Trustees and Fiduciaries: the Limits on any 'No Fetter' Rule: Part 1

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Fetters and chains?

Introduction

It is often said that a fiduciary (such as a trustee or a director) who holds a power or discretion must not 'fetter' the exercise of a relevant discretion that they have been given.[1]

This is quite an easy comment to make and often appears in judgments, articles and commentary. It is used in an incredibly wide way and, as we will see, does not in fact always apply. In some cases, parties are using it as a cover for a proposal or contract that they intrinsically do not like and are not prepared to agree. It sounds better or easier for them to object on a legal ground (no fetter) rather than just say they do not think it proper or appropriate.

This paper looks at the scope of any 'fetter' doctrine in relation to decisions or discretions of trustees and in particular looks at how it applies to trustees of pension schemes:[2]

- Part 1 of this paper looks at the statements of no fetter rule and discusses the modern approach. It also looks at the position of pension trustees and directors of companies.

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1 For example the recent Law Commission report on 'Fiduciary Duties of Investment Intermediaries' (Law Com no 350), published in July 2014 (see below).

2 There is not a huge amount of commentary on this topic. The best (and much cited) discussion is in P D Finn *Fiduciary Obligations* (Sydney, Law Book Co, 1977), Chap 7, 'Fettering discretions', but this is now over 35 years old and it can be difficult to get hold of a copy. Hugh Arthur 'Can trustees fetter their powers?' (1993) 7 TLI 69 is a good, more recent analysis. From Australia, there is a very thought provoking article by Jonathan Swil and Roger Forbes: 'Fettering the fiduciary discretion by agreement: Breach of duty or commercial reality?' (2010) 84 ALJ 32. See also J R F Lehane, 'Delegation of Trustees' Powers and Current Developments in Investment Funds Management' (1995) 7 Bond Law Review 36.

On the position in relation to directors, see Andrew Keay *Directors duties*, 2nd ed (Jordans, 2014), Chap 7 'Duty to exercise independent judgment'; Andrew Griffiths 'The best interests of Fulham FC: Directors' duties in giving contractual undertakings' [1993] JBL 576; and Stephen Kenyon-Slade 'Improper Fettering of Directors' Discretion, or Holding them to their Word?' [1993] CLJ 218.

Geraint Thomas *Thomas on Powers*, 2nd ed (Oxford University Press, 2012), pp 512–518 contains a useful analysis of fetters. Otherwise fetters are discussed relatively briefly in the standard trust books: Lynton Tucker, Nicholas Le Poidevin and James Brightwell, *Lewin on Trusts*, 19th ed (Sweet & Maxwell, 2015) at 29-227; David Hayton, Paul Matthews and Charles Mitchell, *Underhill and Hayton Law of Trust and Trustees*, 18th ed (Butterworths, 2010) at 57.7; Geraint Thomas and Alastair Hudson *The Law of Trusts*, 2nd ed (Oxford University Press, 2010) at 11.39; David Maclean *Trusts and Powers* (Sweet & Maxwell, 1989) at 72; J D Heydon and M J Leeming, *Jacobs' Law of Trusts in Australia*, 7th ed (LexisNexis Butterworths Australia, 2006) at [1614]; and G E Dal Pont *Equity and Trusts in Australia*, 5th ed (Lawbook Co, 2011) at [22.40].

- Part 2 looks the difference between outside parties and internal parties and specific issues on setting 'policies' and ways of avoiding any 'no fetter' issue.

As we will see, the case law in this area suffers, from being:

- in most cases, not very modern (and so of doubtful authority in relation to more modern and wider trustee powers); and
- based on a surprisingly large number of unreserved judgments,[3] with, in one case, the judgment being unreported and 'unavailable'.[4]

Summary

This paper concludes that:

- There can be a no fetter rule or implication, but it is no more than a description of the need to comply with the terms of a relevant power or discretion (eg for the right person to exercise it at the 'right' time) combined with a duty on trustees when exercising a power to have considered the relevant factors, ie in light of the relevant facts and circumstances at that time. This is similar to the rule in public law.
- Any 'no fetter' implication depends on the terms of the power and the trust – it is subject to any express or implied provision to the contrary. For example, it does not apply to a change made by the exercise of a power of amendment.
- A fetter implication can be over-ridden by the exercise of a contrary power – for example the exercise of a power of sale is valid, even though it 'fetters' the ability of the trustee to sell the same property later.
- This means that it is clear that any rule should be described as a 'no improper or unlawful fetter', rather than just 'no fetter'.[5]
- The courts are much more flexible in recent times, recognising the wider powers now given to trustees (under trust instruments and statute) and the need to be practical and flexible (particularly with larger trusts). There is some evidence that the courts are recognising that a restrictive no fetter rule would operate to prevent the trustees entering into advantageous bargains for the benefit of the trust.
- Any fetter rule or implication is primarily an 'internal' or 'intramural' issue to the trust. A restriction, even if infringed, is only relevant to the duty and exercise of the power by the trustee as against the beneficiaries of the trust. A third party dealing with the trustee is not bound by the fetter – if the trustee enters into a contract, it is no defence to a contractual damages action against the trustee by the third party that the contract amounted to a 'fetter'.[6] But this is subject to some concerns for third parties:

3 Eg *Weller v Ker* (1866) LR 1 Sc & Div 11, HL; *Moore v Clench* (1875) 1 Ch D 447 (Jessel MR); *Oceanic Steam Navigation Co v Sutherberry* (1880) 16 Ch D 236, CA; *Greenwell v Porter* [1902] 1 Ch 530 (Swinfen Eady J); *Re Vestey's Settlement* [1950] 2 All ER 891, CA; and *Re Allen-Meyrick's Will Trusts* [1966] 1 All ER 740 (Buckley J).

4 *Re Gibson's Settlements*, discussed below.

5 This is similar to comments that the law requires that employers should not discriminate. This is too wide. The legal position is that employers should not *unlawfully* discriminate, ie not discriminate on a protected ground (eg age, sex, race, etc) without a relevant excuse (eg objective justification or a defence under the Equality Act 2010). The New Zealand Law Commission's recent (2013) proposals to enact a general overriding 'no fetter' default rule falls into this trap (see below).

6 This is a distinction between trust law and public law – contracts can be invalid and unenforceable under public law if the there is an inadmissible fetter, but this probably derives from the public interest in the need for a decision taker to exercise a public law power properly.

- the trustee may seek to agree that the contract contains an express reservation of the position of the trustee to change its mind in the light of changed circumstances (it will be up to the third party whether it is willing to accept this);
- such a reservation may be argued as being implied in any event (but this may be difficult to succeed);
- equitable remedies (eg specific performance) may not be available to the third party, although a common law damages claim against the trustee should be possible; and
- damages may not be an adequate remedy (eg the trustee may be unable to meet any damages claim out of its own resources) resulting in the third party being dependent on relying on the trustee's indemnity out of the assets of the trust. The availability of that indemnity will depend on the terms of the indemnity (express or implied under the Trustee Act 2000), whether the trustee acted properly (or if the indemnity applies if the trustee was acting in 'good faith') in incurring any liability and potentially whether or not the trustee is in breach of trust (even if unrelated to the relevant contract).

What is a fetter?

The word 'fetter' is not perhaps one we use in day-to-day speech. Clearly it means a restriction – perhaps the image is one of a set of handcuffs or chains used to physically restrain individuals, eg prisoners or slaves.

In practice, in legal terms a fetter is an undertaking or contract under which a fiduciary limits or constrains (or exercises in advance) the future exercise of a power or discretion. It is sometimes used in a looser sense of a 'pre-decision' or blindly following an external policy,[7] but this looks to be a confusing misuse (where is the 'fetter' in the sense of a binding obligation or restriction?)

Fetter as a search term

The use of the term 'fetter' as a legal expression is helpful in that it makes it a bit easier to search electronically for relevant cases and articles. But two areas where unhelpful hits can appear:

- some pensions cases use the term 'fetter' to refer to an express restriction on the terms of a power, in particular an amendment power[8] – this paper is more concerned with implied restrictions; and
- some law reports give the address of the court. In recent years, the Chancery Division of the High Court has been at Rolls Buildings on *Fetter* Lane.

Limits on fiduciaries

Generally the courts (mainly working in the context of private family trusts) have held over

7 See the Law Commission report on 'Fiduciary Duties of Investment Intermediaries' discussed below and the Pensions Regulator statements on 'Asset Backed Contributions' and 'Double Counting', also discussed below.

8 Eg *IBM United Kingdom Holdings Ltd v Dalgleish* [2014] EWHC 980 (Ch), [2014] All ER (D) 54 (Apr) (Warren J); and *HR Trustees v German* [2009] EWHC 2785 (Ch), [2009] All ER (D) 235 (Nov) (Arnold J). See also *Courage* [1987] 1 All ER 528 (Millett J) and *Capital Cranfield v Sagar* [2002] OPLR 151 (Neuberger J).

the years that trustees (and other fiduciaries such as directors) possessing a discretionary power should *generally*:

(a) act personally (and so not delegate), unless the trust instrument or statute says otherwise;
(b) act unanimously (unless the trust instrument or statute says otherwise[9]);
(c) act within the authorities and powers of the trust instrument (or statute), including acting at the right time for the power;
(d) at the relevant time, take advice and consider all the relevant facts (and no irrelevant ones); and
(e) act for a proper purpose.

No fetter rule as a combination of duties

A 'no fetter' duty is in effect a combination of some of the above. A trustee (say) agreeing to exercise a discretion too soon runs the risk of breaching (c) – exercise the power within its terms (ie at the right time) – and also (d) – considering all the relevant facts (because the relevant facts may change before the 'right' time).[10]

Thus the general rule is said to be that a fiduciary cannot bind him or herself as to how they will exercise a discretion in the future. To do so would be fettering their discretion.[11]

A similar rule applies in public law, where a person has a statutory power or discretion.

Statements of a no fetter rule

Re Gibson's Settlement Trusts (1981)

This case is sometimes cited as authority for a fetter rule, but in fact on this point it appears to be unreported and the actual judgment (of Whitford J) is 'unavailable'. Instead there is a reported decision of Megarry V-C on the issue of costs, which refers to a previous judgment.

The case is stated by Megarry V-C to have involved trustees of a family settlement giving an undertaking (as part of divorce proceedings between the settlor and his wife) that they would irrevocably appoint fixed amounts to two of the beneficiaries (children of the settlor). This appointment would be in the future (as there was concern about new tax laws). There was then a dispute as to the amount to be apportioned (was it £50,000 now or £50,000 when the child reached age 25?)

In the costs judgment, *Re Gibson's Settlement Trusts*,[12] Megarry V-C commented:

9 Subject to the express terms of the trust/articles – company directors usually act by a majority: *Luke v South Kensington Hotel* (1879) 11 ChD 121, CA; charity trustees also act by a majority: *Re Whiteley* [1910] 1 Ch 600 (Eve J), following *Wilkinson v Malin* (1832) 2 Tyrwhit 544; 149 ER 268 (Lord Lyndhurst CB); and occupational pension scheme trustees can act by a majority of trustees (not just a majority of those present): Pensions Act 1995, s 32.

10 See eg the comment in *Thomas on Powers* at para 10.74 (fn 307).

11 For example *Underhill & Hayton* at 57.7, citing *Swales v IRC* and *Re Gibson's Settlements*, each of which (see below) is very weak authority for this proposition.

12 *Re Gibson's Settlement Trusts, Mellor v Gibson* [1981] Ch 179 (Megarry V-C) at p 182. Cited by Smellie CJ in *ATC (Cayman) Limited v Rothschild Trust Cayman Limited* (2005) 9 ITELR 36. Mentioned (as having been referred to by counsel) by Briggs J in *Jones v Firkin-Flood* [2008] EWHC 2417 (Ch) at [208].

> 'In order to do this, the undertaking under seal of June 7, 1974, was executed by the two trustees. It was a simple undertaking with the wife, the mother of the two children, that the trustees "will by December 31, 1974, enter into such deed or agreement as is necessary to cause the sum of £50,000 ... to be appointed absolutely" to each of the two children "contingent only upon each of them attaining the age of 25." The fact that this appointment was plainly open to the objection that it fettered the trustees in the exercise of their discretionary powers seems to have escaped the notice of everyone.'

And later:[13]

> 'When the originating summons was heard, the objection that the undertaking was invalid, as fettering the trustees' discretion, duly emerged. This disposed of the case, and the originating summons was dismissed,[14] though I was told that the judge indicated that the children's construction of the undertaking was right and the trustees' construction wrong.'

It is a sign of the problem with a general 'no fetter' rule that this case is cited as authority for that proposition.

In *ATC Cayman,*[15] Smellie CJ stated:

> '[6] For these propositions, [Counsel on behalf of the outgoing trustee], relies primarily on the case of *Re Gibson's Settlement Trusts, Mellor v Gibson* [1981] Ch 179. That was a case in which, among other things, an undertaking given by trustees that they "will [by a certain date] enter into such deed or agreement as is necessary to cause the sum of £50,000 ... to be appointed absolutely" to each of the settlor's two children "contingent only upon each of them attaining the age of 25", was set aside for being invalid as fettering the trustees' discretion.
> [7] The actual unreported first instance judgment in the case and in which that conclusion was reached, has not been obtained. I am told that being unreported (and it seems only ever provided by way of a résumé of the judgment) it is unavailable.
> [8] The extraction of that principle which the case decides as cited above, is taken from the reported judgment of Megarry V-C given later in respect of the ancillary issues of costs. In it the Vice Chancellor recites with clear approval, what he describes as the earlier decision of the court. (See [1981] Ch 179 at 182–183).'

Swales v IRC (1984)

In *Swales v IRC,*[16] Nicholls J (as he then was) said:

> 'It is trite law that trustees cannot fetter the exercise by them at a future date of a discretion possessed by them as trustees.'

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13 [1981] Ch 179 at p 183.
14 Whitford J on 16 January 1978. See Megarry V-C [1981] Ch 179 at p181.
15 *ATC (Cayman) Limited v Rothschild Trust Cayman Limited* (2005) 9 ITELR 36 (Smellie CJ). See the discussion below.
16 [1984] 3 All ER 16 (Nicholls J), at 24. Cited by Briggs J in *Jones v Firkin-Flood* [2008] EWHC 2417 (Ch) at [208].

