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**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, "Trustee Exemption Clauses"

Financial Markets Law Committee  
c/o Bank of England  
Threadneedle Street  
London EC2R 8AH  
[www.fmlc.org](http://www.fmlc.org)

**FINANCIAL MARKETS LAW COMMITTEE**  
**ISSUE 62 - TRUSTEE EXEMPTION CLAUSES**  
**WORKING GROUP MEMBERS**

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Secretary: Nicola Heys, Slaughter and May

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Daniel Schaffer, Freshfields Bruckhaus Deringer

Paul Stannard, Travers Smith Braithwaite

Martin Thomas, Financial Market Law Committee

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### **Chapter 1 - Overview and recommendation**

This chapter provides an overview of the role of the trustee in the wholesale financial markets, a brief analysis of section 192 Companies Act 1985, which currently governs the exemption of liability in trust deeds for issues of debentures, and suggests a possible solution to the issue raised by the Law Commission's proposals, in the form of a "ring-fence" for the City.

### **Chapter 2 - Core financial transactions in which trustees are involved**

This chapter gives an outline of the variety of transactions in which trusts are used in the financial markets and a brief description of the role of the trustee in each case. It also includes brief examples of other commercial areas in which the trust structure is favoured, and highlights the flexibility and innovation for which this structure allows.

### **Chapter 3 - The trustee's role in an international bond issue - from cradle to grave**

This chapter highlights the decisions made by the trustee throughout the life of an international bond issue and details particular aspects, including why a trustee is appointed and what steps would be taken by the trustee on the occurrence of an event of default. Further, it analyses what impact the proposed test of reasonableness would have on the trustee's use of discretion and its making proactive decisions on behalf of the noteholders.

### **Chapter 4 - Commentary on customary exculpatory provisions in an international bond issue trust deed**

This chapter outlines the standard clauses which are commonly found in trust documentation. It lists exoneration clauses and gives explanation and analysis of their meaning, what their effect is, and the reasons why the Law Commission's proposals would have such a negative impact.

## OVERVIEW AND RECOMMENDATION

### **The nature and importance of the trust**

This paper is about the continuing importance of the role of the trustee in the City and the expected impact the Law Commission's proposals would have on that role.

The main concern of the FMLC is that the Law Commission has not appreciated the importance of trusts to the wholesale financial markets. 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. The differences between such commercial trusts and the traditional trust was recognised by Lord Browne-Wilkinson in the case of *Westdeutsche Landesbank Girozentrale v Islington LBC*,<sup>1</sup>

“...wise judges have often warned against the wholesale importation into commercial law of equitable principles inconsistent with the certainty and speed which are essential requirements for the orderly conduct of business affairs.”

Over time, the commercial trust has developed its own rules, which are recognised and accepted by all those who are party to it. Such trusts are negotiated by expert parties and their provisions scrutinised. The trustee acts as an independent party playing a crucial bridging role between the parties in a wide range of corporate finance activities. These trustee relationships are in many ways closer in substance to contracts between sophisticated participants with the freedom to contract, than to a traditional trust relationship. The trust deed is thus a blend of contractual provisions and those which would be found in a traditional trust. The beneficiaries in this case are market professionals who are aware in advance of the risks attached and of the duties and powers of the trustee. Negotiation may not take place individually for each particular trust transaction, but market practice has built up over many years and in this way equilibrium has been reached between the parties involved. The Commission's proposals would have the effect of preventing mature parties from

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<sup>1</sup> *Westdeutsche Landesbank Girozentrale v Islington LBC* [1996] AC 669

choosing the terms on which they contract. In *Kelly v Cooper*,<sup>2</sup> Lord Browne-Wilkinson reiterated<sup>3</sup> that,

“...the existence of a basic contractual relationship has in many situations provided a foundation for the erection of a fiduciary relationship. In these situations, it is the contractual foundation which is all-important because it is the contract that regulates the basic rights and liabilities of the parties. The fiduciary relationship, if it is to exist at all, must accommodate itself to the terms of the contract so that it is consistent with, and conforms to them. The fiduciary relationship cannot be superimposed upon the contract in such a way as to alter the operation which the contract was intended to have according to its true construction.”

The FMLC fears that, if the Law Commission’s proposals are implemented in a form close to that in which they are outlined in the Consultation Paper, there is likely to be an extremely detrimental effect on the international markets in London. Trustees may become reluctant to exercise discretions or other rights provided for under the trust instrument for fear of incurring liability, or they may simply not be prepared to operate in the face of the uncertainty which will ensue if legislation is passed to allow the courts effectively to revisit the actions of the trustees with the benefit of hindsight.

Furthermore, restrictions on the power of a trustee to exclude liability may mean that the trust structure is discarded altogether in favour of other structures. In the context of the capital markets, for example, the alternative would be a fiscal agency. This system is employed primarily in civil law jurisdictions and requires the agent to act on behalf of the issuer, rather than the beneficiaries as a whole as the trust structure does. Such a system is not only less flexible than the trust structure, but is also not in keeping with the market’s general move towards collective action, an approach which was recommended in the Report of the G10 Working Group on Contractual Clauses, dated 26th September, 2002.

The proposed changes to the law would have a substantial effect on broader financial practice, and be damaging not only to the corporate sector in general, but also to London’s position as an international centre for corporate finance. This may in turn lead to significant losses of revenue for the City. As a large amount of the financial business based in London is international, there is no requirement for it to be governed by English law. English law is chosen as it is considered the most favourable, and could easily be discarded if this were no longer considered to be the case. It could be argued that the competitive position which English law occupies on

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<sup>2</sup> *Kelly v Cooper* [1993] AC 205

<sup>3</sup> Quoting Mason J in *Hospital Products International Pty Limited v US Surgical Corporation* (1984) 156 CLR 41

the international stage depends largely on the contractual certainty which agreements governed by English law currently enjoy.

In the longer term, it is likely that the considerable areas of financial business currently based in London and dependent on traditional English trust law may move their operations to less restrictive jurisdictions.

Under English law the trustee is able to exercise the discretions provided for in the trust deed, thus giving greater flexibility to deal with changes in the circumstances of the borrower or the commercial climate and avoiding unnecessary delay, expense and administrative complexity. The alternative of seeking investors' approval to these types of matters would be expensive, slow, unwieldy and more than likely impracticable.

As the trust is currently used in financial market structures in a wide variety of ways, as specifically outlined in Chapter 2, there is also concern that if the possibilities and flexibility afforded by the trust mechanism are diminished, so too will the ability of the financial markets to use English law to reflect, rather than inhibit, commercial innovation.

### **Section 192 Companies Act 1985**

Section 192 states that,

*“(1) Subject to this section, any provision contained -*

*(a) in a trust deed for the issue of debentures, or*

*(b) in any contract with the holders of debentures secured by trust deed,*

*is void in so far as it would have the effect of exempting a trustee of the deed from, or indemnifying him against, liability for breach of trust where he fails to show the degree of care and diligence required of him as a trustee, having regard to the provisions of the trust deed conferring on him any powers, authorities or discretions.”*

This provision<sup>4</sup> is based on the recommendation in 1945 of the Cohen Committee on Company Law Amendment.<sup>5</sup> The Committee recommended<sup>6</sup> that a general

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<sup>4</sup> Re-enacting what was originally s75(1) of the Companies Act 1947.

