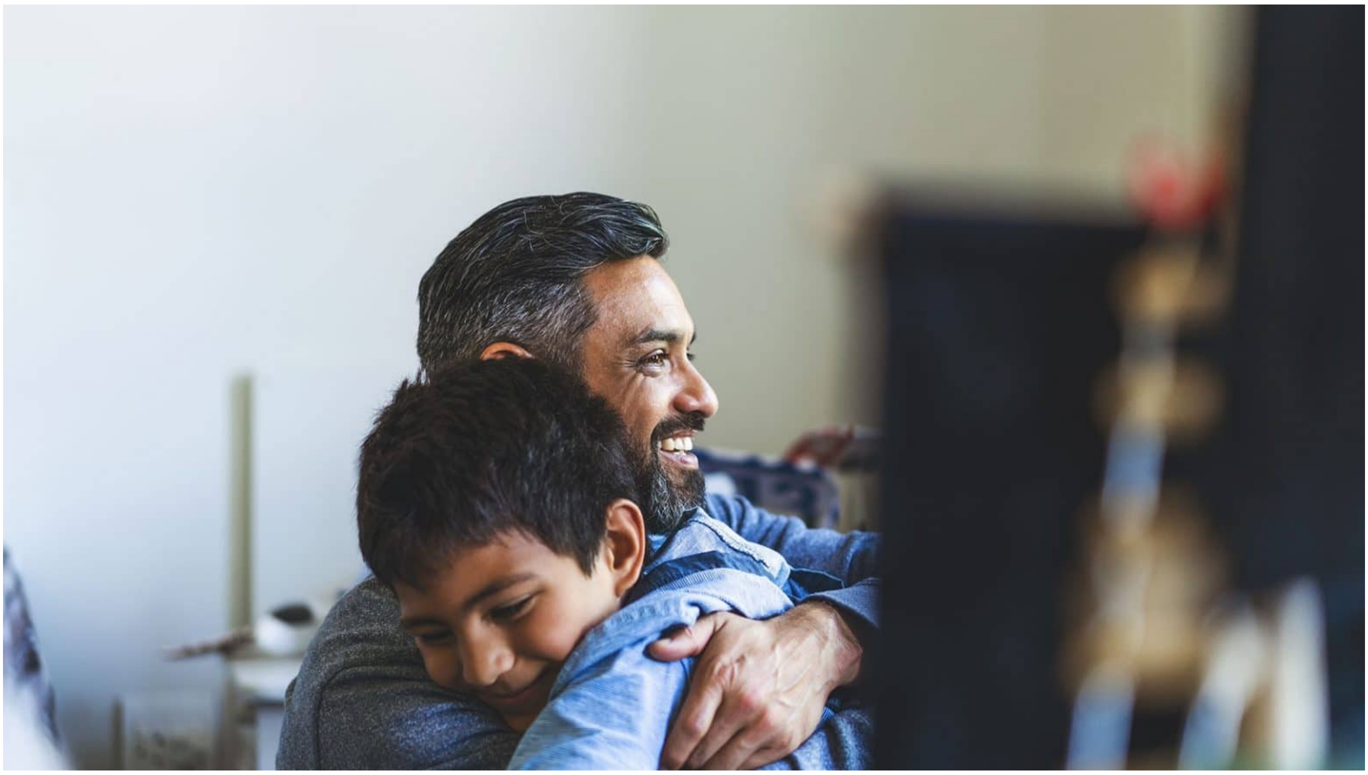
# Trustee shareholders: understanding the issues



Family trusts have long been used as a tax efficient method of holding, maintaining and dissipating family assets. Traditionally, trusts held on to assets in the long term, often over several generations.

The effect on this consistency and control is evident if you wander the streets of Mayfair today, where ownership under trust has enabled prime real estate to be preserved as residential property, and resisting the urge to develop and convert as seen elsewhere across London.

In an increasingly commercialised world, settlors and beneficiaries expect their family trusts not only to hold wealth, but to actively generate it. Placing shares into a family trust can be one way of achieving this, but it is important that family members and trustees alike understand the complexities than can arise should the trust ever wish to sell those shares.

## Managing trusts that hold shares

The first step will be to check that the trust deed gives maximum powers to the trustees to sell assets and to give any warranties or indemnities required to effect such a sale. Trustees can rely on underlying law to some degree, but clear drafting on the face of the trust deed provides certainty and comfort to everyone concerned.

The second step will be to ensure that the trustees owning the shares understand what rights (and obligations) sit with that shareholding. If trustees are to discharge their own fiduciary duties, they need to be able to demonstrate that they exercise independent judgement in the best interests of the beneficiaries when deciding how to exercise these rights.

If the trust is intending to realise the value of the shareholding by selling those shares, the trustees will also need to be aware of the 'pinch points' in advance of negotiating a sale. In particular:

- The scope to which the trustees can dictate terms will depend to a large extent on the size of their shareholding: a minority seller will typically have far less say than the majority.
- All sellers will be expected to give a number of warranties, or contractual statements of fact as at the point of completion. Trustee shareholders who are not actively involved in the management of the company should seek to limit the scope of their warranties to title and capacity, but this will place an increased burden on the other sellers who will be expected to provide warranties on a much broader basis (eg as to finances, key contracts and liabilities).
- Trustee shareholders may also be unable to give absolute warranties (eg "The Company is not subject to any claims") as they may have insufficient knowledge of the way in which the business is run. If the warranty cannot be carved out altogether, trustees will want to build in a knowledge qualification (eg "So far as the trustees are aware, having made all reasonable enquiry…").
- Trustees must also consider the extent to which the trust's assets are exposed if a claim for breach of warranty arises. Options include:
- ring fencing the liabilities of the trustees to the value of the trust assets from time to time;
- ensuring that warranties are given severally, so that the trustees would only be liable for their own breach and not a breach of warranty by any other seller; and
- obtaining insurance to cover the risk of any claim.

Buyers will conversely be keen to keep their ability to recover for a breach of warranty claim as straightforward as possible. They may insist on the trust retaining assets of a value of not less than £x for a period of time post closing, or placing an amount in escrow over a similar period.

If buyers will not agree to the warranties being 'sliced and diced' amongst sellers, trustees could resort to a deed of contribution between the various sellers under which they agree to spread the cost of any claim between them in agreed proportions.

Finally, trustee shareholders need to be aware of their overriding duty to avoid restricting their ability to make independent decisions in the future. This long standing principle can jar in the context of a commercial transaction where the deal will often require the parties to give some form of binding commitment as to how they will act in the future.

Two obvious examples include restrictive covenants and an undertaking to ring fence trust assets for a period of time. The courts have shown a willingness over recent years to acknowledge that circumstances do exist where trustees can validly fetter their discretion, but in doing so they must be able to demonstrate they genuinely considered it was in the best interests of the beneficiaries to do so.

## How we can help

Selling shares in any business, let alone one with trustee shareholders, can be a complex affair. Please contact Victoria Symons if you would like to discuss this further.

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