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Channel Islands update: Effectiveness of anti-Bartlett clauses confirmed

DECEMBER 2019

The Hong Kong Court of Final Appeal (**Court of Final Appeal**) has delivered its highly anticipated judgment in Zhang Hong Li and others v DBS Bank (Hong Kong) Limited and others (**DBS Case**), overturning the earlier judgments and confirming that trustees may continue to rely on the provisions in trust instruments, commonly known as 'anti-Bartlett' clauses, which seek to negate a trustee's duty to enquire into or interfere in the management of underlying companies within a trust structure.

The DBS Case - facts

In 2005, Zhang Hong Li (**Zhang**) and his wife Ji Zhengrong (**Ji**) set up a Jersey-law governed family trust (**Trust**) with the help of the defendant bank, DBS Bank (Hong Kong) (**Bank**). Zhang and Ji were the settlors. The sole asset of the Trust was a BVI company (**Wise Lords**) which held investments through the Bank. The Bank provided a Jersey trustee to the Trust (**Trustee**) and BVI corporate director to Wise Lords (**Director**). Another bank entity provided administration, operational and secretarial support services in Hong Kong to the Trustee. Zhang specifically reserved to Ji the role of investment advisor and she was authorised by the Director to (a) execute investment transactions, (b) operate bank accounts, and (c) negotiate and draw on overdraft facilities, on behalf of Wise Lords.

Between 2005 and 2008, Ji executed over 500 investment transactions on Wise Lords' account. Initially, these trades were in mutual funds, with a medium risk profile. These trades generated impressive returns. During the global financial crisis, Ji changed her investment strategy with dire consequences, and the Trust suffered significant losses.

The claimants, which included Zhang and Ji, brought claims in the Hong Kong Court against the Director for breach of Director's duty and against the Trustee for breach of trust in respect of the losses sustained to the value of the trust fund.

The court at first instance held that, notwithstanding the terms of the trust instrument (**Trust Instrument**) which sought to restrict the Trustee's duties in connection with the management of Wise Lords, principally via a widely drafted anti-Bartlett clause, the Trustee retained a residual obligation to undertake a 'high-level' supervisory role. The judge found that the Trustee failed to discharge the high-level supervisory duty owed to the Trust. The Trustee appealed, and the Court of Appeal affirmed all aspects of the first instance judgment, dismissing the appeal.

Judgment of the Court of Final Appeal

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"Anti-Bartlett provisions are generally incorporated....because the parties wish to enable the settlor or the settlor's nominee freely to exercise control or management of the underlying company, especially regarding matters such as its investment decisions, and to relieve the trustee of any management or supervisory duties in that regard (save where extreme situations such as those involving actual knowledge of dishonesty might arise). To postulate that the parties' chosen scheme may be overridden by some implied, non-derogable external duty arising in circumstances 'where no reasonable trustee could refrain from exercising otherwise excluded powers' would be to introduce an amorphous and ill-defined basis for undermining a legitimate arrangement consciously adopted by the parties, exposing the trustees to unanticipated risks of liability and sowing confusion as to the extent of their duties."

These words, part of the judgment of the Court of Final Appeal, will be widely welcomed by the trust industry.

The Court of Final Appeal examined the anti-Bartlett clauses in the Trust Instrument, together with the Trustee statutory duties pursuant to Article 21(1) of the Trusts (Jersey) Law,1984 (**Article 21**).

It was clear that the Trust Instrument intended that the Trustee powers should be narrowly confined to the conduct of the investment business of Wise Lords. In particular, the terms of the Trust Instrument relieved the Trustee of any duty to interfere in the management of the underlying companies unless they had actual knowledge of dishonesty. It further provided that the Trustee could assume at all times that the business was being carried on honestly, diligently and in their best interests until such time as they had actual knowledge to the contrary.

Article 21 provides:

"21 Duties of trustee

1. A trustee shall in the execution of his or her duties and in the exercise of his or her powers and discretions-

   (a) act –

      (i) with due diligence;
      (ii) as would a prudent person;
      (iii) to the best of the trustee's ability and skill; and

   (b) observe the utmost good faith."

The key point here is that Article 21 sets out the standards which trustee must adhere to in executing their duties and exercising their powers – it does not "create free-standing duties to act prudently." The duties to interfere or become involved in the administration, management or conduct of the business or affairs of Wise Lords was expressly excluded by the anti-Bartlett clause in the Trust Instrument, and therefore, the Trustee held no powers or duties in relation to the company to be exercised prudently or otherwise.

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The Court of Final Appeal also rejected the Respondents' contention that, by electing to approve the relevant transactions, the Trustee had exercised a power to supervise and had assumed the role of controllers and ultimate decision-makers. As a matter of fact, and contrary to the Respondent's contention, that role was undertaken by Wise Lords' investment adviser (Ji) and any such approval by the Trustee only occurred after the transactions were reported to them – the "so-called 'approvals' represented merely a franking or acknowledgement of the information received. In no real sense can they be said to have assumed 'control'." The Court of Final Appeal also held that the actions which the Trustee did take could not be equated to them assuming a power to supervise as such a conclusion failed to recognise that the Trustees did not have a power to supervise unless they had notice of dishonesty on the part of the Directors.
The Court of Final Appeal unanimously held that the existence of any 'high level supervisory duty' was inconsistent with the anti-Bartlett clauses in the Trust Instrument.

Judgment post-settlement

The judgment was also important because it is understood to be the first occasion in which the Hong Kong Courts had cause to consider the exercise of its discretion to deliver judgment, notwithstanding that the parties had already settled following the hearing of the appeal. The Court of Final Appeal considered that delivery of the judgment was appropriate because it involved issues of law of general importance, the matter had attracted international interest and it was "*necessary to correct certain erroneous propositions*".

Comment

The judgment will be a welcome relief to trustees who, prior to the judgment, were faced with the prospect of owing a high level supervisory duty in relation to the supervision and management of a business conducted by an underlying company, whether investment or trading, despite the existence of an anti-Bartlett clause in the trust instrument.

The DBS case was decided under Jersey law, but is understood to be the first final appellate level case in any jurisdiction to examine the effectiveness of anti-Bartlett clauses and so is likely to highly persuasive in most offshore trust jurisdictions. We therefore consider it appropriate for trustees to consider the following:

1. when establishing a new trust, ensure that comprehensively drafted anti-Bartlett clauses are included in the trust deed;
2. pay careful attention to the relevant provisions of existing trust deeds to ensure the proper discharge of a trustee's duties;
3. where less than ideal anti-Bartlett provisions are included in existing trust instruments, consider with professional advisors whether there is scope to vary or amend the provisions of the trust instrument;
4. do no not intermeddle in matters properly delegated to a third party investment manager in the absence of dishonest conduct, unless the trust instrument provides otherwise;
5. where duties to supervise or monitor an underlying company have not been entirely excluded by the terms of the trust instrument, ensure that such residual duties are exercised prudently; and

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6. where investment management agreements or other contracts delegating authority are being entered into, ensure that the trustee is not a party to those agreements, or where the trustee is a party, ensure that the trustee understands its duties and obligations under that agreement.

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