<sup>5</sup> Cmnd 6659

<sup>6</sup> At paragraph 64

exemption from, or indemnification against, liability should be prohibited, but that 'enabling' clauses (equating to the Law Commission's duty exclusion and extended power clauses) should be permitted. Section 192 itself applies only to issues of debt securities by UK companies but wording replicating its effect is included by market practice in most issues, irrespective of who the issuer is. The section thus extends far beyond the express confines of the types of trust deed to which the section applies, as well as ensuring that trustees do not have the wide-ranging liability exemptions the Consultation Paper speaks of. It is accordingly the opinion of the working group that, in relation to the wholesale financial markets, sufficient protection for beneficiaries (at least in relation to transactions in the securities markets) is already provided by section 192. However, the working group does accept that there may be an argument for extending the categories of transactions to which the statutory provisions apply.

The degree of care and diligence required, as referred to in the section, is higher for a professional or paid trustee than that which is otherwise expected, namely to act honestly and with the prudence of a reasonable man conducting his own affairs. The section puts debenture trustees in a similar position to directors and officers of companies as regards their liability for negligence.

The reference in section 192 to the trustee's "powers, authorities or discretions" is generally thought to exclude from the ban imposed by the section provisions which delimit the precise ambit of the trustee's duty in particular situations. These may take the form of provisions that the trustee is entitled to rely on the work or certificate of others, or that the trustee is not obliged to investigate, monitor or satisfy himself about particular matters. Such provisions are common in financial markets trust deeds (as set out in detail in Chapter 4). It is the principal concern of the FMLC that the Law Commission's proposals would bring such clauses within the purview of the court's power to disallow after the event, and thereby undermine the balance between the various parties' interests which has been established in a free market over many years.

## **Conclusion**

Implementation of the Law Commission's provisional proposals would have a number of unattractive consequences in the context of commercial trusts in general, and in the context of international bond issues in particular:

- Trustees would be less willing to exercise their discretionary powers, thereby reducing the benefits to issuers in appointing trustees.
- Trustees would face greater uncertainty as to whether their actions (both in normal monitoring and in enforcement) will subsequently be challenged. This may cause them either to charge higher fees, be less inclined to exercise discretions, or to leave the business altogether.

- The higher level of monitoring and the higher fees might dilute the attractiveness of London as a capital market.

Throughout this paper, the FMLC's concerns are illustrated by reference to the bond markets. However, it should be noted that this is merely by way of example, and the concerns apply across the whole spectrum of wholesale financial markets. The Law Commission suggests that insurance could be taken out by the trustee as an answer to some of the negative consequences. This is an unsatisfactory solution for a number of reasons. First, the possible liability to be covered by insurance would be vast in the context of the transactions under discussion. The amounts of the claims could be huge and the premium would therefore be out of all proportion with the fees earned by the trustee. The premiums would come out of fee income and this would inevitably lead to a narrowing of the market. Secondly, it is unlikely that the insurance market has the capacity for such cover: the amounts involved would be impossible for insurers to ascertain and therefore lead to difficulty in establishing appropriate premiums. The application of a reasonableness test to trustee exemption clauses would certainly add to the difficulty of obtaining sufficient insurance.

Even if the expense of the insurance could be passed on to the issuer, the situation would be unsatisfactory, as it does not take account of the damage to the reputation of a professional trustee of court proceedings for breach of trust (whether or not successful). Also no account is taken of the amount of time spent and disruption to the trustee's business which inevitably results from contesting a legal claim.

Above all, the Law Commission's proposal would lead to uncertainty, which is clearly undesirable from everyone's point of view. To take again the example of the bond markets, the present position, as discussed above, is that bond issue trust deeds governed by English Law invariably contain a provision replicating section 192. Trustees thus operate currently on the basis that negligence is tested after having defined the trustee's role by reference to the duty exclusion and extended power clauses. There is a level of certainty about the nature of the duties of the trustee which would be lost under the Law Commission's proposed regime.

Nor, in our view, would that loss of certainty be compensated for by an increase in the level of real protection for noteholders. Commercial trustees take their functions very seriously and put great store by their professional reputations. In practice, the damage to a trustee's reputation is generally seen as the most powerful sanction against dilatory or casual behaviour. In any event, the protective provisions are standard in all international bond issues, are disclosed in the offering circular, and are routinely accepted by purchasers of the bonds.

Consequently, we feel that the proposed changes will lead to greater uncertainty, with no real benefit in return, and the risk of loss of business to trustees and to the London financial markets generally.

## **Recommendation**

One solution that the FMLC would propose to the issues outlined in the Law Commission's paper is that of a "ring-fence" being created for appropriate business transactions from the effect of any legislation that is introduced as a result of the Consultation Paper. This could be either a complete exclusion from the proposed changes, or an extension of the application of section 192 to those transactions instead. Exemptions for capital markets transactions are already a familiar concept in English law, such as the exemptions contained in the Insolvency Act 2000 and the Enterprise Act 2002. The FMLC would be happy to discuss specific wording for the drafting of such a clause with the Law Commission at a later stage if so desired.

The following chapters discuss these issues in more detail, and highlight the reasons why the trust structure as currently employed has become fundamental to the financial markets and is too useful a structure to compromise. Chapters 3 and 4 focus on the international capital markets in order to be able to give specific examples, but, as already mentioned, the concerns illustrated there are equally applicable to other areas of the wholesale financial markets.

## CHAPTER 2

### CORE FINANCIAL TRANSACTIONS IN WHICH TRUSTEES ARE INVOLVED

#### CAPITAL MARKETS TRANSACTIONS

<b>Transaction</b>	<b>Role of Trustee</b>
<b>Unsecured International Bond/Medium Term Note Programme</b>	<b>Note Trustee</b> <ul style="list-style-type: none"><li>• holds the benefit of the payment obligation and other covenants on behalf of noteholders in parallel with the issuer's payment obligation to the noteholders</li><li>• responsible for passive monitoring of compliance with issuer's obligations</li><li>• has discretion to exercise powers on behalf of noteholders, including declaration of event of default, acceleration of notes, enforcement of noteholders' rights of recovery, agreeing waivers and amendments that are not prejudicial to noteholders, convening noteholder meetings and the substitution of obligors</li><li>• acts in accordance with instructions of noteholders</li><li>• noteholders may only enforce the note individually after trustee fails to do so</li></ul>
<b>Sovereign Bonds</b>	<b>Trustee</b> <ul style="list-style-type: none"><li>• as above</li><li>• encourages use of collective action provisions (as recommended by the IMF)</li></ul>
<b>Secured International Bond/Medium Term Note Programme</b>	<b>Note Trustee</b> <ul style="list-style-type: none"><li>• as above</li></ul> <b>Security Trustee</b> <ul style="list-style-type: none"><li>• holds the benefit of security for the noteholders</li><li>• enforces security following default and distributes</li></ul>

proceeds to noteholders

- acts in accordance with instructions of noteholders

**Asset-Backed  
International  
Bond/Medium Term  
Note  
Programme/Commercial  
Paper Programme  
(including  
securitisations,  
repackagings and  
CDOs)**

**Note Trustee**

- as above

**Security Trustee**

- as above and in addition, may hold the security not only for noteholders but also for other secured parties, such as derivative counterparty, credit enhancement provider or liquidity provider
- enforces security following default and distributes proceeds in accordance with priority of payments

**Share Trustee**

- holds the shares of the issuer-SPV on trust for secured creditors of the issuer-SPV
- may be required to transfer the shares to beneficiaries or another trustee on occurrence of an enforcement event

**Collateral Trustee**

- holds the benefit of security granted by an SPV on trust for secured creditors of the SPV (possibly through other collateral trustees or the security trustee)
- enforces security on behalf of secured creditors and distributes security in accordance with priority of payments
- acts in accordance with instructions of secured creditors