This was *obiter* (Nicholls J had already held that the daughter (Mrs Rylands) in the case was entitled to income under a deed of appointment).

This meant that strictly the trustees did not need to rely on a separate argument that the effect of the deed of appointment and a later standing order to pay income had been sufficient to give the daughter an interest in the income even if the deed was ineffective. Nicholls J commented:

> 'The giving of a bankers' standing order may have been a convenient administrative arrangement for the trustees to make, but it conferred no right on Mrs Rylands in respect of the trust income to which it related. No doubt in practice the trustees would have been unlikely to have revoked that order and ceased paying income to Mrs Rylands without giving her reasonable notice of their change of mind. But that does not mean that she had any entitlement in law to the income as it arose. Assuming that the appointment made under cl 3(1) was wholly ineffectual as an appointment in respect of the current income, it was the trustees' right and duty in this case, as in the case of any other discretionary trust of income, to exercise their discretion regarding the distribution of income as it became distributable from time to time, and Mrs Rylands had no more right in this case than a discretionary object in any other case to be paid that income to the exclusion of the other discretionary objects.'

So what is this 'trite law'? It is tempting to think that judges refer to this when the relevant rule is in fact difficult to define (or cite authority for).

The Law Commission thinks it applies.

Law Commission: 'Fiduciary Duties of Investment Intermediaries' (2014)

The 2014 Law Commission report on 'Fiduciary Duties of Investment Intermediaries'[17] commented on trustee duties and included a 'fetter' section (footnotes included):

> '4. Trustees should not fetter their discretion
> 3.55 Trustees should not bind themselves or their successors about how they will or will not exercise a power in the future.[18] A "fetter" is wrong because it obliges the trustee to exercise their discretion:
>
> > in a specified manner to be decided by considerations other than his own conscientious judgment *at the time* as to what is best in the interests of those for whom he is trustee.[19]
>
> 3.56 This means that any undertaking about how a trustee will exercise a power in the future is ineffective.'[20]

The Law Commission went on to say (at para 6.12) (footnotes included):

17 Law Com no 350, published in July 2014, at para 3.55. See also para 4.46 discussing *Martin v City of Edinburgh* (fetter by applying existing council policy) and para 5.5(4).

18 *Snell's Equity,* 32nd ed (Sweet & Maxwell, 2010) para 10-016.

19 *Osborne v Amalgamated Society of Railway Servants* [1909] 1 Ch 163 at 187, by Fletcher Moulton LJ (emphasis added).

20 *Lewin on Trusts,* 18th ed (Sweet & Maxwell, 2012) para 29-204. The exact consequence of an improper fetter will depend on the form of the fetter: see P Finn, *Fiduciary Obligations,* 1st ed, (Law Book Company, 1977) paras 66–70.

> 'The procedure
> 6.12 We listed the various procedural duties in Chapter 3. Three are particularly relevant.
> (1) Most importantly, trustees must not "fetter their discretion". They must genuinely consider how to achieve a pension for their members and must not simply apply a pre-existing moral or political judgment.[21]
> For example, in *Cowan v Scargill*,[22] the union trustees fettered their discretion by applying pre-existing policy without considering its effect on the diversity of the portfolio.
> (2) The trustees should consider relevant circumstances. This is not necessarily an onerous duty. As the court said in *Pitt v Holt*, there will not necessarily be a breach of duty even if the trustees' deliberations have fallen short of the highest possible standards.[23] But trustees should exercise fair and impartial judgment, regardless of their own political, moral or religious views.'[24]

As we shall see, these statements are a bit over-simplistic and do not give a full picture. To describe the position (say) in *Cowan v Scargill*[25] as being a true fetter on discretion is using the terminology in a very wide sense. The union trustees there did not seem to have legally bound themselves on how to exercise their investment powers, but instead they were seeking to follow a union policy without exercising an independent judgment. Similarly, the councillors in *Martin v City of Edinburgh*.[26] This is using the term 'fetter' to mean a failure to decide independently.[27]

It is noteworthy that the cases cited by the Law Commission did not deal with trustees purporting to bind themselves into the future – *Osborne* is a case involving Members of Parliament rather than trustees (discussed further below) and *Cowan v Scargill* and *Martin* are cases about trustees seemingly just following an externally derived policy.

The Judge over your Shoulder (JOYS)

The Treasury Solicitor issues a helpful publication for the UK Government, called 'The Judge over your Shoulder'[28] or 'JOYS'. The latest (2006) edition includes a summary on 'fetters':

> '*Legitimate Expectation*
> 2.54 We have already seen that it is a principle of public law that the decision-maker must act within his powers; that he must not close off (or "fetter") the exercise of his discretion, but that he may exercise that discretion in accordance with a "policy", provided that he operates that policy consistently but not too rigidly; and that he must act fairly. Sometimes a tension arises between these principles in practice. Suppose for example the decision-maker operates a policy or a procedure consistently, but a change

21 See *Martin v City of Edinburgh District Council* [1989] Pens LR 9 at [33], 1988 SLT 329 at 334.
22 [1985] Ch 270.
23 [2013] UKSC 26 at [73].
24 *Martin v City of Edinburgh District Council* [1989] Pens LR 9 at [33], 1988 SLT 329 at 334.
25 [1985] Ch 270.
26 [1989] PLR 9, 1988 SLT 329.
27 See eg the Pensions Ombudsman's determination in *Sanderson* (77074/1, 18 August 2010) to the effect that the trustee relying on one medical report had 'fettered its discretion'.
28 See https://www.gov.uk/government/publications/the-judge-over-your-shoulder-joys-edition-4.

of circumstances, or a fresh appraisal of where the ''public interest'' lies, mean that he needs to modify the policy or procedure.'

Australian case law

A definition from Australian case law is more helpful:

> 'A trustee which has the discretion or duty to exercise a power from time to time as the circumstances require must not fetter its discretion by binding itself as to how the power will be exercised at some future time, regardless of the circumstances which may exist at that future time.' [29]

However, the Australian cases make it clear that the principle needs to be considered in the context of the relevant governing trust deed.[30]

New Zealand Law Commission: 'Review of the Law of Trusts' (2013)

The New Zealand Law Commission, in its recent (2013) 'Review of the Law of Trusts'[31] recommended a default rule in its proposed new Trusts Bill as including:

> '11(1) A trustee's default duty is a duty that the trustee must perform unless it is excluded or modified or excluded by the terms of the trust or the statute under which the trust is created.
> [. . .]
> 15. A trustee must not fetter the future exercise of the trustee's powers.'

This looks much too wide. It does not distinguish between internal and external discretions. If enacted it is likely to need a fair deal of purposive interpretation if it is not to significantly restrict the actions of trusts and trustees (eg in entering into contracts which are otherwise in the interests of the trust).

Examples of fetter arguments

Examples of situations where fetter arguments could arise are:

- The trustee has a power of sale or a discretion to augment benefits or increase pensions – exercising that power stops the trustee from making a contrary decision later (or not paying the relevant money). This is clearly not an invalid fetter – instead it is the exercise of the relevant power at the right time.

29 *Queensland Local Government Superannuation Board v Superannuation Complaints Tribunal* [2014] FCCA 2473 (Judge Burnett), citing and explaining *Dunstan v Houison* (1901) 1 SR NSW 212; *Watsons Bay & South Shore Ferry Co Ltd v Whitfield* (1919) 27 CLR 268 (HCA); *Re Hurst* (1954) St R Qd 348. These cases are also cited in *Jacob's Law of Trusts in Australia*, 7th ed, (LexisNexis Australia, 2006) at [1615].

30 *Queensland Local Government Superannuation Board v Superannuation Complaints Tribunal* [2014] FCCA 2473 (Judge Burnett) at [41].

31 Report 130 (August 2013). On the New Zealand Law Commission website at http://r130.publications.lawcom.govt.nz/uploads/NZLC-R130-Review-of-the-Law-of-Trusts.pdf.

- *Lewin on Trusts*[32] comments that, provided trustees properly consider the effect of a proposed restriction in narrowing the ambit of their discretionary powers in future, they may properly enter into a transaction which has that effect.

  It cites as an example a decision of trustees who sell a house forming part of the trust property pursuant to their powers of investment, who thereby disable themselves thereafter from making that house available for occupation by a beneficiary, pursuant to an express power to that effect in the settlement.[33]
- Trustees have a power of sale – can they grant an option to a third party to purchase at a future date? This may be the best deal that the trustee can now get (and so in the interests of the trust), but is it an improper fetter because it means that the trustee cannot sell that property at the later date? This depends on the terms of the power of sale under the trust – are options allowed?[34] Even if they are, the normal duties to exercise the power properly will apply.
- Trustees have a power of sale and agree a voting agreement in relation to retained shares or decide they will get a better price if they give warranties on a limited recourse basis (limited to the assets available in the trust) with a restriction on future distributions out of the trust. These have been held not to be invalid fetters.[35]
- Trustees are asked to agree to a bulk transfer out of a scheme being made at a later date. The transfer power mandates a share of fund transfer payment – so an agreement in advance for a fixed amount will not be allowed by the power.[36] However, the trustees could agree to an amendment to the scheme to provide for such a transfer.[37]

Some older cases

An obvious case: Weller v Ker (1866)

It seems obvious that if the relevant power specifies a time at which a trustee must exercise a discretion or refers to them considering the facts at a specific time, then an 'exercise' or fetter in advance of that time will, in terms of the trust, not be an effective exercise of the power.

In *Weller v Ker*,[38] a will provided for property to pass to a son at age 25, but only a life estate if he should 'marry or otherwise conduct himself so as not to merit the approbation of [the] trustees'.

The House of Lords held that the trustees could not validly exercise the power or bind themselves to pass the estate to the son (by a settlement on the son) before age 25. Nor could they decide before that age that they would *not* pass him the estate.

Lord Chelmsford held:

32 19th ed, 2015, para 29-228.

33 The similar statement in the previous (18th) edition of *Lewin* (at 29-205) was cited by Briggs J in *Jones v Firkin-Flood* [2008] EWHC 2417 (Ch) at [211].

34 In *Oceanic Steam Navigation* (1880) 16 Ch D 236, the Court of Appeal, in effect said 'no' in relation to the then investment powers (see below). Commonly trusts now have wider investment powers and options are allowed – see below.

35 *Greenwell v Porter* [1902] 1 Ch 530 (Swinfen Eady J) in an unreserved judgment (voting agreement over shares) and *Jones v Firkin-Flood* [2008] EWHC 2417 (Ch) (Briggs J) (warranties on a sale).

36 *Stannard v Fisons* [1992] IRLR 27, CA. Similarly *Independent Pension Trustee Ltd v Stevens* [2002] 37 PBLR (Judge Weeks QC).

37 *Mettoy Pension Trustees Ltd v Evans* [1991] 2 All ER 513 (Warner J) and *Stena Line Ltd v Merchant Navy Ratings Pension Fund Trustees Ltd* [2010] EWHC 1805 (Ch) (Briggs J).

38 *Weller v Ker* (1866) LR 1 Sc & Div 11, HL. An unreserved judgment.

> 'It was evidently the testator's intention that the trustees should exercise their judgment upon a review of the conduct of the son at the time when the estate was to be conveyed to him. Before that time it is clear that they could not have deprived themselves of the exercise of future judgment by giving him the fee.... It was possible that before twenty-five he might have conducted himself so as to excite the disapprobation of the trustees, but that at that age he might have redeemed himself in their estimation by subsequent good conduct. There was apparently no intention that the heir should either have the fee conveyed to him, or that he should be deprived of it by any judgment of the trustees before the period when they were bound to make the conveyance.'[39]

This seems unremarkable. The trustees were here dealing with the beneficiary. No question of a contract seems to have arisen. Regardless of the position as regards a third party (eg someone who has contracted with the trustees), the terms of the trust in this case made it clear that the trustees needed to consider at or around age 25 how the son had conducted himself up to age 25. This means that they needed to consider the circumstances when he reached that age.

It was incompatible with that (pretty express) time limit (and so hence not a valid exercise of the power under the trust) for the trustees to seek to bind themselves to the son in advance of that age to say that they will (or indeed will not) pass the estate to the son.

The courts move on: Oceanic Steam Navigation (1880)

But what is the position where the trust instrument is less clear on the 'right' time that a discretion or power needs to be exercised? Is there a general 'no fetter' rule that should be implied? What if this works against the interests of the trust or the beneficiaries?

The courts will still look to the terms of the trust instrument to see what it says. If, for example, there is a restrictive investment power (as would have been common in the Victorian age[40]), then the courts may well decide that future exercises are not within the power, eg contracting to sell at some time in the future or granting options. And this can be the case even if the trustee can show that the exercise would have been in the positive interest of the trust/beneficiaries. For example, if the trust instrument positively prohibits investment in land, then (absent an amendment to the trust or overriding statutory power) if the trustee invests in land, it will be in breach of trust (with an unauthorised investment), even if the trustee considers that the land is by far the best investment for the trust.[41]

An example of this, and the most difficult case (to modern eyes), is the decision of the Court of Appeal in 1880 in *Oceanic Steam Navigation Co v Sutherberry*.[42]

The administrator of the estate of his intestate father, granted in 1873 to Oceanic an underlease of some leasehold property within the estate (this was allowed). As part of the underlease, the son also granted Oceanic an option (right of first refusal) to buy the leasehold interest over a seven-year period. Oceanic erected some buildings on the land and then, in 1878 tried to exercise the option.

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39 At p 15.

40 See generally Chantal Stebbings *The Private Trustee in Victorian England* (Cambridge University Press, 2002) at Chap 5.

41 An example of there being no 'overriding' duty on trustees to act in the best interests of beneficiaries: see David Pollard *The Law of Pension Trusts* (Oxford University Press, 2013) at 9.18.

42 (1880) 16 Ch D 236, CA. An unreserved judgment.

The Court of Appeal, in an unreserved judgment, upheld the first instance decision that the option was not binding on the estate and was made in breach of trust, so a claim by Oceanic for specific performance of the agreement failed.

