

**Anti-Bartlett Clauses, Zhang Hong Li and Others v. DBS Bank (HK Ltd) -
Why the decision may not be as helpful for trustees as many think**

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BARTLETT

- One of the fundamental duties of the trustee is to invest the trust assets to a prudent investor standard
- When the assets are held through a substantial interest in a private company, the trustee has an obligation **to monitor** the management of the business beyond merely reviewing regular financial disclosures and **to intervene**.
 - *Re Lucking's Will Trusts* [1968] 1 WLR 866
 - *Bartlett v. Barclays Bank Trust Co. Ltd. (No.1 and No.2)* [1980] Ch D 139; [1980] 1 Ch 515

ANTI-BARTLETT CLAUSES

- Even before Bartlett, practitioners drafted trust clauses purporting to limit the obligation on trustees **to interfere** in closely held companies, where desirable
- Typically these clauses limit the obligation to interfere to instances where they are aware of dishonest or fraudulent (or grossly negligent behavior)
- However exoneration from the duty to interfere does not limit the **duty to investigate**: *Appleby Corporate Services (BVI) Limited v. Citco Trustees (BVI) Limited* [2014] 17 ITELR 413

ANTI-BARTLETT ON STEROIDS: THE AMSUN TRUST

- Recent decision of the Hong Kong Court of Appeal addressed an anti-Bartlett clause with these provisions (amongst others) in *Zhang Hong Li and others v. DBS Bank (Hong Kong) Limited and others* [2019] HKCFA 45:

ANTI-BARTLETT ON STEROIDS: THE AMSUN TRUST

- Provisions Removing Duty to Interfere:
 - *The Trustees shall not be under any duty nor shall they be bound to interfere in the business of any company in which this Settlement is interested...*
 - *...the Trustees shall not be under any duty to supervise such directors officers or other persons so long as the Trustees do not have actual knowledge of any dishonesty relating to such business and affairs on the part of any of them...*
 - *the Trustees shall assume at all times that the administration management and conduct of the business and affairs of such company are being carried on competently honestly diligently and in the best interests of the Trustees ... until they shall have actual knowledge to the contrary and ... the Trustees shall not be under any duty at any time to take any steps at all to ascertain whether or not the assumptions contained in this sub-clause are correct.*

ANTI-BARTLETT ON STEROIDS: THE AMSUN TRUST

- Provisions Removing Duty to Monitor:
 - *The Trustees shall not be under any duty to obtain or seek to obtain in any way whatsoever any information regarding the administration management or conduct of the business or affairs of any company in which this Settlement is or may be interested ...*
 - *The Trustees shall assume that such information as is supplied to them ...is accurate and truthful ... and shall be under no duty at any time to ascertain whether or not the information is accurate or truthful.*

MORE THINGS IN HEAVEN AND EARTH: NO DUTY TO MONITOR OR INTERVENE?

- **Bribery Act 2010:**

- -created the criminal offence of failing to prevent corruption foreign and domestic by associates
- -bribery expanded to include facilitation payments
- -bribery expanded to cover non-governmental people and entities
- Strict liability offence whose only defence is that you have appropriate procedures in place which reasonably prevent bribery

MORE THINGS IN HEAVEN AND EARTH: NO DUTY TO MONITOR OR INTERVENE?

- **Criminal Finances Act 2017:**
- -created the criminal offence of failing to prevent the facilitation of tax evasion foreign and domestic by associates
- No requirement that the foreign tax evasion is prosecuted
- -Strict liability offence whose only defence is that you have appropriate procedures in place which reasonably prevent tax evasion

MORE THINGS IN HEAVEN AND EARTH: NO DUTY TO MONITOR OR INTERVENE?

- **Proceeds of Crime Act 2002:**

- - any individual or corporate that deals in criminal property may be liable under the Proceeds of Crime Act 2002 (POCA) for one of the three primary money laundering offences: concealing, disguising, converting or transferring the proceeds of crime (section 327); assisting or abetting such conduct (section 328); or handling the proceeds of crime (section 329)

NO DUTY TO MONITOR?

- Do you think that the Courts will uphold clauses that either prevent the trustee from monitoring or suggest they are under no duty to enquire into or monitor the companies in which they are a sole or controlling shareholder given these criminal law concerns?

DBS: THE RESULT

- The Court agreed that the trustee had no duty to monitor and was prevented from intervening in the affairs of Wise Lords, the underlying company which made the investments
- Why?
- Bad facts? the investment decisions were being made by one of the settlors and the Court of Final Appeal did not seem convinced that the speculative investments in currency markets were in truth that poor
- Bad law? The decision does not address the argument that these provisions were inconsistent with the trustee's obligations in these other spheres and so it is not clear the argument was advanced.

Post-Zhang observations

The express terms of a Jersey law trust instrument prevail

Court of Final Appeal 2019:

there is no *“implied, non-derogable external duty”* which can override the parties chosen terms for a trust: to say otherwise would 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”*.

- Premised on joint Jersey expert evidence that the anti-Bartlett provisions in the trust instrument were effective.

