

## Trust briefing: Challenges to trustee decisions

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It is often thought that a discretionary decision made by a trustee is difficult or sometimes even impossible to challenge.

However there are many different strategies – based on either technical flaws in the execution of trustee decisions, or substantive flaws with the decision-making process itself – that can allow a beneficiary to have the decision set aside or reconsidered.

This article explores how to challenge a trustee's decision without needing to go as far as seeking to [remove that trustee](#).

### Discretionary trusts decision-making

Discretionary trusts are very common in the offshore world and often confer a very broad range of discretionary decision-making powers on the trustee, for example:

- **distributions** – deciding when, how and who among the beneficiaries can benefit from the trust;
- **whether to redomicile the trust** – deciding whether to change the proper law or jurisdiction in which the trust or the trustee resides;
- **whether to sell, buy or restructure the trust's assets** – including selling trust-owned family companies, businesses or houses which the family has owned or lived in for years;
- **whether to add or remove a beneficiary or group of beneficiaries** – thereby expanding or limiting the number of people who can benefit from the trust and who have rights against the trustee; and
- **whether to restructure the entitlements of beneficiaries** – deciding whether to split up a trust into smaller or separate trusts for different family members.

The type of trust in question and the kind of entitlement that a particular beneficiary has under a trust will be of paramount importance in determining the potential scope for any challenge to the trustee's decision-making.

Often discretionary decision-making will be vested only in trustees. However, in many offshore trusts there may also be powers vested in a protector, or the settlor may have reserved certain powers to themselves, which must be correctly exercised in co-decision with the trustee. This article applies to decision-making trustees but has equal application to other power-holders such as [protectors](#).

### The grounds for challenging a trustee's decision

The grounds on which trustee decisions can be challenged fall into two broad categories:

- **formal invalidity** – a defect in a formal requirement imposed by the trust or by law; and
- **substantive invalidity** – the decision-making is intrinsically and substantively flawed and therefore shouldn't stand

## Challenges to formal validity

The first question is whether the power or decision the trustee has purported to exercised is exercisable at all. A decision taken that is outside the scope of the trustees' powers can be challenged on grounds of its formal validity. This sort of challenge involves an examination of the trust documents to determine the scope of the trustee's powers, and analyse whether what the trustee purports to do falls within the scope of those powers. If it does not, then the trustee's decision and action will be void.

Examples of this sort of challenge include:

- where there is a power of co-consent or veto vested in a protector or power holder that the trustee has not obtained before making a decision;
- where a power contains a limitation on it that the trustee has not observed, eg the trustee has power to lend money from the trust but only at interest or has a power to indemnify but only in respect of prospective liabilities;
- whether the power can only be exercised in favour of a particular class of person and that is overlooked, eg a trustee benefiting an Excluded Person;
- where a power is required to be exercised in a particular way, within a particular time frame, after a particular process, by a particular person, or in a particular manner, eg by the trustees, by deed, using pink writing paper, within three months of notice being given, after seeking approval from 'X' and 'Y'; or
- where the governing law relevant to the exercise of a power or decision provides for some formality that is not evident on the face of the trust instrument.

## Challenges to substantive validity

This sort of challenge is not about whether the trustee's decision was within the scope of the trustee's powers, but whether the trustee's decision is nevertheless defective or flawed on one or more of the following grounds:

### Inadequate deliberation

This grounds for challenge is met where the trustee has consciously or unwittingly committed a breach of its fiduciary duty in failing to give proper consideration to relevant matters (or took into account irrelevant matters).

Trustees have an obligation to properly inform themselves of relevant matters before taking a decision. This may include tax considerations and legal advice. The more complex the decision, the more complex and multi-factorial the trustee's decision-making should be.

A common complaint raised by beneficiaries is that the trustees slavishly followed the wishes of the settlor. There is no innate reason why trustees should not follow the settlor's wishes provided they can demonstrate that they have given proper thought to the matter (but not to the exclusion of other relevant matters).

A factorial analysis can be difficult to prove because the trustee's deliberative process in reaching discretionary decisions is often capable of being withheld from [disclosure](#) to beneficiaries in the ordinary course of administration of a trust.

Often, where it is in the joint interests of the trustees and beneficiaries to set aside a decision of the trustee (to reverse a decision to the status quo ante because of an unfortunate tax consequence) then the trustees will have little difficulty explaining their [decision-making to the beneficiaries and the court](#).

If the court finds the trustees have committed a breach of fiduciary duty, then the decision can be set aside by the court.

## Mistake

This grounds for challenge will be made out where the decision was a result of a mistake by the trustees (either a mistake of law or of fact). An example of a relevant mistake might be that that the trustee has mistakenly assumed facts or circumstances about a beneficiary when deciding on a distribution to them or the trustee has made a mistake about the tax consequences of a particular decision.

To be capable of challenge on this grounds, the mistake must be of sufficient gravity for the court to set it aside. Mistake is often run alongside or in parallel with a challenge based upon inadequate deliberation.