**Receivables Trustee/Master Trust Trustee**

- underlying assets are transferred to the receivables trustee or master trust trustee for the benefit of the originator and the issuer-SPV (for the master trust, one of a number of SPVs covering different transactions), in varying proportions as the transaction progresses

**Collective Investment  
Scheme (also known as**

**Trustee**

- holds assets of the collective investment scheme for the

<b>Unit Trust)</b>	benefit of investors, who have undivided participation of investment in the scheme
	<ul style="list-style-type: none"> <li>• assets of the trust are invested by a manager in accordance with the trust deed</li> <li>• follows the instructions of the manager, e.g. with regard to voting of securities held by the trust</li> <li>• has a duty to take reasonable care to ensure that the manager calculates issue and redemption prices correctly</li> </ul>
<b>Debenture Stock</b>	<b>Stockholder Trustee</b>
	<ul style="list-style-type: none"> <li>• holds security on behalf of the stockholders</li> <li>• holds the benefit of payment obligations and other issuer covenants on behalf of stockholders</li> <li>• takes day-to-day decisions on behalf of stockholders in limited circumstances</li> <li>• enforces security following default and distributes proceeds to stockholders</li> <li>• acts in accordance with instructions of secured creditors</li> </ul>
<b>Mortgage Debenture Stock</b>	<b>Stockholder Trustee</b>
	<ul style="list-style-type: none"> <li>• as above, where the security includes mortgages</li> <li>• holds title deeds to unregistered mortgaged property</li> <li>• handles any releases and substitutions of property, based on valuation, title and security issues</li> <li>• acts in accordance with instructions of secured creditors</li> </ul>
<b>Participation Certificate</b>	<b>Participation Trustee</b>
	<ul style="list-style-type: none"> <li>• holds trust property on behalf of beneficiaries and distributes it in accordance with the terms of issue</li> </ul>
<b>International Equity</b>	<b>Depositary Trustee</b>
	<ul style="list-style-type: none"> <li>• holds underlying equity shares on trust for the investors</li> <li>• issues certificates (known as “global depositary receipts”) to the investors, which are traded in the</li> </ul>

financial markets

- passes through dividends to the investors and exercises voting rights on the underlying equity shares in accordance with investors' directions

**High Yield bonds**  
(trust documentation often contains additional covenants)

**Trustee**

- generally takes a more active role than with investment grade bonds, due to the increased risk of default

**TRUSTEE ROLES WITHIN MARKET INFRASTRUCTURE**

<b>Transaction</b>	<b>Role of Trustee</b>
<b>CREST - Crest Depositary Interests</b>	<ul style="list-style-type: none"><li>• holds international securities under a Global Deed Poll for the benefit of holders in CREST of CDIs</li></ul>
<b>CREST – cross-border securities settlement</b>	<ul style="list-style-type: none"><li>• CREST (or another CSD) holds securities subject to transfer for benefit of seller and buyer during settlement process, to protect integrity of cross-border transactions.</li></ul>

## BANK MARKETS TRANSACTIONS

<b>Transaction</b>	<b>Role of Trustee</b>
<b>Secured loans</b>	<b>syndicated Security trustee</b> <ul style="list-style-type: none"> <li>• holds security over the assets of the debtor on behalf of the creditors</li> <li>• permits new syndicate members to participate in the lending and security without the need to re-charge the security</li> </ul>
<b>Project Finance</b>	<b>Security Trustee</b> <ul style="list-style-type: none"> <li>• holds security over a wide range of assets for the benefit of all the lenders, whose interests may vary</li> <li>• enforces covenants on behalf of the lenders</li> </ul> <b>Trustee</b> <ul style="list-style-type: none"> <li>• holds bank accounts into which project cashflows will be paid prior to their distribution</li> <li>• holds the benefit of covenants designed to protect the integrity of the security</li> <li>• responsible for monitoring the borrower's compliance with covenants</li> <li>• invests and directs cashflows as required by the parties and the project documentation</li> </ul>
<b>Private Initiative</b>	<b>Finance Trustee</b> <ul style="list-style-type: none"> <li>• is assignee of agreements which allow lenders time to arrange substitute providers of finance in the event of failure of particular aspects of financing arrangements</li> </ul>

## OTHER EXAMPLES OF COMMERCIAL TRUSTS

<b>Transaction</b>	<b>Role of Trustee</b>
<b>Dual listed corporate structures</b>	<b>Trustee</b> <ul style="list-style-type: none"> <li>• holds special voting shares in both companies through SPVs</li> <li>• votes on joint electoral resolutions, thus ensuring that votes cast by both shareholders count in determining whether resolutions are passed</li> <li>• holds the benefit of warranties</li> </ul>
<b>Joint Ventures</b>	<b>Trustee</b> <ul style="list-style-type: none"> <li>• holds shares or voting rights in the company, thus providing greater protection for minority shareholders</li> <li>• acts as a controlling director of the company in cases where competition law or banking regulation may prohibit others from holding control</li> </ul>
<b>Intercreditor agreements</b>	<b>Trustee</b> <ul style="list-style-type: none"> <li>• a subordinated lender holds sums received via a subordination agreement on insolvency on trust for senior lenders</li> <li>• ensures that the position of the senior lender is protected, and not defeated by insolvency legislation</li> </ul>
<b>Custody arrangements</b>	<b>Custodian</b> <ul style="list-style-type: none"> <li>• places, maintains and safeguards the trust assets</li> </ul>
<b>Special voting shares</b>	<b>Trustee</b> <ul style="list-style-type: none"> <li>• holds and exercises rights of shareholders through a special voting company ensuring equality of benefits for shareholders</li> </ul>
<b>Holdings of golden/special shares</b>	<b>Trustee</b> <ul style="list-style-type: none"> <li>• holds and exercises rights of the shareholder in order to stream the benefits from its rights to different</li> </ul>

beneficiaries

- can exercise negative control, as consent is required before specific changes are made to the ownership or structure of the company

**Escrow Arrangements**

**Security Trustee**

- holds shares (in the seller) to the order of the purchaser against satisfaction of warranty claims

**National and Euro Lottery**

**Security Trustee**

- holds funds on behalf of lottery winner

## CHAPTER 3

### THE TRUSTEE'S ROLE IN AN INTERNATIONAL BOND ISSUE - FROM CRADLE TO GRAVE

#### 1. Background

International bond issues originated in 1963 with an issue by Autostrade, the Italian motorway operator. They were originally referred to as "eurobonds", but that term is now becoming less common, because of the greater internationalisation of the markets and the potential for confusion with the euro. In the 40 years since the Autostrade issue the international bond markets have grown enormously; according to the Bank for International Settlements, for example, US\$2,100 billion of international bonds were issued in 2002. London has throughout been the dominant financial centre: according to Richard Roberts, one of the leading writers on capital markets, in 1998, London's share of the primary market (i.e. issuance) was 60% and its share of the secondary market (i.e. trading) was 75%.<sup>1</sup>

International bonds are issued as a way of raising finance for the issuer. In return for receiving the issue price, the issuer issues the bonds, which contain a promise to pay to the holders the sum borrowed on the maturity date, and in the meantime to pay interest on specified interest payment dates. The bonds are usually held in an international clearing system (such as Euroclear or Clearstream) and are freely transferable through the clearing systems. They are often, but by no means always, listed on a stock exchange. The issuers include sovereigns, supranational bodies, banks, and ordinary corporates that are considered sufficiently creditworthy, and the investors are predominantly institutional investors and other professionals.

