Reviewing the *Citibank* securitisation: Did it really challenge equity's integrity?

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Introduction

Despite its villainisation[1] as a contributor to the cause of the global financial crisis, securitisation remains an economically important form of financing for corporations. While issuance levels dropped during the financial crisis, evidence suggests that, in some jurisdictions and asset classes (such as auto and credit-card-backed securitisations), levels are recovering.[2] This is to be expected, for securitisation provides well-recognised advantages over traditional forms of financing such as bank lending and share issues. In particular, it is considered to be more economically efficient because it removes intermediaries.[3]

Securitisations are complex transactions and there are a variety of configurations.[4] The legal documentation is often 'forbiddingly' lengthy[5], in part because of the number of parties involved, their competing interests and the complex allocation of risk and reward which may be achieved between them.

The trust deed is the primary document regulating the relationship between the parties who may include the trustee, the secured creditors (including the investors), the special purpose vehicle (SPV), the issuer and parties providing credit enhancement, such as guarantors.[6] The deed also operates like

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[1] Steven Schwarcz, 'Securitization, Structured Finance, and Covered Bonds' [2013] The Journal of Corporation Law 130 at 131. See also McCormick, *Legal Risk in the Financial Markets* (2nd ed, OUP, Oxford, 2010) at [6.11].

[2] Bank for International Settlements, Basel Committee on Banking Supervision, Board of the International Organization of Securities Commissions, Consultative Document "Criteria for identifying simple, transparent and comparable securitisations", Issued for comment by 13 February 2015, dated 11 December 2014, (available on the BIS website, www.bis.org) ISBN 978-9197-018-6 (print) and ISBN 978-9197-017-9 (online) at p 3-4.

[3] For detailed discussion of the advantages of securitisation see Philip Wood, *Law and Practice of International Finance*, (University edition, Sweet & Maxwell, 2008) at [28-12] – [28-17] and [28.41], Steven Schwarcz. 'Securitization Post-Enron' (2004) 25 Cardozo L Rev 1539 at 1550, Schwarcz, above n 1, at 131 and 132 and Jonathon Lipson, 'Re-Defining Securitization' [2012] SC Law Review 1229 at 1240, 1244-5. Advantages include that securitisation offers cheaper capital because of "disintermediation", that is, the removal of intermediaries or middlemen such as banks from the fund-raising. It enables originators of the securitisation to access capital markets directly and to improve liquidity of the assets that they hold. They may also be able to extract profit by receiving excess interest or through servicing fees or price deferment. Originators may diversify sources of funding and be less dependent on bank financing which usually carries more onerous terms. The originator does not carry the risk of repaying investors. Further investors are shielded from the insolvency of the originator and if different tranches of notes are offered may match investment to appetite to risk.

[4] Wood, above n 3, at [28-19] – [28-28]. Alastair Hudson, *The Law of Finance* (2nd ed, Sweet & Maxwell, London, 2013) at [44-10] – [44.22].

[5] Lord Walker recently described the legal documentation for a securitisation of mortgage loans set up by the Lehman Brothers group as 'regrettably and forbiddingly voluminous' in *BNY Corporate Trustee Services Ltd v Eurosail-UK 2007-3 BL plc* [2013] 1 WLR 1408 at [10]; [2013] UKSC 28 [*Eurosail*]. There is currently a project to achieve simple transparent securitisation structures being conducted by the Bank for International Settlements. See above n 2, at p 3-4. See also Hudson, above n 4, at [44-19].

[6] Jan Jobb de Vries Robbé, *Securitization Law and Practice in the Face of the Credit Crunch* (Kluwer Law International, 2008) at [2.49] – [2.50]. For a discussion of forms of credit enhancement see Wood, above n 3, at [28.38] and Hudson, above n 4, at [44.17].

an inter-creditor agreement, regulating the relationship between the secured creditors, including the investors, who typically hold tranches of securities (such as notes or bonds) of varying seniority.[7]

As with any significant financing arrangement, a primary aim of the parties will be to achieve legal certainty. Anything less, increases the risks and, potentially, the costs for participants. It also facilitates "tranche warfare",[8] that is, disputes between senior and junior noteholders, which may arise where there is a threat to the value of the securitised assets or to the payment stream. Junior noteholders, who under the "metaphorical waterfall" receive payment last[9] and absorb losses first, may exploit uncertainty to improve their bargaining position.

There is currently an area of uncertainty with securitisation trust deeds where third parties are granted powers enabling them to direct trustees to act in ways that may benefit those third parties but not all or some of the investors. It has been argued that this form of arrangement may leave a void in terms of the required fiduciary element necessary to create a valid trust.[10] While in *Citibank NA and MBIA Assurance SA v QVT Financial LP*[11], the English Court of Appeal determined that the grant of powers to a third party guarantor in that case did not reduce the trustee's fiduciary obligations below the irreducible core of obligations necessary for a valid trust,[12] the financing arrangement has been criticised as putting the 'integrity of equity … at stake'[13], '[cutting] the beneficiaries' trust rights to vanishing point'[14] and being a trust 'effectively shorn of the core elements of a trust', where the trustee is 'essentially denuded of the fiduciary incidents of its office'.[15]

This paper argues that the trust structure created in the *Citibank* trust deed falls within traditional equitable parameters and is a modern application of fundamental equitable concepts. To that extent, the structure does not strike at equity's integrity or wholly undermine the trustee's fiduciary obligations and was properly recognised as a valid trust. The pertinent issue that requires consideration is not whether the structure was a valid trust but whether the equitable doctrines and principles regulating the operation of powers are adequate given the new commercial context in which they are being used.

Citibank - the facts

Citibank involved the securitisation of Eurotunnel tier 3 junior debt ('tier 3 debt'), owed by the Eurotunnel group. The tier 3 debt was owned by Fixed-Link Finance BV ('FLF'), a Dutch special purpose vehicle, and it was the issuer of the notes. Under the securitisation, seven tranches of notes were created with varying degrees of subordination. The notes were in two currencies with aggregate nominal amounts of £400 million and €700 million. The two senior tranches of notes had a benefit of

[7] Senior debt will generally be more attractive to institutional investors which may have restrictions on the type and rating of notes in which they can invest. Junior debt, which typically carries a higher interest rate, is often of more interest to private equity or hedge funds which can invest in higher risk products.
[8] Steven Schwarcz, 'Fiduciaries with Conflicting Obligations' [2010] Minnesota Law Review 1867 at 1871. See also Philip Rawlings, 'Reinforcing Collectivity: The Liability of Trustees and the Power of Investors in Finance Transactions' (2009) 23 Trust L. Int'l 14 at 14.
[9] *Eurosail*, above n 5, at [12]. Sequential payment is provided for in a "waterfall clause".
[10] Trukhtanov, 'The Irreducible Core of Trust Obligations' (2007) 123 LQR 342. Mr Trukthanov also states that "the integrity of equity is at stake".
[11] *Citibank NA and MBIA Assurance SA v QVT Financial LP* [2007] EWCA Civ 11 [*Citibank CA*]. The High Court decision is *Citibank NA v MBIA Assurance SA & ors* [2006] EWHC 3215 (Ch) [*Citibank HC*].
[12] *Armitage v Nurse* [1998] Ch 241 at 253 [*Armitage*].
[13] Trukhtanov, above n 10, at 347.
[14] Joshua Getzler, 'Ascribing and Limiting Fiduciary Obligations' in Gold and Miller, *Philosophical Foundations of Fiduciary Law*, 39 at 53.
[15] Peter Devonshire, 'Account of Profits for Breach of Fiduciary Duty' (2010) 32 Sydney LR 388 at 389.

credit enhancement and were guaranteed by MBIA Assurance SA ('MBIA'). The five junior tranches of notes did not have the benefit of any guarantee. The appellant, QVT Financial LP ('QVT'), a hedge fund, was a holder of junior notes.

