Trusts and estates litigation forum

Investment management liability: trusts and related structures

REMEDIES ISSUES

1. This part of the session concerns remedies issues that commonly arise in cases concerning the liability of trustees in relation to trust investments. This outline identifies issues that, in my experience, are worth thinking about in cases of this kind and identifies some authorities and arguments I find especially useful.

2. Whereas at the liability stage the law in this area is extremely unfriendly to claimants, at the remedies stage there are a number of claimant-friendly tools, principles and presumptions.

Equitable compensation and the account: principled issues

3. Conceptually there are three possible analyses of equitable compensation:

   (a) Equitable compensation is a reparative remedy akin to damages for tort or breach of contract.

   (b) In addition to that remedy, there is a second species conceptually mediated by the account that is best understood as pecuniary performance of the trustee's duties following unauthorised dealings with trust assets.

   (c) Instead of (a) and/or (b), equitable compensation is a hybrid that is fundamentally reparative but has special claimant-friendly features, for example an idiosyncratic approach to causation and remoteness of loss.

4. The third represents the dominant approach in most Commonwealth jurisdictions, including to a lesser extent in England and Wales following *AIB Group (UK) plc v Mark Redler & Co Solicitors* [2015] AC 1503. My own view is that the third analysis represents an incoherent amalgam of the other two. Also, the special features variously attributed to the third model of equitable compensation are more often described than applied.

5. To the extent a court can be persuaded to recognise a substantive remedy of the second type, this is potentially significant where investment activity is unauthorised. Trustees acting under properly prepared express private trusts will rarely exceed their investment powers because they are nowadays widely drawn and because the investments may often be held at a remove from the trustees (so that their account only shows shares in the investment vehicle). However this type of remedy is possible in less heavily structured arrangements or where the activity involves fraud or fiduciary misconduct.

6. Where misconduct is not deliberate and does not exceed the trustee's powers, these issues are largely irrelevant and in practice English courts treat the remedy as being closely similar to damages for breach of contract for most purposes.

Practical uses of accounting procedure in investment cases

7. Putting aside substantive aspects, the accounting procedure has considerable potential to assist claimants in this context. This so where, as happens surprisingly frequently, the trustee's systems have failed to cope with the investment activity so that it is unclear what has happened. An order for an account directs the trustee to reconstruct the activity in the investment account making "*every assumption against the party whose conduct has deprived it of necessary evidence*."

8. Where the fund has been thoroughly mismanaged, and there are good reasons to believe there are breaches as yet undiscovered, an account on the footing of wilful default may be appropriate, in which case the master conducts an inquisition.

9. On the operation of the account, including substantive and procedural aspects, see especially Lord Millett NPJ's speech in *Libertarian Investments Ltd v Hall* [2014] 1 HKC 368 (CFA) and *Snell's Equity* (33rd edn 2015) chapter 20.

10. What experience do participants have of using the account procedure (and the wilful default account procedure) in this context?

Heads of loss: capital loss, lost profits and loss of a chance

11. The beneficiaries carry the burden of proving their heads of loss on a balance of probabilities: *Nestle v National Westminster Bank plc* [1993] 1 WLR 1260 (CA) 1269, 1283-84; *Parabola Investments Ltd v Browallia Cal Ltd* [2011] QB 477 (CA) [23]. In cases of this kind, heads of loss may include:

    (a) Depreciation of the capital value of the fund or of a particular constituent; or

    (b) Loss of profits that would have been made had the fund or part of it been properly invested.