Post-Zhang observations

Anti-Bartlett protection is against a breach of trust claim

- The Amsun Trust (2005): expressly authorised speculative investments.
- The investments in question were **high risk** but not illegal or otherwise unlawful.
- Zhang is extremely useful authority for excluding (to the extent permissible) trustee liability as a matter of trusts law.
- **However no liability for breach of trust does not mean no liability of any kind.**
- Trust terms have limits: there may be tension or conflict where a trustee has no power to reject an investment which triggers criminal or regulatory liability.

Post-Zhang observations

Anti-Bartlett does not help a trustee exclude its own criminal or regulatory liability

- Trustees must consider:

internal risk (ie. liability for breach of trust as in Zhang)

v

external risk (ie. liability for breach of other laws and regulations resulting in fines, penalties and/or possibly imprisonment).

Trustee liability

What if Madam Ji had proposed the following investments?



Orange juice production: private company in China



Co-investment in luxury hotel development in North Africa



Luxury condo construction & time share investment in Florida

Fiduciary Risk

Managing breach of trust liability

- Use wide Anti-Bartlett clauses: no power and no duty to interfere or intervene.
- Even better... use a Jersey Investment Directed Trust (a **Jersey IDT**) embracing Article 9A TJL to protect even more definitively against breach of trust claims. It can be structured:
 - to gate-keep asset risks; and
 - manage cash flow/transactional commitments and ensure information flow.

Fiduciary Risk

Managing other liabilities

What about other risks for fiduciaries:

- Acting as trustee?
- Acting as shareholder?
- Acting as a director?
- What if you are a director of Wise Lords but are outvoted on adopting these investment recommendations? Consider control using A & B directors.
- Or what if you do not provide director services to Wise Lords so have no seat at the table to be able to reject investment recommendations?

Managing Investment Risk

Structuring Choices (1)

- Does an existing trust provide sufficient protection for a trustee to be able to 'gate-keep' higher risk investments?
- Should a new **Jersey IDT** be established? It can be difficult to amend an existing trust to impose 'gate-keeping' controls.
- Should a regulated trust company act as trustee or should a special purpose private trust company (**PTC**) be used?
- Should individual professionals from the trustee business sit on the PTC board or the board of an underlying trading company? Should a corporate director be used?

Managing Investment Risk

Structuring Choices (2)

- Who will control cash in the structure? Control and information flow is enhanced if a service provider manages bank accounts – no money moves until due diligence/proper enquiry has been made.
- Consider how a trustee will exit the trust structure if unacceptable assets are found to be in the trust fund:
 - under **Article 16(1) TJJ** a trustee must have at least one trustee – resignation otherwise ineffective; and
 - resignation from a PTC board can be easier to exit than regulated trust company retiring as trustee.

Legal Risk v Commercial Reality

What trustees need v what settlors want

- Many settlors have bespoke assets which are concentrated or higher risk in nature eg. family businesses. How else can that risk be managed?
- **Knowing your settlor:** a trustee is largely reliant on the honesty and integrity of the settlor and those who run underlying businesses held in the trust.
- **Knowing your settlor's family or family office:** get to know those who will next lead the relationship and assess the qualities you wish to see as their professional partner.

Legal Risk v Commercial Reality

What trustees need v what settlors want

- **Knowing your asset classes/country risk:** consider co-opting additional external expertise and appropriate professional advice to help manage risk where a trustee is unsure of the criminal or regulatory framework which exists for a particular country or asset risk.
- **Financial resources:** ensure available funds to appoint and retain expert assistance to help manage/oversee specialist, esoteric or higher risk investments.
- **Knowing your settlor's advisers:** have reputable third party professionals supporting the family for legal, tax and audit provides additional comfort regarding lawful behaviour and good governance.

Managing Investment Risk

Express Trust Terms (1)

- Consider using a Jersey IDT: it provides maximum strength breach of trust protection and reassures settlors that the trustee will subject to regulatory checks be directed about trust fund investment strategy.
- Even under a Jersey IDT, a trustee should consider having:
 - the right to information about underlying assets;
 - the right to inspect documents, premises and assets and the power to require an audit of any investment if it wishes;
 - a power to veto an investment:
 - (a) which does not satisfy the trustee's own "Regulatory Verifications";
 - (b) where there are concerns about solvency of the trust fund; and
 - (c) to protect trustee personally against onerous contract terms.

Managing Investment Risk

Express Trust Terms (2): sample Jersey IDT wording

"Regulatory Verifications" means anti-money laundering verifications and such other verifications which the Trustees (acting reasonably) consider necessary or appropriate in respect of any [Investment Decision/Direction]...

Notwithstanding the terms of any [Investment Decision/Direction], before exercising any powers to give effect to the [Investment Decision/Direction], the Trustees may require:

- (a) to be provided with reasonable security for liabilities whether existing, future, contingent or otherwise; and/or
- (b) their Regulatory Verifications to be satisfied.

Managing Investment Risk

Express Trust Terms (3)

Consider ongoing requirements to manage external risk: continued compliance with Regulatory Verifications.

The 'nuclear' option (subject to having regulatory permission to deal with the assets) is unilateral (and momentous) power:

- (i) to terminate the trust; and
- (ii) distribute all of the assets to the settlor or to stated beneficiaries.

THANK YOU FOR YOUR ATTENDANCE

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