Sir George Jessel MR held:

> '. . . but the question is not whether this was a proper rent, but whether it was right to insert an option of purchase so as to fetter the exercise of the trust for sale by preventing the administrator from selling the property to any one but the Plaintiffs for a period of seven years at a price then fixed. It appears to me that it would be dangerous to hold that an administrator could do this, a mere trustee whose duty was to sell within a reasonable time';[43]

and James LJ:

> 'In my opinion it would be most dangerous if a trustee could enter into a contract for sale binding the estate for some years afterwards, whatever might be the alteration in the value of the property.'[44]

It is noticeable that the Court of Appeal considered this a 'hard case'[45] and one decided 'with reluctance'.[46] The Court of Appeal cited no authority,[47] and did not even need to call on counsel for the next of kin in reaching its decision. The Court considered that it was not relevant that 'the price fixed was a fair one at the time'[48] or that the bargain that the son/administrator had made 'was the best that could have been made under the circumstances'[49] or that Oceanic would lose the benefit of the buildings that it had put up on the land.

Oceanic has not been expressly cited by the courts much. One example is *Johnson v Clarke*[50] where Maugham J held that a trustee had no power to grant an option to renew to a tenant and so the contract was not specifically enforceable and so was not a reason to say that the trustees could not give good title on a sale to a third party.

Pushing to a wide general rule? eg Osborne (1909) and Vestey (1950)

The danger with the wide statements in *Oceanic* is that it looks to be moving almost to a general principle. So that, for example, trustees can never agree to sell in advance or if a power is given to apply income, it can only be applied as it arises (and there cannot be a binding commitment to apportion in advance).

43 (1880) 16 ChD 236, Jessel MR at p 243.

44 (1880) 16 ChD 236, James LJ at p 245.

45 (1880) 16 ChD 236, James LJ at p 244.

46 (1880) 16 ChD 236, Jessel MR at p 244.

47 However, authority had been cited by Little V-C at first instance, including that '. . . there is the decision of Sir James Parker in *Clay v Rufford* (5 De G & Sm 768), in which he held it to be clear, and clear beyond the point of reasonable argument, that a trustee could not, through the medium of such an option clause as we have in this case, enter into, as he expressed it, ''a contract to sell at a future time at a price now fixed, without exercising any judgment whether the thing was beneficial or not at the time of sale.'' ' *Clay v Rufford* (1852) 5 De G & Sm 768, (1852) 64 ER 1337 (Parker V-C) is a case on an option contract being invalid as a fetter. *Clay* is discussed further by Jonathan Swil and Roger Forbes in their article: 'Fettering the fiduciary discretion by agreement: Breach of duty or commercial reality?' (2010) 84 ALJ 32 at 34.

48 (1880) 16 ChD 236, Jessel MR at p 244.

49 (1880) 16 ChD 236, Lush LJ at p 245.

50 [1928] Ch 847 (Maugham J).

So in 1909 in *Osborne v Amalgamated Society of Railway Servants*,[51] Fletcher Moulton LJ commented (obiter) that trustees must not bind themselves contractually to:

> 'exercise a trust in a specified manner to be decided by considerations other than [their] own conscientious judgment at the time as to what is best in the interests of those for whom [they are] trustee'.

This was however in the context of a claim against a trade union in relation to the position of members of Parliament. Fletcher Moulton LJ used the analogy of a trustee (my emphasis):

> 'This deep-seated principle of law is the basis of the illegality at common law of bribery at parliamentary elections, for the power of voting for a representative is also a trust towards the public. Now to my mind it can make no difference whether such a contract be that B shall vote as A tells him or as any body of third persons may decide. Every such agreement is *tainted with the vice of the trustee binding himself contractually for valuable consideration that he will exercise a trust in a specified manner to be decided by considerations other than his own conscientious judgment at the time as to what is best in the interests of those for whom he is trustee*. And it is no answer to say that before or at the election he openly avowed his intention to be thus contractually fettered. The majority who elected him may be willing to permit it, but they cannot waive the rights in this respect of the minority. By our Constitution a representative is chosen by the vote of the majority, and however little the political views of the elected member coincide with those of the minority, they cannot complain. But that election is the election of a representative, and, whoever be chosen, their right remains that he shall be a representative, and not one who has contractually fettered himself in discharge of the duty of representative which he has accepted as regards the public, and not only as regards his own supporters. It is no excuse for a breach of trust towards any one of the cestuis que trust that many, or even a majority, of the cestuis que trust are willing to permit it. They may waive their own rights as against the trustee, but they cannot waive the rights of others.'

In 1950, in the private trust case, *Re Vestey's Settlement*,[52] the Court of Appeal commented (in passing) that a resolution of the trustees to exercise a power to pay income to certain beneficiaries could not cover future exercises of the discretion. Evershed MR commented (again obiter) that:

> 'the first resolution ... appears on the face of it to be a resolution covering future exercise of the discretion, but it has been pointed out that it could not, of course, be an effective exercise, *nunc pro tunc*, for the future and that it must therefore, be regarded as a statement of policy to be followed, subject of course to review and possible alteration on every subsequent occasion'.

It is noticeable that *Vestey* only mentions a potential fetter rule in passing (it was not the main focus of the decision).[53]

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51 [1909] 1 Ch 163, CA, at p 187. Cited by the Law Commission in its 2014 report on 'Fiduciary duties of investment intermediaries' – see above.

52 [1950] 2 All ER 891, CA, an unreserved judgment.

53 This is also the position in two of the other more modern cases: *Swales v IRC* (1984) and *Re Gibson's Settlements* (1981).

The rule gets more sensible: three modern cases – Thorby, Cabra Estates and Firkin-Flood

Australian High Court looks at the 'right' time: Thorby (1964)

In *Thorby v Goldberg*[54] the High Court of Australia upheld a contract between the shareholders of a company (including its directors) with other individuals for the purpose of re-capitalising the company by allotting shares to the individuals and agreeing terms as to rights of occupancy of space in a proposed new building owned by the company. The directors agreed to hold various board meetings, register share transfers and alter the share capital and to replace certain directors.[55]

The High Court rejected the argument that the agreement was void as an impermissible fetter, holding that the right time for exercising the discretion was at the point of entering into the transaction, not at the point of completion.

The relevant part of the headnote reads:

> 'If, when a contract is negotiated on behalf of a company, the directors bona fide think it in the interests of the company as a whole that the transaction should be entered into and carried into effect they may bind themselves by the contract to do whatever is necessary to effectuate it.'[56]

Kitto J stated the argument[57] of the appellants (the defendant shareholders/directors):

> 'They say . . . that because it [the alleged contract] purports to bind the directors of a company as to the manner in which they shall exercise a discretion of a fiduciary nature it is void for illegality.'

He dealt with that argument[58] (my emphasis):

> ... 'The argument for illegality postulates that since the discretionary powers of directors are fiduciary, in the sense that every exercise of them is required to be in good faith for the benefit of the company as a whole, an agreement is contrary to the policy of the law and void if thereby the directors of a company purport to fetter their discretion in advance . . . There may be more answers than one to the argument, but I content myself with one. *There are many kinds of transactions in which the proper time for the exercise of the directors' discretion is the time of the negotiation of a contract, and not the time at which the contract is to be performed*. A sale of land is a familiar example. Where all the members of a company desire to enter as a group into a transaction such as that in the present case, the transaction being one which requires action by the board of directors for its effectuation, it seems to me that the proper time for the directors to decide whether their proposed action will be in the interests of the company as a whole is the

54 [1964] HCA 41; (1964) 112 CLR 597, HCA.

55 See the discussion of this case by Jonathan Swil and Roger Forbes: 'Fettering the fiduciary discretion by agreement: Breach of duty or commercial reality?' (2010) 84 ALJ 32.

56 Later cited by the English Court of Appeal in *Cabra Estates* (see below) at p 392. Also cited by the Law Commission in its 1998 consultation paper on Directors' duties (Con Doc no 153, 1998) at 11.12.

57 (1964) 112 CLR 597 at p 601.

58 (1964) 112 CLR 597 at pp 605–606, in a passage cited later by the Court of Appeal in *Cabra Estates*.

time when the transaction is being entered into, and not the time when their action under it is required. If at the former time they are bona fide of opinion that it is in the interests of the company that the transaction should be entered into and carried into effect, I see no reason in law why they should not bind themselves to do whatever under the transaction is to be done by the board. In my opinion the defendants' contention that the agreement is void for illegality should be rejected.'

McTiernan and Windeyer JJ agreed with KittoJ. Owen J supported[59] this particular point of the judgment of Kitto J:

... 'For all that appears from the plea, the directors of the Company may, before the execution of the agreement, have given proper consideration to the desirability of entering into it and decided that it was in the best interests of the Company that it should be made. If so, it would be impossible to argue that they had, by executing the document, improperly fettered the future exercise of their discretion. In fact they would already have exercised it and, in the absence of an allegation that they had done so improperly, the suggested defence could not be sustained.'

In 2010 in their article, 'Fettering the fiduciary discretion by agreement: Breach of duty or commercial reality?'[60] Jonathan Swil and Roger Forbes commented it could be argued that the decision in *Thorby* is limited to a situation where all the shareholders agreed to the relevant contract. But they note that the English Court of Appeal in *Cabra Estates* (see below) has taken a wide view of the comments made in *Thorby v Goldberg*, holding that it was not so limited.[61]

The English Court of Appeal follows Thorby: Fulham Football v Cabra Estates (1994) – external contract upheld

In *Fulham Football Club Ltd v Cabra Estates plc*,[62] the Court of Appeal followed *Thorby v Goldberg*, holding[63] that it states 'the true rule'. The Court of Appeal upheld a contract made by a third party (Cabra Estates) with Fulham Football Club and its directors that the company (and the directors) would support a planning application. The directors later tried to argue that they could decide that they should no longer support the planning application. The Court of Appeal reversed Chadwick J and upheld the agreement as binding on the company and also on its directors.

Neill LJ (giving the judgment of the court) held that a contract between a third party and a company (and its directors) to support a planning application was valid and not an

59 (1964) 112 CLR 597, HCA at pp 617–618.
60 (2010) 84 ALJ 32.
61 The Court of Appeal in *Cabra Estates* clearly did not view the unanimous shareholder consent in *Thorby* as determinative, commenting (at p 393g) that 'we prefer to reject the plaintiffs' arguments on the more general grounds set out above.'
62 [1994] 1 BCLC 363, CA. The Court of Appeal stated 'For a general discussion of this question see *Finn on Fiduciary Obligations* (1977) pp 25–30'. *Cabra*, and the position of directors is discussed by Andrew Keay *Directors duties*, (2nd ed (Jordans, 2014), Chap 7 'Duty to exercise independent judgment'; Andrew Griffiths 'The best interests of Fulham FC: Directors' duties in giving contractual undertakings' [1993] JBL 576; and Stephen Kenyon-Slade 'Improper Fettering of Directors' Discretion, or Holding them to their Word?' [1993] CLJ 218.
63 Neill LJ (giving the judgment of the Court) at p 392b.

impermissible fetter. The case involved an external contract – with a third party outside the company. All shareholders had agreed, but the Court of Appeal did not rely on this.[64]

Neill LJ held (at p 392):

> 'It is trite law that directors are under a duty to act bona fide in the interests of their company. However, it does not follow from that proposition that directors can never make a contract by which they bind themselves to the future exercise of their powers in a particular manner, even though the contract taken as a whole is manifestly for the benefit of the company. Such a rule could well prevent companies from entering into contracts which were commercially beneficial to them.'

Neill LJ held that *Thorby* established a wide rule and was not dependent on unanimous shareholder approval. He held (at p 393e):

> 'The judge rejected the plaintiffs' arguments under these heads on the somewhat different ground that the undertaking in the present case was to use powers as members as well as directors, and that all the members of the company were parties to the undertaking. He referred to a passage from the judgment of Menzies J in *Thorby v Goldberg* (1964) 112 CLR 597 at 616 which relied on the fact that in that case all the shareholders were party to the agreement, and what the directors undertook to do was what all the shareholders committed themselves to ensure that they did.
>
> We find some difficulty in supporting this reasoning. The duties owed by the directors are to the company and the company is more than just the sum total of its members. Creditors, both present and potential, are interested, while s 309 of the Companies Act 1985 imposes a specific duty on directors to have regard to the interests of the company's employees in general. Accordingly we prefer to reject the plaintiffs' arguments on the more general grounds set out above.'

The Court of Appeal also clearly held that in the circumstances there was no scope for the implication of a term in the undertaking that the directors would not be 'required to do anything that would be inconsistent with the fiduciary duties owed by them to the company'.[65] The Court of Appeal held that two first instance cases where such an implication had been applied: *Rackham v Peek Foods Ltd*[66] and *John Crowther Group plc v Carpets International plc*[67] should be regarded as decided on their particular facts and 'should not be read as laying down a general proposition that directors can never bind themselves as to the future exercise of their fiduciary powers.'[68]

64 Neill LJ seems to have taken the view that unanimous shareholder consent would not be enough to modify any director duty, given that directors can sometimes owe duties in favour of creditors as well. This is misguided, at least for a solvent company, as pointed out by Thomas Courtenay 'Fettering Directors' Discretion' (1995) 16 Company Lawyer 227. But given that Neill LJ did not rely on the consent factor, this does not detract from the authority of the Court of Appeal decision in *Cabra* on the ambit of the fetter rule.

65 Neill LJ at ppn391h and 393g.

66 (1977) [1990] BCLC 895 (Templeman J).

67 [1990] BCLC 460 (Vinelott J). Stephen Kenyon-Slade also points out, in his casenote on *Cabra Estates* [1993] CLJ 220, the decision of the Inner House of the Court of Session in Scotland in *Dawson International plc v Coats Patons plc* [1990] BCLC 560, CSIH. He points out that all three cases refer to a 'best endeavours' obligation on the directors to obtain shareholder approval. This looks to be less than the more absolute obligation in *Cabra Estates*.

68 [1994] 1 BCLC 363, Neill LJ at p 393i.

The principle in *Cabra Estates*, and the subsequent Law Commission consultation paper (see below) were cited by Arden J (as she then was) in *Re Benfield Greig Group plc*,[69] holding that directors had power to make binding contracts about how they would exercise their discretion under a valuation provision in the articles (although she held that this was not found on the facts).

