[2013] NZLJ 249

Farewell to *Hastings-Bass*?

Jeremy Johnson, Wynn Williams, Christchurch

considers a landmark UKSC judgment

The "rule in *Hastings-Bass*" (*In re Hastings Bass* [1975] Ch 25, [1974] 2 All ER 193 (CA)) is a misnomer and its application has been too liberal. So said Lord Walker in his swan song judgment for a unanimous United Kingdom Supreme Court in *Futter v Commissioners for Her Majesty's Revenue and Customs* [2013] UKSC 26, on appeal from a unanimous decision of the English Court of Appeal on two cases heard jointly (*Pitt v Holt* and *Futter v Futter* [2011] EWCA CIV 197, [2012] Ch 132, [2011] All ER 450).

This article focuses on the first issue dealt with in the appeal namely the applicability of the so-called rule in *Hastings-Bass*. We now have a re-statement of the basis on which courts will intervene in trustee decision making and a confirmation of the comparatively limited nature of the jurisdiction. The Court also confirmed that actions such as this should be brought by beneficiaries adversely affected rather than by trustees.

The practical application of this judgment may well be limited in New Zealand; the cases in which the rule in *Hastings-Bass* has typically been applied involve cases where trustee decisions have had unexpected, and adverse, tax consequences. The consequences often relate to liability for inheritance tax. Given the simplified nature of New Zealand's tax regime, those sorts of issues have not often arisen.

Nevertheless, the decision is important as it provides good guidance, in a tightly and well-reasoned judgment, for the New Zealand courts to follow when considering whether or not to intervene in the exercise of trustee discretions. It serves as an excellent warning against poorly reasoned judicial overreach into decisions made by trustees of private trusts.

BACKGROUND FACTS

The two cases under appeal were heard separately at first instance, although there was some overlap: the decision in *Pitt v Holt* [2010] EWHC 45, [2010] 2 All ER 774 (Ch) was handed down at the beginning of the hearing in *Futter v Futter* [2010] EWHC 449 (Ch).

The facts are set out at CA [147]–[159] and SC [53]–[55]. *Pitt v Holt* involved a claim by personal representatives of a Mr Derek Pitt who died in 2007 aged 74. In 1990, Mr Pitt suffered serious head injuries and became mentally incapable. His wife had been appointed as his receiver.

Mr Pitt's injuries arose as a result of a traffic accident which gave him a right to sue. His claim for damages for his injuries was compromised by a structured settlement, which was approved by the Court, and a total sum of £1.2 million was paid. Following financial advice, Mrs Pitt settled the damages into a discretionary settlement and that was done with the authority of the Court of Protection in 1994.

The advice given to Mrs Pitt included a written report which referred to various advantages which the discretionary settlement was intended to have, including income tax and capital gains tax advantages. Unfortunately, the advice left out reference to inheritance tax. Inheritance tax could have been easily avoided by the insertion of a provision into the deed of settlement which simply needed to provide that at least half the settled property applied during Mr Pitt's lifetime would be applied for his benefit.

Unfortunately, that did not occur and so on Mr Pitt's death there was an immediate liability to inheritance tax in the order of £100,000. By the time the proceeding came to be heard in 2010 the total tax, together with interest and penalties, would have "amounted to between £200,000 and £300,000".

Futter v Futter concerned the trustees of two non-United Kingdom resident trusts. They received advice from solicitors as to the effect of legislation around charging capital gains tax in respect of gains made by non-resident trustees. The advice of the solicitors was to distribute capital to Mr Futter, pursuant to an exercise of a power of enlargement and then also to distribute capital to Mr Futter's children in equal shares, pursuant to an exercise of a power of advancement. It was intended that in making these distributions, the capital gains would be able to be off-set by losses previously incurred by the subjects of the advances and, as a result, there would be no tax liability.

Unfortunately, that was not the case. Accordingly, an application was made to have both the deed of enlargement and the deed of advancement declared void. In both cases, the first instance decision saw the exercise of powers by the receiver, Mrs Pitt, and by the trustees of the Futter Trusts set aside pursuant to the rule in *Hastings-Bass*. That was overturned by the Court of Appeal and then that decision was upheld by the Supreme Court.

