pilot unit for the company's franchise network') which was owned and run by him personally and which had nothing whatsoever to do with his position as a director of the company. In other words the relevant knowledge and experience was entirely his qua Mr Mistlin, and not his qua director. Indeed I would go so far as to say that, in reality, Mr Mistlin held himself out as personally responsible for the only available figures to support the projections, as was indeed the fact.'

In concluding his judgment Hirst LJ expressed the view that there was no risk, on the particular facts of this case, of compromising the general concept of limited liability. Waite LJ agreed. A dissenting judgment was delivered by Sir Patrick Russell.

LESSONS FOR THE FRANCHISE COMMUNITY

Few franchisees who fail in business blame themselves. All franchisors run the risk of claims arising out of pre-contractual representations which they make to prospective franchisees either in pre-contract documentation such as franchise brochures, or in negotiations. Larger organisations may have difficulty controlling what may be said by a range of staff from the telephone receptionist to the franchise sales director. The *Natural Life* case points out that smaller franchisors have a higher exposure risk. This case does turn on its facts to some extent. The franchisor company was in its infancy. It had no real experience. The experience it offered to prospective franchisees was that of the single founding director. Its marketing literature claimed experience it did not have. When the financial projections were provided to the plaintiffs, the franchisor company had no other franchisees with any relevant experience to provide a basis for them.

For new businesses who want to franchise, this case sends these messages:

- learn about franchising before selling franchises;
- sell the franchises yourself. Do not use intermediaries;
- only claim that you have a proven system if you actually do have one;
- do not pluck sales figures out of the air and dress them up as profit forecasts. For a franchisee the most important factor when he buys will be working out realistic and supportable projections for sales, expenses and profits. No franchisee has the experience to do this. It is only a franchisor who is able to supply accurate information, with appropriate clarifications and disclaimers;
- officers of a company should avoid making statements in a personal capacity.

FRANCHISORS' RISK

Few franchisees who fail in business blame themselves. All franchisors run the risk of claims arising out of pre-contractual representations which they make to prospective franchisees either in pre-contract documentation such as franchise brochures, or in negotiations. Larger organisations may have difficulty controlling what may be said by a range of staff from the telephone receptionist to the franchise sales director.

Paul Heatherington

Eversheds (Newcastle upon Tyne)

Trusts & Equity

How dumb is the blind trust?

by Paul Matthews

A common phenomenon in the modern offshore trust world is the so-called blind trust. Typically, a nominal trust fund – say £10 – is declared by a professional offshore trustee to be held on the terms of a lengthy and sophisticated trust deed. In substance, this amounts to discretionary trusts of income and capital, during the longest period allowed by the governing law, for the benefit of a defined class of objects. Again typically this class at the outset contains only one or two members. They will be charities of worldwide reputation, such as the International Red Cross.

The trust deed also confers power on the trustee to add further persons to the class. Some time after the original declaration of trust, the settlor decants substantial wealth into the hands of the trustee, on the same trusts. But, because the original deed is a unilateral declaration of trust by the trustee, the identity of this real settlor nowhere appears. Later still, the trustee – at the 'suggestion' of the settlor – appoints persons, who just happen to be his or her relatives or even himself or herself, into the class of objects, and then – surprise, surprise – the trustee appoints significant wealth out of the trust fund to them.

Such trusts have been known in the offshore world for years (see eg *Re Gea Settlement*, 17 March 1992, Royal Court of Jersey). Those who promote such trusts say they are cheap to set up, flexible, and may prevent intended beneficiaries having too many rights until appointed into the class (compare *West v Lazard Brothers & Co (Jersey) Limited* 1987–88 JLR N-22). All true. They are also a godsend to the shifty, the secretive and the downright fraudulent. And in any event the bit about charity is almost certainly a sham. In bad cases the whole thing will be.

TRUST'S DISSERVICE

But my purpose here is not to point out these obvious truths. It is to say that, even if the blind trust is utterly genuine, it may do a real disservice to those who create it. This is illustrated by a recent decision of the Isle of Man Court of Appeal (actually called the Staff of Government Division), *Ahuja v Scheme Manager, Depositor's Compensation Scheme* (8 April 1997, unreported).