The securitisation was structured using a trust. The parties to the trust deed were Citibank (as trustee), MBIA and FLF (as issuer of the notes). Citibank, as trustee, held direct covenants from FLF on trust for the noteholders, including a covenant from FLF to pay the notes when due. Under a separate deed of charge, Citibank held a charge over FLF's assets and FLF assigned to Citibank all its rights, including its voting rights as lender, under the underlying financing agreements, which included the documentation constituting the original Eurotunnel debt.[16] The overall arrangement has been described as 'a very elaborate structure'.[17] Under the trust deed, MBIA was given certain powers to give directions and exercise controls over duties and discretions (described in greater detail below), which would commonly be exercisable by Citibank, as trustee. This was achieved by granting to MBIA. Citibank was obliged,[18] to follow MBIA's directions when MBIA was 'Note Controlling Party', which meant while it remained liable under its guarantee. When it was exercising these powers, the deed stipulated that MBIA did not have to take account of the interests of the note holders. Similarly, when Citibank was acting on instructions from MBIA, Citibank was not required to take account of the interests of the note holders and was exempted from liability to noteholders.

In 2006, the Eurotunnel group, having encountered financial difficulties, entered safeguard proceedings before the Commercial Court in Paris. Negotiations were conducted between creditors and others and a restructuring plan, called the Safeguard Plan ('the Plan'), was developed. The Plan provided that the tier 3 debt would be assigned by FLF to a Eurotunnel company in exchange for certain notes redeemable as shares in Eurotunnel plus a cash payment. However, the Plan also gave the holder of the tier 3 debt an option to elect simply to take cash instead (the 'cash option'). Exercising the cash option would result in noteholders receiving only 61 per cent of the par value of their notes.

MBIA was involved in the negotiations leading to formulation of the Plan.[19] Further, QVT had some knowledge of earlier negotiations and had stated its objections at the time to a similar proposal under which tier 3 debt would be replaced by redeemable notes. MBIA sought to use its powers as Note Controlling Party to direct Citibank, as trustee, to exercise the cash option at the earliest available opportunity or to procure FLF to do so. Citibank, aware of QVT's continued opposition and concerned

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[16] *Citibank HC,* above n 11, at [7j)].

[17] At [5].

[18] Above. In *The Law of Finance*, above n 4, Hudson suggests at [34-26] that there remains an issue in the *Citibank* case as to whether Citibank was *bound* to follow MBIA's directions or *free* to act as it wished. He states at [34-26] that "the resolution of the issues between the parties was that Citibank as trustee was free to consider itself bound by MBIA's direction." He does not fully articulate how he reaches this conclusion but it appears to rely on the position taken by Citibank before the High Court (see at [25]). However, his suggestion is questionable given that Schedule 4 of the trust deed stated as follows, that, "[s]o long as MBIA is the Note Controlling Party, all the Issuer's rights in respect of the Financing Agreements … shall be exercised by the Trustee *acting solely and in all circumstances, in accordance with the prior written instructions of MBIA* (subject as aforesaid)". Further, clause 10.1 of the trust deed, which regulated the extent of Citibank's obligations in relation to MBIA, only excluded Citibank from complying with directions from MBIA in limited situations. Mann J appears to accept that Citibank would be obliged to follow directions (see paragraphs 7(c) where he states with regard to clause 2.2 of the trust deed that "[w]hat is important is that Citibank has to do those acts ("shall") if instructed by MBIA …). Further, Hudson does not discuss the Court of Appeal judgment where both Arden LJ and Dyson LJ (as he was then) specifically address the following question "is Citi obliged, at the direction of MBIA, to instruct FLF to exercise the cash option or must it exercise its own independent judgment in deciding whether to give such an instruction". The Lord Justices respectively state (at [68] and [94] that Citibank is obliged to follow the directions of MBIA.

[19] *Citibank HC,* above n 11, at [17].

to avoid allegations of breach of duty, sought directions from the Court, inter alia, on whether it was obliged to comply with MBIA's direction.[20]

Citibank appropriately adopted a broadly neutral role in the litigation,[21] but maintained the position that, when acting in accordance with the directions of MBIA, it did not need to have regard to the interests of noteholders. It favoured a construction of the documentation which would not preclude it from accepting MBIA's directions so that it was not obliged to exercise its own discretion as trustee in relation to exercising the cash option.

QVT raised a number of legal objections to MBIA's actions based on construction both of the trust deed and the deed of charge, one of which was to challenge the validity of the securitisation trust because of the wide powers granted to MBIA. QVT contended that the rights that MBIA asserted it had (principally, to direct Citibank to exercise the cash option without having to take account of the interests of the note holders) were so wide that they intruded upon the irreducible core of trustee obligations from *Armitage v Nurse.*[22] It argued that if MBIA could make decisions solely in its own interests then that would cut across 'the whole idea of the trust structure'.[23] In the High Court, QVT argued that the Court should make a factual assumption that exercise of the cash option would result in an undervalue because that would enable the Court to test the legal submissions on the footing that the exercise of the option would not be in the interests of the noteholders as a class but was being exercised in MBIA's sole interest. The High Court refused to make any such assumption, stating that it was not appropriate to assume facts and that MBIA's powers 'are what they are'[24] irrespective of whether or not there was an assumed undervalue. Before the Court of Appeal, QVT made the same point in a slightly different way by asserting that if MBIA could require Citibank to consent to the cash option under the negative pledge provision in the deed of charge, then MBIA could give a direction to Citibank to consent to a disposal of the trust assets for £1.

