The developing Rule in *Hastings-Bass*

Received: 13th October, 2003

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Abstract In the case of *Re Hastings-Bass*, a principle emerged that a court would hold a trustee's *bona fide* exercise of discretion to be void if it is clear that he would not have acted as he did: (a) had he not taken into account considerations which he ought not to have taken into account; or (b) had he not failed to take into account considerations which he ought to have taken into account.

This paper examines the Rule in *Hastings-Bass*, tracking its development through case law, up to the 2003 case of *Abacus v Barr*, looking at the implications of the principle on pensions scheme trustee decision making.

Keywords: *Hastings-Bass*; trustee duties; decision making; relevant and irrelevant considerations

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Mistakes happen, there is no doubt about that. They also have repercussions. Just think of how many hours pensions lawyers spend analysing whether trustees' decisions are valid or not. Some decisions will be easily identifiable as flawed, others will not, but the Rule in *Hastings-Bass* should be part of the armoury of those considering the validity of a trustee decision.

Doubts as to the validity of pensions scheme trustees' acts may arise for a variety of reasons:

- Were they the correct trustees? Had they been validly appointed?
- Did the trustees embody the decision in the correct way, eg by deed?
- Did they follow other procedural requirements laid down in the trust deed, eg obtain the written consent of the employer or the members? Did they comply with any accrued rights protection provisions?
- Was s. 67 complied with, post-Pensions Act?
- Did they go beyond the permitted scope of the power, eg by benefiting the wrong person?

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- Did they infringe the rule against perpetuities or against excessive accumulations?
- Did they exercise the power for an improper purpose, eg to benefit the trustees of the pension scheme or the employer?
- Did they realise that they had a discretion to exercise or just follow instructions?
- Did they take into account all relevant considerations (and no irrelevant considerations) when making their decision?

When things have gone wrong, there may be various options available to remedy the situation. This brings us to the Rule in *Hastings-Bass* which is a much visited area, but by no means a settled principle. The Rule in *Hastings-Bass* may help but how far does it go? Does it mean that, when trustees make a mistake with disastrous consequences, they can simply turn the clock back and get themselves off the hook?

The general principle was that the courts would not interfere with the exercise of trustees' discretions. However in a number of cases this principle has been eroded.

The Rule has become known as the *Hastings-Bass* principle because it was formally set out by Lord Justice Buckley in the case of *Re Hastings-Bass (deceased), Hastings and others v Commissioners of the Inland Revenue*.¹ This was a trust case concerning estate duty and perpetuities. The trustees had made an advance of a cash sum to another settlement which conferred a life interest and various remainder interests. It was accepted that the trusts, other than the life interest, were void for perpetuity under *Pilkington v Commissioners of the Inland Revenue*.² The question before the court was whether, as argued by the Inland Revenue, the whole transfer including the life interest failed, so

no estate duty was saved.

In his judgment, Buckley LJ enunciated what has become known as the Rule in *Hastings-Bass*.

'Where ... a trustee is given a discretion as to some matter under which he acts in good faith, the court shall not interfere with his action notwithstanding that it does not have the full effect of which he intended, unless

- (1) what he has achieved is unauthorised by the power conferred on him, or
- (2) it is clear that he would not have acted as he did:
 - (a) had he not taken into account consideration which he should not have taken into account, or
 - (b) had he not failed to take into account considerations which he ought to have taken into account.'

In this case, the second limb was not established because on the facts, it was not clear that the Trustees would have acted any differently if they had known that the remainder interests were perpetual. The transfer to the life interest trust was valid and estate duty was saved. The court declined to apply the Rule, but it should be noted that the Rule was expressed in the negative.

Clear identification of a principle

The Rule was transposed into a positive statement in the case of *Mettoy Pension Trustees Ltd v Evans*³ when it was summarised by Warner J as:

'Where a trustee acts under a discretion given to him by the terms of the trust, the court will interfere with his action if it is clear that he would not have acted as he did had he not failed to take into account considerations which he ought to have taken into account.'