Wide approach: Even limiting internal powers can be valid: Firkin-Flood (2008)

In 2008 in the private trust case *Jones v Firkin-Flood*,[70] Briggs J (as he then was) upheld contractual limitations entered into by trustees as part of a sale by trustees.

In *Jones v Firkin-Flood*, Briggs J held that the agreement – between trustees of a private trust and the buyer of shares from the trust – including a limit on the trustees' ability to distribute assets to the beneficiaries, was within the trustees' powers.

The trustees were asked to give warranties on the sale (this is common and should mean that the trust gets a better price). The trustees were willing to give the warranties, but only on the basis that any personal liability was limited to the assets in the trust (against which they had an indemnity). The buyer accepted this limitation, but required the trustees to commit that they would not distribute the assets of the trust to any beneficiary during the warranty period (unless the beneficiary committed to the warranty in place of the trustees).

Some of the beneficiaries complained about the sale, including the contractual limits in the sale agreement, and brought various actions against the trustees (the buyer was not a party to the case).

Briggs J did not refer to *Cabra Estates*. But having cited the fetter principle from *Swales v IRC*,[71] and referred to *Lewin on Trusts* and *ATC (Cayman)*,[72] Briggs J held that the trustees were acting within their powers in making the agreement. Effectively this was a valid exercise of the wide 'beneficial owner' investment power and was 'plainly beneficial' in realising the best value for the shares being sold.

Briggs J held:

> '213. In my judgment the Trustees plainly had power both to give the warranties and enter into the provisions of Schedule 9 to the Sale Agreement for the protection of the value of those warranties to the Buyer, in the exercise of their investment powers under the Will. The giving of warranties is a common if not standard incident to the sale of shares in private companies, well within the beneficial owner power of investment conferred by clause 14.3, and it was plainly beneficial for them to do so in terms of realising best value for the shares. But for the detailed provisions of Schedule 9 (which it was demonstrated to me were derived from a form in common use where trustees are required to give warranties) it would have been both competent and prudent of the trustees to retain a substantial part of the Trust Fund, if not indeed all of it, for the duration of the warranty period, in order to protect their indemnity in respect of any liability arising from the giving of those warranties. The effect of Schedule 9 was to enable the Trustees to distribute the Trust Fund notwithstanding giving those

69 [2000] 2 BCLC 488 (Arden J). Reversed on other grounds: [2001] EWCA Civ 397; [2002] 1 BCLC 65.

70 [2008] EWHC 2417 (Ch) (Briggs J). Noted by J Cousins and A Charman (2010) PCB 181.

71 [1984] 3 All ER 16, at 24 per Nicholls J – see above. Briggs J also mentioned that counsel for the beneficiaries had also referred to *Re Gibson's Settlement Trusts* [1981] Ch 179, at 182 and *Oceanic Steam Navigation Co v Sutherberry* (1880) 16 Ch D 236, at 243 to 244.

72 See below.

warranties, albeit only to beneficiaries who each undertook to stand in their shoes, up to the amount distributed to each of them.'

Briggs J also rejected an alternative argument that the trustees had failed to consider the effect of the restrictions before entering into the agreement:

'214. [Counsel for the beneficiaries]'s final complaint in this respect was that even if prima facie within the Trustees' powers, their entry into Schedule 9 was a breach of trust because they did not even pause to consider the effect of those restrictions upon their ability to distribute thereafter. I reject that complaint. First, the presence or absence of such considerations in the minds of the Trustees cannot sensibly be relevant to the question whether their entry into Schedule 9 was strictly ultra vires, so as to be void as between them and the Buyer, even though it might be relevant to the question whether their conduct amounted to a breach of trust. Secondly, in my judgment it is impossible to suppose that trustees asked to consider whether to sign up to a covenant expressly restricting distribution can have failed to have in mind the fact that their powers to distribute would thereafter be restricted pursuant to that covenant. Whether they had in mind, or were advised by Mr Jones, of the rules about fetters on discretion, is a separate question and for present purposes neither here nor there.'

Briggs J also referred to the 2005 Cayman case, *ATC (Cayman) Ltd v Rothschild Trust Cayman Limited*,[73] involving a change of trustee, including a citation from *Thomas on Powers* (see below).

Two years after his judgment in *Jones v Firkin-Flood*, in 2010 in a pension scheme case, *Stena v MNRF*,[74] Briggs J rejected a claim that the exercise of an amendment power in a pension scheme could be contrary to a 'no fetter' rule (see further below).

ATC (Cayman) (2005)

The 2005 Cayman case, *ATC (Cayman) Ltd v Rothschild Trust Cayman Limited*,[75] involved a change of trustee.

ATC replaced Rothschild as trustee of two trusts but Rothschild refused to relinquish the trust assets until it received a satisfactory indemnity from any claim it might face as outgoing trustee. ATC agreed to ensure that funds remained in the trust fund for a specified period to cover its estimate of any potential liability on Rothschild. Rothschild refused to accept this undertaking on the ground that it was an unenforceable fetter on the trustee's discretion. The trusts included an express power (in cl 6.19) for a new trustee to give indemnities to an outgoing trustee.

Smellie CJ referred to *Swales v IRC* and *Re Gibson's Settlements* and held that the application of the principle against trustees fettering their discretion could be excluded or restricted by an express provision.

He held:

73 (2005) 9 ITELR 36; [2007] WTLR 951 (Smellie CJ).

74 *Stena Line Ltd v Merchant Navy Ratings Pension Fund Trustees Ltd* [2010] EWHC 1805 (Ch) (Briggs J).

75 (2005) 9 ITELR 36; [2007] WTLR 951 (Smellie CJ). The outgoing trustee was later held to be entitled to costs of the proceedings 'from beginning to end but on the standard party and party, rather than on the full indemnity basis': *ATC (Cayman) Ltd v Rothschild Trust Cayman Ltd* (2011) 14 ITELR 523 (Smellie CJ).

'[17] ATC construes cl 6.19 of its respective trust deeds as expressly allowing it to give the undertaking. On the face of that clause, one is immediately inclined to be sympathetic to ATC's construction, as it appears to address precisely the point in issue:

> "Power to Indemnify: The Trustees are authorised to indemnify and to enter into any indemnity in favour of any former Trustee or other persons in respect of any contingent or prospective liability, including any Tax in respect of the Trust Fund or the income thereof, or otherwise in connection with the trusts created pursuant to this Agreement. The Trustees may, in the exercise of an absolute discretion, apply the whole or any part of the Trust Fund or the income thereof by way of mortgage, pledge or otherwise howsoever as security for such indemnity".

[18] In light of this provision, the question becomes whether an express provision in the trust deed can be taken as overriding the prohibition, to be regarded as settled in the case law, against the fettering of the exercise of a trustee's discretion.

[19] If there is a fetter at all to be apprehended in this case, it would in effect be a fetter, by exercise of that plain, express administrative or managerial power, upon the exercise in the future of dispositive powers; however transitory the fetter and however relatively minor the consequential diminution in the amount of trust funds to be available for distribution to beneficiaries while the fetter is in place.

[20] None of the cases I have seen is directly on point. The authors of *Thomas on Powers* (1998, Sweet & Maxwell, London) at p 307, paras 6–26, express the following views, it seems with due hesitancy, given the absence of any case authority to the contrary or directly on point:

> "The application of the principle (or prohibition against fettering their discretion) may be excluded or restricted by an express provision (although, unlike express provisions authorising the release of powers, this is perhaps neither common nor always easy to draft). Moreover, it must be doubtful whether fetters and restriction of all kinds are prohibited, irrespective of the circumstances. Thus, on a sale or purchase of land by trustees, are they prohibited (in the absence of express provision to the contrary) from entering into a covenant which restricts their future use of either retained land or the land thus purchased?"

[21] However hesitant the view, it is one which I think accords with the modern realities of trust administration. It addresses the kind of eventuality properly anticipated by the draftsman of cl 6.19 of the present deeds, as likely to arise and to be provided for in the often complex management and administration of valuable trusts.

[22] In Underhill and Hayton *Law of Trusts and Trustees* (16th edn, 2003), 690–691 fn 17 where the authors discuss the prohibition against fettering; there is nonetheless the recognition that [by virtue of express provisions] "Trustees now have much wider powers than previously when grants of options were impermissible as fettering trustees' functions".

[23] The present impasse has had an unfortunate impact upon the proper management of the trusts. The assertion by Rothschild of their lien over the assets pending satisfaction of their claim to a special form of indemnity, has, at the very least, impeded the timely and smooth transfer of the assets to ATC, and may even have hampered proper administration and investment in the meantime. I make no observations one way or the other at this juncture, as to the propriety or otherwise of Rothschild seeking to act in that way. However, it is appropriate to note in passing, that it can seldom, if ever, be appropriate for a trustee to exert undue pressure to secure its own entitlements, to the detriment of its beneficiaries, by withholding the entire or very large portions of the trust fund.

[24] That stated, it is clearly settled principle none the less, that the beneficial entitlements under a trust are subject to the right of indemnity to which a retiring trustee is entitled and to the lien which that trustee will have over the assets in his possession for satisfaction of that indemnity. It seems also, that the retiring trustee is entitled to an amount in satisfaction of his lien (subject of course to there being no debt owed to the trust, for example, in respect of some unrelated breach of trust) even in priority to the interests of the beneficiaries. See *Re Griffith, Jones v Owen* 1904] 1 Ch 807, *Octavo Investments Proprietary Ltd v Knight* [1999] 144 CLR 360 and *Chief Comr of Stamp Duties v Buckle* [1998] 72 ALJR 242.
[25] In light of all the foregoing principles and factors, the inclusion of cl 6.19 in the deeds cannot be regarded as other than prudent drafting. It is in everyone's interest that when there is to be succession of trustees, the process of transition takes place without undue detriment to the trusts. In providing as it does for the indemnity of a former trustee, that proper process of transition is what cl 6.19 seeks to vouchsafe.
[26] I am therefore unable to accept that the principle of *Re Gibson's Settlement Trusts* (more fully developed and articulated in the earlier case law discussed above) must be taken and applied as suggested by Rothschild, so as to defeat the plain words and intent of cl 6.19 of the respective trust deeds. Those provisions expressly vest the trustee with the power to indemnify a former trustee against liabilities and in the exercise of an absolute discretion, to give the whole or any part of the trust fund or income by way of a pledge or otherwise howsoever as security for such indemnity.
[27] The exercise of that power with the bona fide intention to meet obligations owed to a former trustee, is not to be regarded as an improper or impermissible fetter upon the exercise in the future by the trustee of its discretionary dispositive powers under the trusts.'

Modern position

Trustees commonly now have much wider powers than in the Victorian age and there are more commercial trusts (eg pension schemes and unit trusts). Many pension schemes are very large.

It is likely that courts will be reluctant to impose a 'no fetter' rule or consider that an exercise of a power is within its terms even if in advance. In effect the courts are likely to regard the issue of whether or not a power has been exercised properly by reference to the usual duties of a trustee (or director), even if exercised in advance, rather than apply a rigid no fetter doctrine.[76]

The position in the Victorian age:

- family trusts (often small);
- unanimous trustee agreement usually needed;
- not commercial enterprises;
- general cautious approach, eg investment powers;[77]

76 For example see *Thomas on Powers* at 10.73 (p 516), citing *ATC* and *Jones v Firkin-Flood*, and *Capital Cranfield v Sagar* [2002] OPLR 151 (Neuberger J) (a case on fetters on amendment powers). See also Jonathan Swil and Roger Forbes: 'Fettering the fiduciary discretion by agreement: Breach of duty or commercial reality?' (2010) 84 ALJ 32.

77 For a good discussion on the evolution of trusts over the 19th century, see Chantal Stebbings 'The Private Trustee in Victorian England' (Cambridge University Press, 2002).

- delegation was not allowed;

is to be contrasted with the current position:

- large commercial trusts;
- expanded investment powers (eg Pensions Act 1995, Trustee Act 2000);[78]
- delegation now expressly allowed (trust instrument/Trustee Act 2000/Pensions Act 1995);
- corporate trustees much more common; and
- courts more developed in reviewing trustee decisions.

Would *Oceanic* be decided the same way today? Almost certainly not, because trustees now have far wider investment powers[79] and there is an express statutory power to grant options.[80] There has been a similar movement in the fetters cases in the public law area.[81]

No mention in *Equitable Life*

It is noticeable that no argument about fetters seems to have been raised in the *Equitable Life*[82] judgments from 1999 to 2002. That case involved the exercise of discretion by directors of a mutual company in declaring bonuses when with profits policies matured.

The with-profit policyholders effectively owned the company. A discretion for the directors to declare bonuses was contained in art 65 of the articles of association of the company. Some policies had been issued in the past with a 'guaranteed annuity rate' (GAR) element, effectively giving a contractual right to a minimum level of annuity rate to be applied to the member's policy amount in certain circumstances. Other (later) policies did not include GARs.

Following a fall in interest rates, the GAR element could apply to give a better annuity than the market rate. The directors adopted a policy (which they followed each year) of granting differential rates of terminal bonuses (under the discretionary power in the company's articles) between GAR policy holders and the non-GAR policy holders, with a view to ending up with the same share of fund for both sets of policy holders.

On application to the court, Sir Richard Scott V-C (as he then was) upheld the

78 See eg Hugh Arthur 'Can trustees fetter their powers?' (1993) 7 TLI 69 at 70; and *Thomas on Powers* at 10.72 and 10.73. See also *Underhill and Hayton Law of Trusts and Trustees* at 57.7 (fn 3): 'Trustees now have much wider powers conferred on them than previously, when, for example trustees for sale had no power to grant options to purchase trust property'. This was cited by Smellie CJ in *ATC Cayman* at para [52]. On options, see eg the Australian decisions: *Rosset v Antunovich* [1963] WAR 52 (Hale J) (cited in Finn *Fiduciary Obligations* at p 26 (fn 8) and by Swil and Forbes at p 35) and Bryson J in *Junefield Pty Ltd v Zahra* NSW BC9002167 6 August 1990 (cited by Swil and Forbes at p 36).