MBIA argued that exercising the cash option did not amount to a disposal under the negative pledge provision. Its position was that it had a clear right under the trust deed (clause 12.2 and schedule 4) to direct Citibank, as trustee, to exercise the cash option and that Citibank was obliged to accept those directions.[25]

Judgments – High Court and Court of Appeal

QVT's argument failed both in the High Court and the Court of Appeal. In the High Court, Mann J held that, although MBIA held wide powers, the powers did not contravene the irreducible core necessary for the creation of a valid trust and that the trust remained intact with the property held on identifiable trusts.[26] Whilst the deed provided that various powers were surrendered to MBIA when it was acting as Note Controlling Party, he considered that, if MBIA did not so act or ceased to hold that role, Citibank would resume those functions. In the Court of Appeal, Arden LJ declined to accept that the trust deed reduced the trustee's obligations below the minimum core. She considered that the trustee retained the obligation to act, at all times, in good faith and that the trustee had other 'real discretions' to exercise.[27] In recognition of the fact that the financing arrangement was one negotiated between

[20] At [20] and *Citibank CA,* above n 11, at [7].
[21] *Citibank HC,* above n 11, at [25].
[22] *Armitage*, above n 12.
[23] *Citibank HC,* above n 11, at [47].
[24] At [37].
[25] At [28].
[26] At [48].
[27] *Citibank CA,* above n 11, at [82].

sophisticated commercial parties, Arden LJ commented that finding the trust to be invalid would be a 'surprising interpretation of the documentation, against which the court should lean'.[28]

Traditional and commercial trusts

Trusts are of vital importance in the modern financial world. As Hon Mr Justice Hayton has commented, extra-judicially, the most significant role for the trust concept, in recent times, has been its use in financial markets and for money-raising.[29] The flexibility of the trust concept, the insolvency protection achieved by the creation of a discrete fund, the fiduciary and equitable duties attaching to the office of the trustee and the underlying operation of equitable principles and doctrines make the trust an indispensable device for regulating complex financial relationships. Equity provides a spectrum of equitable obligations from mere powers to fixed trusts, which can be combined to enable settlors to deal with property largely in the manner they wish.[30] In a commercial context, the ability to combine trusts and powers enables narrowly defined personal and property rights to be created to give legal effect to the negotiated positions of disparate market participants. The tractability of trusts and powers also enables the structuring of innovative financial products.[31] Within a competitive global economy, innovation within financial markets is a constant process.

The English Financial Markets Law Committee ('FMLC') has recognised the pivotal role played by trusts in wholesale financial markets and emphasised the fundamental differences between commercial trusts and traditional family trusts stating that:[32]

> The use of trusts in the financial world is not only widespread, but there is a trust relationship behind most situations of ownership which are found in this area. The most important aspect to note about such trusts is their variance from the traditional trust which occurs in, for example, a family setting. Whilst protecting the beneficiaries' interests is of course central to all trusts, it must also be recognised that the commercial or business trust does differ in several respects from the traditional trust. The commercial trust arises out of contract rather than the transfer of property by way of a gift.

It has emphasised the different roles played by trustees of traditional trusts and commercial trusts, respectively. Both must protect beneficiary rights, but trustees of commercial trusts act 'as an independent party playing a crucial bridging role between the parties in a wide range of corporate finance activities' and trustee relationships are 'closer in substance to contracts between sophisticated participants with freedom to contract, than to a traditional trust.'[33]

In a traditional trust, the trust will often be structured so that the trustees carry full dispositive and administrative powers and beneficiaries cannot dictate what the trustees should do, unless the

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[28] At [82].

[29] Professor David Hayton, 'Trusts and Their Commercial Counterparts in Continental Europe', A Report for The Association of Corporate Trustees, (January 2002) at [3.7.8] – [3.7.9].

[30] For a general discussion see Tucker, Le Poidevin and Brightwell, *Lewin on Trusts* (19th ed, Sweet & Maxwell, London, 2015) at [29-036] and Pearce and Barr, *Pearce and Stevens' Trusts and Equitable Obligations* (6th ed, OUP, Oxford, 2015) at 44 – 47.

[31] Randell Krebs, 'Flexible Friend' (2008) 16(2) STEP J 17. This quotation, no doubt, drew on the words of Dr Austin Scott who wrote that '[t]he purposes for which trusts can be created are as unlimited as the imagination of lawyers', AW Scott, *The Law of Trusts* (2nd ed, Little Brown & Co, 1956) 1. See also, Worthington, *Equity* (2nd ed, Clarendon Law Series, OUP, Oxford 2006) at 77 with regard to the 'slicing up' up of property rights through the use of trusts.

[32] The Financial Markets Law Committee (UK) is an independent committee of legal and industry experts. Its role includes acting as a bridge to the judiciary to help the courts remain up-to-date with developments in financial markets' practice. See www.fmlc.org. See Report of the Financial Markets Law Committee 'Issue 62–Trustee Exemption Clauses: Analysis of the role of the trustee in the wholesale financial markets and of the proposals contained in the Law Commission's Consultation Paper No 117 [sic] - Report' (1 May 2004) at 1–2 (5http://www.fmlc.org/Pages/papers.aspx4).

[33] FMLC Report, above n 32, at 1.

beneficiaries act in accordance with the rule in *Saunders v Vautier*[34] or statute.[35] Trustees would be in breach of trust if they did not actively make independent decisions, but blindly followed the directions of beneficiaries.[36] In contrast, commercial trusts are commonly structured to allow the investors or noteholders to be actively involved in decision-making. Commercial trust deeds will generally contain detailed provisions enabling 'note-holder democracy'.[37] These provisions will establish procedures which enable noteholders to reach binding decisions and issue directions to trustees in relation to specified events.[38] As 'expert investors'[39] or 'sophisticated professional investors'[40] capable of looking after their own interests, it is appropriate that, provided they act within the ambit of their powers, such investors should carry the responsibility for the decisions they make and that trustees should not.

One of the hallmarks of a trust is the existence of fiduciary obligations that bind the conscience of the trustee, as legal owner of the trust fund.[41] As Lord Browne-Wilkinson made clear in *Westdeutsche Landesbank Girozentrale v Islington London Borough Council,*[42] equity operates on the conscience of the legal owner and requires the legal owner to carry out the purposes for which the property was vested in him or her. English law recognises that trustees of commercial trusts are fiduciaries *per se*, but allows the exact nature of the fiduciary duties attaching to the office of trustee to reflect, to a certain degree, the nature and extent of the obligations undertaken by the trustee and the nature and extent of powers granted to noteholders and others as set out in the trust deed.[43] It does not require trustees to carry the full mantle of duties that one might often see in a traditional trust.

