

A rare example of a court exploring the nature of unit trusts

October 2015

Barclays Wealth Trustees (Jersey) Limited & Another v Equity Trust (Jersey) Limited and Another [2014] JRC102D

Summary

If you are involved with a unit trust structure (as trustee, manager or unitholder), and are in any way unsure of the legal nature of a unit trust, then you should read this article. It will assist you to fully appreciate the nature of a unit trust, the rights and obligations involved between the parties and that a manager can be considered a trustee for liability purposes.

Facts

Barclays Wealth Trustees (Jersey) Limited (“**BWT**”) and Barclays Wealth Fund Managers (Jersey) Limited (“**BWFM**”) (together “**Barclays**”) are the present court appointed trustee and manager of three Jersey proper law units trusts known as R2R Bulgaria Property Fund, R2R Croatia Property Fund and R2R Montenegro Property Fund, of which Equity Trust (Jersey) Limited and Equity Trust Services Limited (together “**Equity**”) were the original trustee and manager. The purpose of the unit trusts were to make investments, through intermediary companies and other investment vehicles, in property of various kinds in Bulgaria, Croatia and Montenegro, but significant investment losses arose.

Equity brought the current application before the Royal Court of Jersey to strike out certain parts of Barclay’s claims against Equity. However, the application raised important questions about:

1. the nature of unit trusts (i.e. is it a contract, or a trust, or a quasi contract/ trust?);
2. the legal status of managers and trustees of unit trusts; and
3. the judicial basis of claims against a former trustee and manager by a successor trustee and successor manager.

There is little judicial authority on this area in Jersey, or England and Wales, but there is some academic and professional literature exploring these questions, albeit not all of it unanimous in its conclusions.

Trust instruments and the claim under contract law

As is often usual with unit trust instruments, each unit trust was described as an instrument made between trustees and manager, the terms of which relieved the trustee of all, or most, of the duties relating directly to the investment function. The manager was tasked with managing and administering the trust fund with the trustee concurring in, and performing, the acts necessary to enable the manager to exercise its powers.

It was argued by Barclays that, by each of the trust instruments, a contract was formed between the manager and the unitholders such that, by virtue of its office, the manager owed duties in contract to all unitholders of each fund. Consequently, the manager was subject to the express duties and responsibilities in contract set out in the trust instrument and it was also subject to an implied duty of care and skill in the discharge of its functions as a manager. Thus, it was further argued, that Equity acted in breach of contract by not devoting enough time and attention to its duties as to prevent certain actions, failed to comply with the provisions of the prospectus and failed to satisfy the requirements of due diligence.

In the alternative, Barclays argued that Equity was in breach of its duties as trustee under Article 21(1)(a) of the Trusts (Jersey) Law 1984 (as amended) (i.e. to act with due diligence as would a prudent person to the best of his ability and skill and to observe the utmost good faith) and/or in breach of its contractual duty of care and skill in agreeing or failing to take reasonable steps to prevent certain actions. Therefore, was Equity liable under contract or trust law or both?

The Academics

Underhill & Hayton, a long-standing English trust practitioners text, provides that unitholders are not beneficiaries with equitable proprietary interests as equitable

co-owners of the property held by the trustee until the time comes for determination of the trust. Before such determination, the terms of a unitholder's contract of subscription, as reflected in the trust deed, oust such equitable right. Unitholders have contractual rights to income and to redemption of their units, but, Underhill & Hayton continue to say that, a trust automatically imposes fiduciary obligations upon the trustee and manager to the extent permitted by the Financial Services and Markets Act 2000 (if the parties are resident in England and Wales).

The Court acknowledged that a unitholder's primary entitlement is to his unit, which is essentially a bundle of contractual rights enforceable against the manager. However, the Court took the view that, because Underhill & Hayton provides that the trust element imposes fiduciary obligations upon the trustee and manager during the existence of the unit trust, a unitholder is indeed a beneficiary of the fiduciary obligations owed, indicating that a unitholder has a beneficial interest (perhaps of a limited kind) in the trust property.

However, the Court also looked at two further academic sources from:

1. Mr Kam Fan Sin of the University of New South Wales, Australia, who is of the view that *"the trust in a unit trust is a contractual creation [and the] 'three certainties' exist because there is mutual intention that the property will be held on trust and not in any other capacity and because the subject matters and objects have been agreed. This contrasts with the position of a private trust inter vivos..."*. Therefore, Mr Sin's view is that a unit trust is essentially contractual, but with a trust relationship created by the contractual nexus between the parties, with the manager having fiduciary obligations owed to the unitholders; and
2. Professor Alastair Hudson of the University of Southampton, England, who takes the pragmatic view that *"the role of the trustee is to ensure that the scheme manager does not use the trust fund for any purpose outwith the terms of its investment powers as contained in the unit trust's scheme rules."* Consequently, Professor Hudson's view is that a unit trust is a network of investment contracts between investors, manager and trustee. However, Professor Hudson does also state that "the property is held on trust for the participants" meaning that the trust structure constitutes an essential part of the unit trust.

Courts' Preliminary Conclusions

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In the light of the academic views, the Court expressed the following preliminary conclusions:

1. as a matter of pure generality, a unit trust can be expected to establish a triangular relationship between the manager, the trustee and the unitholders;
2. there are contractual and trust features of that triangular relationship;
3. the trustee and manager owe trustee- like, or fiduciary duties and obligations, to the unitholders;
4. pursuant to the trust instruments, the manager and trustee agreed to owe contractual obligations to each other;
5. it is at least arguable that the manager is liable as a trustee; the Court will not regard itself as bound by the titles and descriptions, which the parties have chosen to give themselves, when virtually all trustee-like functions are allocated to the manager and virtually none to the trustee;
6. even if the manager is not a trustee, its duties and obligations are to be carried out for the benefit of the unitholders, not for the personal benefit of the manager or the trustee, and if it can be shown there is sufficient relationship of trust and confidence between the unitholders and the manager, the unitholders would have the right to enforce the manager's obligations and claim equitable remedies in respect of any breach;
7. the locus standi of a successor trustee to sue a former trustee does not depend on the breach having a particular character as a breach of fiduciary duty; it applies generally to breaches of trust of all kinds. In this instance, the allegations made against Equity were unauthorised payments and breaches of care owed to the beneficiaries of the trust; both of which are claims which a successor trustee may legitimately make; and
8. the locus standi of a successor manager to bring a claim against a former manager turns on whether the manager can be viewed as a trustee. In this instance, it was at least arguable that BWFM is a trustee and, even if it is not, BWT is required to act on the directions of BWFM and it would be a strange result if BWT were the sole plaintiff in circumstances where the actual decisions about the litigation were being made by BWFM. Hence, in such circumstances, the Court strongly implied that a successor manager should have the locus standi to bring a claim against a former manager.

It is crucial to remember that the context of the facts at hand will always be relevant to determining the nature of the duties owed and the locus standi of a successor to bring a claim.

Conclusion

This recent judgment of the Royal Court is helpful to clarify certain issues for trust practitioners and unit trust administrators accordingly. As trust practitioners, we have always been of the view that a unit trust is a quasi arrangement featuring elements of both contract and trust laws. However, the lack of judicial authority in this area was not particularly helpful and this judgment assists to re-enforce our view. The lack of judicial authority is also a sign that not many unit trusts have been the subject of litigation before the English and Jersey courts.

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