The *Mettoy* case brought the application of the Rule to a pension

scheme which was winding up following the liquidation of the employer. The court was asked to determine a number of questions including whether or not a 1983 deed which gave the employer a discretion over any surplus was valid.

Warner J accepted that there was a principle which could be labelled the Rule in *Hastings-Bass* and drew a distinction with rectification and mistake. He dismissed an argument that the Rule can only apply where the trustees' exercise of a discretionary power is partially ineffective because of some rule of law or because of some limit on their discretion which they have overlooked. He did however, emphasise that:

'for the principle to apply however, it is not enough that it should be shown that the trustees did not have a proper understanding of the effect of their act. It must also be clear that, had they had a proper understanding of it, they would not have acted as they did.'

It was confirmed that the burden of proof is not the same high standard as in claims for rectification. Warner J contemplated the possibility that the court would declare void only part of the purported exercise of the trustees' discretion where it is satisfied that the trustees would have acted in the same way with the omission of a particular provision, had they not failed to take into account considerations which they ought to have taken into account.

Three questions emerged which should be considered where it is claimed that the Rule applies:

- What were the trustees under a duty to consider?
- Did they fail to consider it?
- If so, what would they have done if they had considered it?

In *Mettoy*, the Judge decided that the trustees failed to consider material changes effected by the 1983 deed, particularly as regards the winding-up provisions, but that the Rule in *Hastings-Bass* did not apply because if the trustees had taken all the consequences into account, they might still have executed the deed.

Failure to appreciate current value of pension fund

The case of *Stannard v Fisons Pension Trust Ltd*⁴ concerned a bulk transfer from one occupational pension scheme to another following the sale by Fisons of one of its divisions.

The Court of Appeal held that the trustees' decision was invalid because they had failed to take into account the current value of the fund at the relevant date and the implications of that value — the relevant date was 31st December, 1982, whereas the trustees relied on a 1979 actuarial valuation and the actuary's advice in April 1982 when the sale of the division was negotiated. The value of the fund had increased significantly between April and December 1982. This was, of course, in the days of booming stock markets.

The judgments do not reveal any detailed consideration of the Rule in *Hastings-Bass*. Dillon LJ relied on *Kerr v British Leyland (Staff) Trustees Ltd*⁵ where it was held that the trustee was under a duty to give properly informed consideration to an application for a disability pension. In *Kerr*, the trustees' decision was ineffective since it did not carry out its duty. *Hastings-Bass* was not looked at in this case, but it is notable that the decision was made on the basis that if the trustee had appreciated the correct position, it might have materially affected its decision.

It is not apparent if it was realised that

the Rule had moved from what Warner J called in *Mettoy*, the all important question of what the trustees would have done if they had considered the matters they had failed to consider. 'Would' had become 'might'.

Rescue from catastrophic tax consequences

In *Green v Cobham*⁶ the case related to a non-UK resident settlement where the trustees executed a deed of appointment in 1990 to settle a fund on trusts for a minor beneficiary.

Parker J had to consider an application by the trustees for a declaration that the deed of appointment was void. The evidence was that no consideration had been given to the capital gains tax (CGT) consequences of the deed of appointment (which the Judge described as catastrophic), and that the trustees would not have executed the deed had they considered the consequences.

The deed of appointment was held to be void. Does this mean that trustees can routinely avoid the consequences of failing to make a tax-efficient decision by treating the offending decision as void? This would go against the general position that a person who fails to take into account the tax consequences of an action, but who understands its legal consequences, cannot have the action set aside under mistake.

A day too late

The opportunity to further expand the Rule arose in the case of *Breadner v Granville-Grossman*.⁷ This concerned a family settlement where it was crucial that a deed was completed before a specified date in 1989 to cut out beneficiaries who would otherwise benefit under a 1976 appointment.

Someone misread the document and the deed was done a day too late.