This attenuation of duties can be seen in *Elektrim SA v Vivendi Holdings 1 Corporation.*[44] This decision involved the construction of a 'no-action' clause in a trust deed governed by English law. A bondholder, Vivendi, claimed that the trustee of the bond issue and the issuer were in breach of fiduciary duty and negligent, and issued proceedings in Florida. The claims arose from actions taken by the trustee following the default of the issuer and Elektrim as guarantor of the issue. The principal allegation was that the trustee had failed to disclose information. The trustee asserted that it had acted, as obliged under the trust deed, on instructions of bondholders holding more than 30 per cent in value of the bonds.[45] An anti-suit injunction was granted by the English High Court in relation to the Florida proceedings and that decision was appealed. In upholding the injunction, Lawrence Collins LJ (as he then was) noted that, under the trust deed, the trustee was not required to take any action unless it was directed or requested to by either an extraordinary resolution of bondholders or in writing by 30 per cent in value of the bondholders and, in each case, only if satisfactorily indemnified. Further, if the trustee received such instructions, it was *required* to act. He accepted that even if it could be argued that the trustee was under a duty to disclose, it was impossible to argue that the trustee had failed to comply with that duty because the trustee had acted under instructions.[46] More

[34] *Saunders v Vautier* (1841) 4 Beav 115.
[35] *Holding and Management Ltd v Property Holdings and Investment Trust plc* [1989] 1 WLR 1313 at 1324H (CA) and *Re Brockbank* [1948] Ch 206.
[36] See *Gibley v Rush* [1906] 1 Ch 11 on active decision-making. There are however complex rules which can act to relieve trustees of liability where beneficiaries request or consent to acts that amount to breaches of trust.
[37] *Assénagon Asset Management SA v Irish Bank Resolution Corporation Ltd* [2012] EWHC 2090 at [11] (*Assénagon*).
[38] Such provisions would include procedures for noteholder meetings and would define the extent of powers for a majority of noteholders to bind the minority.
[39] *Elektrim SA v Vivendi Holdings 1 Corporation* [2008] EWCA Civ 1178 at [154] [*Elektrim*].
[40] *Assénagon*, above n 37, at [10].
[41] *Don King Productions v Warren* [2000] Ch 291, at 317.
[42] *Westdeutsche Landesbank Girozentrale v Islington London Borough Council* [1996] 1 AC 669 at 705.
[43] The trust must satisfy the requirements of *Armitage v Nurse.* See also Rawlings, above n 8.
[44] *Elektrim,* above n 39, at [152].
[45] At [154].
[46] At [156].

importantly, for current purposes, Lawrence Collins LJ stated that the duties of trustees of bond issues were mainly ministerial and administrative. He found it 'surprising' that Vivendi had alleged the duties were owed and he was satisfied that there 'were no such duties in the circumstances of [the] case under English law'.[47]

Although there are stark differences in the ways that commercial and traditional trusts are structured (not least because commercial trusts arise out of contract, rather than gratuitous transfer), the attenuation of trustee duties and the combining of trusts and powers so that others, besides trustees, can be involved in decision-making is equally permissible in traditional trusts. Indeed, alternative decision-making structures have existed in traditional trusts since at least the 1800s. Where there was a family business, traditional trusts are said to have often included powers enabling one of the beneficiaries to direct trustees on investments, including requiring the trustees to purchase that beneficiary's own shares.[48] The trust deed would typically vest a power (either dispositive or administrative) in the trustee and that power would be subject to a power held by a beneficiary or third party to give directions to the trustee mandating how the trustee must act.[49] In more recent times, it has become common, particularly in offshore trusts, to grant powers of direction or consent to third parties who are often referred to as 'protectors'.

This layering of powers enables control of some trustee action to be allocated to non-trustees. Trustees will have discretionary, administrative or dispositive powers which they may decide to exercise or not. However, in specific circumstances, that discretion can be overridden and particular courses of trustee action can be made mandatory because trustees are obliged to comply with directions.[50]

Such layering can result in an overall reduction in a trustee's fiduciary duties because trustee discretion is reduced. The powers held by trustees under a trust deed are generally fiduciary powers.[51] As such, a trustee is required to consider, from time to time, whether and how to exercise the power. If the trustee does decide to exercise the power, he must do so properly. Equitable limitations, including the doctrine of 'fraud on a power' (otherwise known as the improper purposes doctrine), will control the exercise. However, the reduction in the trustee's fiduciary duties does not necessarily mean that beneficiaries will be less well protected. Powers of direction held by third parties (being the 'donee' or holder of the power) may be fiduciary powers, in which case they will carry similar protections to trustee powers. Powers of direction may also be non-fiduciary, in which case they will not carry fiduciary duties. If a power of direction is non-fiduciary, the donee may, depending on the wording of the power, require the trustee to bestow a benefit on some of the beneficiaries, or a third party or even the donee him or herself, without having regard to the interests of all the beneficiaries.[52] Even then, it is not the case that beneficiaries will be wholly unprotected because equitable limitations (discussed in more detail below) apply to non-fiduciary powers.

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[47] At [153].

[48] *Re Hart's Will Trusts* [1943] Ch D 557, [*Re Hart*]. The editorial note to this case states that the 'case deals with a power, now quite often included, intended to enable trustees to invest in a family business'. The power in question enabled a life tenant to direct the trustees to purchase shares from the beneficiary and even sell existing investments in order to do so.

[49] See *Beauclerk v Ashburnham* (1845) 8 Beav 322: 50 ER 126 [*Beauclerk*] and *Re Hart,* above n 48.

[50] *Lewin on Trusts*, above n 30, at [29-122].

[51] At [29-018] and John Mc Ghee QC, *Snell's Equity* (33rd ed, Sweet & Maxwell, London, 2014) at [10-009].

[52] See *Lord Vestey's Executors v Inland Revenue Commissioners* [1949] 1 All ER 1108 at 1115F; [1949] UKHL J0506-2 (*Lord Vestey's Executors*) and *Re Hay's Settlement Trusts* [1982] 1 WLR 202 at 209 per Megarry V-C, where he stated that a donee of a non-fiduciary power is 'unhampered by any fiduciary duties. See also Geraint Thomas, *Thomas on Powers* (2nd ed, OUP, Oxford, 2012) at [10.53].

In order to create a non-fiduciary power of direction, careful drafting is required, particularly if the power may be used to benefit the donee. As Lord Simmonds stated in In *Lord Vestey's Executors v Inland Revenue Commissioners,* when analysing a power held by 'authorised persons' to direct trustees on investments: [53]

> 'The first question here for consideration is what is the nature of the right to direct investment which is vested in the authorised persons. On behalf of the Crown, it is urged that it is not a fiduciary power or right, but a right exercisable by the authorised persons for their own benefit, so that they can require the trustees to invest the trust funds by way of loan to themselves or any company in which they are interested at any rate of interest whether or not that investment is or is intended to be for the benefit of the trust estate … *Nothing short of the most direct and express words would, I think, justify a construction which would enable those who exercised the power of direction to disregard the interests of the beneficiaries* (emphasis added).

There are various examples of traditional trusts where trustees could be directed to exercise administrative powers in a manner that was not for the benefit of some or all of the beneficiaries. In *Beauclerk v Ashburnham,*[54] a life tenant was empowered to direct the trustees to buy interests in land, although the purchase might not have been of benefit to the remainderman.

