

R2R: The mysterious case of the unit trust

UPDATE

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In *Barclays Wealth Trustees (Jersey) Limited v Equity Trust (Jersey) Limited* [2014] JRC 102D, the Royal Court declined to strike out proceedings brought by the successor trustee and manager of three unit trusts (for whom Mourant Ozannes act) against the former trustee and manager of those unit trusts. We believe this to be the first judgment anywhere in the world dealing expressly with the nature of the legal relationships within a unit trust.

Unit trusts emerged in England in the second half of the 19th century as a means of enabling collective investment. Joint stock companies had effectively been banned following the South Sea Bubble in 1711. Although it became possible under the Joint Stock Companies Registration and Regulation Act 1844 to incorporate companies by registration and limited liability was conferred on companies by means of the Limited Liability Act 1855, there was still considerable suspicion of limited liability companies. This was compounded in 1866 with a financial crash which started with the failure of Overend, Gurney Ltd. It was against this background that the first unit trust, the Foreign and Colonial Trust, came into being in 1868. As limited liability companies became a more settled feature of the landscape, the popularity of unit trusts waned but their popularity rose again in the 1930s.

In a typical unit trust, investors subscribe for and purchase units which are issued by the trustee. The unit trust is constituted by a trust instrument to which the trustee and manager are party and which generally contains a provision that the obligations apply as between trustee, manager and subscribing unit holders in a similar way as happens in relation to articles of association when an investor becomes a shareholder.

An important feature of the unit trust is that there are two office holders, the trustee and the manager, who have different roles. The assets of the unit trust are vested in the trustee who controls them but responsibility for the management of those assets lies principally with the manager.

The former trustee and manager sought to strike out the claims brought against them for breach of trust, breach of fiduciary duty and breach of contract. The principal arguments were as follows.

1. The former trustee was obliged to follow the directions of the former manager and had done so.
2. The former manager was not a trustee and could not be liable for breach of trust.
3. To the extent that the former manager was a fiduciary, it owed duties only to individual unit holders and this was not something for which the successor trustee and manager had standing to sue.
4. The former manager had not acted in breach of fiduciary duty anyway since it had not breached and was not alleged to have breached its obligation of loyalty.
5. The trust instrument was not a contract and could not give rise to a contractual relationship between trustee and manager.

The first issue was the nature of the relationships within a unit trust. There was no judicial authority on this question and the leading commentators had differing views, particularly with regard to the status of the manager. Notwithstanding that this was a strike out application, the court expressed some preliminary conclusions.

The court said that a unit trust established a triangular relationship between the manager, the trustee and the unit holders. This relationship had both contractual and trust features. The court went on to find that the trustee and the manager owed trustee-like or fiduciary duties and obligations to the unit holders and contractual obligations to each other.

The court then considered each type of claim in turn.

Contractual claims

The former trustee and manager argued that the trust instruments created trusts and not contracts and that, even if it did create contractual obligations, Article 34 of the Trust (Jersey) Law 1984 released the former trustee from liability on its retirement.

The court expressed doubt that a contract could arise between unit holders and trustee. However, the court accepted that a contract arose between unit holders and the former manager through the unit holders' subscriptions, with it no doubt being an implied term that the manager would comply with the terms of the trust instrument.

The court went on to find that the trust instrument created contractual obligations between trustee and manager and that the clause of the trust instrument by which the terms and conditions were said to be binding on and to enure for the benefit of unit holders showed that the obligations set out in the trust instrument were made for the benefit of the unit holders. This probably meant that that the successor trustee and manager had standing to enforce those obligations.

As far as Article 34 was concerned, the court said that it was at least arguable that Article 34 only applied to claims against a trustee as trustee and not as a contracting party.

Breach of trust claim against the former trustee

As far as the breach of trust claims were concerned, the court said that it was at least arguable that there was a residual duty on the trustee to challenge unauthorised instructions from the manager and that it did not read the express terms of the trust instrument as negating that duty. That could arise either from having actual knowledge of the relevant facts or from the fact that, if it had acted properly, it would have had knowledge of those facts.

Claims against the former manager

The court held that it was at least arguable that the manager was a trustee. The court said that it would look at the substance of the situation and use that analysis to determine the remedies available. Almost all the relevant investment management powers and duties and powers were exercisable by the manager and virtually all the trustee-like functions were allocated to the manager. The court said that it would be 'stultifying' for the court not to hold the manager responsible for the way in which it executed its duties and exercised its powers.

Even if the manager was not technically a trustee, the court seemed in little doubt that the manager was a fiduciary office holder. The former trustee and manager argued that a claim for breach of fiduciary duty was limited to a claim for breach of the fiduciary's duty of loyalty. Again, the court rejected this argument. A fiduciary office holder could be sued for a wide range of breaches of duty. This was not restricted to breaches of the duty of loyalty.

The final question was whether the successor trustee and manager had standing to sue for these alleged breaches. The court found that the successor trustee did and that this was the case irrespective of the category of breach of trust. The court also found that the successor manager was entitled to sue. It was at least arguable that it was a trustee and, in any event, the court thought that it would be absurd to insist on the successor trustee being the sole litigant in circumstances where the actual decisions about the litigation were being made by the successor manager.

Conclusion

This is the first judgment to deal with the question of the nature of the legal relationships within the four walls of a unit trust. The court was clearly not attracted by the arguments of the former trustee and manager which would have led to both effectively being immune from suit. Although it was only a strike out application, the court made some findings. It recognised the contractual position. It also found that a

manager is at the very least a fiduciary office holder and it is at least arguable that a manager is in fact a trustee. Finally, it has also found that the successor trustee and manager have standing to sue for those breaches.

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[Document Reference]