79 For statutory powers, see the Trustee Act 2000 and (for investment matters under occupational pension schemes) the Pensions Act 1995.

80 Eg Trusts of Land and Appointment of Trustees Act 1996, s 6, giving trustees of land the same powers as an absolute owner. This replaced the Law of Property Act 1925, s 28 which cross-referred to the powers of a tenant for life under the Settled Land Act 1925 ss 51 and 90 (these were cited in Finn *Fiduciary Obligations* at p 26, fn 8). See *Thomas on Powers* at para 10.70.

81 Contrast the 1883 decision in *Ayr Harbour Trustees v Oswald* (1883) 8 App Cas 623, HL with the later more flexible and lenient approach in the decisions in *Birkdale District Electric Supply Co v Southport Corp* [1926] AC 355, HL and *British Transport Commission v Westmoreland CC* [1958] AC 126, HL. See the discussion at 18-022 in Paul Craig *Administrative Law*, (7th ed, (Sweet & Maxwell, 2012) and at pp 276 and 277 in Wade and Forsyth *Administrative Law*, 10th ed (Oxford University Press, 2009).

82 *Equitable Life Assurance Society v Hyman* [1999] OPLR 213 (Scott V-C); [2002] 1 AC 408, CA and HL.

policy,[83] but this was overturned on appeal by the Court of Appeal and the House of Lords.[84] The House of Lords held that this was an improper use of the discretion and contrary to the reasonable expectations of the GAR policyholders.

This is a controversial decision.[85] The House of Lords[86] effectively limited the directors' discretion by use of an implied term. Of interest for our purposes is that it does not seem to have been argued at any stage in these proceedings that the issue of the GAR policies was inconsistent with the discretion under the articles of association (and so vulnerable to an 'undue fetter' argument).[87]

In a later talk and article, 'The fetters on trustees' discretions',[88] Lord Scott raised some issues with the ultimate decision:

> 'Lord Steyn held that the requisite term was to be implied. It was essential in order to give effect to the parties' ''reasonable expectations''. The ''parties'' he was referring to were the GAR policy-holders. It was their ''reasonable expectations'' that had to be given effect to.
>
> But article 65 was much older than the earliest of the guaranteed annuity rate policies. The GAR policies were relatively new innovations in the life of the society, the oldest of the mutual societies. The ''strict necessity'', which Lord Steyn regarded as requiring the implication of the requisite term, limiting the breadth of the article 65 discretion so as to preclude the directors ''from adopting a principle which has the effect of overriding or undermining the GARs'' would not have arisen until the advent of the GAR policies.
>
> This produces obvious problems. If it was the advent of the GAR policies which produced the strict necessity for the implied term, it would seem to follow that the society's directors, by granting the GAR policies, had thereby limited the breadth of their article 65 discretion, and thereby side-stepped whatever formal procedure for amendment of the articles was prescribed under the Equitable Life's constitution.
>
> Case-law in relation to limited companies teaches that this does not work. A company cannot by contract entered into outside its articles of association alter its articles or the rights of its members under its articles. So it cannot have been the granting by the society of GAR policies that produced the implied term qualifying the article 65 distributive power.
>
> There may be ways around this difficulty. It may be that the term to be implied into article 65 could simply be expressed as a prohibition precluding the directors from exercising their power to allot bonuses in a manner that would be inconsistent with the terms of a policy subsequently issued to a participating policy-holder. But an implied term to that effect would allow the directors by subsequent contract to fetter the previous breadth of their article 65 discretion. It would not be in the interests of ordinary policy-holders that there should be any such fetter and the test of ''strict

83 *Equitable Life Assurance Society v Hyman* [1999] OPLR 213 (Scott V-C).

84 *Equitable Life Assurance Society v Hyman* [2002] 1 AC 408, HL.

85 See Tim Cox 'Equitable Life - A Lawyer's View'. On the Equitable Members Action Group website at: http://www.emag.org.uk/documents.php?id=2.

86 Lord Steyn giving the main speech and Lord Cooke giving the only other speech, agreeing with Lord Steyn, but adding some supplemental points. The other three Law Lords agreed with both Lord Steyn and Lord Cooke.

87 It may be relevant that the case did not include any representation of the non-GAR policyholders. The only parties were Equitable Life itself and a representative of the GAR policyholders.

88 (2002) 16 TLI 214. The lightly revised text of a lecture given in September 2002 by Lord Scott to the Association of Pension Lawyers.

necessity'' can hardly be satisfied. Or, alternatively, Lord Steyn's implied term might have been implied into the GAR policies themselves. But here, too, the propriety and efficacy of such an implied term, purporting by contract to limit a previously broad discretion, exercisable under the society's constitution, would be questionable.

Moreover, it is not generally open to those with fiduciary discretionary powers to fetter in advance their exercise of their powers. Nor can one set of trustees bind their successor trustees as to the manner in the future in which their successors will exercise the powers. No attention seems to have been given in the case to the question whether the Equitable Life directors had power, via contracts entered into with the GAR policy holders, to limit in advance the width of their article 65 discretion.[89]

If the right view is that the Equitable Life directors who issued the GAR policies could not by doing so thereby fetter the exercise of the distributive power vested in the directors for the time being under article 65, then the differential bonuses would have been within the breadth of the article 65 power albeit they might have constituted a breach of the individual contracts between the society and each GAR policy holder. Since, presumably, such a breach of contract would lead to a damages claim at the suit of the GAR policy holders, the question whether this analysis would lead to a preferable or markedly different result for the society than Lord Steyn's analysis is moot. There might, in terms of financial consequence, be very little difference.'

It may be that the GAR contracts were best regarded as external matters (and so not limited by the article 65 discretion) – see the analysis below. But the rights of policyholders seem more internal than external and were held by Lord Steyn in the House of Lords to be subject to the terms of the discretion. It may be that the limitation on the discretion in art 65 was too indirect – the directors retained the discretion over terminal bonuses, but could not exercise it in the way they had (under the policy they had adopted), given the GAR contract terms.

Scope of this Note

Only fiduciaries discussed here

The no fetter rule or doctrine is best considered as only applying to a person holding a power or discretion with a duty owed to a third party (eg beneficiaries in the case of a trustee, or the company in the case of a director) as to how it will be exercised. In practice this is mainly applicable to a person acting in a fiduciary capacity[90] or to public law governed discretions (where there is a duty to the public or the state).

The 'no fetter' or 'right time' principles applicable to trustees apply in a very similar way to directors. The case law applicable to directors will therefore apply equally to trustees (and vice versa).

Non-fiduciaries (such as shareholders or employers) can clearly enter into contracts and bind themselves as to how they will act in the future. If they hold a right or discretion, they can usually exercise it as they please (subject to being within the terms of the power). They may hold a property right that they are free to contract about (ie fetter).

89 Cf Millett J in *Re Courage Pension Schemes* [1987] 1 WLR 495, 514 C-E.

90 *Thomas on Powers*, 2nd ed (Oxford University Press, 2012) at 10.53 argues that any fetter doctrine is limited to powers conferred on persons who are fiduciaries. This seems too narrow (see below).

For example shareholders can contract about how they will exercise their votes and this is enforceable, but cannot exclude statutory powers of the company (eg to change its articles).[91] On this see the House of Lords in *Russell v Northern Bank Development Corpn Ltd*[92] where Lord Jauncey held:

> 'The issue between the parties in this House was whether art 3 of the agreement constituted an unlawful and invalid fetter on the statutory power of TBL to increase its share capital or whether it was no more than an agreement between the shareholders as to their manner of voting in a given situation. Both parties accepted the long-established principle that "a company cannot forgo its right to alter its articles" (*Southern Foundries (1926) Ltd v Shirlaw*, [1940] AC 701 at 739 per Lord Porter), a principle that was earlier stated in *Allen v Gold Reefs of West Africa Ltd* [1900] 1 Ch 656 at 671 per Lindley MR:
>
> > "... the company is empowered by the statute to alter the regulations contained in its articles from time to time by special resolutions (ss. 50 and 51); and any regulation or article purporting to deprive the company of this power is invalid on the ground that it is contrary to the statute: *Walker v. London Tramways Co* ((1879) 12 Ch D 705)."
>
> Murray J and MacDermott LJ both considered that this principle applied also to the right of a company to alter its memorandum and I agree that this must be the case. Mr McCartney QC for the appellant advanced a number of arguments to the effect that the agreement in no way contravened the above principle inasmuch as it was merely an agreement between shareholders outside the scope of company legislation which in no way fettered the statutory power of TBL to alter its memorandum and articles. Mr Girvan QC, on the other hand, submitted that the agreement was not only a voting arrangement between shareholders inter se but was tantamount to an article of association which constituted a restriction on the power of TBL to alter its share capital.
>
> My Lords, while a provision in a company's articles which restricts its statutory power to alter those articles is invalid an agreement dehors the articles between shareholders as to how they shall exercise their voting rights on a resolution to alter the articles is not necessarily so. In *Welton v Saffery* [1897] AC 299 at 331, which concerned an ultra vires provision in the articles of association authorising the company to issue shares at a discount, Lord Davey said:
>
> > "Of course, individual shareholders may deal with their own interests by contract in such way as they may think fit. But such contracts, whether made by all or some only of the shareholders, would create personal obligations, or an exceptio personalis against themselves only, and would not become a regulation of the company, or be binding on the transferees of the parties to it, or upon new or non-assenting shareholders. There is no suggestion here of any such private agreement outside the machinery of the Companies Acts."
>
> I understand Lord Davey there to be accepting that shareholders may lawfully agree

91 Although even a statutory provision (eg a power for shareholder to vote to change articles or to remove a director) can be circumvented by weighted voting provisions: *Bushell v Faith* [1970] AC 1099, HL.

92 [1992] 3 All ER 161, HL at p 165. Discussed by Ellis Ferran 'The decision of the House of Lords in Russell v Northern Bank Development Corporation Limited' [1994] CLJ 344. See also Michael Duffy 'Shareholders Agreements and Shareholders' Remedies: Contract versus Statute?' (2008) 20 Bond Law Review Iss. 2, Article 1.

inter se to exercise their voting rights in a manner which, if it were dictated by the articles, and were thereby binding on the company, would be unlawful.'

Employers?

The position of employers looks to be a bit more complex. They are clearly not fiduciaries in relation to employees or pension schemes,[93] but there are a number of cases where it has been held that a statement by an employer as to how it will decide a future matter (eg agree to a pension increase[94] or a pay rise[95]) could amount to a 'threat' and so a breach of the implied mutual duty of trust and confidence. The precise reasoning for this is unclear,[96] but it is outside the scope of this paper.

Discretions under contracts?

Similarly, under a contract, one of the parties may have a discretion (eg for a bank to change an interest rate or value security[97]). Exercise of such a discretion or power may give rise to contractual issues – there may be implied limitations, particularly in long-term 'relational' contracts (for example to only exercise the power in good faith and not arbitrarily or capriciously).[98] A fetter agreed with a third party on how such a discretion or power may be exercised could perhaps be envisaged as being contrary to the contract (but this is also outside the scope of this paper).

Current position: Only a presumption

Having said this, the general 'no fetter' rule is clearly only a presumption. It is no more than an implied limit on when and how relevant powers or discretions are to be exercised (and by whom).

- If it is clear from the terms of a particular instrument or power that the use of the power can indeed be on a 'fettered' basis, then the 'no fetter' presumption falls away.
  - For example, if the trust instrument requires and authorises an agreement to be entered into by the trustee,[99] then entry into the agreement is required and cannot

93 Eg *Imperial Tobacco* [1991] 1 WLR 589 (Browne-Wilkinson V-C) and Chap 11 'Employer powers – non-fiduciary' in David Pollard *The Law of Pension Trusts* (Oxford University Press, 2013).

94 *Imperial Tobacco* [1991] 1 WLR 589 (Browne-Wilkinson V-C).

95 *IBM United Kingdom Holdings Ltd v Dalgleish* [2014] EWHC 980 (Ch) (Warren J), but seemingly based on rather extreme facts.

96 See, eg Chap 13, 'Employer powers – the implied duty of trust and confidence' in David Pollard *The Law of Pension Trusts* (Oxford University Press, 2013), especially at 13.141. It may be clarified in the second stage 'remedies' judgment awaited (in 2015) from Warren J in the *IBM case*.

97 Eg *Socimer International Bank Ltd v Standard Bank London Ltd* [2008] EWCA Civ 116, CA.

98 See David Pollard *The Law of Pension Trusts* (Oxford University Press, 2013) at 13.15: 'Good faith obligation in contracts generally' and Richard Hooley 'Controlling Contractual Discretion' [2013] CLJ 65. This is very fact and contract specific: *Yam Seng Pte Limited v International Trade Corporation* [2013] EWHC 111 (QB) (Leggatt J) *Compass Group UK and Ireland v Mid Essex Hospital Services NHS Trust* [2013] EWCA Civ 200, CA and *Bristol Groundschool Limited v Intelligent Data Capture Limited* [2014] EWHC 2145 (Ch) (Richard Spearman QC). See also Stephen Kos 'Constraints on the Exercise of Contractual Powers' (2011) 42 Victoria U Wellington Law Rev 17.

99 Eg on the trust being first established. Sometimes seen in pensions, eg where there is an agreement for a bulk transfer into a new scheme established for that purpose.

be objected to as being a 'fetter' or fraud on a power: see eg the Australian case, *BrisConnections*.[100]

– However, some statutory powers (eg to amend articles) cannot be overridden in this way – see *BrisConnections*[101] and *Russell v Northern Bank Development Corp*.[102]

- If all the affected beneficiaries agree (or all the members of a company) then the fetter rule does not apply, eg *Thorby; Cabra; Ringuet v Bergeron*.[103]
- It does not apply to amendment powers – see *Mettoy* and the discussion below.
- The courts are going to be reluctant to apply it if the commercial interests of the trust or company are in favour of such a commitment – *Cabra Estates* and *Jones v Firkin-Flood*.

This means it is unlikely to apply (at least separately from a general proper purpose/best interest test) in a company or large commercial trust, such as a pension scheme.

Pension schemes and fetters

Does a no fetter rule apply at all?