In *Re Hart's Will Trust,*[55] a life tenant was empowered, provided he acted in good faith, to direct the trustees to purchase shares from the life tenant and even to sell existing investments to fund such purchases.

In *Citibank v Hayim*[56], a trustee of a Hong Kong will trust was able to postpone sale of a house in Hong Kong, acting on the instructions of a trustee of an American will trust even though postponement was not in the interests of the ultimate beneficiaries of the house under the American trust and was, in fact, prejudicial to them. In issuing instructions to postpone sale, the second trustee was relieved under provisions in the American trust of responsibility to the beneficiaries. The power to postpone sale was held to have been designed with a purpose, namely to enable the brother and sister of the testator, who were not beneficiaries of either trust, to remain in the house so long as the second trustee thought fit.[57] If the power was exploited for any reason other than in the interests of the brother and sister or in the interests of the beneficiaries, the beneficiaries could complain. Because the sale was postponed, the house sold for HKD$8 million less than it would have reached if sold earlier. An action for breach of trust against the Hong Kong trustee failed as it was held to have been obliged to follow the lawful direction of the American trustee, even though that direction was not in the best interests of the beneficiaries.

The *Citibank* trust appears to have adopted this kind of layering of powers. Administrative powers were vested in Citibank as trustee and some of those powers were subject to powers of direction vested in MBIA, with which Citibank was obliged to comply.[58]

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[53] *Lord Vestey's Executors*, above n 52, at 1115F.
[54] *Beauclerk*, above n 49. Although, in this case, the court considered that the trustees retained a discretion as to value, title and locality. Similarly see *Cadogan v Earl of Essex* (1854) 2 Drew 227; 61 ER 706.
[55] *Re Hart,* above n 48.
[56] *Citibank v Hayim* [1987] 1 AC 730 (*Hayim*).
[57] At 746E-F.
[58] See *Citibank HC*, above n 11, at [7c)] states 'Clause 2.2 provides that on an Event of Default Citibank shall or may do certain acts. The acts are unimportant for these purposes. What is important is that Citibank has to do those acts ("shall") if instructed by MBIA while MBIA is Note Controlling Party; otherwise is "may" do them. In other words, it must comply with MBIA's instructions if MBIA is still potentially liable under its guarantee. This is a familiar pattern thereafter in this document." See also [7f)], [7g)], [7j)] and [7k)].

Was the *Citibank* trust a valid trust?

The powers of direction granted to MBIA under the trust deed were extensive. It could give directions in relation to the following: the taking of enforcement action; the substitution of another debtor on the notes; modification of the notes in limited aspects and to authorise or waive breaches by FLF.[59] More importantly, MBIA was empowered to direct Citibank, after an event of default, as to how it should vote as lender, including in relation to any compromise.

Even so, it is overstating matters to suggest that Citibank's over-arching fiduciary duties to the noteholders were wholly negated by MBIA's powers so that there was no trust or that beneficiaries' rights were cut to vanishing point. As a matter of construction of the deed, it appears evident that Citibank remained subject to sufficient duties and discretions for recognition of a valid trust. Pursuant to the deed, Citibank was, at times, free to act without instruction from MBIA and, in those circumstances, its conscience was bound to carry out the purposes for which the trust property was vested in it. In particular, Citibank was only obliged to follow MBIA's instructions where MBIA was acting as Note Controlling Party, which under the deed meant whilst it remained liable under the guarantee or was not in default.[60] If MBIA ceased so to act, Citibank was permitted to follow MBIA's directions but was not obliged to do so. In the Court of Appeal decision, Arden LJ stated that there were 'other clauses' where Citibank had a 'real discretion to exercise'.[61] Further, Citibank could not self-deal or misapply trust assets. Nor could it act in conflict or take profits except to the extent permitted under the deed, statute or general law.

Moreover, it may be possible to construe MBIA's powers of direction and other provisions in the trust deed as enabling Citibank to act without MBIA's instructions in other circumstances.[62] These include when Citibank was entitled to refuse to follow a direction, if MBIA refused to indemnify it, if MBIA refused or failed to provide a direction, or if MBIA was unable to give a direction. With regard to these circumstances:

1. Citibank was not always obliged to follow MBIA's directions. It was entitled to refuse to follow directions if, in Citibank's opinion, any directions were illegal, contrary to any requirement or request from any monetary, fiscal or governmental authority, or in breach of any contract, treaty or agreement, the terms of which bound Citibank (Clause 10.1). Under the exemption clause in the trust deed (clause 10.4), MBIA was not excused from liability if it exercised its powers with wilful default or negligently. If Citibank formed the opinion that a direction from MBIA was made with wilful default or was negligent, then arguably Citibank could refuse to follow that direction if compliance would place Citibank in breach of trust. The exemption clause stated that Citibank did not have to consider the interests of the noteholders and had no liability as a consequence of following directions, but it did not state that Citibank's actions in complying with such a direction did not amount to breaches of trust. To this extent, any such breaches might be caught by clause 10.1 of the trust deed, if the deed itself was held to be an 'agreement' which bound Citibank.

2. Pursuant to clause 14.2.3 of the trust deed, Citibank had absolute discretion in the exercise or non-exercise of its powers, but where it was bound to follow MBIA's directions, it was only so bound if it was indemnified and/or provided with security to its satisfaction.

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[59] At [8] and [48].
[60] *Citibank CA*, above n 11, at [15].
[61] At [82].
[62] See *Hart,* above n 48, at 558A. In this case, a power of direction was construed as leaving the trustee free to act if the donee of the power of direction refused or failed to act.

3. MBIA's powers of direction would be likely to be characterised as non-fiduciary powers[63] because MBIA was able to exercise them without considering the interest of the noteholders or assuming any 'fiduciary or other duty'.[64] If so, MBIA would have been under no duty to exercise the powers or even consider exercising them and would have been free to disregard them completely.[65]

4. If MBIA ceased to exist, the powers of direction, being non-fiduciary, would not survive unless the deed made express provisions for succession, which it does not appear to do.[66]

Further, if a direction by MBIA contravened equitable limitations on the exercise of MBIA's powers so that the exercise was invalid or void, Citibank would, arguably, have been obliged to maintain the integrity of the trust fund and refuse to follow MBIA's directions. Even if there was only uncertainty over validity, Citibank arguably would be obliged to do the same and would place the matter before the court for determination under the court's inherent jurisdiction to supervise the administration of trusts. Indeed, in *Citibank*, that is precisely what occurred.

In addition, it is possible to grant a general power of appointment or a power to revoke a trust to a third party and still have a valid trust. If these powers may be included without offending equity's integrity, given that they can enable a third party to take all the trust assets for him or herself, it makes the *Citibank* trust appear less challenging, despite the extensive powers of direction granted to MBIA.

Practical effect of granting power of direction to MBIA

Before looking at equity's regulation of powers, it is useful to consider the likely practical implications of granting powers of direction to MBIA.