In many issues, the issuer appoints a trustee to represent the holders. The decision whether to do so depends largely on whether the issuer considers the advantages of having a trustee described below to be sufficiently attractive. If a trustee is appointed, it is the representative of the holders, and owes its duties to them (although its fees and expenses are payable by the issuer). Its functions are primarily to monitor compliance by the issuer with its obligations and to take enforcement action on behalf of the holders where necessary. It also has certain discretions to agree modifications with the issuer, or to waive defaults, without reference to the holders.

The trustee's role described below is that for a standard, straightforward, unsecured bond issue.

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<sup>1</sup> Inside International Finance (1999), p120.

## 2. Why are trustees appointed?

In some cases, a trustee may be necessary, e.g. because of a listing requirement, or because of the need to hold security on behalf of the holders. In most cases, however, the decision is based on whether the advantages of having a trustee are sufficiently attractive. There are advantages both for the holders (therefore making the bonds easier to market) and for the issuer. Cost is not normally a significant factor, as the fees charged by trustees are usually minimal in the context of the overall expenses of an issue.

### *Advantages for the holders*

- The trustee is usually given certain rights to obtain information from the issuer and is therefore likely to be in a better position than the holders to monitor the issuer's compliance with covenants, to identify a breach, and to take appropriate action earlier rather than later.
- As the trustee rather than the holders is responsible for enforcement, enforcement proceedings are taken in one unified action on behalf of all the holders, and the legal and financial advice which the trustee obtains is for the benefit of all the holders. In fact, many trust deeds contain wording to prohibit individual holders from taking action to enforce rights against the issuer, unless the trustee, having been bound to act, fails to do so. This is also of benefit to the holders as it prevents individual holders from acting in ways contrary to the wishes of the majority. It is in this way that the trustee performs the role of a referee. More than simply playing a fiduciary role between the issuer and the holders, it also plays a role between the holders themselves.
- If there were no trustee structure and individual holders had to take action themselves, this would be less practicable due to the expense, the general disparity of the holders, the difficulties in organising them and, in the case of bearer bonds, the wish of many holders to remain anonymous.
- In the case of a restructuring, the trustee will often be involved in settling the form in which proposals are put to the noteholders. For instance, the circular would include wording to the effect that, whilst the trustee had no involvement in the negotiation of the commercial terms of the proposals, it has no objections to such proposals being put to the noteholders for their consideration. Trustees would be expected to satisfy themselves that the proposals are put correctly and with a clear explanation and are in a suitable state for noteholders to vote on them.

- Any moneys recovered by the trustee are distributed to all the holders *pro rata*, thereby avoiding the risk that some holders recover and others do not.
- The trustee may have a stronger negotiating position than individual holders in any discussions with the issuer, since it represents a larger amount of debt.

#### *Advantages for the issuer*

- The trustee's powers to agree to waivers and modifications without reference to the holders can be an important flexibility for the issuer, especially in long-term issues or issues with detailed covenants, since the alternative would be approval by a resolution at a meeting of the holders. Convening meetings of holders is a cumbersome and time-consuming process, usually requiring a 21 day notice period, and the issuer often has no way of negotiating with the holders or of knowing whether the resolution will be acceptable until the votes are cast at the meeting. Certain matters may have a higher quorum requirement than others, and the fact that a quorum is often not achieved at a first meeting adds to this difficulty, as the meeting will have to be adjourned, introducing a further notice period. If enforcement proceedings are taken against the issuer, it only has to defend one action, rather than a multiplicity of actions, (since, as mentioned earlier, many trust deeds contain wording prohibiting individual holders from taking action unless the trustee has previously failed to take action when bound to do so).
- The trustee is available to discuss any issues which may arise, regardless of whether or not these issues require prior noteholder approval. By drawing on the experience of the trustees, companies and their professional advisers may find it easier to formulate proposals in a way which are best put to noteholders, or in a way which may not require the approval of noteholders.
- Many events of default do not arise unless the trustee certifies that the event in question is in its opinion materially prejudicial to the interests of the holders. As the consequence of an event of default is acceleration of the issue (i.e. declaring the principal to be repayable immediately rather than on the maturity date), this is an important protection for an issuer. It protects the issuer against acceleration or enforcement by maverick holders, who, in an issue without a trustee, might take unreasonable opportunistic advantage of a technical default.
- The issuer can deal directly with the trustee rather than the noteholders in the reporting of compliance with covenants.

### **3. The trustee's role**

The three key elements of the trustee's role are: monitoring compliance by the issuer with its obligations; discretions to agree modifications, to waive defaults and to give other consents; and taking enforcement action where necessary. In each of these areas, the trustee has the benefit of a number of "boilerplate" protective provisions, as further outlined in Chapter 4, which give the trustee

confidence in taking decisions safely and without undue delay in potentially difficult circumstances. The provisions are in a standard form, and vary little from issue to issue.

Most of these provisions can be characterised as "duty exclusion" or "extended power" clauses. Accordingly, the provisional proposal in paragraph 4.97 of the Law Commission's consultation paper (i.e. allowing a court to strike out these clauses where it thought they were unreasonable) puts the certainty of these provisions in doubt.

The following is an examination of the potential impact of the Law Commission's proposal on each of the three key elements of the trustee's role in turn.

#### *Normal monitoring*

Most trust deeds contain duty exclusion clauses which permit the trustee to assume that the issuer is complying with its obligations and that there is no event of default, unless it has actual knowledge or express notice to the contrary. Clauses illustrating this are included at points 1.1.8 and 1.1.11 of Chapter 4. Until the trustee has such knowledge or notice, the normal practice of trustees in monitoring compliance by the issuer is to obtain from the issuer annually a directors' certificate that the issuer has complied with its obligations and to review the issuer's annual accounts and other documents sent out to its shareholders or creditors (all of which the issuer will have covenanted to supply to the trustee). In addition to this, the trustee, in most issues, will accept the responsibility to ensure that, at the date of issue, the terms of the bonds make sense and are workable. If the terms include financial covenants, such as a borrowing limit or a restriction on disposal of assets, the issuer will be obliged to provide annually either an auditors' report or a directors' report as to compliance with those covenants.

If the Law Commission's proposal is enacted, the duty exclusion clauses described above could be struck down by a court in certain cases. A trustee would thus be running the risk of being held to be negligent in not properly monitoring an issuer. It would also be faced with uncertainty as to what the required level of monitoring is in any particular case (and, indeed, the standard required could vary from issue to issue). Trustees may therefore feel that, in order to protect themselves from liability, they have to undertake a more strenuous level of monitoring (which would entail them having to charge significantly higher fees). The increased level of monitoring, coupled with the increase in fees, is likely to be unattractive to issuers. The result therefore could be a significant loss of business to trustees (through issuers either choosing not to appoint trustees or raising their finance in the US capital markets instead of through London). Alternatively, some trustees may be forced to decide that the level of risk and uncertainty is too great, and therefore to pull out of the business altogether.

*Modifications, waivers and other consents*

Modifications or waivers may become necessary or desirable during the life of an issue as a result of accounting changes, changes in the regulatory regime to which the issuer is subject, the issuer wishing to change the nature or focus of its business, or merely because the covenants have turned out to be unduly onerous in practice. There may well be a large number of holders, and the clearing systems will not usually divulge their identities, and so it is often impracticable to negotiate with the holders. In the absence of a trustee, the best that the issuer can do is convene a meeting of the holders, put a resolution to the meeting, and see whether it gets passed or not. For minor or technical changes, this can prove to be unnecessarily cumbersome and expensive. In addition, with the increasing presence of aggressive debt traders the issuer may well be forced to offer some incentive payment to get the resolution passed.