There can be an issue as to whether 'traditional' trust law applies to commercial trusts such as pension schemes. The leading comment is by Lord Browne-Wilkinson in *Target Holdings v Redferns*:[104]

> 'But in my judgment it is in any event wrong to lift wholesale the detailed rules developed in the context of traditional trusts and then seek to apply them to trusts of quite a different kind. In the modern world the trust has become a valuable device in commercial and financial dealings. The fundamental principles of equity apply as much to such trusts as they do to the traditional trusts in relation to which those principles were originally formulated. But in my judgment it is important, if the trust is not to be rendered commercially useless, to distinguish between the basic principles of trust law and those specialist rules developed in relation to traditional trusts which are applicable only to such trusts and the rationale of which has no application to trusts of quite a different kind.'

This was recently followed and approved by the Supreme Court in *AIB Group (UK) plc v Mark Redler & Co Solicitors*.[105] Lord Toulson (with whom the other judges in the Supreme Court agreed) commented:

> '[70] As to the criticism of the passage in *Target Holdings* where Lord Browne-Wilkinson said that it would be "wrong to lift wholesale the detailed rules developed in the context

100 *Macquarie Capital Advisers Ltd v BrisConnections Management Co Ltd* [2009] QSC 82; (2009) 71 ACSR 234 (Dutney J) at [39] and [102]. Upheld on appeal: *Macquarie Capital Advisers Ltd v BrisConnections Management Co Ltd* [2009] QCA 272 at [32] (Holmes JA). Discussed by Jonathan Swil and Roger Forbes 'Fettering the fiduciary discretion by agreement: Breach of duty or commercial reality?' (2010) 84 ALJ 32.

101 *Macquarie Capital Advisers Ltd v BrisConnections Management Co Ltd* [2009] QSC 82; (2009) 71 ACSR 234 (Dutney J).

102 [1992] 1 WLR 588, HL. See further below.

103 (1960) 24 DLR (2d) 449 (Canadian Supreme Court). Cited by Chadwick J at first instance in *Cabra Estates*.

104 [1996] AC 421, [1995] 3 All ER 785, HL at p 795. The other Law Lords agreed with Lord Browne-Wilkinson.

105 [2014] UKSC 58, SC.

> of traditional trusts'' and apply them to a bare trust which was ''but one incident of a wider commercial transaction involving agency'', it is a fact that a commercial trust differs from a typical traditional trust in that it arises out of a contract rather than the transfer of property by way of gift. The contract defines the parameters of the trust. Trusts are now commonly part of the machinery used in many commercial transactions, for example across the spectrum of wholesale financial markets, where they serve a useful bridging role between the parties involved. Commercial trusts may differ widely in their purpose and content, but they have in common that the trustee's duties are likely to be closely defined and may be of limited duration. Lord Browne-Wilkinson did not suggest that the principles of equity differ according to the nature of the trust, but rather that the scope and purpose of the trust may vary, and this may have a bearing on the appropriate relief in the event of a breach.'

A similar endorsement of Lord Browne-Wilkinson's comments in *Target Holdings* was recently made by the High Court in Australia in *Wellington Capital Ltd v ASIC*.[106]

Despite this, the presumption is that the usual trust law rules apply equally to pension schemes: see eg *Cowan v Scargill*[107] and *Wilson v Law Debenture*.[108]

In practice, given that the no fetter rule is nothing more than a combination of interpretation of the relevant power or discretion, combined with a 'right time' analysis, there seems no reason why the principle should not apply to pension schemes. There are several pensions cases that look at the principle (eg the cases discussed below: *Courage*,[109] *Mettoy*,[110] *Entrust*,[111] *Stena*[112]) and they seem to assume that it could apply (but it does not seem to have been argued that it could not).

Practicalities and pension schemes?

But it seems likely that the nature of a large pension trust and the practicalities in running it will be taken into account by the courts when considering any application of the fetter principle. For example it is clearly appropriate that trustees can delegate decisions and establish policies (rather than seek to run the scheme on a day-to-day basis).

Jonathan Swil and Roger Forbes in '*Fettering the fiduciary discretion by agreement: Breach of duty or commercial reality?*'[113] argue that the effect in England and Wales of the Court of Appeal decision in *Cabra Estates* is that if 'a fetter is in the interests of the principal whenever it is agreed, it is always permissible no matter what subsequent events occur'. They criticise this approach, but note that the Companies Act 2006 includes a form of statutory underpin for directors (see below).

In practice, the fetter principle is likely to be of relatively limited application to the dealings of a pension trust. This is in light of various factors:

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106 [2014] HCA 43 at [13].

107 [1985] Ch 270 (Megarry V-C).

108 [1995] 2 All ER 337; [1995] OPLR 103 (Rattee J). See the discussion in Chap 2 'Pension Trusts and General Trust Law' in David Pollard *The Law of Pension Trusts* (Oxford University Press, 2013). See also Hugh Arthur 'Can Trustees Fetter their Powers' (1993) 7 TLI 69.

109 *Re Courage Group Pension Scheme* [1987] 1 All ER 528 (Millett J).

110 *Mettoy Pension Trustees Ltd v Evans* [1990] 1 WLR 1587 (Warner J).

111 *Entrust Pension Ltd v Prospect Hospice Ltd* [2012] EWHC 3640 (Ch) (Henderson J).

112 *Stena Line Ltd v Merchant Navy Ratings Pension Fund Trustees Ltd* [2010] EWHC 1805 (Ch) (Briggs J).

113 (2010) 84 ALJ 32 at 42.

- Practicalities: value of assets and liabilities, numbers of beneficiaries, etc;
- Width of trust powers (eg investment);
- Ability to use amendment powers;
- Difficult to apply a rigid 'no fetters' doctrine in practice:
  - For example in *Entrust* (2012) Henderson J dealt with a case where pension scheme trustees were given power to apply surplus to benefit members. He held that the power should be exercised when the member left service (and not when he or she retired and drew benefits). Trustees are able to have a general policy on applying surplus (to apply until varied or countermanded).
- A 'no fetter rule' is likely to prevent practices which are beneficial to pension schemes but irrelevant to family trusts. For example:
  - setting policies to ensure consistency across large member population; and
  - using contingent arrangements to prevent overfunding.

TPR uses the term with abandon

But the question of fetters is still topical. The Pensions Regulator (TPR) issues guidance to pension trustees and has been at pains to remind trustees to consider the impact of any decisions in that it may fetter their future discretion (the implication is that this would be wrong, but TPR does not really explain its view on why this would be wrong). See its guidance on:

- asset backed contributions (ABCs);
- double counting; and
- clearance (in relation to confidentiality agreements).

Asset backed contributions

In its asset backed contributions guidance (November 2013),[114] TPR includes various statements that trustees need to consider the potential for the asset backed funding arrangements to have the effect of fettering the trustee's future discretion on funding:

> '37 Trustees need to consider whether entering into an ABC fetters their ability to negotiate increased deficit repair contributions in future, for example when a sponsoring employer's increased profitability enables it to make additional contributions to the scheme.'

Given that the trustees' statutory powers in relation to funding[115] will remain (and cannot be contracted-away), it is difficult to see why trustees receiving an asset need to be concerned about its effect on their ability to negotiate future increased funding. Presumably the same issue would also arise whenever an employer pays a contribution or gives security.

114 http://www.thepensionsregulator.gov.uk/guidance/asset-backed-contributions.aspx.
115 Pensions Act 2004, Pt 3 and the Occupational Pension Schemes (Scheme Funding) Regulations 2005 (SI 2005/3377).

Double counting

TPR issued a statement on 'Double Counting' in October 2013,[116] indicating concern that trustees may be agreeing to include in a schedule of contributions (and a recover plan) a provision that reduces future contribution levels where an employer has paid a statutory debt under s 75 of the Pensions Act 1995.

The statement is rather confused about precisely why TPR has concerns about this, but one comment it makes is that such an adjustment provision could be a fetter on the powers of the trustees:

> 'Where trustees attempt to use double counting to discharge section 75 debts that have not yet triggered, but may arise in the future, this reduces the chance that trustees can properly assess the impact on the employer covenant, and take appropriate action in the interests of the scheme. Agreeing to treat section 75 debts in a particular way without knowing the circumstances in which the debts will actually arise and the impact on the scheme could also fetter the proper exercise of the trustee's discretion.'

Given that:

- the use of variable contributions obligations within a schedule of contributions seems to be allowed and can be desirable (eg TPR itself has previously suggested that trustees should consider a provision for contributions to increase if the financial position of the employer improves[117]); and
- the trustee's statutory powers in relation to funding will remain and cannot be contracted-away (so the trustee will be able to review and revise the schedule in light of any section 75 event),

from a 'no fetter' perspective it is very difficult to see what TPR is getting at here.

Clearly the process of entering into a schedule of contributions is allowed and mandated by the legislation (and does not constitute an invalid fetter). It is difficult to see why TPR's comments about 'double counting' and fetters do not equally apply to any schedule of contributions.

The statement does finish by saying:

> 'This statement must be read in conjunction with the relevant legislation. It does not override the legislation or provide a definitive interpretation and trustees should seek their own legal advice.'

Clearance

In its clearance guidance (March 2010),[118] TPR comments (my underlining):

> '**Negotiation**
> 99. When negotiating with an employer, trustees should generally adopt the approach of a bank that has advanced a large unsecured loan. Employers should view the scheme

116 http://www.thepensionsregulator.gov.uk/docs/statement-double-counting-2013.pdf.
117 TPR Statement 'Scheme Funding and the employer covenant' (June 2009).
118 http://www.thepensionsregulator.gov.uk/guidance/guidance-clearance.aspx.

in a similar way, and employers and trustees should co-operate with each other to achieve an appropriate outcome for the scheme.

[. . .]

102. *Trustees should be cautious about agreeing to fetter their powers or discretions* or restrictions to their duties. For example, trustees should not generally fetter their discretions in relation to investment decisions and should not be restricted from discussing any matters with the regulator.

103. Trustees can also contact the regulator, who may be able to provide help and guidance.

[. . .]

Confidentiality

105. Most of the information trustees receive in their position as trustees will be confidential. Confidentiality will be particularly important when trustees receive sensitive information about scheme members or the employer, including price-sensitive information. Trustees should be able to pass all information to their appointed professional advisers, if appropriate.

106. One way of ensuring that all parties understand the importance of confidentiality is to enter into a confidentiality agreement. This agreement should ideally be reviewed and revised every time a new trustee joins the board, rather than waiting until there is some important issue, which the employer may be reluctant to discuss because of confidentiality issues. The lack of a confidentiality agreement may cause delay, which would be a particular problem if quick action by trustees is required.

107. *Confidentiality agreements should not restrict the trustees' duties or fetter their power or discretion* or seek to prevent the trustees from contacting the regulator. If trustees feel that the terms of an agreement would affect their ability to carry out their duties as trustees, they should consult their independent legal advisers and consider raising this with the employer and with the regulator, as appropriate.'

The comment at [102], that trustees should be cautious about agreeing to fetter their discretions, looks right – but does no more than emphasise that trustees should think about what they are doing. Should they be making an agreement with the employer in these circumstances?

The comment at [107] is more absolute and hence more difficult to understand. Why should a confidentiality agreement prevent trustees from carrying out their duties? If one of their duties is to provide information to beneficiaries if requested,[119] then it seems to be perverse to argue that they cannot accept a confidentiality obligation (as TPR points out this will mean that the employer is reluctant to pass on information and can cause delay – neither being in the interest of the scheme).

Trustees probably need to consider a distinction between:

- disclosure of the actual confidential information (which will need to be limited, although allowing sharing with TPR seems sensible); and
- use of the confidential information provided (which the trustees should be able to do for the purposes of the scheme).

119 Eg under *Re Londonderry* [1965] 1 Ch 918, CA and *Schmidt v Rosewood* [2003] UKPC 26, [2003] 2 AC 709, PC. See [18.80] to [18.87] in David Pollard *The Law of Pension Trusts* (Oxford University Press, 2013).

However, 'right time' can sometimes still be an issue for pension schemes

However, a 'no improper fetter' or 'right time' principle can still apply in some areas:

- A discretion can be lost if not exercised within reasonable time of it arising. But a pension scheme (without a default beneficiary in the absence of exercise) may be different to private trusts: *Entrust (No 1)*.[120]
- Investment power – do not just follow union or council policy: *Cowan v Scargill*,[121] *Martin v City of Edinburgh*.[122]
- If the trust deed requires bulk transfer on share of fund basis as at a particular date, then it cannot be changed to a fixed sum in advance (absent an amendment): *Stannard v Fisons*.[123]
- No contracting-out of most pensions statutory powers or duties, eg:
  - obligations in relation to the statement of investment principles (SIP) or scheme specific funding:[124]
  - compromise of s 75 debt much in advance of its trigger is not allowed: *Bradstock*;[125]
  - agreement to a scheme apportionment arrangement or regulated apportionment arrangement modifying a debt under s 75 of the Pensions Act 1995[126] – the funding test needs to be assessed by the trustee as at the time of the 'employment cessation event' (ECE). It is clear from the regulations that this can be in advance of the ECE, but in practice the assessment gets more difficult the further in advance it is; and
  - do not decide on a 'listed change' (Pensions Act 2004, s 259) in advance of required consultation with members being completed.

Statements of Investment Principles (SIPs)

The Law Commission discussed SIPs in its 2014 fiduciary investment report (at para 6.16) (footnotes included):

> 'THE STATEMENT OF INVESTMENT PRINCIPLES (SIP)
> 6.16 As discussed in Chapter 4, pension trustees must prepare a SIP stating their policy on the kinds of investments to be held and the extent (if at all) to which social,

120 *Entrust Pension Ltd v Prospect Hospice Ltd* [2012] EWHC 1666 (Ch) (Henderson J) at [109] to [119], discussing *In re Locker's Settlement* [1977] 1 WLR 1323 (Goulding J); *In re Allen-Meyrick's Will Trusts* [1966] 1 WLR 499 (Buckley J); *Breadner v Granville-Grossman* [2001] Ch 523 (Park J) and *In re Gulbenkian's Settlements (No 2)* [1970] Ch 408 (Plowman J). See *Lewin on Trusts* at 29-255, also citing *BRK (Bris) Pty Ltd v Commissioner of Taxation* [2001] FCA 164 (Cooper J). On timing of exercise of powers, see also *Mallone v BPB Industries plc* [2002] EWCA Civ 126, [2002] ICR 1045 at [57] (Share options grant to employee with discretion for the directors to move away from default allocation: not exercisable before or too long after dismissal: point not decided by the Court of Appeal) and *Spreadborough v Pensions Ombudsman* [2004] EWHC 27 (Ch) (Lightman J) (ill health pension claim could be revived some time after leaving service in exceptional circumstances).

