# In the matter of the Poulton Family Trust: Mental incapacity and undue influence

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On 18 February 2022, Justice Ian Kawaley of the Cayman Islands Grand Court delivered an extensive 250-page judgment in a long-running trust dispute which touched on issues of mental capacity, undue influence, fraud on the power, estoppel, and conspiracy /conspiracy to injure.

The case, which revolved around a Cayman Islands-governed trust, represents the current state of the law in relation to mental incapacity and undue influence in the Cayman Islands and largely follows the leading Commonwealth and Cayman Islands cases on point.

This article outlines the background to the case, the grounds of litigation, the judge's rulings and key takeaways for trust advisors and trustees.

## Background

The trust in question – known as the Poulton Family Trust (the **Trust**) – was established in 2003 by the sole settlor, Mr. Alan Poulton (**Alan**).

Alan was an English national and successful entrepreneur from a very young age. He managed to purchase several valuable commercial properties all of which were held in one operating company and one holding company. The shares of the holding company comprised the assets of the Trust. The Trust was otherwise cash-poor.

The Trust deed provided that Alan would receive the Trust income the whole of his life, but otherwise the capital was to be preserved for his children and remoter issue.

Alan had a series of intimate relationships during his lifetime with several women, three of whom he married, producing five children in total. His last marriage prior to his death took place in 2004 to Deborah McMullan (**Deborah**). Deborah survived Alan when he died in 2016 and is the primary Defendant in this case.

In late 2014 Alan's Cayman Islands trustee informed him they were obliged to report the existence of the Trust to the US Internal Revenue Service (**IRS**) under the Foreign Accounts Tax Compliance Act (**FATCA**), a newly enacted US law which compelled certain foreign financial institutions (including the Trustee of the Trust) to provide information to the IRS on any foreign trusts with a US connection. Since Alan had been habitually resident in the United States for many years he was liable to pay US tax on Trust distributions. This news came as a shock to Alan who had assumed such distributions did not attract US tax. Alan urgently sought the advice of a highly regarded Miami-based tax lawyer who confirmed he indeed was liable to pay US tax on distributions. This oversight also resulted in fines and late penalties as well as potential criminal penalties.

With the guidance of his US tax attorney, it was determined the best course of action was:

1. to apply to enter the IRS Voluntary Disclosure Program, to allow him to 'come clean' in exchange to the payment of the outstanding tax and penalties, and to avoid any risk of imprisonment; and

2. to collapse the Trust and appoint all of the Trust assets to Alan, liquidate sufficient assets to pay the tax due, and then re-settle the remainder of the Trust assets on two US domestic trusts on roughly identical terms to that of the Trust.

While the above plan (the **Plan**) may have seemed reasonable on its face, Alan's children, some of whom were directors of the operating company viewed it with suspicion, and resisted its implementation for a variety of reasons. It was alleged by Deborah that the resistance stemmed not from any concerns about the veracity of the legal advice or any technical aspects of the Plan, but rather from a concern that it was in fact a scheme to effectively disinherit them and remove them from the operating business.

In late 2015 Alan was diagnosed with terminal colon cancer, and it was unclear how long he had left to live, this making him more determined than ever to carry out the Plan to put his affairs in order.

Alan's children, however, became increasingly concerned about his state of mind in light of his ill health, which also included impaired mobility, loss of vision, dependence of certain prescription medications, allegations of alcohol abuse and chemotherapy side-effects.

Alan's children were also concerned that they found it increasingly difficult to get into direct contact with him, and that Deborah had taken on the role of 'gatekeeper' and allegedly sequestered him away from his children. Deborah, on the other hand, asserted that she was merely carrying out Alan's wishes and that he had become disillusioned with his children putting their own interests ahead of their father's, at a time when he was fighting for his life and freedom.

During the course of 2015 and 2016, Alan took steps to implement the Plan without the consent or cooperation of his children, which culminated with him removing them as beneficiaries of the Trust, terminating the Trust, and receiving all of the Trust assets outright. Alan died shortly after receiving the Trust assets and they automatically vested in Deborah by right of survivorship[1] — much to the dismay of his children. As one might anticipate, litigation was commenced by Alan's children (the **Plaintiffs**) shortly after his death on the grounds set out below.

