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ADDRESSING MISTAKES BY CORPORATE TRUSTEES

By Rani Mina

For more than 20 years, trustees who suffered serious remorse about their decisions have had a powerful route by which to revisit and unwind those decisions, in the form of a ‘magic pill’ called the Hastings-Bass rule. In a recent decision, the Court of Appeal has significantly cut down the scope of this rule, noting that it had taken on a life of its own over a long line of cases and that this was a rare example of the law “taking a seriously wrong turn”.

This has important implications for all trustees, including corporate trustees, where the trust deed is governed by English law, since they will no longer be able to use the rule to correct mistakes which have adverse consequences for beneficiaries. The decision also has important implications for beneficiaries, such as noteholders, under those trust structures because in re-stating the relevant principle, the Court of Appeal said that it is necessary for beneficiaries to bring court action against a trustee and prove breach of duty if they are aggrieved by a trustee’s actions.

What is the Hastings-Bass rule?

In brief, the rule in Hastings-Bass was to the effect that where trustees exercised a discretion, but the effect of doing so was different from what they intended, the decision could be declared invalid if the trustee had failed to take into account relevant considerations or if they had taken into account irrelevant considerations. It seems to have been deployed most commonly where a trustee had taken a decision that turned out to have unintended adverse tax consequences, but its potential application was much wider and it could be used even if the decision had been taken with the benefit of professional advice.

What is the position now following the Court of Appeal decision?

The Court of Appeal has now held that if trustees have exercised a discretion which is within their powers, but they have done so in breach of their fiduciary duties, the trustees’ decision may be voidable, i.e. capable of being unwound. If the exercise of the discretion is outside the scope of the trustees’ powers, it will be void. It will normally be for the beneficiaries to apply to have the trustees’ decision set aside and whether such a claim succeeds will be at the discretion of the Court.

It is important to appreciate that even under the ‘new look’ rule, failing to take into account relevant considerations (including fiscal considerations) or taking into account irrelevant considerations will normally constitute a breach of duty by a trustee. A common example is where a corporate trustee has a discretion to modify or amend the trust deed or to waive certain rights that it has under the trust deed, provided this will not result in “material prejudice” to bondholders. If the corporate trustee fails to take into account relevant matters in assessing whether this would result in “material prejudice” to bondholders, the trustee may be found to be in breach of its fiduciary duty.

The principle may even apply in circumstances where corporate trustees have acted upon a direction from the requisite majority of bondholders, depending on the terms of the resolution. For example, a trustee may be left with a discretion to implement matters that may be incidental to the direction or there may



Rani Mina

Partner, Commercial
Dispute Resolution
rmina@mayerbrown.com

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be some element of discretion that remains with the trustee, such as in the timing or manner in which the direction is exercised. If the trustee fails to take into account relevant matters in deciding when the particular matter is to be implemented or in deciding how it should be implemented, the trustee may be found to be in breach of its fiduciary duty.

In a positive step, the Court of Appeal has confirmed that trustees will not be in breach of duty – and the exercise of the discretion will not be voidable – if they have acted on appropriate professional advice. Trustees should, therefore, be able to protect themselves by obtaining appropriate legal or other professional advice to ensure that decisions are taken on the correct legal and factual basis. Trustees who fail to take professional advice may be in a more vulnerable position, although corporate trustees are often protected from personal liability by special indemnity provisions in the trust deed.

If trustees have acted on the basis of wrong advice, the Court of Appeal has made it clear that the appropriate action lies against the professional adviser. This is an action that the trustee may be faced with having to commence, since the claim is likely to be trust property. Whilst the potential for professional negligence claims against advisers does, therefore, seem to have increased, it does not necessarily follow that this type of action will be any easier to establish. Professional advisers may specifically disclaim responsibility for advising on certain matters.

The somewhat perverse result of the Court of Appeal's decision may be that beneficiaries who are affected by the unintended consequences of a trustee's actions may be left with no remedy, whether against the trustee or the professional adviser. If so, beneficiaries who are aggrieved by a trustee's actions may decide that there is little point in bringing an action, despite the Court of Appeal's insistence that beneficiaries need to "grasp the nettle".