12. Under English law, loss of a chance to profit from investment activity is unlikely to be an available head in cases of this kind. That is because either:

    (a) the beneficiaries are able to prove on a balance of probabilities that the investment activity would have been profitable, in which case the relevant head is loss of profits and there is no need to rely on the loss of a chance. That leaves an issue of quantification (see further below) to which loss of chance analysis is not relevant; or

    (b) the beneficiaries are unable to prove that the investment activity would likely have been profitable, in which case it must be at least as likely that the activity would have generated losses, for which reason loss of chance analysis is inappropriate: *Nestle v National Westminster Bank plc* [1993] 1 WLR 1260 (CA) 1269; *E Bailey & Co v Balholm Securities* [1973] 2 Lloyd's Rep 404, 415-416; *Ata v American Express Bank Limited* (CA The Times 26 June 1998).

    Loss of a chance analysis might be relevant if the likelihood of profit depended on the hypothetical conduct of a third party (e.g. *4 Eng Limited v Harper* [2009] Ch 91).

13. In *Appleby Corporate Services (BVI) Limited v Citco Trustees (BVI) Limited* (2014) 17 ITELR 413 (BVI HC) the trust company breached its duties by failing to properly monitor the investment manager, which depleted the fund by a course of speculative trading outside the trust's investment guidelines. Bannister J required the defaulting trustee to "*reconstitute the trust fund*" by making good the capital depreciation. However, he considered that an award of lost profits measured by reference to the average performance of a portfolio managed within the guidelines would be "*contrary to principle*". He said this (at [62]):

> *Citco agreed, for reward, to act as Trustee and it was responsible . . . for monitoring the conduct of the Investment Manager. The scope of the duty which I have found Citco to have broken was to take reasonable care to see that the Trust Fund was managed by Mr Lanusse and Mr Wiegers, or by whatever entity they represented in accordance with the authority conferred upon them. Citco was not responsible for the performance of the investments. It never engaged to deliver a fund with any, let alone any particular, rate of growth. Moreover, had the losses been stopped at the end of February 2006, it is impossible to say precisely how the fund would have performed in the hands of whoever had in fact been engaged as a replacement Investment Manager. Miss Valtanen's approach, like the pleaded claim for income which it is said would have been received had the fund been in the hands of a 'reputable' investment manager is effectively a claim for damages for breach of contract which gives the Trust the benefit of a bargain that it had no entitlement to and correspondingly throws upon Citco a burden which it was never liable to discharge.*

14. Was Bannister J right about this? Note that 2006 to 2014 was a period of ultra low interest rates and generally good stock market returns.

Quantification of lost profits

15. *Parabola Investments Ltd v Browallia Cal Ltd* [2011] QB 477 (CA) [23]: where the court must quantify lost profits by way of

> *a hypothetical exercise, the court does not apply the same balance of probability approach as it would to the proof of past facts. Rather, it estimates the loss by making the best attempt it can to evaluate the chances, great or small (unless those chances amount to no more than remote speculation), taking all significant factors into account*

16. It is sometimes appropriate to quantify loss by reference to the performance of an appropriate index or model portfolio: but see *Daniel v Tee* [2016] 4 WLR 115, [158] on the limits of this. The approach in some modern cases is already out of date in that they pre-date the general availability of tracker funds, which enable even a small fund to "buy the index" at low cost: e.g. *Nestle v National Westminster Bank plc* [1993] 1 WLR 1260 (CA) 1267; *Re Mulligan* [1998] 1 NZLR 481, 510.

Adverse presumptions

17. It is sometimes suggested that at the stage of quantifying loss, presumptions may be made against a defaulting trustee: *Nestle v National Westminster Bank plc* [1993] 1 WLR 1260 (CA) 1284 (Leggatt LJ only); *Daniel v Tee* [2016] 4 WLR 115, [157].

18. More specifically, some cases have held that where the assessment of loss depends on the use that would have been made of trust property had the breach not occurred, the courts will presume that the property would have been invested or applied in what with hindsight can be seen to have been the most favourable manner: *Jaffray v Marshall* [1993] 1 WLR 1285; *McNeil v Fultz* (1908) 38 SCR 198, 205; Wilson J's concurring minority reasons in *Guerin v The Queen* [1984] 2 SCR 335; *Re Mulligan* [1998] 1 NZLR 481, 508 (but then ignoring that principle).