A typical international bond issue permits the trustee to waive past defaults, or to authorise future potential defaults, which in its opinion are not materially prejudicial to the interests of the holders. It also permits the trustee to agree to modifications of the terms which in its opinion are not materially prejudicial to the holders' interests, are of a formal, minor or technical nature or correct a manifest or proven error. In addition, some significant matters may require the consent of the trustee before they can be effected by the issuer. Examples of such matters are the disposal of a substantial part of the issuer's assets or, in secured issues, consent to the release or substitution of security.

A trustee asked to approve a modification or waiver, or to give consent, will usually take advice from its legal and financial advisers, as well as receiving a directors' certificate from the issuer itself. This should all give it a high degree of comfort that the decision to approve is a reasonable one which is not negligent. However, it also gains considerable comfort from the duty exclusion and extended power clauses in the trust deed protecting it from liability if it has taken professional advice and received a directors' certificate. These typically state that the trustee may act on the advice of lawyers, bankers and other experts and, so long as it is acting in good faith, will not be liable for any loss resulting from doing so; and that the trustee may call for a directors' certificate from the issuer as to any fact or the expediency of any act, and will not be responsible for any liability caused by acting on such a certificate. Examples of such clauses are given at points 1.1.2 and 1.1.7 of Chapter 4.

No reputable trustee would rely on these provisions where it was felt that it was not proper to do so, but there is no doubt that they give the trustee an added measure of confidence to take decisions safely and without undue delay in potentially difficult circumstances, in a way which meets the interests of both the issuer and the holders.

Under the Law Commission's proposed regime, these provisions could be struck down. There is a concern that any uncertainty surrounding the results of a trustee's actions would be likely to produce "defensive" trusteeship, whereby the trustee acts to avoid its own liability rather than in the best interests of the beneficiaries. Consequently, trustees would be much less likely to exercise their

discretionary powers other than in situations which were totally straightforward (which in practice, are rare). This is undesirable from both an issuer's and an investor's viewpoint, as it would lead to a proliferation of meetings of holders and the uncertainty, delay and expense which that would entail. This would result in one of the major advantages of appointing a trustee being lost, with a corresponding loss of business to trustees.

### *Enforcement*

The role of a trustee in relation to enforcement can be divided into four main stages: investigating whether there has been a breach or event of default; deciding whether to certify material prejudice; deciding whether to accelerate the maturity of the issue; and taking enforcement proceedings for repayment.

- *Investigating breaches and events of default.* As seen earlier, the 'normal monitoring' position (i.e. the trustee being entitled to rely on directors' certificates and to assume that there has been no breach or event of default) ceases once the trustee has actual knowledge or express notice of a breach or event of default. In that event, the trustee would clearly be obliged to make detailed enquiries of the issuer: but should it, for example, appoint investigating accountants? The costs of doing so could be considerable; but if the issuer is in financial trouble there will clearly be a risk that the trustee may not be able to recover the costs and will thus be significantly out-of-pocket.

A typical international bond issue permits the trustee to hold off taking action unless it has been indemnified by or on behalf of the holders to its satisfaction against the resultant costs and liabilities. Clauses illustrating this are included at points 1.2.3 and 1.3.2 of Chapter 4. Implementation of the Law Commission's proposals would mean that such provisions might be struck down, depending on the circumstances. Trustees would then be faced with uncertainty as to whether and to what extent, in any given case, they are required to incur expenses without any assurance of whether they will be reimbursed. This uncertainty and the risk of liability could therefore lead to trustees either having to raise their fees significantly (making issuers less likely to appoint them) or quitting this area of business.

- *Certifying material prejudice.* As already mentioned, many events of default do not arise unless the trustee has certified that, in its opinion, the event in question is materially prejudicial to the holders' interests. In deciding whether to certify, the trustee will often take legal and financial advice. However, it will also rely on the protective provisions described earlier: that it need not take action (including incurring expenses) unless indemnified to its satisfaction by or on behalf of the holders; and that it may rely on the advice it receives. If these provisions are capable of being struck down, trustees again could find that it is not clear to what extent they are required to incur the expense of legal and financial advice without an assurance of reimbursement, and would lose an important

element of comfort that they have made the right decision as to whether to certify or not.

- *Acceleration.* The consequence of an event of default is that it gives the trustee the right to accelerate the issue (i.e. declare that the principal is repayable immediately rather than on the maturity date). A typical international bond issue provides that the trustee may accelerate at its discretion, but is not obliged to do so unless it is directed by a specified percentage (or a resolution) of the holders and is indemnified to its satisfaction against costs and liabilities (i.e. a duty exclusion clause).

The decision as to whether to accelerate is often straightforward: but if a workout is in progress or being contemplated, for example, it may be more finely balanced. There may also be a risk (particularly in the US) that acceleration could give rise to some form of 'lender liability' to the issuer or to other creditors. In these circumstances, the trustee will usually seek directions (and an indemnity) from the holders, a process which obviously takes time.

If the duty exclusion clause were capable of being struck down, the trustee could find itself in a very invidious position, where accelerating could expose it to liability to the holders or to other creditors for prejudicing a successful workout, and not accelerating could expose it to liability to the holders for undue delay.

- *Enforcement proceedings.* As with other aspects of the enforcement process, the trustee would normally rely on the standard protective provisions described earlier that permit it to hold off incurring the expense of enforcement proceedings without an appropriate indemnity from the holders, and to rely on the legal advice it receives. If these provisions were capable of being struck down, the trustee again would face uncertainty as to what was required of it, a greater risk of liability, and the possibility that it has to incur expenses for which it does not get reimbursed.

## CHAPTER 4

### COMMENTARY ON CUSTOMARY EXCULPATORY PROVISIONS IN AN INTERNATIONAL BOND ISSUE TRUST DEED

#### 1. TERMS OF APPOINTMENT

By way of supplement to the Trustee Acts, it is expressly declared as follows:

##### 1.1 Reliance on Information

1.1.1 *Advice:* The Trustee may in relation to this Trust Deed act on the opinion or advice of or a certificate or any information obtained from any lawyer, banker, valuer, surveyor, broker, auctioneer, accountant or other expert (whether obtained by the Trustee, the Issuer, the Guarantor, any Subsidiary or any Agent) and which advice or opinion may be provided on such terms (including as to limitations on liability) as the Trustee may consider in its sole discretion to be consistent with prevailing market practice with regard to advice or opinions of that nature and shall not be responsible for any Liability occasioned by so acting; any such opinion, advice, certificate or information may be sent or obtained by letter, telegram, telex, cablegram or facsimile transmission and the Trustee shall not be liable for acting on any opinion, advice, certificate or information purporting to be so conveyed although the same shall contain some error or shall not be authentic;

*It is common practice for trustees of international bond issues to rely on the advice or opinions of various types of expert when exercising their powers and discretions. The advice or opinion may be obtained from an expert appointed by the trustee or from an expert appointed by the borrower or a guarantor. For example if the borrower has been involved in a re-organisation this may raise the question of whether an event of default has occurred. If the borrower is able to produce a legal opinion from reputable legal advisers that the reorganisation falls within a permitted exception, the trustee may be willing to rely on that opinion. In secured issues the borrower may be required to maintain security having a specified value. It would be normal practice for the trustee to rely on a valuation certificate from independent valuers appointed by the borrower in satisfying itself that the valuation criteria have been met.*

*It has become the practice of some experts (in particular accountants) to seek to limit their liability when accepting appointments and the clause permits the trustee to accept such limitations since it may otherwise be unable to obtain the advice which is being sought.*

*These provisions make clear that the trustee will not be exposed to liability from relying on such types of opinions and advice.*

*Section 61, Trustee Act 1925 gives the court the power to relieve a Trustee from personal liability for any breach of trust where it appears that the trustee has acted honestly and reasonably. This clause is consistent with this.*