Here a blind trust was set up in 1989 by eight persons, all related. Unusually, two of them appeared in the trust as settlors and trustees. But essentially it was a nominal sum held on discretionary trusts for a class which, at the date of setting up, contained only one object, namely the International Red Cross. This was also the beneficiary in default of appointment. One week after being created, two events occurred. First, the

eight persons were added to the class of objects (so there were then nine), and second, a trust account was set up at the Isle of Man branch of BCCI. Substantial further funds were then added to the trust fund. In total the sum amounted to some £160,000, each of the eight persons contributing about £20,000.

BCCI collapsed in 1991. The Isle of Man bank deposit compensation scheme would pay three-quarters of a maximum loss of £20,000, i.e. £15,000, to a depositor in a Manx bank. Each of the eight persons claimed that maximum of £15,000. The scheme manager, considering the regulations covering the scheme, disallowed their claims. He allowed a single suit of £15,000 to the trustees.

If this had been a bare trust for the eight persons, each could have claimed under the regulations in his or her own right. But it was not. Instead, under reg. 9(3)(e), a deposit by trustees of the trust was to be treated as one account:

'unless the beneficiaries of the trust are individuals whose identity and right to benefit can be conclusively established'.

UNTRUSTWORTHY

Those who promote such trusts say they are cheap to set up, flexible, and may prevent intended beneficiaries having too many rights until appointed into the class ... All true. They are also a godsend to the shifty, the secretive and the downright fraudulent.

NO REMEDY

At first instance, the court said that the beneficiaries' identities and their right to benefit could be conclusively established.

It was not necessary that any appointment out be made in favour of the eight persons. It was sufficient that they had been added to the class. This, of course, proves too much. If the eight individual members of the class were entitled to compensation, why not the ninth member, the International Red Cross? But no one was concerned to argue for them. And, almost certainly, no one ever intended them to benefit anyway.

On appeal, the Judge of Appeal, Benet Hytner QC, took a different view. Although the eight persons had been added to the class, no appointment had been made in their favour. Thus, it could not be said that the right of the beneficiaries to benefit could be conclusively established. The trustees might have appointed the whole to the International Red Cross, or made no appointment at all, so that it vested in the International Red Cross at the end of the trust period.

So the eight persons who had contributed £160,000 had to be satisfied with compensation paid to the trustees of just £15,000 (they would, of course, also obtain some sort of modest dividend from the liquidation of the bank). The question to be asked is, why did they use this kind of trust?

TRUST'S DUBIOUS ATTRACTIONS

Well, first, they may not have wanted a bare trust. Perhaps tax reasons made that unattractive, though strictly speaking (as far as UK tax is concerned) any UK settlors amongst the eight would pay tax on the income whether they received it or not, as they had not been excluded from all benefits. So even an ordinary discretionary trust with them in the class would have meant that they were still taxable. Perhaps they thought – or were advised – that a blind trust, where the real beneficiaries are not added till later, was somehow outside the tax rules, or was simply more difficult for a Revenue authority to see through. But, if that was the case, why did the trustees add the eight persons to the class of beneficiaries exactly one week after the execution of the trust deed and decant the substantial wealth into the trust account then?

Perhaps it was not tax but exchange control. At least two of the persons concerned lived in India. Did they think that a blind trust was outside the exchange control rules? Or would it just be harder for a government to track down? We do not know.

But you cannot help thinking that the blind trust has been turned into a product: it's new, it's wonderful, it avoids taxes or exchange control. Well, it may or may not do that (though in any event it may not be the blind aspect that achieves it). However if the intention is to save in a bank account, rather than to invest in some other way, any kind of discretionary trust – let alone a blind trust – is likely to take the beneficiaries outside the scope of compensation schemes.

TRENDY PRODUCT

You cannot help thinking that the blind trust has been turned into a product: it's new, it's wonderful, it avoids taxes or exchange control ... if the intention is to save in a bank account, rather than to invest in some other way, any kind of discretionary trust – let alone a blind trust – is likely to take the beneficiaries outside the scope of compensation schemes.

And so it proved here. Why did they not just put all the money in a bank account in their own names, or in the names of one of them for all? Look at Mr Anand, who did just that, without any trust deed, and the Special Commissioner accepted (as the Inland Revenue had not) that there was a bare trust for him and his three sons equally (see *Anand v IRC* (1996) Sp C 107).

Sometimes the simplest things are the best.

Paul Matthews

Withers