## Grounds of litigation

The Plaintiffs sought relief on five main grounds:

1. That Alan lacked the mental capacity necessary to take the steps he did to terminate the Trust in his favour;

2. If Alan did have sufficient mental capacity to terminate the Trust, he was unduly influenced by Deborah, and, therefore, his acts were void or voidable;

3. Alan, in his capacity as Protector, failed to exercise his powers in a fiduciary manner when he took the steps he did to terminate the Trust;

4. Alan should be estopped from implementing the Plan on the basis that it ran contrary to representations he had made to his children regarding his intention that the Trust should remain intact for multiple generations; and

5. Deborah and the other Defendants conspired to injure the Plaintiffs by encouraging Alan to carry out the Plan to their detriment.

## Mental incapacity

The judge first had to identify the current test for mental capacity in relation to the exercise of trust powers.

The judge cited with approval the recent Cayman Islands case, **Re O Trust**[2] , that applied the old English authority of **Banks v Goodfellow**[3] which set out a threefold test requiring the powerholder (Alan, in this case) to:

- understand the nature of the act and its effects;
- understand the extent of the property being disposed; and
- understand the legal claims that may give effect.

The judge also stressed that the level of understanding depended on the context of the situation, the complexity of the transaction, and the value of the property being disposed citing in **Re Beany**[4] :

*"…the degree [of understanding] required varies with the circumstances of the transaction. Thus, at one extreme, if the subject matter and value of the gift are trivial in relation to the donor's other assets a low degree of understanding will suffice. But at the other extreme, if its effect is to dispose of the donor's only asset of value and thus, for practical purposes, to pre-empt the devolution of his estate under his will or intestacy, then the degree of understanding is as required is as high as that required for a will…"*

The judge then had to determine who carried the burden of proof, concluding that the Plaintiffs bore the initial burden to make out a prima facie case of mental incapacity, at which point the burden of proof switched to the Defendants.

The judge did, however, distinguish between the levels of mental capacity required, and cited the English case of **Perrins v Holland**[5] to support the notion that an individual is capable of lacking capacity at the time of formal execution of documents if he or she had the requisite mental capacity at the time the instructions were given; for example, to prepare documents to collapse a trust. It was also agreed by all parties that mental capacity is capable of waxing and waning from time to time.

The judge concluded that although Alan may have suffered from temporary cognitive impairments from time to time in the months preceding the termination of the Trust, at the time he set the Plan in motion there was no cogent evidence he was suffering from any significant degree of mental impairment capable of impeding the exercise of his powers, and that he understood the general nature and intent of the Plan. On the balance of probabilities in the light of the extensive evidence adduced at trial, the judge concluded that Alan's mental capacity was sufficient to take the steps he did in furtherance of the Plan.

## Undue influence

Now that Alan's mental capacity was determined, the judge turned his attention to arguably the more difficult question of whether (or not) he was unduly influenced, and whom between the warring parties had the obligation to prove or disprove it.

The judge relied heavily on the **Royal Bank of Scotland v Etridge (No 2)**[6] House of Lords decision in distilling the key legal principles in relation to who held the burden of proof. Those being in summary:

- There is no automatic presumption of undue influence between a husband and a wife;
- If a prima facie case can be made out that one spouse was sufficiently subject to the influence of the other, a rebuttable presumption of undue influence will arise; and
- If such rebuttable presumption does arise, the onus to uphold an impugned transaction falls on the party seeking to uphold such transaction.

In this case, the facts were sufficiently persuasive to make out a prima facie case that undue influence did arise with respect to Deborah against Alan.

The judge then summarised the test for undue influence based on the **Etridge** case as follows:

- There must be a relationship of influence between the parties;
- The impugned transaction must be one that calls for an explanation; and
- In the absence of a satisfactory explanation the court may infer that a transaction has been procured by undue influence.

Undue influence, therefore, requires a degree of influence of such weight and nature that its product ought not fairly be treated as the expression of another person's free will[7].

The facts of this case revealed that Alan:

- was suffering from a range of serious health issues, including failing vision, stage IV colon cancer, an anxiety disorder, and occasional heavy alcohol consumption;
- had become heavily dependent on Deborah in terms of both home care, and his day-to-day business affairs which included the steps he took to terminate the Trust and have the Trust assets appointed to him in accordance with the Plan, with Deborah acting as the liaison between his professional advisors;
- did not receive direct relevant independent legal advice, as such legal advice was often channeled through Deborah;
- had originally intended to keep the Trust intact, as reflected in the terms of the Trust itself and the accompanying letter of wishes, and the Plan was in direct contradiction to this;
- had become heavily dependent on Deborah to act as the liaison between him and his children, had become estranged from his children, and rarely communicated with them directly between 2015-2016; and
- had at some point between 2015-2016 decided that the Trust, which was originally established to ensure the continuance of his business and to provide for his children and remoter issue, should now be terminated and the whole of the Trust assets be distributed to him and Deborah — albeit with the intention that once the IRS debt was paid any balance left over would be re-settled on domestic US trusts on near identical terms to that of the Trust. This, however, was viewed by Alan's children as an attempt to 'dis-inherit' them from Alan's estate, particularity in light of his terminal cancer diagnosis which significantly reduced his life expectancy[8].