- 1.1.2 *Certificate of directors or Authorised Signatories:* the Trustee may call for and shall be at liberty to accept a certificate signed by two directors and/or two Authorised Signatories of the Issuer or the Guarantor or other person duly authorised on their behalf as to any fact or matter *prima facie* within the knowledge of the Issuer or the Guarantor, as the case may be, as sufficient evidence thereof and a like certificate to the effect that any particular dealing, transaction or step or thing is, in the opinion of the person so certifying, expedient as sufficient evidence that it is expedient and the Trustee shall not be bound in any such case to call for further evidence or be responsible for any Liability that may be occasioned by its failing so to do;

*If trustees have any concerns as to whether there has been a breach of covenant on the part of a borrower or guarantor or whether an event of default has occurred, it is common practice to seek confirmation from the borrower/guarantor that such is not the case. The only alternative would often be for the trustee to appoint a firm of accountants or other experts to undertake an independent investigation. Such an investigation would often be extremely costly as well as time consuming and it not would be reasonable to expect the trustee to bear the expense of the investigation from its own resources. Requesting such certificates is frequently the only way in which trustees can persuade borrowers/guarantors to respond to enquiries. They also provide a convenient mechanism to back up information which has been supplied in relation to a request for a consent or waiver being sought from a trustee. It is probable that if trustees were unable to rely on such certificates that they would be less flexible and the advantages of having a trustee to represent the interests of noteholders would be frustrated.*

- 1.1.3 *Certificate of Auditors:* a certificate of the Auditors that in their opinion a Subsidiary is or is not or was or was not at any particular time or during any particular period a Principal Subsidiary shall, in the absence of manifest error, be conclusive and binding on the Issuer, the Guarantor, the Trustee and all Noteholders;

*Events of default and covenants, such as negative pledges, are frequently made to apply to the principal or major subsidiaries of the borrower or guarantor. The relevant subsidiaries will be defined by reference to the percentage of a group's profits, net or gross assets or turnover. It would not normally be possible for a determination to be made as to whether a particular subsidiary fell within the defined criteria from the group's audited accounts. It is therefore standard practice to provide that an auditor's certificate which specifies which companies*

*fall within the definition can be relied upon by the trustee, the borrower being required to procure the provision of such a certificate on an annual basis.*

- 1.1.4 *Resolution or direction of Noteholders:* the Trustee shall not be responsible for acting upon any resolution purporting to be a Written Resolution or to have been passed at any meeting of the Noteholders in respect whereof minutes have been made and signed or a direction of a specified percentage of Noteholders, even though it may subsequently be found that there was some defect in the constitution of the meeting or the passing of the resolution or the making of the directions or that for any reason the resolution purporting to be a Written Resolution or to have been passed at any Meeting or the making of the directions was not valid or binding upon the Noteholders;

*This provision is self-explanatory. Trustees will need to rely on the validity of resolutions purporting to have been passed by noteholders in discharging their duties; for example a resolution changing the terms of the bonds or containing a waiver or consent. It is not the role of a trustee of an international bond issue to guarantee that all necessary formalities required to be fulfilled for a resolution to be validly passed have been fulfilled.*

- 1.1.5 *Reliance on certification of clearing system:* the Trustee may call for and shall be at liberty to accept and place full reliance on as sufficient evidence thereof and shall not be liable to the Issuer, the Guarantor or any Noteholder by reason only of either having accepted as valid or not having rejected an original certificate or letter of confirmation purporting to be signed on behalf of Euroclear or Clearstream, Luxembourg or any other relevant clearing system to the effect that at any particular time or throughout any particular period any particular person is, was or will be shown in its records as having a particular nominal amount of Notes credited to his securities account;

*Most notes are now represented by a single global note held by a depositary on behalf of recognised clearing systems which maintain records of the underlying holders of the notes recorded in the books of the clearing systems. The records of such clearing systems are not open to public inspection and a trustee must therefore be able to rely on certifications provided by such clearing systems. A trustee should not be exposed to liability if such a certification proved to be false or inaccurate.*

- 1.1.6 *Trustee not responsible for investigations:* the Trustee shall not be responsible for, or for investigating any matter which is the subject of, any recital, statement, representation, warranty or covenant of any person contained in this Trust Deed, the Notes, or any other agreement or document relating to the transactions herein or therein contemplated or for the execution, legality, effectiveness, adequacy, genuineness, validity, enforceability or admissibility in evidence thereof;

*The terms of an international bond issue will be negotiated by the investment bank which arranges the issue and it will be that investment bank and its legal advisers who document the issue and undertake all relevant due diligence. The trust related to the issue only comes into being at the time the notes are issued. The provisions of this clause therefore merely reflect reality and market expectations. If for some reason circumstances are not such as they are described in the documentation or the documentation is in some way defective a trustee would not be prepared to accept responsibility for the discrepancy. If a prospective trustee were to have to undertake independent due diligence the cost of so doing would be unacceptable to the market.*

- 1.1.7 *No Liability as a result of the delivery of a certificate:* the Trustee shall have no Liability whatsoever for any loss, cost, damages or expenses directly or indirectly suffered or incurred by the Issuer, any Noteholder, Couponholder or any other person as a result of any determination formed by it pursuant to Condition [ ] (*Events of Default*), in good faith, as to whether or not the occurrence of any circumstances referred to in that Condition is capable of remedy and/or materially prejudicial to the interests of Noteholders.

*It is common practice to provide that certain events will not constitute events of default (enabling the notes to be declared immediately due and repayable) unless the trustee has certified that in its opinion the occurrence of the relevant event is materially prejudicial to the noteholders' interests. Such a requirement is commonly insisted upon by borrowers to ensure that a noteholder or group of noteholders cannot force an acceleration of the notes by reason of a technical breach which will have no adverse impact on the ability of the borrower to meet its financial obligations under the notes. For example in a contested takeover a bidder may acquire notes for this very purpose with a view to weakening the position of the borrower target. It is even possible that a competitor may try to use this as a way of putting the borrower out of business. If trustees are to accept these provisions then they require protection against the consequences of exercising the discretions conferred on them.*

- 1.1.8 *No obligation to monitor:* the Trustee shall be under no obligation to monitor or supervise the functions of any other person under the Notes or any other agreement or document relating to the transactions herein or therein contemplated and shall be entitled, in the absence of actual knowledge of a breach of obligation, to assume that each such person is properly performing and complying with its obligations;

*Trustees are not investigating accountants or financial analysts nor is their remuneration such as to justify the expenditure of employing people to scrutinise the financial press for any information relevant to borrowers or guarantors for whose note issues they act as trustee. It is therefore appropriate that they should*

*be entitled to assume that borrowers and guarantors and any other entities which are involved in a transaction are performing their obligations. The market does not expect that trustees should do otherwise. Rather, the trustee will rely on certifications from borrowers and guarantors that they are in compliance with their obligations under the notes on both a regular basis and in special circumstances, an ad hoc basis. In more structured transactions, such as securitisations, there are many parties carrying out various functions such as servicer and cash manager and trustees are not expected to have any responsibility for ensuring that such entities are carrying out their respective responsibilities and functions.*

1.1.9 *Notes held by the Issuer:* in the absence of knowledge or express notice to the contrary, the Trustee may assume without enquiry (other than requesting a certificate of the Issuer under sub-clause • (*Notes held by Issuer and Guarantor*)), that no Notes are for the time being held by or for the benefit of the Issuer or the Guarantor or their Subsidiaries;

*It is customary for notes which are owned or held on behalf of borrowers or guarantors or companies connected with them to be disenfranchised for voting purposes. There is no way that a trustee can verify whether any notes are so held. It is therefore common practice to allow a trustee to assume no notes are so held in the absence of knowledge to the contrary.*

1.1.10 *Entry on the Register:* the Trustee shall not be liable to the Issuer, the Guarantor or any Noteholder by reason of having accepted as valid or not having rejected any entry on the Register later found to be forged or not authentic and can assume for all purposes in relation hereto that any entry on the Register is correct;

*This clause is only relevant to issues which are in registered form and merely provides that the trustee can rely on the accuracy of the Register without undertaking any independent verification.*

1.1.11 *Events of Default:* the Trustee shall not be bound to give notice to any person of the execution of this Trust Deed or to take any steps to ascertain whether any Event of Default or Potential Event of Default has happened and, until it shall have actual knowledge or express notice to the contrary, the Trustee shall be entitled to assume that no such Event of Default or Potential Event of Default has happened and that each of the Issuer and the Guarantor is observing and performing all the obligations on its part contained in the Notes and under this Trust Deed and no event has happened as a consequence of which any of the Notes may become repayable.

