

RED | ALERT

DISPUTE RESOLUTION

TRUSTEES' MORNING AFTER PILL – REMEDY NO MORE!

Since 1975 trustees have had the benefit of what is often referred to as the "Morning After Pill", also called the Hastings-Bass principle. The principle allowed transactions which had been entered into by trustees and which had unintended consequences (often associated with tax) to be set aside.

The Court of Appeal recently handed down its eagerly awaited judgments in the cases of *Pitt v Holt* and *Futter v Futter*ⁱ. The Court concluded that this long held principle was **not** a correct statement of law.

The Court concluded that there were two possible scenarios which might pertain:

- (i) *"on the one hand there may be a case in which, for example, because of an inadvertent misunderstanding of the provision, an act done by trustees in the exercise of a positive discretion is not within the scope of the relevant power";* and
- (ii) *"on the other hand, the case may be one in which the trustees' act in exercise of their discretion is within the terms of their power, but is said to have been vitiated by their failure to take into account a relevant matter, or their taking something irrelevant into account, when deciding to exercise, and exercising, the discretion"ⁱⁱ.*

In respect of scenario (i), where the trustees acted outside their power, the Court concluded (as was to be expected) that the resulting act would be void. However, in respect of scenario (ii), the Court concluded that the act was not void but **may** be

voidable. An act will be voidable where it has *"been done in breach of the fiduciary duty of the trustees. The duty to take relevant, and no irrelevant, matters into account is a fiduciary duty. However, if the trustees fulfil their duty of skill and care by seeking professional advice.... from a proper source, and act on the advice so obtained, then ... they do not commit a breach of trust even if, because of inadequacies of the advice given, they act under a mistake as to a relevant matter, such as tax consequences. In the absence of a breach of the trust, the trustees' act is not voidable."*

This represents a significant shift away from the previous approach.

The cases in more detail: *Pitt v Holt*

Mrs Pitt had powers conferred on her by the Court of Protection, following a personal injury claim involving her husband. Mr Pitt had been seriously injured in an accident and had received a structured settlement under which a lump sum and monthly payments were paid. Pursuant to her appointment, Mrs Pitt owed her husband certain fiduciary duties.

Mrs Pitt took advice on placing the lump sum and annuity into trust. That advice was incorrect, and resulted in unforeseen inheritance tax consequences. The Court concluded that she was not in breach of her fiduciary duty to her husband since she had taken appropriate advice. Accordingly, her action of placing the funds into trust was not voidable.

It was also argued that, even if the Hastings Bass rule didn't operate so as to allow the transaction to be overturned, it should be overturned ('set aside') anyway on the basis that the transaction was entered into under a mistake. The Court's jurisdiction to set

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aside decisions based on a mistake stems from its equitable jurisdiction. Unfortunately for Mrs Pitt, the Court of Appeal rejected this submission too. It concluded that the only ground for invoking the Court's equitable jurisdiction was where there was a mistake on the part of the donor at the time of the transaction, either as to the legal effect of the transaction or as to an existing fact which was basic to the transaction.

Moreover, the mistake had to be of sufficient gravity to justify this approach, with the Court endorsing the dictum from a previous case that *"gifts cannot be revoked, nor...set aside, simply because the donors wish they had not made them and would like to have back the property given. Where there is no fraud, no undue influence, no fiduciary relation between donor and donee, no mistake induced by those who derive any benefit by it, a gift, whether by mere delivery or by deed, is binding on the donor"*ⁱⁱⁱ.

In this case, the Court held that Mrs Pitt was under a mistake, in that she believed the transaction would not have any tax disadvantages. However, this was not a mistake as to the legal effect of the transaction but a mistake as to its consequences. It was therefore not a mistake of a kind sufficient to invoke the equitable jurisdiction of the Court so as to set aside the transaction.

The cases in more detail: Futter v Futter

The second case under appeal was that of *Futter v Futter* whereby the trustees' actions had resulted in unexpected capital gains tax implications. Their actions were found to be within their powers under the settlement and therefore could not be held to be void. Furthermore, the trustees had taken advice from appropriate solicitors as to the tax

consequences of what they were doing, albeit that advice had failed to address a relevant point. The trustees had acted in accordance with that advice, and were therefore not in breach of their fiduciary duties, even although they were mistaken as to the tax consequences of their actions. As a result, the transactions were not voidable.

The Future

The effect of the decisions in *Pitt v Holt* and *Futter v Futter* is that the Morning After Pill has gone. Trustees and beneficiaries will now have to live with the tax consequences of trustees' decisions, even where these consequences could have been avoided. As a result, now that the scope for unwinding transactions is much more limited, trustees are much more likely to face a claim for breach of trust and to seek to recover damages from their tax and legal advisors in respect of defective advice.

This Red Alert does not constitute legal advice and should not be relied upon as doing so. Specific advice should be sought in any particular case. If you have questions relating to any Trust Law issues, please contact our Dispute Resolution Team at dr@aohall.com or telephone on 01481 723723

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ⁱ [2011] EWCA Civ 197

ⁱⁱ Above, at paragraph 222

ⁱⁱⁱ *Ogilvie v Littleboy* (1897) 13 TLR 399, at page 400

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