

Elementary, my dear Watson: Royal Court of Jersey issues landmark judgment in *Kea Investments Limited v Watson*

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The Royal Court of Jersey has issued a landmark judgment in *Kea Investments Limited v Watson* [2021] JRC 009, determining that it is not possible to obtain execution measures against the interest of a discretionary beneficiary under a trust. Although a beneficiary's interest may be movable property, the Court did not consider that such property was transmissible unless expressly provided for by the trust instrument.

Background

The Jersey proceedings formed part of the well-publicised legal battle in the High Court of England and Wales between two New Zealand businessmen, Sir Owen Glenn KNZM and Eric Watson. Mr Watson had been found to have made fraudulent misrepresentations in order to secure funding from Sir Owen's company, Kea Investments Limited (**Kea**), and to have acted in breach of fiduciary duty.^[1] In September 2018, the High Court (Nugee J, as he then was) set aside the funding transactions and ordered equitable compensation to be paid with accounts to be taken, also ordering an immediate interim payment of over £29 million inclusive of costs. Kea also obtained the benefit of notification undertakings in respect of Watson's worldwide assets, including provision for asset disclosure. In October 2020, Kea secured Watson's committal to prison for four months for contempt in relation to shortcomings in his asset disclosure.^[2]

As part of its enforcement efforts, Kea registered its monetary judgment in the Royal Court of Jersey pursuant to the Judgments (Reciprocal Enforcement) (Jersey) Law 1960 in September 2019. This gave Kea the ability to take execution steps and bring enforcement proceedings against Watson's assets in the jurisdiction in the same manner as it would if it had the benefit of a Jersey judgment.

In Jersey, it is possible to apply for execution measures known as the *arrêt* and *arrêt entre mains*. These measures, which are creatures of customary law, enable judgment creditors to distrain on the debtor's movable property, both tangible and intangible. The initial attachment order operates to create an immediate proprietary interest in favour of the creditor akin to a charge on the property concerned. In the case of the *arrêt entre mains*, the order applies to property in the hands of a third party, such as a debt owed to the judgment debtor. The initial order can be obtained as a form of interim relief which has the effect of freezing a specific asset and depriving the debtor of the ability to deal with it. On confirmation of the order, the property may be sold or appropriated towards satisfaction of the debt.

The Jersey application

After having registered its English judgment in Jersey, Kea was informed that Watson intended to procure the appointment of a replacement trustee of three Jersey law trusts, the Kowhai, Libra and Glacier Trusts, of which Watson was on the face of things a discretionary beneficiary, in another jurisdiction. Kea therefore applied *ex parte* to the Royal Court in March 2020 for urgent interim relief. The Royal Court granted a suite of orders restraining the Jersey trustee from transferring the trust assets, suspending the powers of the protector and prohibiting Watson from disclaiming his beneficial interest under the trusts.

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Kea also sought and was granted provisional execution measures to be confirmed at a subsequent *inter partes* hearing, on the footing that it was entitled to attach and seize Watson's interests as a beneficiary under the three trusts by way of an *arrêt*. Kea also attached the benefit of certain loans that Watson had made to the trustees and to a trust-owned company by way of *arrêts entre mains*.

The Judgment Creditor's arguments

The *inter partes* hearing to confirm the provisional execution measures took place some months later on 1 December 2020. Neither Mr Watson, the protector nor the trustee appeared, leaving Kea and a court-appointed guardian for Mr Watson's children to argue the case. The central issues for determination were the extent to which a beneficiary's interest under a discretionary trust constitutes property and, if so, whether that interest is amenable to execution by a creditor.