*In some jurisdictions a trust deed may require registration in a public register. This clause provides that it will not be the responsibility of the trustee to discharge the relevant requirement. More importantly it re-enforces the*

*provisions of clause 1.1.8 and the comments made in relation to that clause are equally applicable to this clause. That the trustee can assume all is in order in the absence of actual knowledge to the contrary is a cardinal point for the role of trustees in international bond issues. In the absence of such a provision on which total reliance can be placed it is unlikely any professional trustees would be prepared to undertake such trusteeships.*

- 1.1.12 *Interests of accountholders or participants:* so long as any Note is held by or on behalf of Euroclear or Clearstream, Luxembourg, in considering the interests of Noteholders, the Trustee may consider the interests (either individual or by category) of its accountholders or participants with entitlements to any such Note as if such accountholders or participants were the holder(s) thereof.

*As previously mentioned most notes are represented by a single global note which is held by a depositary on behalf of the clearing systems. The depositary is therefore technically the “noteholder” even though it has no economic interest in the notes. Again the clearing systems themselves have no economic interest in the notes. They simply record in their books the number of notes to be credited to the accounts of their customers. These account holders may themselves be acting as custodians for others. This clause recognises the realities of the situation and provides that the trustee, when exercising its powers and discretions, will consider the interests of the account holders rather than those of the depositary or clearing systems (although it does not address the fact that an ultimate beneficial owner may not itself be the accountholder). For example if an event has taken place, which on certification by the trustee that it would be materially prejudicial to noteholders’ interests, would constitute an event of default, the trustee should consider the interests of the accountholders and not those of the depositary. The depositary itself will not suffer any economic consequences from the event.*

## **1.2 Trustee's powers and duties**

- 1.2.1 *Trustee's determination:* The Trustee may determine whether or not a default in the performance or observance by the Issuer or the Guarantor of any obligation under the provisions of this Trust Deed or contained in the Notes is capable of remedy and/or materially prejudicial to the interests of the Noteholders and, if the Trustee shall certify that any such default is, in its opinion, not capable of remedy and/or materially prejudicial to the interests of the Noteholders, such certificate shall be conclusive and binding upon the Issuer, the Guarantor and the Noteholders;

*The purpose of this clause is to prevent individual noteholders attempting to take over the role of the trustee and ensure that, where the trustee has made a determination in relation to a set of circumstances, it is not open to others to*

*attempt to re-open the matter. It seeks to bind the borrower/guarantor in a similar manner.*

- 1.2.2 *Determination of questions:* the Trustee as between itself and the Noteholders shall have full power to determine all questions and doubts arising in relation to any of the provisions of this Trust Deed and every such determination, whether made upon a question actually raised or implied in the acts or proceedings of the Trustee, shall be conclusive and shall bind the Trustee and the Noteholders;

*This clause is intended to have a similar effect to the preceding clause.*

- 1.2.3 *Trustee's discretion:* the Trustee shall (save as expressly otherwise provided herein) as regards all the trusts, powers, authorities and discretions vested in it by this Trust Deed or by operation of law, have absolute and uncontrolled discretion as to the exercise or non-exercise thereof and the Trustee shall not be responsible for any Liability that may result from the exercise or non-exercise thereof but, whenever the Trustee is under the provisions of this Trust Deed bound to act at the request or direction of the Noteholders, the Trustee shall nevertheless not be so bound unless first indemnified and/or provided with security to its satisfaction against all actions, proceedings, claims and demands to which it may render itself liable and all costs, charges, damages, expenses and liabilities which it may incur by so doing.

*This clause addresses a number of different issues. Firstly, it seeks to exonerate the trustee from the consequences of the exercise of its powers and discretions, subject always to the provisions of section 192, as reflected in paragraph 1.5 below. Otherwise noteholders could undermine the role of the trustee and also seek to question the trustee's decisions with hindsight.*

*Secondly, the clause protects the trustee from being asked by noteholders to do things which would involve the trustee in expense or expose it to liabilities. See also commentary on clause 1.3.2 below.*

- 1.2.4 *Error of judgment:* the Trustee shall not be liable for any error of judgment made in good faith by any officer or employee of the Trustee assigned by the Trustee to administer its corporate trust matters;

*This clause seeks to relieve the trustee from the consequences of mistakes made by its employees provided they were acting in good faith. Its scope is however subject to the limitations of section 192 of the Companies Act or corresponding provisions incorporated in the trust deed (which is commented on below).*

- 1.2.5 *Agents:* the Trustee may, in the conduct of the trusts of this Trust Deed instead of acting personally, employ and pay an agent on any terms, whether or not a lawyer or other professional person, to transact or conduct, or concur in transacting or conducting, any business and to do

or concur in doing all acts required to be done by the Trustee (including the receipt and payment of money) and the Trustee shall not be responsible for any loss, liability, expense, demand, cost, claim or proceedings incurred by reason of the misconduct, omission or default on the part of any person appointed by it hereunder or be bound to supervise the proceedings or acts of any such person;

*Clauses such as this one have typically been incorporated in trust deeds. If a trustee acting within the authority conferred on it to do so employs a third party to undertake tasks on its behalf, the trustee is not required to have personal responsibility for the acts or omissions of the third party. Without this clause the trustee would be required under the Trustee Act 2000 to review the appointment regularly. Section 26 of the Trustee Act 2000 provides that the restrictions imposed on appointing an agent, nominee or custodian are 'subject to any restriction or exclusion imposed by the trust instrument'; thus this clause gives the Trustee wider powers in relation to the appointment of agents than under the Trustee Act 2000.*

- 1.2.6 *Delegation*: the Trustee may, in the execution and exercise of all or any of the trusts, powers, authorities and discretions vested in it by this Trust Deed, act by responsible officers or a responsible officer for the time being of the Trustee and the Trustee may also whenever it thinks fit, whether by power of attorney or otherwise, delegate to any person or persons or fluctuating body of persons (whether being a joint trustee of this Trust Deed or not) all or any of the trusts, powers, authorities and discretions vested in it by this Trust Deed and any such delegation may be made upon such terms and conditions and subject to such regulations (including power to sub-delegate with the consent of the Trustee) as the Trustee may think fit in the interests of the Noteholders and the Trustee shall not be bound to supervise the proceedings or acts of and shall not in any way or to any extent be responsible for any loss, liability, expense, demand, cost, claim or proceedings incurred by reason of the misconduct, omission or default on the part of such delegate or sub-delegate;