121 [1985] 1 Ch 270 (Megarry V-C).

122 [1988] SLT 329; [1989] PLR 9 (CSOH, Lord Murray).

123 [1992] IRLR 27, CA. See also *Independent Pension Trustee Ltd v Stevens* [2002] 37 PBLR (Judge Weeks QC) – surplus distribution on winding-up: held trustee could not agree in advance.

124 See s 117 (Overriding requirements) of the Pensions Act 1995 and s 306 (Overriding requirements) of the Pensions Act 2004.

125 *Bradstock Group Pension Scheme Trustees Ltd v Bradstock Group plc* [2002] EWHC 1461 (Ch), [2002] ICR 1427 (Charles Aldous QC).

126 Under the Occupational Pension Schemes (Employer Debt) Regulations 2005 (SI 2005/678, as amended). See Chapter 3.3 in *Freshfields on Corporate Pensions Law 2015* (Bloomsbury Professional, 2015).

> environmental or ethical considerations are taken into account. This does not give trustees special authority to consider social, environmental or ethical issues. Any investment strategy in the SIP must accord with the general law.[127]
> 6.17 Trustees must exercise their powers with a view to giving effect to those principles "so far as reasonably practicable".[128] The legislation also requires trustees to review and, if necessary, revise the SIP.[129] A SIP might be considered a fetter on discretion if it were applied blindly after circumstances had changed.'

This last comment is rather confusing. References to a 'fetter' do nothing to add to the fact that the statute allows (indeed requires) the trustees to adopt a policy and then to follow it (and for the investment managers also to follow it), subject to a specific obligation to keep the SIP under review. Referring to a 'fetter' does no more than restate in different terms the statutory review duty.

No fetter rule means no estoppel claims?

It must be arguable that the 'no fetter' principle means that a member will not find it possible to raise an estoppel or 'custom and practice' case against a scheme or trustee. Such a claim would raise the argument that the member is arguing for an increased benefit beyond that provided for by the trust instrument and this is outside the trustee's powers – or an invalid fetter.

Henderson J briefly discussed this in *Entrust (No 1)*.[130] The pension scheme there envisaged the trustees having a discretion to increase benefits to a target level. The scheme having entered a funding deficit, the issue was whether or not the trustees should continue the previous practice of increasing benefits. Henderson J rejected the members' argument that the trustees were obliged to increase benefits holding (my emphasis):

> '71. Before moving on, I should also deal with one discrete aspect of the argument for the members on Issue 2, to the effect that, even if the Trustee did have a discretion, it could as a matter of law be exercised in only one way, because to do anything else would be so unreasonable or capricious that no reasonable trustee could properly so act. An explanatory note at the end of the List of Issues identifies the facts and circumstances relied upon in support of this argument as being (a) that the Scheme was set up with, and was understood to have, the aim and purpose (albeit not a guarantee) of providing target benefits; (b) that the actuarial valuations of the Scheme until 2002 disclosed sufficient available assets to meet target benefits, and until 2005 were carried out with a view to identifying and calculating what target benefits would cost; and (c) that the contributions to the Scheme, from at least the late 1980s, were determined and provided on three different levels which were matched to three different target benefit levels.
> 72. In order for this argument to succeed, it would be necessary for the members to demonstrate that the de facto practical administration of the Scheme so as to provide target benefits had over time become so entrenched that the Trustee ceased to have any

127 Nabarro Pensions Team, *Pensions Law Handbook*, 11th ed (Bloomsbury Professional, 2013) para 10.26.
128 Pensions Act 1995, s 36(5).
129 Above, s 35(1)(b).
130 *Entrust Pension Ltd v Prospect Hospice Ltd* [2012] EWHC 1666 (Ch) (Henderson J).

real choice in the matter and became obliged for the future to exercise its nominal discretion so as to achieve the same result. In my judgment this is an ambitious contention, which the evidence before me does not begin to bear out. *The argument seeks to elevate the consistent past practice of the. Trustee in the exercise of its discretion (by granting target benefits out of surplus, when this was considered to be affordable) into a fetter on the future exercise of the discretion, even in radically changed circumstances. Such a result would be inconsistent with any conventional analysis of the Trustee's fiduciary obligations*, and would also be inconsistent with the clear understanding conveyed to members that they had no entitlement to target benefits. I am therefore satisfied that this alternative way of putting the members' case is untenable.'

However, this point does not seem to have been raised in the various decided pension cases (in practice estoppel arguments do not often succeed[131] and the employer/trustee may be happy to provide the increased benefit (the trustee relying on an enhanced indemnity out of the scheme assets?)

Is public law any guide?

Trust law is clearly similar to public law in many respects. The two areas have tended to borrow from each other over the years (and in some cases public officials are seen as being fiduciaries in a similar role to trustees. It may therefore be appropriate to look at how the 'no unlawful fetter' rules have been applied in public law cases.[132]

General issues on use of public law

However in *Pitt v Holt*[133] the Court of Appeal discouraged the use of public law cases in a private law context. Lloyd LJ referred to the decision of Chadwick LJ in *Edge v Pensions Ombudsman*[134] and its reference to public law tests. He held:

'[77] Having used that formulation, [Chadwick LJ] referred to *Associated Provincial Picture Houses Ltd v Wednesbury Corporation* [1948] 1 KB 223. He did not have to consider how far the analogy with the principles applicable in public law cases could or should be pressed in a pension scheme case. For my part, I would wish to discourage reference to such public law principles in relation to trust law, since trust law has plenty of satisfactory means of dealing with the issues that arise under trusts, and those issues are inherently different from those arising in public law.'

Mummery LJ commented:

131 The leading case on estoppel in pension schemes is *Hutchinson v Steria Ltd* [2006] EWCA Civ 1551, [2007] ICR 445. A general analysis of the cases (but not mentioning any fetter issue) is given in the September 2011 APL paper by Dan Schaffer and Sarah McNally 'Misleading Member Communications: The last word? Estoppel, Negligent Misrepresentation, Maladministration. Where are we now?' Available (for members) in the library on the APL website: www.apl.org.uk.

132 This is suggested by *Thomas on Powers* at 10.74 and by P D Finn in *Fiduciary Obligations* at [62].

133 [2011] EWCA Civ 197, [2012] Ch 132 at [77] and [235].

134 [2000] Ch 602, CA.

> '[235] ... analogies with judicial review in public law are unhelpful and unnecessary. There is an elementary distinction between, on the one hand, the liability in private law of a fiduciary for breach of duty and, on the other hand, the availability of judicial review for the control of abuses of public power. There are surface similarities in the language of discretion and in the debates about the limits of discretionary power, but the contexts are so different that it is dangerous to develop the private law of fiduciaries by analogy with public law on curbing abuse of power. Judicial review in public law is concerned with the lawfulness of decisions and acts of public authorities to ensure that they are acting within the limits of a power usually set by statute. Breaches of duty in fiduciary law relate to discretionary dispositive powers privately entrusted to a fiduciary who has been selected to exercise the powers for the benefit of members within a designated class. The discretion of the fiduciary is not controlled by the court, which will not interfere with matters of judgment by the fiduciary. The only ground on which the court will review the exercise of the discretion is that of a breach of fiduciary duty. The underlying principles of fiduciary law and private property law are conceptually different from the public interest basis for reviewing the lawfulness of administrative action.'

On appeal to the Supreme Court,[135] Lord Walker upheld the Court of Appeal's decision and reasoning and commented:

> '[11] There are superficial similarities between what the law requires of trustees in their decision-making and what it requires of decision-makers in the field of public law. This was noted by the Court of Appeal in its judgment, delivered by Chadwick LJ, in *Edge v Pensions Ombudsman* [2000] Ch 602 at 628–629. It was also noted by Lord Woolf MR in *Equitable Life Assurance Society v Hyman* [2002] 1 AC 408 at para 20. The analogy cannot however be pressed too far. Indeed it was expressly disapproved by the Court of Appeal in these appeals (Lloyd LJ at [77] and Mummery LJ at [235]). In *Re Barr's Settlement Trusts, Abacus Trust Co (Isle of Man) v Barr* [2003] Ch 409 at [29], Lightman J identified three important differences as the discretionary nature of relief on judicial review, a different approach to nullity, and strict time limits.'

Jonathan Evans, in 'Challenging Trustee Decisions: Differing Approaches to the Supervision of the Exercise of Trustees' Powers',[136] reviewed the use of public law in a trust context (this was after the Court of Appeal decision in *Pitt v Holt*, but before the Supreme Court decision), in particular looking at whether the public law concepts of 'legitimate expectation' or 'reasonable expectation' could apply in a trust context.

Thomas on Powers comments (at para 10.74) that looking at public law cases can be useful in a private law context in relation (for example) to the use of policies. (This was before the decision of the Supreme Court in *Pitt v Holt*.)

Professor Finn has (since the Supreme Court in *Pitt v Holt*) commented that this division between public law and private fiduciary law is a mistake.[137]

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135 Called in the Supreme Court: *Futter v Revenue and Customs Comrs; Pitt v Revenue and Customs Comrs* [2013] UKSC 26, [2013] 2 AC 108.

136 (2012) 26 TLI 55.

137 Paul Finn 'Fiduciary Reflections' (2014) 88 ALJ 127 at 128. See also Paul Finn 'Good Faith and Fair Dealing: Australia' (2005) 11 NZBLQ 378, cited by Stephen Kos 'Constraints on the Exercise of Contractual Powers' (2011) 42 Victoria U Wellington Law Rev 17 with comments at pp 35 and 36.

The analogy of public law is still used in other areas – for example the Court of Appeal in *Socimer International Bank Ltd v Standard Bank London Ltd*[138] referred to various cases on when a contractual discretion in a contract could be challenged, referring to the public law 'Wednesbury' test. In the recent *IBM* case[139] on an implied duty of trust and confidence as a limit on employer powers (called the 'Imperial duty'), Warren J followed this:

> '442. Although one must heed Lord Hoffmann's warning in *O'Neill v Phillips* [1999] 1 WLR 1092 (the well-known case concerning unfair prejudice petitions in a company law context) about importing concepts from one area of law to another in an inappropriate way, I do not see any difficulty in using the concepts of irrationality and perversity, as developed in the context of public law, to identify the test for establishing the scope of the Imperial duty.'

Use of public law in 'fetters' cases?

Accordingly, it seems likely that it can still be appropriate to refer to public law cases in relation to these 'fetter' issues, but noting that public policy issues are more applicable in public law cases (so that, for example, the relevant contract may be considered to be totally invalid even as against the third party, with damages for breach of contract not being appropriate in a public law case[140]).

Thus in *Peregrine Mineral Sands Pty Ltd v Wentworth Shire Council*[141] the New South Wales Court of Appeal held that a power of a council to enter into contracts could not overcome the duty to assess rates each year. McColl JA commented:

> '4. Underlying the parties' competing positions is the tension between a principle which would deny governments or public authorities power to enter a valid contract merely because the contract affects the public welfare with the concomitant detrimental effect on public confidence in such contracts and, too, the public interest and the principle that the public interest requires that neither the government nor a public authority disable itself or its officer from performing a statutory duty or from exercising a discretionary power conferred by or under a statute by binding itself or its officer not to perform the duty or to exercise the discretion in a particular way in the future: see *Ansett Transport Industries (Operations) Pty Ltd v Commonwealth* [1977] HCA 71; (1977) 139 CLR 54 (*Ansett*) (at 74–75) per Mason J (as his Honour then was); see also Aickin J (at 113–114) with whom Barwick CJ agreed. (The principles to which Mason J referred concerning fetters on statutory discretion have been accepted as authoritative despite being uttered in a dissenting judgment.)
> 5. In a series of cases Mason J discussed in *Ansett* (at 75–76) it has been held that contracts entered into by the repository of a statutory power or discretion were invalid if they were 'incompatible with the due exercise of their powers or the discharge of their duties' (*Birkdale District Electric Supply Co Ltd v Southport Corp* [1926] AC 355 (at 364)) or if they constituted 'an anticipatory fetter by that person on his future exercise of the

138 [2008] EWCA Civ 116, [2008] Bus LR 1304, CA at [66] per Rix LJ.
139 *IBM United Kingdom Holdings Ltd v Dalgleish* [2014] EWHC 980 (Ch) (Warren J).
140 See the discussion by Patricia Ieong 'Contracting with public authorities: the rule against fetters' [2012] 2 NZLSJ 779.
141 [2014] NSWCA 429, Ward JA at [150], citing *Darkinjung Pty Ltd v Darkinjung Local Aboriginal Land Council* [2006] NSWSC 1008 (Barrett J).

statutory power or discretion': *Cudgen Rutile (No 2) Pty Ltd v Chalk* [1975] AC 520; *Watson's Bay & South Shore Ferry Co Ltd v Whitfeld* [1919] HCA 69; (1919) 27 CLR 268.

6. Accordingly, Mason J concluded (*Ansett* (at 77)):

> "[T]he doctrine that an agreement of the kind in question may constitute an anticipatory fetter on the exercise of a statutory discretion is closely connected with the question whether the agreement is authorised by statute, or is prohibited by, or incompatible with it. If the agreement is authorised, then it is valid, and any breach of the undertaking it contains will be enforceable by damages but only when the effect of statutory approval is to convert the discretion into a duty will it be enforceable specifically."

See also *Camberwell City Council v Camberwell Shopping Centre Pty Ltd* [1994] 1 VR 163 (at 182 ff).'

The analogy between private trustees or companies and public law duties seems particularly appropriate when looking at the use of 'policies' by fiduciaries (see below).