Here Nicholas Warren QC sought to take the Rule in *Hastings-Bass* a significant step further by asking the court to hold that a trust took effect as if the trustees had done something they had never done at all, ie that they had signed the deed a day earlier than they actually had and, in so, doing changed people's beneficial interests. Park J rejected that argument, perhaps understandably. He accepted that the cases looked at in this paper showed that the court had jurisdiction to declare void something done by the trustees if they had not taken all relevant factors into account. However, he could not see any precedent for the court substituting something which it thinks the trustees would have done.

An additional argument was tendered concerning the validity of the 1976 deed. It was argued that owing to a particular reference to future adopted children,⁸ it was not a valid accumulation and maintenance settlement for inheritance tax purposes. Park J pointed out that there had been an intervening period of over 20 years and he was not prepared to allow the application of the *Hastings-Bass* principle to invalidate a decision so long after the event.

Would or might?

*AMP (UK) Plc v Barker*⁹ concerned the trustees of a pension scheme who had amended the Rules to increase the benefit payable to members retiring due to incapacity. The fact that under the Rules the deferred pension payable for early leavers was to be calculated as if the leavers were retiring due to incapacity was overlooked. The cost of the increased benefit for early leavers was substantial.

The decision is useful because it

considered rectification, mistake and *Hastings-Bass*. Rectification of the Rules was ordered and it was said that, alternatively, the amendment would have been void on the basis of *Hastings-Bass*.

Collins J found that there was overwhelming evidence that there was a continuing common intention by both the trustees and the employer to affect only the incapacity benefit, so there was a mistake and rectification could be ordered.

Although it was not necessary, Collins J also dealt with the claims for setting aside for mistake and the application of *Hastings-Bass*. As to *Hastings-Bass*, the judgment refers to the fact that in the proceedings there was some debate as to whether trustees' decisions which could be attacked on the basis of the Rule were to be regarded as void or voidable and whether the Rule required it to be shown that the trustees would have acted otherwise, or simply might have acted otherwise, had they taken into account the proper considerations. He concluded that the cases strongly suggest that the application of the principle leads to the act being void rather than voidable.

As to the would/might question, the Judge felt that he was bound by the Court of Appeal decisions in *Kerr* and *Stannard* and so might was the appropriate test.

More tax saving

The principle was further developed in the case of *Abacus Trust Company (Isle of Man) Ltd v NSPCC*.¹⁰ Again this concerned a non-UK resident trust and CGT avoidance. The trustee completed an appointment on 3rd April, 1998, failing to take into account previous advice it had received that the appointment should not be completed before 6th April, 1998. As a result, a significant CGT liability arose.

Patten J followed *Green v Cobham* in deciding that the appointment was void *ab initio* because he was satisfied that, had the trustee properly considered the tax advice it had received, it would not have made the appointment before 6th April, 1998.

Patten J had no difficulty in finding that trustees are bound to take into account the fiscal consequences of their actions, and so to find that, where it can be shown that proper consideration of the fiscal consequences would have led to the appointment not going ahead, then the court should treat the appointment as void *ab initio*.

Back to pensions

Last year saw the consideration of a further pensions case concerning a scheme which was being wound-up in *Hearn v Younger*.¹¹ The question before the court was whether the scheme rules had been amended in 1993 to guarantee members an annual increase in the whole of their pension, including the guaranteed minimum pension (GMP) element, of 5 per cent limited price indexation (LPI) or whether the increase only applied to pensions in excess of GMP.

Etherton J referred to the trustees' decision as being void (as opposed to voidable) if the trustees' failure might (as opposed to would) materially have affected their decision.

On the facts of the case, the submission was accepted that the Rule in *Hastings-Bass* applied because the trustees had failed to take into account the fact that the scheme was not currently being funded on the basis of a guaranteed annual increase of 5 per cent LPI to the entire pension in payment and that, if they had considered the funding implications for the scheme and received proper professional advice, that might have affected their decision.

Void or voidable?