THE RULE IN "*HASTINGS-BASS*"

The rule in *Hastings-Bass* arose in particular from an obiter comment in the judgment (found at 41 in the Chancery report) which said:

> [w]here a trustee is given a discretion as to some matter under which he acts in good faith, the Court should not interfere with his action, notwithstanding that it does not have the full effect which he intended unless (1) what he has achieved is unauthorised by the power conferred on him or where he has acted outside of the power conferred on him; or (2) it is clear that he would not have acted as he did (a) had he not taken into account considerations which he should not have taken into account; or (b) had he not failed to take into account considerations which he ought to have taken into account.

Those obiter comments were later taken up in a series of first instance judgments dating from the early 1990's. The first of those was the decision of Warner J in *Mettoy Pension Trustees Ltd v Evans* [1991] 2 All ER 513(HC). As Lord Walker noted at [1] of *Futter*:

the rule would be more aptly called "the rule in *Mettoy*"…but the misnomer is by now so familiar that it is best to continue to use it [the rule in *Re Hastings-Bass*], inapposite though it is.

The rule as it developed became a rule about trustees making decisions without having given proper consideration to relevant matters which they ought to have taken into consideration, or where they failed to properly consider it. There were a number of matters about the rule that were contestable. First, it was unclear from the authorities whether a decision that ran afoul of the rule was void or voidable, although the balance of authority favoured voidability (eg, *Sieff v Fox* [2005] 3 All ER 693(HC)).

The second matter that was still contestable was the test for intervention; did the trustees need to show that, had they considered matters properly, they would have made a different decision, or just that they might have? The Court of Appeal in *Stannard v Fisions Pension Trust Ltd* [1991] PLR 224 came down in favour of "might"; Lloyd J (as he then was) in *Seiff v Fox* said that it depended on whether the beneficiaries could compel the trustee to exercise his or her discretion. If so, the test was "might", if not the test was "would".

The rule was primarily used to set aside transactions entered into by trustees (typically transactions which involved the exercise of a power of appointment or power of advancement) in circumstances where the tax effects of that decision were adverse. The action typically arose in cases where advice on the tax and financial implications of the decision at hand was either not received or was negligently given, and typically it was, unusually, the trustees themselves who were taking steps to have their own decisions impugned. It arose in the context of private trusts and pension funds; indeed, *Mettoy* was about an exercise of discretion to amend the terms of a pension fund trust deed.

As Norris J said at [2] in *Futter* (HC):

> [t]his is another application by trustees who wish to assert that they have acted in an un-trustee like fashion and so they fail properly to exercise a power vested in them. The trustees wish to take advantage of this failure to perform their duties in order to enable the beneficiaries to avoid paying the tax liability consequent upon the trustees' decision. Put like that (and I am conscious that that is not the only way in which the situation may be described) the possibility is raised that the development of the rule may have been diverted from its true course.

Futter is an excellent example of the sorts of situations where this rule has been relied upon in order to undo a transaction entered into by trustees with adverse consequences. As has been outlined, it involved two dispositions, one under a power of enlargement and another under a power of advancement from two different settlements. The financial consequences of those dispositions were not what were intended due to the provision of negligent tax advice. The trustees sought to minimise the trust liability to tax by relying on the rule in *Hastings-Bass*.

The rule was typically applied in such cases but not much relied upon outside cases such as these. The practical reasons for that are relatively obvious — the beneficiaries did not oppose the application by the trustees and the only person left to oppose was often the Revenue. The Revenue did typically argue these cases but without success and prior to *Pitt v Holt* and *Futter v Futter* the rule was not considered in detail by the Court of Appeal, except in *Stannard v Fisons* where a transfer from one pension trust to another was set aside because the trustees relied upon an out-of-date valuation. However, as Lord Walker noted (at [34]), the discussion of the rule was less than fulsome.

As has been recognised in *Futter*, the rule in *Hastings-Bass* and the way it was applied was somewhat anomalous (see RC Nolan "Controlling Fiduciary Power" [2009] CLJ 293 at 306 to 309 referred to by Lord Walker at [1]). Rather than involving cases where the trustee has either acted outside the scope of the power, acted improperly or acted in breach of an equitable duty, the rule in *Hastings-Bass* was effectively developed and used to allow trustees to put aside decisions that they, in retrospect, did not like. The decision by the Supreme Court can simply be seen as correcting this.