As mentioned above, trustees of bond and note issues hold largely administrative duties, the fulfilment of which will often involve exercising discretion. Where events suggest a potential default, trustees can face 'exquisite judgment calls',[67] the end result of which could benefit one class of investor at the expense of others. In these circumstances, it may be virtually impossible (or, at least, highly problematic) for trustees to determine what might be in the best interests of all the noteholders.

A recent example is *BNY Corporate Trustee Services Ltd v Eurosail-UK 2007-3 BL plc.*[68] This decision involved the securitisation of mortgage loans secured on residential properties in the United Kingdom through Eurosail, a special purpose vehicle formed by the Lehman Brothers group. Notes to the value of £660 million were issued by Eurosail to five principal classes of noteholders, with 14 sub-classes. The terms governing the notes provided that if an 'event of default' occurred, the trustee could issue an enforcement notice. An 'event of default' included if Eurosail was unable to pay its debts within the meaning of s 123 of the Insolvency Act 1986 (UK), a test which has some flexibility. If the trustee issued an enforcement notice, under the terms of the notes, priorities for payment of principal were altered so that A2 and A3 noteholders ranked equally for repayment of principal where, previously, A2 noteholders had priority.

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[63] *Mettoy Pension Trustees Ltd v Evans* [1990] 1 WLR 1587, 1613 – 1614.

[64] *Citibank HC*, above n 11, at [7(i)] which sets out clause 10.4 of the trust deed. See also *Re Wills Trust Deeds* [1964] Ch 219 at 228.

[65] *Thomas on Powers*, above n 52, at [1.14] and [10.145].

[66] The powers would be held in abeyance or end. Although, it is possible if the powers were beneficial that a liquidator of administrative receiver could exercise them. See *Lewin on Trusts*, above n 30, at [29-066] and [29-090].

[67] Schwarz, above n 8, at 1869.

[68] *Eurosail*, above n 5.

Similar issues arose in *Bank of New York v Montana Board of Investments.*[69] Here, during the GFC, senior investors sought to direct a trustee to sell the assets of a structured investment vehicle, Orion Finance Corporation, quickly, when market prices were near collapse. More junior investors wanted to wait until the market improved, before selling the assets. A quick sale might have enabled repayment of the senior investors but was likely to leave nothing for more junior investors.

To assist in decision-making, trust deeds may contain provisions requiring trustees to prioritise interests of one group of investors, for example, senior noteholders. Providing such parameters for decision-making reduces the risk of allegations that trustees are in breach of duty for failing to adopt the 'proper' course of action.[70]

In voting to accept or reject the cash option in the Plan, Citibank would have been exercising a power of compromise. Generally, when exercising such a power, trustees are required to act honestly, actively and consciously[71] and must be satisfied that the compromise is expedient 'for the trust as a whole'.[72] However, the *Citibank* trust deed (clause 14.1.6) contained a provision that, subject to any directions by MBIA, enabled the trustee to resolve conflicts of interest between classes of noteholders by giving priority to the 'more senior noteholders'. As a conflict had arisen over whether or not to accept the cash option, Citibank would have been obliged to give priority to senior noteholders, who had the benefit of the MBIA guarantee.

In practical terms, it may be questionable whether there would be any significant alteration in the position for noteholders if either MBIA or Citibank made the decision. Details of the terms of the guarantee are lacking in the decisions, but it is likely that the economic or financial interests of the senior noteholders and MBIA were aligned. If Citibank made the decision, it would be required to prioritise the interests of senior noteholders and adopt the course of action to ensure that they were paid first and then look to the interests of junior noteholders. Similarly, if MBIA behaved rationally and without ulterior motive, it would seek to minimise the risk of having to pay senior noteholders under its guarantee so would wish to ensure that senior noteholders were paid first. Thereafter, there would be no incentive not to accept the best deal overall. Certainly, Mann J recognised an alignment of interests between the senior noteholders and MBIA when he stated as follows:

> 'What has happened is that various powers have been surrendered to MBIA for the time being, but that was done as a matter of commerce. The position would look less unusual if the directions were to come from the G Noteholders (who are likely to have similar interests to MBIA), but would still be in substance the same.'

If this were the case, it is difficult to see why in practical terms, this financial arrangement could be said to have put the integrity of equity at stake.

Equitable limitations on exercise of powers by MBIA

To assess the criticisms of the *Citibank* judgment, it is necessary to consider what protections would be available to junior noteholders if MBIA had acted irrationally or with an ulterior motive so that junior noteholders were actively prejudiced.

[69] *Bank of New York v Montana Board of Investments* [2008] EWHC 1594.
[70] Even if priorities are set out in trust deeds, factual complexities, complex forms of arrangements and differing interpretations of contractual terms can give rise to divergent opinions as to the proper course of action. For a general discussion of these sorts of issues and of the practical and social implications of trustee decision-making, see Schwarz above n 8, especially at 1875.
[71] See the default power in s 15 of the Trustee Act 1925 (UK) and Thomas and Hudson, *The Law of Trusts* (2nd ed, OUP, Oxford, 2010) at [14.86].
[72] *Snell's Equity*, above n 51, at [28-026].

The equitable limitations on exercise of a non-fiduciary power depend on whether the power is classified as a 'limited' or a 'beneficial' power. Classification depends on the wording and purpose of the power.

A limited power

A power will be 'limited' if it is conferred for the benefit of one or more of the beneficiaries.[73] Equitable limitations on limited powers include that the donee must act within the scope of the power[74] and cannot exercise the power for an improper purpose.[75] Under this doctrine (also called 'fraud on a power'), the donee must exercise the power *bona fide* in favour of the objects of the power and in furtherance of the purpose for which it was conferred. This doctrine has been described as a 'slippery concept' because it requires an evaluation of the motive, intention and purpose.[76] The effect of the doctrine was famously summarised by Lord Parker as *Vatcher v Paull*[77] as follows:

> The term fraud in connection with frauds on a power does not necessarily denote any conduct on the part of the appointor amounting to fraud in the common law meaning of the term, or any conduct which could properly be termed dishonest or immoral. It merely means that the power has been exercised for a purpose, or with an intention, beyond the scope of, or not justified by, the instrument creating the power.

