></td>
</tr>
<tr>
<td><strong>How is Arbitrator to be selected?</strong></td>
<td>Selection of Arbitrator – nominating body always required – Is there an IBA role and panel desirable? We normally suggest Chairman of Chancery Bar Association</td>
</tr>
<tr>
<td><strong>Is it to be ad hoc or subject to some set of rules</strong></td>
<td>Ad hoc or ICC or similar? NB no set of rules uniquely directed to trust arbitration – probably best if ad hoc but with express power to adopt a procedural set of rules or such parts as arbitrator thinks fit</td>
</tr>
<tr>
<td><strong>Consider Governing Law of Arbitration</strong></td>
<td>Governing Law/Seat not necessarily same as for settlement, particularly if settlement governed by law of place with little developed arbitration law</td>
</tr>
<tr>
<td><strong>Special Provisions for particular cases eg language of arbitration, place in which hearings to be held, costs awarded, provision for interim costs</strong></td>
<td>Special Provisions: Language if not English will need to be tied in to arbitrator selection but note many able Geneva and Zurich multi-lingual arbitrators who are experienced in trusts; similarly, the place where the arbitration is to be held is not invariably the same as the governing law of the trust or the arbitration;</td>
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<tr>
<td>Costs takes special mention. Several settlers have wanted to adopt the American rule in costs – no costs in favour of successful party or against defeated party; however, some have wanted a proviso enabling “certified” or “authorized” questions to be funded – the approval coming from the trustee or the protector</td>
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<tr>
<td><strong>Binding the beneficiaries:</strong></td>
<td>A contentious subject in the absence of specific legislative provision: But the interest of a beneficiary must come by derivation from the settlor and/or the trustee so that they are usually capable of being bound.</td>
</tr>
<tr>
<td>eg An arbitration under the provisions of this clause shall bind not only the parties who participate in the arbitration but also all parties who derive title under or through them including, without prejudice to the generality of the foregoing, all successors in office of the Trustee and the Protector and every person who is or might be or claims to be a beneficiary and whether or not such person is of full age, sound mind or is not yet born or in existence or is not yet ascertained. The interest, right, title and liabilities of all such parties hereunder are as shall be found in such arbitration.</td>
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<tr>
<td><strong>Representing all interested parties:</strong></td>
<td>This is closely related to binding the beneficiaries – it is important to ensure that recognizable interests are represented but, in the absence of conflict, there is no reason why the Trustee should not take on this role – there is every reason why he should do so</td>
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<tr>
<td>In any arbitration, the interest of every beneficiary and class of beneficiary shall be represented by the Trustee without any need for all such beneficiaries or classes to be individually represented PROVIDED that:</td>
<td></td>
</tr>
<tr>
<td>1. If the Trustee shall think it necessary or desirable that some beneficiary or class of beneficiaries (whether or not being or consisting of minors, unborn person or unascertained persons) may appoint any person whom he considers to be a fit and proper person to represent such beneficiary, beneficiaries or class and he may remunerate such person from the Trust Fund and provide to him an indemnity in respect of any liability incurred in the course of so acting</td>
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<tr>
<td>2. If the Trustee's conduct is the subject of complaint in the Arbitration, this clause shall be read as if the references to the Trustee were references to the Protector unless the Protector is similarly the subject of complaint in which case [appointor to be selected]</td>
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<tr>
<td>3. If any dispute shall arise as to the validity or appropriateness of any appointment under this clause, the arbitrator shall determine such dispute summarily and speedily and shall if, he thinks fit, have power appoint some other person to represent the beneficiary or class of beneficiaries without deciding finally as to the validity or appropriateness of such appointment</td>
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**Compromise** – Insert power of compromise on representative parties so as to bind parties represented including minors unborn and unascertained persons

Practical experience has demonstrated the need for this subject to be provided for in the Settlement Deed

**Discretionary Pointers – Opt Outs**

Discretion – No universal principles – question being raised is whether settler wishes to provide pointers as to how discretion to stay proceedings in favour of arbitration might be exercisable – if so, write a message to the Court here

Opt Outs – rarely encountered but simple – enable neutral person, usually Protector to disapply arbitration clause because not thought appropriate

**Confidentiality Clause** – Essential to make provision for confidentiality as to subject matter of dispute and arbitration proceedings rather than rely on implied term

Should there be a penalty for breach? A frequently asked question but we have been unable to see how this could work – an enforceable obligation is best that can be done