## Improper purpose

This grounds for challenge will be made out where the decision is formally valid (ie within the scope of the trustee's powers) but was exercised for a purpose, or an intention, which was outside the intended basis for which the power exists. This is commonly referred to as a 'fraud on a power' or 'improper purpose' doctrine.

There is no need for a beneficiary to demonstrate that the trustee acted dishonestly (though they may well have done). Where the power has been exercised improperly, then the trustee's act will be void and will be set aside.

A challenge based on improper purpose requires that it be clear what the proper purpose of the power is. That involves an inquiry into the wording of the trust instrument and the circumstances in which it was first created. Letters of wishes that post-date the trust are not relevant to that inquiry. A challenge based upon the doctrine of 'fraud on a power' or 'improper purpose' was at the heart of the groundbreaking Privy Council decision in *Wong v Grandview*.

## Conflict of interest

A trustee has a duty to exercise its powers only for the benefit of the beneficiaries, free from any conflict between those duties and its own interests. There is potentially some overlap here with a challenge to the exercise of a power for an improper purpose.

Unless it can be shown that such a decision was expressly authorised by the terms of the trust, the trustee must demonstrate the decision was one which any reasonable trustee might have taken and that it was not influenced by the conflict to withstanding a challenge.

Any one or more of these grounds for challenge could of itself constitute a breach of trust. Should the decision cause loss to the trust fund, such a breach would not only entitle a beneficiary to seek to have the decision set aside but also to seek compensation.

## The remedies available to beneficiaries

There are a number of remedies available to beneficiaries depending on the specific problems encountered with the trust in question but, of the more general remedies, there are four types.

1. The first is an order for an account on the basis of wilful default. This remedy is most useful where a trustee has acted in breach of trust, for example by spending trust money on their own expenses or otherwise dealing with the trust property in an unauthorised manner. If the court finds that the trustee has acted in breach, then they will be obliged to restore the trust property to what it would have been but for the breach.
2. The next remedy is that of equitable compensation. If a beneficiary can prove a loss as a result of the trustee's breach of a fiduciary duty and the position cannot be restored, then the court may make an order of equitable compensation.
3. Another remedy is to seek a court order striking down a decision of the trustee on any of the above grounds or an order restraining them from taking a particular course of action, known as an injunction. The beneficiary will have to satisfy the court that the trustees should or should not act in a particular way.

In any of the above circumstances, an application could also be made for removal of the trustee acting in breach and an appointment of a replacement trustee. However, case law shows that even in cases where a trustee was found to be in breach of trust, it does not follow that the court will necessarily remove and replace the trustee.

4. Lastly, there is of course the ultimate remedy available in some cases, namely where all the beneficiaries are ascertained and of full age and capacity, ie that they terminate the trust. It may be that a threat of such an outcome might be sufficient to stop an errant trustee from committing a breach in the first place.

## Practical challenges for beneficiaries

A challenge based on the formal invalidity of a decision can be more straightforward than a challenge based upon a substantive flaw in the trustee's decision. That is because a formal validity challenge will be relatively obvious from the terms and the form of the power the trustee has purported to exercise.

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A challenge as to the substantive validity of a decision requires a beneficiary to get behind a decision that appears on its surface to be valid. To do this requires that the beneficiary be in a position to get disclosure of and examine the reasons for the trustee's decision-making. Obtaining voluntary [disclosure](#) from a trustee about its reasons can be complex and is something on which a beneficiary should seek legal advice.

## A trustee's actions to limit their liability

Occasionally, trustees find themselves in a situation where they have difficulty in making a decision. Often this will be the case where the trustee may have to weigh up conflicting beneficial interests or may be facing external pressures. There may be a concern about a challenge from a disgruntled beneficiary which trustees will be keen to avoid. In such circumstances, trustee can invoke the court's supervisory jurisdiction by making an application to seek the court's approval or 'blessing' for its decision.

The four recognised categories for such applications as follows:

1. **A construction application:** Is a particular action within the trustee's powers?
2. **A blessing sought for a particularly significant or momentous decision:** Is a particular course of action a proper and rational exercise of the trustee's powers?
3. **A trustee surrenders its decision to the court on a course of action:** These applications involve the court taking a decision in place of the trustee because the trustee is genuinely conflicted.
4. **Retrospective blessing sought for a particular action:** Were the trustees right to pursue a course of action?

As can be seen from the above, all the remedies – both those available to trustees and the beneficiaries – require court intervention. Making an application to court can be expensive, especially where the decision is contentious and likely to be contested. Often the costs of such applications are ordered by the court to be paid out of the trust fund.

## How can Collas Crill help?

Collas Crill's private client and trust team have decades of experience advising trustees and beneficiaries about trustee decision-making. Our advisory practice frequently assists fiduciaries with the increasing complexity of decision making, including restructuring.

When decision-making has gone wrong, leading to complaints of a possible breach of trust, Collas Crill's skilled and experienced disputes team can advise on how best to challenge and correct the defective decision making.

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