This doctrine operates to prohibit irrational conduct, being conduct that 'could be said to be irrational, perverse or irrelevant to any sensible expectation of the settlor'.[78] It would also be likely to catch the exercise of powers for an ulterior motive such as to thwart the interests of junior noteholders and benefit the donee. In considering the application of this doctrine, the court would need to ascertain the true purpose of power and it would interpret the trust deed in the light of admissible factual context so as to give effect to its 'objective commercial purpose'.[79] The mere fact that a donee might obtain some incidental benefit from the exercise of the power would not invalidate the exercise of the power. The court would also need to determine the donee's purpose for exercising the power. Where a donee has more than one motive or purpose, one of which is proper and one of which is fraudulent (because, for example, it benefits the donee), the validity of the exercise of the power is tested by application of a 'but for' test. The question is whether, but for the improper purpose, the power would have been exercised anyway.[80] In evaluating the purpose of the donee in exercising the power, the court would consider extrinsic evidence which revealed the donee's state of mind.[81]

An argument (although, somewhat strained) could be made that the MBIA's powers of direction were limited powers, the primary purpose being to benefit senior noteholders by giving priority to their interests where necessary, with the power to be exercised only in the interests of senior noteholders and after that, junior noteholders. The references in clause 10.4 of the deed to the 'interests of the Noteholders' and to MBIA assuming no duties to noteholders would have to be construed as referring to all noteholders as a class, rather than to any particular group of noteholders. It would be necessary

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[73] *Lewin on Trusts*, above n 30, at [29-017] and [29-130].
[74] For a recent example, see *Roadchef (Employee Benefits Trustees) Ltd v Hill* [2014] EWHC 109 [*Roadchef*].
[75] Also known as the equitable doctrine of fraud on a power. For a definition of fraud on a power see *Vatcher v Paull* [1915] AC 372 at 378 [*Vatcher*] and *Arakella v Paton* [2004] NSWSC 13 at [119] per Austin J. See also *Thomas on Powers,* above n 52, at [9.115] and *Lewin on Trusts* above n 30, at [29-289].
[76] *Thomas on Powers*, above n 52, at [9.01].
[77] *Vatcher,* above n 75, at 378.
[78] *Re Manisty's Settlement* [1974] Ch 17 at 26.
[79] *BNY Mellon Corporate Trustee Services Ltd v LBG Capital No 1plc* [2015] EWHC 1560 at [36] (currently on appeal to the English Court of Appeal).
[80] *Lewin on Trusts*, above n 30, at [29-301] and *Roadchef* above n 74, at [130].
[81] At [29-303].

too to construe these words as intended only to creating a non-fiduciary power, rather than a non-fiduciary, *beneficial* power.

If part of MBIA's motive in exercising the power was to obtain a release from its guarantee, it would be necessary to show that MBIA would have exercised the power in any event.

A beneficial power

Probably, the more natural explanation for MBIA having been granted the powers of direction would have been so that it could control and minimise its own financial risk under the guarantee. If the purpose of the power was to benefit MBIA in this way, the power would be non-fiduciary and 'beneficial'. Beneficial powers are powers that may be exercised in any way for the benefit or purposes of the donee.[82] As mentioned above, *Lord Vestey's Executors* requires 'the most direct and express words' in order to create a beneficial power capable of benefitting the donee. It is arguable that the terms of clause 10.4 satisfy that requirement, particularly given the reference to MBIA not having to regard the interests of the noteholders.

There is some debate as to the ambit of the limitations on the exercise of beneficial powers.[83] It must be the case, that exercise is limited at least to the scope of the actual power as drafted. Other than that, traditionally, it has been said that holders of beneficial powers 'owe no duties of any kind'[84] and that beneficial powers may be exercised 'in any way for the benefit or purposes of the donee, as he wishes and without restriction'.[85] It is well-established that beneficial powers are, generally, not subject to the improper purposes doctrine.[86] It has, however, been suggested that a donee must be subject to a duty to act in good faith or not in bad faith or *mala fides*[87] and to exercise the power honestly and properly, although the precise content and application of these duties remains unclear. The phrase 'good faith' is capable of a number of different meaning and envelopes concepts not only of honestly but of capriciousness, arbitrariness, reasonableness and absence of improper purpose.[88]

With the increased use of trusts in a commercial context, there is jurisprudence developing to increase the equitable limitations of beneficial powers. The essential method by which equity operates is to refine and improve principles on a case by case basis.[89] This practice enables subtle developments to be made where necessary, which is appropriate given that property rights will often be affected. Development is focussed on ascertaining rules which would enable a donee to exercise a beneficial power for its own benefit, but at the same time, would restrict the exercise where it is unfair in the context of the whole financial arrangement or the legitimate expectations of the parties. It has principally occurred in relation to occupational pension schemes.

Under pension trust deeds, where an employer holds a non-fiduciary beneficial power, a duty to act in good faith or, as it is sometimes known, a duty of trust and confidence, has been recognised.[90] This duty arises from the implied duty owed by employers under employment contracts not, without

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[82] At [29-016], [29-130] and [29-289].

[83] At [29-130] which states that holders of beneficial powers owe 'no duties of any kind'. *Snell's Equity*, above n 49, at [10-019] suggests that holders of non-fiduciary powers hold duties to exercise powers in good faith (meaning that good faith qualifies the exercise), because 'it is inconceivable that anyone should be allowed by law to act in bad faith'.

[84] *Lewin on Trusts*, above n 30, at [29-130].

[85] At [29-016].

[86] *Re Triffit's Settlement* [1958] Ch 852 at 963-864. *Lewin on Trusts*, above n 30 at [29-013]. See also *Thomas on Powers*, above n 52, at [9.115] and [10.145].

[87] See *Snell's Equity*, above n 51, at [10-019] which cites *Gisborne v Gisborne* (1877) 2 App Cas 300 at 305; see also Re Hart, above n 48 and *Thomas on Powers*, above n 52, at [10.145].

[88] See, for example, *Vodafone Pacific Ltd v Mobile Innovations Ltd* [2004] NSWCA 15 at [193].

[89] See *Re Hallett's Estate* (1880) 13 Ch D 696 at 710 per Jessel MR.

[90] *Imperial Group Pension Trust Ltd v Imperial Tobacco Ltd* [1991] 1 WLR 589 [*Imperial*].

reasonable and proper cause, to conduct themselves in a manner likely to destroy or seriously damage the relationship of trust and confidence between employer and employee. In exercising a power in a pension trust deed, the employer can have regard to its own commercial interests, but subject to the implied duty under the employment contract. In effect, this means that while an employer can consider its own interests in deciding how to exercise the power, it cannot act for an ulterior motive which would adversely affect the scheme members or limit their benefits.[91] As noted in *Thomas on Powers*, the *Imperial* duty of good faith, is markedly similar to the improper purposes doctrine, but that doctrine was not argued in the case.[92]

In other commercial contexts, legal controls on the operation of powers are often utilised and have been since the 1800s.[93] Recent examples include the following:

- In *Assénagon Asset Management SA v Irish Bank Resolution Corporation Ltd,*[94] Briggs J applied the 'well-recognised constraint' on the exercise of a power by a majority to bind a minority to act *bona fide* in the interests of the class of bondholders as a whole and not in an oppressive or unfair manner to a minority, and held that the operation of an 'exit consent' in a bond issue was an abusive exercise of powers by the majority. This case involved an attempt to deal with the problems arising from the liquidity crisis faced by Anglo-Irish Bank Corporation Ltd. The Irish Government, which has rescued the Bank, was seeking to force subordinated bondholders to 'burden share'.[95] A plan was put in place for restructuring subordinated debt. Under the plan, bondholders would be able to exchange current notes for new notes in the exchange rate of 0.20. To achieve this, bondholders were invited to offer their bonds for exchange but on terms that bound them to vote at a bondholders' meeting for a resolution to amend the bonds in terms that substantially destroyed the value of the bonds. The bonds would then become redeemable upon a payment of €0.01 per €1000. Bondholders who did not offer their bonds for exchange would lose the ability to acquire new notes. Briggs J held that the exit consent procedure in that case was 'quite simply, a coercive threat … nothing more or less. Its only function is the intimidation of a potential minority, based upon the fear of any individual member of the class that, by rejecting the exchange and voting against the resolution, he (or it) will be left out in the cold'.[96]

- In *Redwood Masterfund Ltd v TD Bank Europe Ltd,*[97] a small minority of lenders in a syndicated loan facility, who has acquired their interests in the secondary market, challenged the validity of a purported variation by a two-thirds majority of the facility on the basis that it discriminated against them. The loan facility comprised three tranches, of which tranche A was wholly undrawn and the other two tranches were almost fully drawn. The claimants' interests were in tranche A only. The effect of the changes meant that the debtor could draw on tranche A and those drawings could be used to prepay drawings under tranche B. Rimer J considered whether the majority had acted in good faith and whether a reasonable person would see the restructuring as being in the interests of all the lenders. He answered both questions positively.

[91] For detailed discussion see *Lewin on Trusts*, above n 30, at [29-049] - [29-050] and *Thomas on Powers*, above n 52, at [10.195] – [10.210].
[92] *Thomas on Powers*, above n 52, at [10.199].
[93] See for example *Dallman v King* (1837) 4 Bing NC 105, 109 and *Thomas on Powers*, above n 52, at [10.193].
[94] *Assénagon,* above n 37.
[95] At [27].
[96] At [84].
[97] *Redwood Masterfund Ltd v TD Bank Europe Ltd* [2006] 1 BCLC 149; [2002] EWHC 2703 [*Redwood*].

- *Paragon Finance plc v Nash; Paragon Finance plc v Staunton.*[98] Here, Paragon Finance, as mortgagee, made loans to two borrowers. Both mortgages contained variable interest clauses and powers enabling the mortgagee to set interest rates. Paragon exercised the powers to increase rates and, around the same time, the borrowers got into financial difficulty. The borrowers asserted that the rate increases were exorbitant. The English Court of Appeal held that there were implied terms in each mortgage that the discretion to vary interest rates should not be exercised dishonestly, for an improper purpose, capriciously, arbitrarily or in a way that no reasonable mortgagee, acting reasonably, would do. As there was no evidence that the mortgagee was motivated by anything other than purely commercial considerations and no real prospect of the borrowers proving a breach of the implied terms, their defences and counterclaims were struck out.

The authors of *Snell's Equity* rely on the latter two cases as a basis for their thesis[99] that non-fiduciary powers must always be exercised in good faith and when that duty is applied to 'economic matters' the duty limits 'the breadth of legitimate decisions that can be taken, by requiring that the decision-maker does not intentionally or consciously harm the economic interests of the other party in the relevant relationship'.[100]

This proposition gives rise to some significant problems on application, principally because it likely in practice to prove to be far too blunt. If appears simply to comprise an improper purposes doctrine but, without the subtle rules that operate, within that doctrine, to allow valid exercises of powers even if donees have mixed motives.

Moreover, in the commercial world decisions often, and simply as a matter of course, benefit some parties and damage others. It is possible to envisage scenarios where a donee of a beneficial power wishes to exercise a power in its own commercial interests but knows with certainty that the exercise will harm another parties' economic interest. The facts of *Redwood* above might well be caught by this proposition. Deciding to amend a facility agreement so that an undrawn tranche may be utilised to prepay another fully drawn tranche, in circumstances where it has been necessary to restructure debt, is absolutely likely to harm the economic interests of a lender who holds interests in the undrawn tranche. Effectively, that lender is being placed in a position where it is being forced to lend to the debtor at the very time when the debtor is under financial pressure and may not survive, and it is being done to enable other lenders to be paid. If the proposition could be used to prevent this sort of restructuring (which, incidentally, Rimer J found permissible), then it would give a discontented lender (or, indeed, junior noteholders in a securitisation) enormous bargaining power which would be likely to distort negotiations and might prevent a sensible compromise. Short term detriment to some investors might be used to prevent a compromise bringing long-term benefits to the investors as a class or to a prioritised class.

In the financial markets, where fund-raising arrangements are highly complex with numerous participants and subtle allocations of risk and reward between them, the more sensible approach would be to allow equity to develop and refine principles on a case-by-case basis. If we wish to allow donees to exercise powers in their own interests (and that is a useful form of equitable obligation to adjust risk) then care needs to be taken before, arguably, unrefined limitations are put in place that

[98] *Paragon Finance plc v Nash; Paragon Finance plc v Staunton* [20002] All ER 249; [2001] EWCA Civ 1466.
[99] *Snell's Equity*, above n 51, at [10-019]. They refer to other similar cases not mentioned here.
[100] Above.

might be used to prevent donees using rights they bargained for and were allocated. However, we do need increased regulation with respect to the use of beneficial powers in financial arrangements.

In relation to MBIA's powers of direction, if MBIA had attempted to act irrationally, by say, directing Citibank to accept a compromise of payment of £1 in surrender of all the rights held in trust, or it acted in a similar way to the employer in *Imperial*, using a power to benefit itself, for its own ulterior motives unrelated to the repayment of senior noteholders and its release from the guarantee and to the detriment of the junior noteholders, it is likely that a court would prevent it by finding that the exercise of power was not exercised in good faith. If equity does not refine its principles to limit such behaviour, it is likely that this would prove a serious deterrent to investors and they might cease using this form of financial arrangement or, more likely, they would negotiate their own limits to the operation of beneficial powers within the transaction documentation.

Conclusion

Trusts are an essential device for the holding of property and, in modern times, their most important role is their use in financial markets. The flexibility of the trust device and the ability to combine trusts and powers enables us to adjust financial products and create new products as our economy evolves. Trusts' jurisprudence has developed over 700 years. During that long passage of time, equity's regulation of trusts has enabled the device to become and to remain an indispensable part of our domestic and commercial lives. That system remains in place. The regulation of powers in commercial trusts is an area where we need to take particular care. If we allow trustee's fiduciary duties to be reduced, by granting powers to third parties, to take account of negotiated positions in complex financial arrangements, we need to ensure that those powers are properly regulated. The developments in relation to pension trusts indicate that appropriate controls can be fashioned by our courts. There is no need for alarm. Equity's integrity is likely to remain intact.