What the rule really is

That brings us to the central question; what is the rule in *Hastings-Bass* now? At the outset it should be noted that the decision by Lord Walker effectively followed the judgment of Lloyd LJ in carefully analysing the way in which the rule in *Hastings-Bass* developed. In particular, there was a focus on the true nature of the situation confronting the Court of Appeal in *Hastings-Bass* itself.

Hastings-Bass was not a case where the trustees had failed to take into account relevant considerations, or taken into account irrelevant ones; rather, it simply involved a question of what happened when there was an excessive execution of power. In that sense, Warner J in *Mettoy* was wrong to conclude (at 555 — in a nice twist, Mr Nugee QC was one of the counsel for the appellants in *Futter v HMRC*):

> I have come to the conclusion that there is a principle while may be labelled "the rule in *Hastings-Bass*". I do not think that the application of that principle is confined, as Mr Nugee suggested, to cases where an exercise by trustees of a discretion vested in them is partially ineffective because of some rule of law or because of some limit on their discretion which they overlooked.

Hastings-Bass was, however, concerned with precisely the sort of situation described by Warner J; accordingly, the law went wrong at that point. *Hastings-Bass* involved an exercise of a power to create a settlement but parts of the settlement were void due to the rule against perpetuities. The case effectively involved one of an excessive execution of power and a question as to whether the parts of the exercise of the power that were not void for perpetuity were still valid. It was held they were.

Both the Court of Appeal and Supreme Court judgments explain in excellent detail the complex factual background to *Hastings-Bass* and some of the more arcane legal aspects of that decision which were not often considered. They then go on to trace the development of the rule from *Mettoy* all the way through to the decisions in *Pitt v Holt* and *Futter v Futter*.

The Supreme Court has effectively righted a wrong-turn taken the law by way of an orthodox restatement of the principles underpinning the court's interference in the exercise of a trustee's discretion, and by clarifying the true nature of the decision in *Hastings-Bass*. At [60], Lord Walker said:

> In the core of his judgment Lloyd LJ correctly spelled out the very important distinction between an error by trustees in going beyond the scope of a power (for which I shall

> use the traditional term "excessive execution") and an error in failing to give proper consideration to relevant matters in making a decision which is within the scope of the relevant power (which I shall term "inadequate deliberation"). *Hastings-Bass* and *Mettoy* were, as he rightly observed, cases in quite different categories. The former was a case of excessive execution and the latter might have been, but in the end was not, a case of inadequate deliberation.

But what constitutes a case of inadequate deliberation? Inadequate deliberation now must involve a breach of what was termed "fiduciary duty" (at [68]). Although Lord Walker used the term "fiduciary" duty, it was probably a slip of language in light of the comments of Millet LJ (as he then was) in *Bristol & West Building Society v Mothew* [1998] Ch 1 (CA) at 16–18. where is seems clear that fiduciary duties are limited to the no conflict and no profit rules (see M Conaglen "The Nature and Function of Fiduciary Loyalty" (2005) 121 LQR 452).

It is unlikely that Lord Walker meant that the court would set transactions aside only in circumstances where the no conflict or no profit rules were broken; indeed, it is unlikely that it was intended the rule in *Hastings-Bass* would extend to that sort of situation. The consequences at equity for breach of those rules are well-established, and the circumstances where those rules are breached cannot truly be called situations of "inadequate deliberation".

Accordingly, it seems that for the rule in *Hastings-Bass* to be invoked now it is necessary for the inadequate deliberation to be so inadequate that it would be seen to constitute a breach of an equitable duty. The nature of the duty to be breached is not explained, but it is easy to see that a breach of an equitable duty of care could give rise to the application of this rule. In bringing an action under this rule, plaintiffs should be careful to specify the precise nature of the duty that has been breached.

Part of the rationale of this finding was expressed at [73] where Lord Walker said:

> Breach of duty is essential (in the full sense of that word) because it is only a breach of duty on the part of the trustees that entitles the Court to intervene…it is not enough to show that the trustees' deliberations have fallen short of the highest possible standards, or that the Court would, on the surrender of discretion by the trustees, have acted in a different way. Apart from exceptional circumstances (such as an impasse reached by honest and reasonable trustees) only breach of fiduciary duty justifies judicial intervention.