Express authority for fetters in statute

It is worth noting that statute law sometimes expressly authorises fetters by name. For example:

- Energy Act 2011, s 106: 'Subsections (3A) to (3D) apply notwithstanding that the agreement or amendment fetters the Secretary of State's discretion'.
- Crossrail Act 2008, s 39: 'The Secretary of State may fetter the exercise of his discretion under subsection (1) by agreement with– (a) the Mayor of London, or (b) a person who is, or is proposed . . .'.

Such an authority to fetter can also impliedly arise under the terms of a statute – for example if it authorises the issue of a policy or structure that the decision making body must then follow; see eg *R (Nicholds) v Security Industry Authority*[142] and *Security Industry Authority v Stewart*,[143] discussed below.

Directors and companies

Historically, directors have operated in a more commercial environment than private family trustees. But directors are clearly fiduciaries (with duties to the company). So any 'no unlawful fetter' rule would apply equally to them as to trustees (but subject to any relevant statutory provision). The key cases involve directors, eg *Thorby* and *Cabra*.

Delegation

In practice it would be impossible for a large commercial trading company to operate without delegating decisions to managers and workers.

142 [2006] EWHC 1792 (Admin), [2007] 1 WLR 2067 (Kenneth Parker QC).

143 *Security Industry Authority v Stewart; Rahim v Security Industry Authority; R (on the application of Egenti) v Highgate Justices* [2007] EWHC 2338 (Admin); [2008] 2 All ER 1003 (Divisional Court: Laws LJ and Mitting J).

Contracts are with the company, not the director

Similarly companies enter into agreements from time to time and thereby inevitably 'fetter' any discretion. Unlike trusts, such agreements will be valid and binding on the company even if entered into in breach of duty by the directors/deciding body, provided the third party is acting in good faith (ie does not have the required knowledge of any relevant breach[144]): see eg *Bell Group*[145] and *Rolled Steel Products*.[146]

There is a good discussion on the differences between contracts entered into by trustees (generally personal liability, but usually with an indemnity from the trust assets), and by directors on behalf of companies (directors not personally liable and contract will bind the company unless the third party knows of a breach of duty), in the article by Matthew Conaglen and Richard Nolan 'Contracts and knowing receipt: principles and application'.[147]

A director of a trustee company will not usually be liable personally to a third party under a contract, absent a formal guarantee, but could incur some liability (to the trustee company) if the contract resulted in wrongful trading or to the beneficiaries if dishonestly assisting a breach of trust.

Companies Act 2006, s 40: Power of directors to bind the company

Legislation has clarified the position for companies. Section 40 of the Companies Act 2006 (Power of directors to bind the company) provides:

> **'40 Power of directors to bind the company**
> (1) In favour of a person dealing with a company in good faith, the power of the directors to bind the company, or authorise others to do so, is deemed to be free of any limitation under the company's constitution.
> (2) For this purpose–
> (a) a person 'deals with' a company if he is a party to any transaction or other act to which the company is a party,
> (b) a person dealing with a company—
> (i) is not bound to enquire as to any limitation on the powers of the directors to bind the company or authorise others to do so,
> (ii) is presumed to have acted in good faith unless the contrary is proved, and
> (iii) is not to be regarded as acting in bad faith by reason only of his knowing that an act is beyond the powers of the directors under the company's constitution.
> (3) The references above to limitations on the directors' powers under the company's constitution include limitations deriving—
> (a) from a resolution of the company or of any class of shareholders, or
> (b) from any agreement between the members of the company or of any class of shareholders.
> (4) This section does not affect any right of a member of the company to bring proceedings to restrain the doing of an action that is beyond the powers of the directors.

144 See *Lindgren v L & P Estates Ltd* [1968] Ch 572. Cited in *Gore Browne on Companies* at 15[11].
145 *Westpac Banking Corporation v The Bell Group Ltd (in liq) (No 3)* [2012] WASCA 157, [274] to [278].
146 *Rolled Steel Products (Holdings) Ltd v British Steel Corporation* [1986] Ch 246, CA.
147 [2013] 129 LQR 359.

But no such proceedings lie in respect of an act to be done in fulfilment of a legal obligation arising from a previous act of the company.

(5) This section does not affect any liability incurred by the directors, or any other person, by reason of the directors' exceeding their powers.
(6) This section has effect subject to–
section 41 (transactions with directors or their associates), and
section 42 (companies that are charities).'

Section 40 derives from previous Companies Acts and ultimately from s 9(1) of the European Communities Act 1972.

This protection for third parties does not relieve the directors of liability (s 40(5)), nor does it apply to contracts with directors or their associates (s 41) or to charities (s 42).

It is unlikely that s 40 would be treated as applicable to the acts of directors of a trustee company in relation to the trust to override any restrictions or capacity issues in the trust itself (as opposed to the company's constitution which is all the section mentions).

Shareholder consent

Many companies only have a small number of shareholders. In these cases it may be comparatively easy to get unanimous shareholder consent to any major advance decisions. Absent any question of insolvency (when duties to creditors may impact), such consent should mean there is no breach of duty by directors: see eg the Irish case *Clark v Workman*[148] and in Canada *Ringuet v Bergeron*.[149]

Independent judgment: CA 2006, s 173

Section 173 of the Companies Act 2006 clearly flows from the Court of Appeal decision in *Cabra Estates*. The decision was cited by the Law Commission in its 1998 consultation paper on Directors' duties, 'Company Directors: Regulating Conflicts of Interests and Formulating a Statement of Duties'.[150]

> **'No fetters on discretion**
> 11.11 Directors must in general not fetter their discretion. This means that they must not enter into an agreement with a third party as to how they will exercise their discretion. To do so would prevent them from exercising an independent judgment at the appropriate time. An exception to this is where directors decide that it is in the best interests of the company to enter into a contract and to carry it into effect. In this situation they can themselves enter into any undertaking to exercise their powers in a particular way if it is necessary for them to do so to effectuate the contracts. In *Fulham Football Club Ltd v Cabra Estates plc* [1994] 1 BCLC 363 at 392 the Court of Appeal stated: "It is trite law that directors are under a duty to act bona fide in the interests of their company. However, it does not follow from that proposition that directors can never make a contract by which they bind themselves to the future exercise of their powers in a particular manner, even though the contract taken as a whole is manifestly

148 [1920] 1 IR 107 (Ross J).
149 (1960) 24 DLR (2d) 449, Can Sup Ct.
150 Con Doc no 153, 1998 at 11.11.

for the benefit of the company. Such a rule could well prevent companies from entering into contracts which were commercially beneficial to them."

11.12 The Court of Appeal went on to hold: "The true rule was stated by the High Court of Australia in *Thorby v Goldberg* (1964) 112 CLR 597. The relevant part of the headnote reads: 'If, when a contract is negotiated on behalf of a company, the directors bona fide think it in the interests of the company as a whole that the transaction should be entered into and carried into effect they may bind themselves by the contract to do whatever is necessary to effectuate it'." '

This was cited by Arden J (as she then was) in *Re Benfield Greig Group plc,*[151] holding that directors had power to make binding contracts about how they would exercise their discretion under a valuation provision in the articles (although she held that this was not found on the facts).

The final Law Commission report[152] does not mention *Cabra*.

Section 173 of the Companies Act 2006 states:

'173 Duty to exercise independent judgment

(1) A director of a company must exercise independent judgment.

(2) This duty is not infringed by his acting–

   (a) in accordance with an agreement duly entered into by the company that restricts the future exercise of discretion by its directors, or

   (b) in a way authorised by the company's constitution.'

The explanatory note to the Companies Act 2006 explains s173:

'Section 173 : Duty to exercise independent judgment

333. This duty codifies the current principle of law under which directors must exercise their powers independently, without subordinating their powers to the will of others, whether by delegation or otherwise (unless authorised by or under the constitution to do so).

334. The section provides that directors must not fetter the future exercise of their discretion unless they are acting:

   (a) in accordance with an agreement which has been duly entered into by the company; or

   (b) in a way authorised by the company's constitution.

335. The duty does not confer a power on the directors to delegate, nor does it prevent a director from exercising a power to delegate conferred by the company's constitution provided that its exercise is in accordance with the company's constitution. Under the draft model articles of association for private companies limited by shares, the directors may delegate their functions in accordance with the articles.'

On the position in relation to directors see Chap 7 'Duty to exercise independent judgment' in Andrew Keay's *Directors duties*.[153]

151 [2000] 2 BCLC 488 (Arden J). Reversed on other grounds: [2001] EWCA Civ 397; [2002] 1 BCLC 65.

152 'Company Directors: Regulating Conflicts of Interests and Formulating a Statement of Duties' 1999, Law Com No 261; Scot Law Com No 173. The report is on the Law Commission website: http://lawcommission.justice.gov.uk/docs/lc261_company_directors_regulating_conflicts_of_interest_and_formulating_a_statement_of_duties.pdf.

153 2nd ed, Jordans, 2014.

Under s 40(4), a similar protection to s 173(2)(a), for legal obligations already entered into by the directors, applies to protect against member challenge.

Fetters and changes of trustees

One issue is whether a fetter agreed by one trustee would then not bind any successor trustee should there be a change in trustees.[154]

In *Re Wills Trust Deeds* [1964] Ch 219, Buckley J held (at p 238):

> 'A power granted to successive holders of an office is unlike trust property the entire ownership of which is vested in the trustees for the time being of the settlement and devolves on each change of trustee by succession. Where a power is granted to successive holders of an office all that is vested in the incumbent for the time being of the office is the capacity to exercise the power while he holds that office. In other words, the power is granted by the original donor directly to each successive holder of the office and none of them acquires the power by succession from his predecessor. It appears to me to follow that none of the successive holders of the office is capable of binding any subsequent holder of the office not to exercise the power. Accordingly, although, if I am right in my view that this power is not coupled with a duty, the present trustees of the founder's will can by releasing the power preclude themselves from exercising it, they cannot, in my judgment, by a release exclude their successors in office from being able to exercise it. They might by a complete exercise of it exhaust the power and so exclude their successors in office from being capable of any further exercise of it.'

However, in Australia I J Hardingham has doubted this approach. In his article 'Controlling Discretionary Trustees'[155] he argued that Buckley J's analysis was 'not convincing' in relation to separate exercises of an existing power.

However, now in a pensions scheme the sole trustee is often a trustee company, so there will in practice not be a change of trustee. This will mean that the *Re Wills* issue would be unlikely to arise.

Former trustee stays liable in contract

The general issue in relation to valid contracts and liabilities to third parties is that the departing trustee will remain liable (subject to any express release in the contract).

But the departing trustee will retain:

- a lien over the trust assets;[156] and
- (even after it has ceased to be a trustee and has passed over any assets to the new trustee) an indemnity from the trust assets.[157]

154 See eg Hugh Arthur '*Can trustees fetter their powers?*' (1993) 7 TLI 69.

155 [1975] UWALawRw5; (1975) 12(2) University of Western Australia Law Review 91.

156 The departing trustee may retain trust assets to cover liabilities: *X v A* [2000] 1 All ER 490 (Arden J) following *Re Pauling's Settlement (No 2)* [1963] Ch 576 (Wilberforce J).

157 *Siefert v Pensions Ombudsman* [1997] 1 All ER 214 (Lightman J) and the Australian cases: *Rothmore Farms Pty Ltd v Belgravia Pty Ltd* [1999] FCA 745, (1999) 2 ITELR 159 (Mansfield J); *Coates v McInerney* (1992) 6 ACSR 748; *Dimos v Dikeakos Nominees Pty Ltd* [1996] FCA 1619; *Apostolou v VA Corporation Aust Pty Ltd* [2010] FCA 64 (Finkelstein J); and *Agusta Pty Ltd v Provident Capital Ltd* [2012] NSWCA 26, NSW CA at [43]–[45]. Where beneficiaries combine under Trusts of Land and Appointment of Trustees Act 1996, s 19 to direct that a trustee

Departing trustees may seek to obtain an indemnity from the new trustee, eg the *ATC (Cayman)* case.[158]

In *Jones v Firkin-Flood*,[159] Briggs J clearly had regard to the sale agreement with the buyer when looking at changes in the trustees.

Trustee can agree to limit activities if there is a dispute as to whether he holds office: Fitzwood

It seems that a trustee can agree to limit his activities for a short time to enable the resolution of a dispute as to whether or not he or she holds office: In Australia in *Fitzwood Pty Ltd v Unique Goal Pty Ltd*[160] Finkelstein J held:

> '121 I should observe here that the trustee did not contend that an agreement to refrain from dealing with trust property without consent is contrary to public policy and therefore void. Speaking generally, a trustee is not entitled to fetter the exercise of a discretionary power (for example a power to sale) in advance: *Thacker v Key* (1869) LR 8 Eq 408; *In re Vestey's Settlement* [1951] Ch D 209. If the trustee makes a resolution to that effect, it will be unenforceable, and if the trustee enters into an agreement to that effect, the agreement will not be enforced (*Moore v Clench* (1875) 1 Ch D 447), though the trustee may be liable in damages for breach of contract (*Coronation Syndicate v Lilienfeld* [1903] TS 489, 497, (South Africa)).
> 122 In any event, in my view, the general rule has no application to the present case. It is not contrary to public policy for a trustee to agree to limit his activities for a short time to enable the resolution of a dispute as to whether the trustee still holds office. It often happens that, for example, a trustee will give an undertaking not to dispose of a trust property pending the completion of litigation concerning the trustee's powers to deal with that property. Indeed, in some cases if such an undertaking is not given, an injunction to that effect will go. Indeed, public policy will be advanced if the trustee is able to give the undertaking rather than force the parties to go to court. This case is no different.'

Part 2

Part 2 follows in the next issue of *Trust Law International*.

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cont.
retires from the trust, the trustee must then retire provided 'reasonable arrangements have been made for the protection of any rights of his in connection with the trust' – s 19(3)(b) (see *Underhill & Hayton Law of Trusts and Trustees* at 81.32).

158 (2005) 9 ITELR 36 (Smellie CJ), discussed above.

159 [2008] EWHC 2417 (Ch), at paras [297] to [300].

160 [2001] FCA 1628 (Finkelstein J) at [121]. Not discussed on appeal.