In light of the above factors, notwithstanding that all parties agreed that Alan was a strong-willed individual, the judge inferred that Deborah had unduly influenced Alan by assuming "*moral command[9]*" over him in such a way as to advantage herself to the prejudice of the Plaintiffs.

## Fraud on a power

An issue arose regarding the proper exercise of the power of exclusion of beneficiaries by Alan.

Alan had retained the said power of exclusion in his capacity as the Settlor and Protector of the Trust but it was not clear from the terms of the Trust instrument whether such power was meant to be personal or fiduciary in nature. It was argued by the Plaintiffs that such power was fiduciary in nature, and on this occasion was exercised improperly so as to exclude the Plaintiffs (Alan's children). It was argued by the Defendants that in the absence of clear drafting, Alan would not have intended to restrict the said power by making it a fiduciary one, and that in light of the recent Bermudian Court of Appeal decision in **Grand View v Wong**[10], such power could be exercised to alter the 'substratum' of the Trust if Alan so wished.

The point was not subject to extensive submissions, and the judge ultimately stated *obiter* that he would have ruled that the said power had been validly exercised, had he been required to rule on it based on the evidence before him.

## Estoppel

The Plaintiffs initially pleaded and then later abandoned this argument during the course of the trial due to insufficient evidence. Nonetheless, the Plaintiffs asserted that owing to Alan's repeated representations to his children that the Trust was established to hold the family business for their continued benefit, which the children relied upon, that it was inequitable for Alan to 'go back on his word' and terminate the Trust to their detriment.

The judge was not required to rule on the point and therefore did not do so.

## Conspiracy and conspiracy to injure

The Plaintiffs alleged that Deborah, her son and daughter-in-law agreed between them to take certain steps to remove the Plaintiffs as beneficiaries and terminate the Trust to the detriment of the Plaintiffs to their collective benefit.

The tort of conspiracy / conspiracy to injure consists of three elements:

- Two or more persons having a common agreement or understanding to act unlawfully;
- The conspirators intending to cause damage to the plaintiff by such unlawful act; and
- That the plaintiff suffered the intended damage[11].

The Plaintiffs failed to address this point in their closing argument, suggesting there was little cogent evidence to support it, so the judge did not have to make a ruling on the point, however, he stated that he would have dismissed it in any event based on the available evidence.

## Key takeaways

- Where drafting reserved powers, it is important to ensure the nature of the power, whether personal or fiduciary, is made explicit in the trust instrument to avoid confusion.
- Where the mental capacity of a powerholder is in question, it is important to consult with medical experts prior to the exercise of any trust powers and to document matters properly with contemporaneous medical evidence wherever possible.
- Professional advisors and trustees should be alive to the presence of undue influence, particularity where an asset of significant value is being disposed of, contrary to the previous intentions of the settlor / trust powerholder.
- Professional advisors and trustees should inquire what (if any) representations were made to beneficiaries of any trust which are contrary to a proposed course of action, particularly if it involves a disposal of significant trust assets by persons other than the trustee, such as a protector or other powerholder.

[1] The Trust assets were appointed to Deborah and Alan jointly as co-beneficiaries.

[2] 2018 (1) CILR 59

[3] (1869-70) LR 5 QB 549

[4] 1978 1 WLR

[5] 2011 Ch 270

[6] 2 AC 773

[7] Paraphrased from Snell's Equity at [8-016].

[8] Alan died within days of receiving the Trust assets, and Deborah became the sole owner by right of survivorship.

[9] See paragraph 493 of the judgment. The judge also speculated that Alan may have surrendered his free will "…f*or the sake of peace and quiet*" underscoring the wide range of behavior that might capable of constituting undue influence.

[10] 2020 CA 6 (Bda) 37 Comm.

[11] The judge indicated that a possible fourth requirement, that the conspirators must have known their action was unlawful, was contentious based on the current jurisprudence.