Lord Walker, in his lecture on the topic in 2002,¹² considered the question of whether a trustee decision successfully challenged under the principle is void or voidable. He said:

‘The issue of ‘void or voidable?’ is one of great practical importance. If an appointment made by the trustees may be void, despite having been (to all outward appearances) arrived at and recorded in the proper manner, it may lead to great uncertainty. The matter might be raised many years afterwards, when the trust fund had been distributed (and tax paid) on the assumption that the appointment was valid. If on the other hand it was merely voidable, all the restrictions appropriate to the equitable remedy of rescission would come into play, including delay and the acquisition of third-party rights.’

The issue was considered by the High Court in *Abacus Trust Company (Isle of Man) v Barr*¹³ when Lightman J decided that the application of the Rule rendered a trustee decision voidable not void.

In the *Barr* case, a settlement had been established in 1992 in the Isle of Man. The settlor decided that he wanted the trustee to exercise its power of appointment to create discretionary trusts in respect of 40 per cent of the trust fund for the benefit of his sons, to the exclusion of any interest for himself and his wife. The settlor asked his contact with the trustee to relay his wishes, however the intermediary informed the trustee that the settlor wished to appoint 60 per cent of the trust fund on the discretionary trusts. The mistake was discovered soon afterwards, but no action was taken until November 2001, when an action was commenced.

Lightman J did not consider in detail the would/might issue because it was clear that the trustee would not have

appointed 60 per cent of the trust fund if it had known of the settlor’s true wishes that it should only be 40 per cent.

Lightman J considered Lord Walker’s lecture and addressed some of the issues raised.

He said that the first issue was whether there was a need for a fundamental mistake for the Rule to come into play and decided that there was not.

The second issue was whether all that was needed for the Rule to apply was that there was a mistake on the part of the trustee, however it arose. Here Lightman J saw an opportunity for limiting the ambit of the Rule. He found that, for the Rule to apply, it must be established that the trustee failed to consider what he was under a duty to consider. A breach of duty by the trustee is required.

He emphasised that where there is no breach of duty on the part of the trustee, the trustees or beneficiaries cannot have the decision declared invalid because it was mistaken. In *Barr*, Lightman J found that there was a breach of duty by the trustee because it failed to take adequate steps to ensure it received the correct version of the settlor’s wishes.

The final issue was whether, by application of the Rule, the appointment is void or voidable. Lightman J agreed with Lord Walker’s earlier comments in describing this as of critical significance given the period of ten years since the appointment, what he referred to as the settlor’s acquiescence, and the significant capital payments that had been made in the meantime.

Lightman J considered that the authorities left open the question of whether an appointment is void or voidable if the Rule applies. He pointed to the statement in *Stannard* that the Court had the discretion to declare the trustee’s decision invalid. Like Lord

Walker, he differentiated this sort of case from that in *Turner v Turner*.¹⁴ In *Turner*, the trustees had no understanding that they had any discretion to exercise and so could not be said to have made a decision at all. In this case, there was a decision, but it was flawed, so he decided that the application of the Rule results in a decision being held voidable and not void.

The claim has been compromised and there will be no appeal. Therefore, there will not, unfortunately, be a decision on whether the appointment should be avoided and, if so, on what terms. There is a decision that *Hastings-Bass* applies and, as a result, the relevant deed was voidable not void.

Current state of the law

Following on from the line of cases culminating with *Barr*, it now appears that the following principles have been established:¹⁵

1. When exercising their discretionary powers, trustees have a fiduciary duty to recognise that they hold a discretion and to inform themselves of all matters relevant to that decision.¹⁶
2. When making the decision, trustees have a fiduciary duty to take into account all relevant factors, to the exclusion of all irrelevant factors.¹⁷
3. Tax implications are relevant factors which should be considered by the trustees.¹⁸
4. If it can be established that the trustees breached their fiduciary duty but that had they not done so, their decision might have been different, then the decision is voidable and may be set aside by the court.¹⁹

It remains to be seen how the Court will approach such cases in the future and how the discretion to set aside

flawed trustee decisions will be exercised.