Kea argued that article 10(10) of the Trusts (Jersey) Law 1984 (as amended) (the **Trusts Law**) stated in terms that "the interest of a beneficiary [i.e. a beneficiary's interest under a trust] shall constitute movable property", and that the definition of a beneficiary pursuant to the Trusts Law encompassed both a discretionary beneficiary and a mere object of a discretionary power. The bundle of rights enjoyed by a discretionary beneficiary such as Watson therefore amounted to property and was an asset in his hands. This accorded with article 10(11) of the Trusts Law which provides that, "subject to the terms of the trust, a beneficiary may sell, pledge, charge, transfer or otherwise deal with his or her interest in any manner". The Jersey statutory position was distinguishable from that in England and Wales, where conventional wisdom holds that an object of a discretion does not have a proprietary interest or asset which is capable of being transferred to a third party.

Kea did not seek to argue that confirmation of the *arrêts* over Mr Watson's beneficial interest would give Kea any interest in or entitlement to the underlying assets of the trusts themselves. Instead it argued that having seized his beneficial interests, which was a matter for the Court's discretion, Kea would subrogate to Watson's rights as a beneficiary. It would then have the ability to request a distribution – something which Watson as an adjudicated fraudster and contemnor of the English High Court was highly unlikely to do – which the trustee would then be obliged to consider, seeking directions if necessary. Standing in Watson's shoes, Kea would be able to give the trustee a good discharge for any appointment of assets to it.

Decision

The Royal Court (Commissioner Clyde-Smith OBE and Jurats Crill and Averty) refused to confirm the *arrêts* over Watson's beneficial interests. While the Court accepted that the beneficial interests constituted movable property, it held that they were not inherently transmissible or amenable to execution. The Court noted that article 10(11) of the Trusts Law was expressed to be "subject to the terms of the trust" and that there was nothing in the terms of the specific trust instruments concerned which provided that Mr Watson could alienate his beneficial interest.

In addition, any attempt to appoint trust assets to a creditor of a beneficiary would meet with the objection that it would be a fraud on the power, being tainted by the intention to benefit a stranger to the trust. The bundle of rights enjoyed by a discretionary beneficiary was not equivalent to a positive entitlement to the trust assets and there was no utility in ordering distraint. By analogy, on the bankruptcy of a discretionary beneficiary, the beneficial interest would not vest in the hands of the Viscount (the executive officer of the Royal Court and official receiver) as other property would pursuant to Jersey bankruptcy law. The Court was also concerned that the consequence of the creditor stepping into the shoes of the discretionary beneficiary would be to enable the creditor to interfere with the proper administration of the trust.

On the other hand, the Court had no difficulty with confirming the *arrêts entre mains* in respect of the loans made by Watson to the trusts, as a result of which the debts became due to Kea instead. The Court also demonstrated some sympathy for Kea's position and granted it a period of time within which to plead factual claims against the three trusts on more conventional grounds, including resulting trust and proprietary tracing claims.

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Comment

The decision will no doubt come as a considerable relief to the trust industry in Jersey. It seems likely that the Court was motivated by policy considerations and the desire to reinforce, rather than be seen to undermine in any way, the nature of the Jersey law discretionary trust as an ownership "structure" which is separate and distinct from the assets of its beneficiaries. The Court may have been influenced by floodgates-type considerations and the prospect of a rise in claims against Jersey discretionary trusts by creditors, ex-spouses and foreign tax authorities.

Having said that, given that Jersey is an international finance centre which seeks to promote itself as transparent and well-regulated, the judgment may be seen as somewhat encouraging to fraudsters seeking to insulate assets, as its effect is to make the pursuit of civil recovery claims that much more difficult. As the judgment itself acknowledges, the enforcement route proposed by Kea could have been a shortcut to avoid expensive, fact-intensive proceedings.

A key takeaway for trustees from the judgment is that they should now undertake a review of their trust instruments in order to establish whether there is express provision for beneficiaries to deal with their beneficial interests, including the ability to sell or transfer that interest, or to use it as collateral for finance. If no such provision has been made, then beneficiaries may lack the flexibility to transact in relation to their interests.

[1] See *Glenn v Watson & Ors* [2018] EWHC 2016 (Ch)

[2] *Kea Investments Ltd v Watson* [2020] EWHC 2796 (Ch)

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