*There are times when professional trustees will wish to delegate all or some of their powers and discretions. The most common occurrence is when the trustee considers a conflict of interest has arisen and it would not be appropriate for the trustee to act itself. The alternative of the trustee resigning and a new trustee being appointed in its place is not always practicable because of the time and expense involved in having a noteholders' meeting to pass a resolution to effect the change. The London Listing Rules require the new trustee to have been approved by the noteholders. There are also circumstances where it is necessary for a delegate residing in the jurisdiction of the borrower or guarantor to be appointed to undertake actions in that jurisdiction. Trustees would not consider it reasonable to be accountable for the activities of such delegates. To remove the*

*protection might mean that trustees would be more reluctant to exercise the powers of delegation which would be contrary to the interests of the noteholders. Under section 25 of the Trustee Act 1925 (as amended by the Powers of Attorney Act 1971) a trustee may delegate all or any of its trusts, powers and discretions by a formal power of attorney although the period of delegation must not exceed twelve months, the trustee remaining liable for the acts and defaults of his attorney and notice having to be given to the co-trustees and anyone with the power to appoint new trustees. Sub-clause 1.2.6 expressly overrides these restrictions on delegation.*

- 1.2.7 *Custodians and nominees:* the Trustee may appoint and pay any person to act as a custodian or nominee on any terms in relation to such assets of the trust as the Trustee may determine, including for the purpose of depositing with a custodian this Trust Deed or any document relating to the trust created hereunder and the Trustee shall not be responsible for any loss, liability, expense, demand, cost, claim or proceedings incurred by reason of the misconduct, omission or default on the part of any person appointed by it hereunder or be bound to supervise the proceedings or acts of any such person; the Trustee is not obliged to appoint a custodian if the Trustee invests in securities payable to bearer;

*Clauses similar to this clause have been included in international bond issue trust deeds for many years. They effectively reflect the powers which have now been given to trustees by the Trustee Act 2000.*

- 1.2.8 *Confidential information:* the Trustee shall not (unless required by law or ordered so to do by a court of competent jurisdiction) be required to disclose to any Noteholder confidential information or other information made available to the Trustee by the Issuer or the Guarantor in connection with this Trust Deed and no Noteholder shall be entitled to take any action to obtain from the Trustee any such information;

*Borrowers and guarantors will frequently wish to discuss confidential proposals with trustees to ascertain whether the trustee considers they will give rise to a breach of covenant or an event of default or whether the trustee would be prepared to exercise its powers to grant a consent or waiver in relation to the proposals. It will usually be in the interests of noteholders that these disclosures take place and by ensuring the information is kept confidential it may also mean holders will not become subject to insider knowledge restrictions. It should be noted it remains within the discretion of the trustee whether or not to agree to the confidentiality.*

### **1.3 Financial matters**

- 1.3.1 *Professional charges:* any trustee being a banker, lawyer, broker or other person engaged in any profession or business shall be entitled to charge and be paid all usual professional and other charges for business

transacted and acts done by him or his partner or firm on matters arising in connection with the trusts of this Trust Deed and also his properly incurred charges in addition to disbursements for all other work and business done and all time spent by him or his partner or firm on matters arising in connection with this Trust Deed, including matters which might or should have been attended to in person by a trustee not being a banker, lawyer, broker or other professional person;

*The trustee's remuneration is dealt with elsewhere in the Trust Deed; however this clause would apply to any additional trustee appointed and would also allow the initial trustee to charge for its services in other capacities (such as paying agent or registrar) in connection with the transaction.*

1.3.2 *Expenditure by the Trustee:* nothing contained in this Trust Deed shall require the Trustee to expend or risk its own funds or otherwise incur any financial liability in the performance of its duties or the exercise of any right, power, authority or discretion hereunder if it has grounds for believing the repayment of such funds or adequate indemnity against, or security for, such risk or liability is not assured to it; and

*Professional trustees consider these protections of prime importance. Even obtaining legal advice can result in tens of thousands of pounds of expenditure in complicated situations. Unlike a traditional trust which holds tangible assets, there are no trust assets which can be realised to reimburse the trustee for any such expenditure. Whilst the borrower and guarantor may be contractually committed to defray the expense, if they are insolvent, or in financial difficulties, they will in practice be unable or unwilling to do so. Indeed the legal moratoriums which have become more prevalent in recent years would prevent borrowers and guarantors from discharging these obligations. It is not the role of a trustee to fund out of its own resources the protection of the trust assets. Whilst in practice many professional trustees will fund some expenditure themselves they cannot be expected to do so – particularly in the context of the levels of remuneration which is paid to them.*

1.3.3 *Trustee may enter into financial transactions with the Issuer:* no Trustee and no director or officer of any corporation being a Trustee hereof shall by reason of the fiduciary position of such Trustee be in any way precluded from making any contracts or entering into any transactions in the ordinary course of business with the Issuer, the Guarantor or any Subsidiary, or any person or body corporate directly or indirectly associated with the Issuer, the Guarantor or any Subsidiary, or from accepting the trusteeship of any other debenture stock, debentures or securities of the Issuer, the Guarantor or any Subsidiary or any person or body corporate directly or indirectly associated with the Issuer, the Guarantor or any Subsidiary, and neither the Trustee nor any such director or officer shall be accountable to the Noteholders or the Issuer, the Guarantor or any Subsidiary, or any person or body corporate directly

or indirectly associated with the Issuer, the Guarantor or any Subsidiary, for any profit, fees, commissions, interest, discounts or share of brokerage earned, arising or resulting from any such contracts or transactions and the Trustee and any such director or officer shall also be at liberty to retain the same for its or his own benefit.

*Many professional trustees either carry on other businesses themselves or form part of a group which undertakes other kinds of business. Such businesses may include the acquisition, underwriting, holding and disposal of securities. Even if it is not specifically required, the trustee business will be kept entirely separate and Chinese walls maintained between the separate parts of the businesses. This clause is used to ensure that there is no obligation to account for any profits arising from such other business. The clause thus overrides the general rule that a trustee must not put itself in a position where its own interests and those of its beneficiaries (here the noteholders) conflict. Another part of the trustee may for example carry on investment activities, such as underwriting, from which it will derive profits.*

#### **1.4 Disapplication**

Section 1 of the Trustee Act 2000 shall not apply to the duties of the Trustee in relation to the trusts constituted by this Trust Deed. Where there are any inconsistencies between the Trustee Acts and the provisions of this Trust Deed, the provisions of this Trust Deed shall, to the extent allowed by law, prevail and, in the case of any such inconsistency with the Trustee Act 2000, the provisions of this Trust Deed shall constitute a restriction or exclusion for the purposes of that Act.

*Section 1 of the Trustee Act 2000 applies a duty of care to trustees. Schedule 1, paragraph 7 of that Act provides that the duty of care from section 1 of the Act does not apply in so far as it appears from the trust instrument that the duty is not meant to apply.*

*The reason for providing that any inconsistency will constitute a restriction or exclusion under the Trustee Act 2000 is that most of the provisions of the Act are subject to any 'restriction or exclusion' in the trust instrument. Therefore, rather than relying on an inconsistency being interpreted as a 'restriction or exclusion' it is explicitly provided for here. Contrast this with the wording of s.69 in the Trustee Act 1925, which refers to a 'contrary intention'.*

#### **1.5 Trustee Liability**

Nothing in this Trust Deed shall exempt the Trustee from, or indemnify it against, any liability for breach of trust where the Trustee has failed to show the degree of care and diligence required of it as a trustee, having regard to the provisions of the Trust Deed conferring on it any trusts, powers, authorities or discretions.

*Section 192, on which this clause is based, is discussed in some detail in Chapter 1.*

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