Final thoughts

Interestingly, the Rule in *Hastings-Bass* emerged out of an attempt by the Inland Revenue to launch an attack on the tax-payer and secure further revenue. This has backfired on the Revenue, with trustees using the Rule to escape paying tax.

Establishing that the application of the Rule renders decisions voidable rather than void goes a long way to addressing concerns over uncertainty that the Rule may create. This allows further restrictions to be placed on the Rule through the application of limits, in particular, time limits and consideration of the rights of third parties.

It has been suggested that the Rule protects trustees from negligence claims. However, often the trustees have the protection of an exoneration clause in the trust deed. It is the case though that the unwanted consequences of the flawed action of the trustees can be undone through the application of the Rule. This in turn may be of benefit to the beneficiaries, because, for example, the trust fund would be protected against further depletions.

For pensions lawyers, the Rule will come into play at two stages; first in examining ways in which to challenge a past exercise of a trustee's discretion to undo an undesired consequence, and secondly in advising trustees at the time that they are making decisions. The application of the Rule needs to be in the minds of trustees when any exercise of their discretion is made. The types of situations which have already been or may well be the subject of disputes include:

— payment of death benefits: have the trustees taken into account the full

family situation of the member?
Irrelevant factors should not be considered;

- augmentation arising out of a surplus: although not a common occurrence in these times, the trustees must consider the circumstances in which the surplus has arisen. Other relevant factors will include: the main purpose of the scheme; the effect on the employer; the full situation of scheme funding; the benefits to be provided under comparable schemes; and whether pensions have kept up with the cost of living;
- granting of an ill-health pension: the trustees must ensure that all aspects of the member's medical condition are given due consideration;
- corporate acquisitions: the method to be applied to the calculation of bulk transfers will depend on the consideration of the appropriate factors.

Decisions would most likely be open to challenge where the trustees had not checked the correct provision of the trust deed and rules, or relied on an out-of-date report on the finances of the scheme or the employer. A decision is at risk of being set aside where the trustees fail to take the existing scheme rules into account when executing a new trust deed and rules, especially if the new deed omits specific scheme protections, for example in relation to winding up. A failure to take the law into account, such as statute, regulations, Inland Revenue requirements, may well also allow the Rule to be invoked.

It is accepted that the interest of the employer is a relevant consideration to be taken into account by trustees reaching a decision, for example the closure of the scheme to new entrants and future accrual. However, trustees should be cautious not to consider

matters which may be deemed irrelevant, such as the adverse publicity to be generated as a result of a trustee decision.

What is or is not a relevant factor will turn upon the facts of each case and the trustees may well need to take expert advice from lawyers, actuaries, accountants, medical advisers and others, to ascertain this. The trustees must base their decision on all the relevant information.

For the Rule to be successfully invoked, not only must it be shown that the trustees failed to take into account a relevant factor, or considered an irrelevant factor, but also that had they not made this error, they would (or might) have made a different decision. Even where this is established, the Court may determine that it is just and equitable to allow the challenged decision to stand if the decision was taken many years previously or a third party has relied on the decision to his detriment.

It will be interesting to see how the principle is developed further when the next case reaches the Court of Appeal.

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- 2 [1962] 3 All ER 622.
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- 4 (1991) PLR 224.
- 5 (1986) CA.
- 6 (2000) WTLR 1101.
- 7 [2001] Ch 523.
- 8 Therefore it could not be said that 'one or more persons ... will on or before attaining a specified age not exceeding 25 become entitled to an interest in possession' as required of the Finance Act 1985, Sch. 5, Para 15.
- 9 (2001) OPLR 197.
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14 [1983] 2 All ER 745.

15 The authors thank Edward Nugee QC for his comments in 'Re Hastings-Bass Again — Void or Voidable? And further reflections' (2003) PCB, May/June p. 180.

16 *Turner v Turner*, *Scott v National Trust* [1998] 2 All ER 705; *Abacus v Barr*.

17 *Edge v Pensions Ombudsman* [2000] Ch 602

18 *Green v Cobham*; *Abacus v NSPCC*.

19 *Abacus v Barr*.