19. Dominant English authorities tend to be against this approach: *Target Holdings Ltd v Redferns* [1996] AC 421, 440; *Nestle v National Westminster Bank plc* [1993] 1 WLR 1260 (CA) 1268. In Canada, see *Fales v Canada Permanent Trust Co* [1977] 2 SCR 302, 322 ("*Highest value is not the sole criterion. All factors bearing on value must be considered*"). This is consistent with the approach in cases where the remedy is profits-based – *JJ Harrison (Properties) Limited v Harrison* [2002] 1 BCLC 162 (CA) – notwithstanding the earlier decision in *Nant-y-glo and Blaina Ironworks Co v Grave* (1878) 12 ChD 738, 748.

20. The opposite suggestion based on *Robinson v Robinson* (1851) 1 De GM & G 247 – that compensation should be assessed on the basis of the trustee's minimum obligation – has also been rejected because there is no true analogy with the position of a covenantee acting in his own interests who can choose the cheapest way to perform: *Nestle v National Westminster Bank plc* [1993] 1 WLR 1260 (CA) 1268.

Gains and losses: offsetting and accumulation of claims

21. In some cases the courts have held that losses resulting from wrongful investment management should be offset by gains resulting from the same investment policy, on the basis that the breach is properly characterised as adoption of the policy: *Bartlett v Barclays Bank Trust Co Ltd* [1980] Ch 515, 538; *Ata v American Express Bank Limited* (unreported Commercial Court 1996) 128-129.

22. However the general rule is that a claimant is entitled to choose which breaches to sue on (or which misapplications to falsify in the account) and there may be cases where such an approach makes a significant difference in this context.

23. Have any participants had experience of an issue of this kind?

Taxability in the hands of the beneficiaries

24. Compensation should not, however, be reduced because of any tax saving the beneficiaries stand to make in consequence of the breach (cf the *Gourley* principle). Brightman J explained why in *Bartlett v Barclays Bank Trust Co Ltd* [1980] Ch 515, 545:

> *the obligation of a trustee who is held liable for breach of trust is fundamentally different from the obligation of a contractual or tortious wrongdoer. The trustee's obligation is to restore to the trust estate the assets of which he has deprived it. The tax liability of individual beneficiaries, who have claims qua beneficiaries to the capital and income of the trust estate, do not enter into the picture because they arise not at the point of restitution to the trust estate but at the point of distribution of capital out of the trust estate.*

25. Why is this? Whose loss is being compensated? Would the same principle apply if the beneficiary suffered an additional tax *loss* because of the breach? What if the only loss resulting from a breach was a tax loss to the beneficiary: would that be recoverable? What if the breach was deliberate? (My own view is that Brightman J was wrong about this.)

26. See also *Elder's Trustee and Executor Co Ltd v Higgins* (1963) 113 CLR 426. 447-448 and 453: "*The liability of a trustee committing a breach of trust is measured by the loss or depreciation which his act or omission has caused to the trust estate. He must make good any depreciation and damage which the estate has suffered.*" The High Court accordingly rectified the judge's order requiring payment to the claimant beneficiaries in the amount of the loss they had suffered.

Interest

27. Where the claim period is prolonged it is worth considering the equitable jurisdiction to award compound interest, as to which see especially: Elliott, 'Rethinking interest on withheld and misapplied trust money' [2001] Conv 313 and *Sempra Metals Limited v IRC* [2008] 1 AC 561, not a trusts case but indicating a much more liberal attitude than earlier cases.

28. Putting aside questions of pleading and proof, was Bannister J right to give only simple interest in *Appleby Corporate Services (BVI) Limited v Citco Trustees (BVI) Limited* (2014) 17 ITELR 413 (BVI HC) [59]? Compounding is likely to have made a substantial difference between 2006 and 2014.

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