

Offshore Cases

Hong Kong

Court of Final Appeal

Zhang Hong Li and others v. DBS Bank and others [2019] HKCFA 45

The Court of Final Appeal held that trustees do not have a high level supervisory duty for an underlying investment company where the trust instrument contains anti-Bartlett clauses exempting such duty. As a result, trustees will not be liable for any losses resulting from transactions by the underlying investment company.

This appeal was made by DBS Trustee HK (Jersey) Limited, the former trustee of the trust, and DHJ Management Limited, which was the sole director of a private investment company wholly owned by the trust. The appeal was made against an order of the lower courts which found DBS Trustee HK (Jersey) Limited, as trustee, was in breach of its duties.

Background

In 2005, Zhang Hong Li (Zhang) and his wife Ji Zhengrong (Ji) established a family trust called the Amsun Trust (the Trust) governed by Jersey law. Zhang, Ji and their two minor sons were the beneficiaries of the Trust. They also set up a BVI company called Wise Lords Limited, of which the Trust was the sole shareholder, to make high-return investments (the Company). DBS Bank (Hong Kong) Limited (the Bank) aided in setting up the Trust and Company. DBS Trustee HK (Jersey) Limited was appointed as the original trustee to the Trust (the Trustee) and DHJ Management Limited was appointed as sole director of the Company (the Director). Ji was appointed as the Company's investment advisor.

In 2008, the Company suffered significant losses due to Ji's investment strategy. In 2011, Zhang, Ji, the successor trustees and the Company brought a claim against the Director for dishonest and negligent breach of fiduciary duty and against the Trustee for dishonest and negligent breach of trust.

Anti- Bartlett Clauses

Anti-Bartlett clauses are trust instrument provisions that expressly disapply trustee duties in respect of responsibility to supervise the investment and business management of

underlying controlled companies.¹ In the current case, there were anti-Bartlett clauses in the trust deed that restricted the Trustee's duties in connection to the Company.

Specifically, the Trustee was not to interfere in or seek information regarding the administration, management or conduct of the Company; not to supervise any Company directors, officers or others unless the Trustee had actual knowledge of any dishonesty; and expected to assume at all times that the administration, management and conduct of the business and affairs of the Company were being carried out competently, honestly, diligently, and in the best interests of the Trustees in their capacity as shareholders.²

Earlier Judgements

The Court of First Instance ruled that the Trustee was liable for negligent breach of trust and the Director was liable for negligent breach of fiduciary duty. The reasoning was that the Trustees breached their 'high level supervisory duty' over the Company's investments and acted in a way that was not something a reasonable prudent trustee would have done. The degree of negligence was a 'serious or flagrant degree of negligence'.³ The same reasoning was applied to the Director's breach.

The Hong Kong Court of Appeal (COA) agreed. The Trustee has a residual obligation stemming from its power to supervise or obtain information on the Company as it is a member of the Company.⁴ This residual obligation was what resulted in the high level supervisory duty and made it so that the Trustee's obligation could not be limited by the anti-Bartlett clauses in the trust deed.

¹ Bartlett and others v Barclays Bank Trust Co Ltd (Nos. 1 and 2) [1980] 1 Ch 515

² [2019] HKCFA 45, 34(a)

³ Ibid., 49

⁴ Ibid., 55

Residual Obligation

A residual obligation is an obligation that remains even where other obligations have been excluded. The COA found that for trusts, a residual obligation arises where ‘no reasonable trustee could refrain from exercising otherwise excluded powers’.⁵ An example of a circumstance where no reasonable trustee could lawfully refrain from exercising its power is where the trustee was informed by a credible source that the directors of the company were stealing its assets.⁶

Court of Final Appeal Judgment

The parties agreed to a post-hearing settlement, but the Court of Final Appeal (CFA) used its discretion to deliver judgment as the case involved important issues of law and had attracted significant public interest.

The CFA reversed the decisions of the Court of Appeal and Court of First Instance. The CFA found that the trustees had no high level supervisory duty in relation to the company’s activities since the anti-Bartlett clauses relieved the Trustee from any duty to interfere with or obtain information on the Company subject to the Trustee becoming aware of any actual dishonesty by the directors.⁷ There was also no basis for equating the high level supervisory duty to any residual obligation. The order for the assessment of equitable compensation was set aside as well.

In this situation, the CFA found that to impose a residual obligation equating a high level supervisory duty, where the parties involved had expressly excluded such obligation, would undermine the legitimate arrangement of the parties. This would open the Trustees to unforeseen risks and create uncertainty as to their duties.⁸ A residual obligation would have only existed had there been dishonesty on the part of the Director, which there had not been.

Moreover, the Trustee and Director would have been protected from any liability from acts or omissions as i) the trust deed allowed the taking of speculative and risky transactions and ii) the trust deed and Director’s service agreement contained liability and indemnities in relation to losses to the Trust Fund or Company except in cases where gross negligence was involved.⁹

In addition, the CFA found that the Director of the Company also had no such high level supervisory duty and was not in breach of its fiduciary duties for the same reasoning.

Conclusion

Trustees do not have a high-level supervisory duty or residual obligation to interfere in or obtain information on the affairs of an underlying company where the trust instrument expressly removes any duty to do so.

This judgement is likely to be very persuasive in the courts of Bermuda, the British Virgin Islands, and the Cayman Islands due to it being one of the first cases to examine the effectiveness of an anti-Bartlett clause at a final appellate level. Trustees will welcome the decision as it clarifies when they will owe a high level supervisory duty to underlying company investments.

Nonetheless, trustees should still be cautious as anti-Bartlett clauses do not offer guaranteed protection.

This article is not intended to be a substitute for legal advice or a legal opinion. It deals in broad terms only and is intended to merely provide a brief overview and give general information.

⁵ Ibid.

⁶ Zhang Hong Li and others v DBS Bank (Hong Kong) Ltd and others [2018] HKCA 435, 6.9

⁷ Ibid. (n2), 45

⁸ Ibid., 64

⁹ Ibid., 86