This approach is undoubtedly correct. There is a danger of judicial "overreach" where judges intervene in the exercise of trustee discretions simply because trustees had not acted in accordance with the highest standards, or have reached a decision which the court would not. Such an approach would go against centuries of authority where the scope for judicial intervention in the affairs of trustees managing private trusts is limited to situations of:

- decisions that fall outside the scope of the power;
- decisions made for an ulterior purpose, otherwise known as fraud on a power (*Wong v Burt* [2003] 3 NZLR 526 (HC) being an excellent example); or
- a breach of an equitable (or fiduciary) duty justifying intervention.

As the Law Commission finalises its review of trustee law, and as trusts become more and more popular and judicial intervention is called for more and more, the principled approach outlined by Lord Walker should be borne in mind.

What of the role of legal advice received by trustees? The position is that reliance on legal advice, while not necessarily absolving trustees of all forms of liability, will probably mean that trustees will not be vulnerable under the rule in *Hastings-Bass* (at [80] of *Futter*). However, the question is entirely contextual — disregarding legal advice would count against trustees; and it may be possible that, having received legal advice, the consideration is still inadequate if, for example, the trustees, in breach of a duty, fail to give proper consideration to other relevant matters. As Lord Walker said "[c]ases of this sort will call for detailed fact-finding by the judge, and sometimes no doubt for cross-examination" (at [85]).

But, what of the two matters that were previously unclear? Namely, when will the courts intervene and what are the consequences of a decision that runs afoul of the rule in *Hastings-Bass*?

On the question of whether the impugned trustees have to satisfy the court that they would or might not have made the decision they made had they not undertaken inadequate deliberations, Lloyd LJ in the Court of Appeal did not resolve the issue. Lord Walker agreed with that approach. The reasons for that, at [92], relate to the need for the court to be able to retain some flexibility as to its responses:

> [a]s a matter of principle, there must be a high degree of flexibility in the range of the Court's possible responses. It is common ground that relief can be granted on terms. In some cases the Court may wish to know what further disposition the trustees would be minded to make, if relief is granted, and to require an undertaking to that effect…to lay down a rigid rule of either "would not" or "might not" would inhibit the Court in seeking the best practical solution in the Hastings-Bass rule in a variety of different factual situations.

Void or voidable?

That then leads to consideration of what the consequences of a breach of the "new" rule in *Hastings-Bass* would be. In other words, is the transaction entered into by the trustees void or voidable?

Both Lloyd LJ and Lord Walker held that the impugned act is voidable rather than void and it is voidable at the instance of a beneficiary adversely affected. As Lord Walker said at [6], trustees "should not regard them as uncontroversial proceedings in which they can confidently expect to recover their costs out of the trust fund".

The rationale for voidability is explained at [93]:

> [h]ere we are concerned not with equitable fraud, nor with dispositions which would exceed the scope of the power, or infringe the general law (such as the rule against perpetuity). We are in an area in which the Court has an equitable jurisdiction of a discretionary nature, although the discretion is not at large, but must be exercised in accordance with well-settled principles.

In other words, Lord Walker was drawing a distinction between acts of trustees that are outside the scope of their powers and acts that simply involve a breach of equitable duty. That distinction is a relatively well-established one and the distinction between void and voidable is also consistent with well-established principles of equity.

[2013] NZLJ 249

Restatement

Accordingly, the new rule in *Hastings-Bass* can be summarised as follows: an act of a trustee where the trustee has undertaken inadequate deliberation that constitutes breach of an equitable duty will be voidable on the instance of an adversely affected beneficiary.

CONSEQUENCES FOR NEW ZEALAND

The consequences of this decision in New Zealand will be comparatively limited. First, there are only a handful of cases that have mentioned or considered this rule. Indeed, in one case *Atkinson v Congalton* HC Auckland M1660/99, 20 March 2001, the decision was relied upon as authority for the proposition that provided trustees act within the powers conferred and bona fide then the Court will not interfere. The case was also relied upon as authority for the proposition that where trustees would have made the same decision in any event, then the court would not interfere with the exercise of the trustees discretion (eg *Wong v Burt*). It appears that in no case in New Zealand was the rule in *Hastings-Bass* successfully relied upon to challenge a trustee's act.

Accordingly, the impact of the decision will be limited. Nevertheless, it does serve as a good reminder of the fundamental principles that operate in relation to trustees' discretions. Those principles are that exercises of discretion are not to be impugned or interfered with lightly and, indeed, should only be interfered with when the trustee's act goes outside the scope of the power, is done for an improper purpose, or follows deliberations that are so inadequate that it constitutes a breach of an equitable duty.

The judgment itself is a reminder, given its length and the way in which is traverses in detail the considerable historic background to the rule in *Hastings-Bass*, of the need for the courts to carefully consider equitable principles and long standing authority when making decisions in this area, and of the danger of misreading judgments.

CONCLUSION

Futter v HMRC is a landmark decision; it corrects an error in the law that has developed over the past 20 years, although the range of cases in which it has been applied is narrow. Nevertheless, it is a welcome correction as it provides clear guidance to the lower courts as to when it is appropriate to intervene in acts undertaken by trustees.

On that basis alone the decision should be welcomed. The decision should also be welcomed as an outstanding example of judicial research and reasoning at its best; Lord Walker's judgment for the Court was a true valedictory by the way in which it not only corrected the law but clearly enunciated the principled basis for the decision made. ❐

Continued from page 248

Comity with Australian law

The Supreme Court in *0867* also claimed that the *Clear* counterfactual was consistent with Australian law. It used the wording of the Australian Act of "caused, enabled or facilitated" the taking advantage of market power. However, this opens up a variety of different interpretations and applications, including rejecting the *Clear* counterfactual. Put more starkly, the Australian High Court and s 46(6A) make clear that the Australian law is not exclusively based on a counterfactual test, and certainly not the *Clear* counterfactual. The guidance provided by s 46(6A), and particularly the reasoning in *Melway*, accepts that a counterfactual analysis is under-inclusive and may lead to false negatives. The "materially facilitated test" fills this gap and overrides any finding based on a counterfactual approach to causation. If this interpretation is accepted, then the claim of the New Zealand Supreme Court in *0867* that the *Clear* counterfactual is consistent with Australian law is incorrect.

There is another general observation. Although there is supposed to be comity between the competition laws of Australia and New Zealand, and the respective Acts are worded similarly, the approaches remain very different. The three leading New Zealand cases all failed to find an infringement, whereas the Australian courts have typically found an infringement. This is because they are based on very different economic theories of competition and the legitimate role of the courts. New Zealand competition law, and the way the *Clear* counterfactual has been applied, reflects a more permissive view of legitimate corporate behaviour in oligopolistic markets and hostility to the use of competition law to impose a duty to supply on dominant network operators. In this regard, New Zealand competition law takes the position of the US courts which have proved hostile to the use antitrust to impose a duty to supply. Indeed, this was expressly stated in *Clear* and led to the collapse of the then New Zealand government's attempt to use the Commerce Act to regulate incumbent network monopolies. Australian law reflects a market failures approach where violations of some (vague) model of workable competition are seen to generate inherent market power problems which need to be regulated. In this way, Australian competition law shares the more interventionist bias of European competition law. Indeed, it is noteworthy that Kirby J's dissenting judgment in *Northern Territory Power* took the position set out in the US *Trinko* decision (*Verizon Communications v Law Offices of Curtis V Trinko, LLP* 540 U.S. 398 (2004)).

CONCLUSION

The *Clear* counterfactual does not ask the right question or assist in providing a good answer. This is because it treats conduct alone as the test for causation rather than setting a counterfactual outcome as the benchmark, which recognises that the anticompetitive consequences of specific conduct depend on the circumstances in which it is administered. The use of a counterfactual also re-casts the parties' case theory and pleadings, and the court's reasoning in a way that shifts the focus of contention to the definition of the counterfactual and away from a direct evaluation of dominance and anticompetitive effects. This has become evident in Australian and New Zealand merger cases where the counterfactual has become the focus of its own standard of proof and pleadings eg, *Australian Competition and Consumer Commission v Metcash Trading Ltd* [2011] FCAFC 151, and *Woolworths Ltd v Commerce Commission* [2008] 8 NZBLC 102 generating confusion and uncertainty (for full analysis see Veljanovski "Mergers, Counterfactuals and Proof after *Metcash*", (2012) 40 Aus Bus L Rev 263). ❐