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PROMOTING ESG INVESTING BY TRUSTEES: RISK MANAGEMENT AND STRUCTURING SOLUTIONS

Vincent OOI[*] and Alvin W-L SEE[**]

Abstract: Whether a trustee is permitted to have regard to ethical considerations when making investment decisions has been a hotly debated topic attracting diverse views. Although the strictness of the best financial interest rule has been downplayed by the existing literature (including a Law Commission report), the lingering uncertainty—owing mainly to the lack of judicial and statutory clarification—means that trustees remain cautious about engaging in ESG investing, hence impeding efforts to divert more funds into sustainability causes. In response, users of the trust device have explored a variety of structuring tools which settlors may use to empower trustees to engage in ESG investing while ensuring accountability to the beneficiaries. This article contributes to the debate by proposing additional structuring solutions, drawing on recent legal developments in the contexts of charitable purpose trusts and the company shareholder stewardship movement.

1. INTRODUCTION

The world is falling behind on its commitments to tackle some of the most pressing problems of this century: climate change, inequality, and other obstacles to building a sustainable future. In 2015, all Member States of the United Nations adopted the 2030 Agenda for Sustainable Development which set out 17 Sustainable Development Goals ('UNSDG') and 169 targets spanning the spectrum of environmental, social and economic dimensions of development.[1] At the mid-point to 2030, the UN Secretary-General reported that of the roughly 140 targets for which data is available, about 12 per cent are on track; more than half are moderately or severely off track; and some 30 per cent have either seen no movement or regressed below the 2015 baseline.[2] In short, based on current trajectories, the world is not on track to achieving these goals.[3] It is in light of this sobering thought that we consider the opportunities for channelling more of the world's wealth, often held in trust funds, towards initiatives aligned with these goals. As the Intergovernmental Panel on Climate Change observed with regards to the implementation of the Paris Agreement 2015, 'pursuing 1.5°C mitigation efforts requires a major reallocation of the investment portfolio, implying a financial system aligned to mitigation challenges'.[4] Within the investment world, businesses or financial products are increasingly rated based on their

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[1] United Nations, *Transforming our world: the 2030 Agenda for Sustainable Development* (2015) <https://documents-dds-ny.un.org/doc/UNDOC/GEN/N15/291/89/PDF/N1529189.pdf?OpenElement> accessed 20 January 2024.

[2] United Nations, *The Sustainable Development Goals Report 2023: Special Edition* (2023), 2 <https://unstats.un.org/sdgs/files/report/2023/secretary-general-sdg-report-2023--EN.pdf> accessed 20 January 2024.

[3] United Nations, UN Global *Compact Strategy: 2021-2023* (2021), 7 <https://ungc-communications-assets.s3.amazonaws.com/docs/about_the_gc/UN-GLOBAL-COMPACT-STRATEGY-2021-2023.pdf> accessed 20 January 2024.

[4] Intergovernmental Panel on Climate Change, *Global Warming of 1.5°C* (2019), 154 <https://www.ipcc.ch/site/assets/uploads/sites/2/2022/06/SR15_Full_Report_HR.pdf> accessed 20 January 2024.

environmental, social and governance ('ESG') credentials, which broadly correspond with their contributions to furthering many, if not all, of the UNSDG.[5]

There are of course different ways of channelling trust funds towards sustainability causes—notably through charitable donations and grants—but the focus of this article is on a trustee's exercise of investment powers in alignment with sustainability causes. To avoid doubt, we do not propose ways to redirect existing trust funds against the will of settlors or the principal purposes for which the trusts were established. Instead, our focus is on settlors of private express trusts who want greater alignment between the trust and sustainability goals, often out of reputational considerations.[6] For such settlors, the way the trust fund is grown—whether its investment is aligned with sustainability goals—will likely be an important consideration. However, as the law currently stands, the question whether, and to what extent, trustees are allowed to include ethical considerations in the exercise of the general power of investment vested in them has traditionally been restrictive and at best uncertain. A series of English cases starting with *Cowan v Scargill*[7] has led many to question the ability of trustees to exercise their general power of investment to pursue anything other than the best financial return for the trust. Although the ensuing literature (including a Law Commission report) has sought to downplay the perceived strictness of *Cowan v Scargill*, the lack of legislative or judicial adoption meant that there is lingering uncertainty. Trustees may prefer to err on the side of caution. The risk of litigation brought by disgruntled beneficiaries, however remote, may be sufficient to dissuade trustees from exercising their investment powers in support of sustainability causes, even if that was what the settlors may have intended.

In the face of lingering uncertainty, users of the trust device have demonstrated the spirit of innovation and creativity by exploring a variety of structuring solutions. This article contributes to the endeavour by proposing two other types of structuring solutions. The first proposal, which draws upon recent legal developments in the context of charitable trusts, is that the inclusion of a clear statement of the non-financial purpose in the trust document will allow the trustee to engage in ESG investing; even of a kind that does not pursue financial maximisation. The second proposal is to establish a trust-corporate structure, thereby placing the investment power in the hands of a non-trustee director who may enjoy greater freedom than a traditional trustee in making investment decisions considering the rise of the shareholder stewardship movement. However, instead of proposing any 'right answer', we leave the ultimate choice to the informed settlor after considering how each structuring tool accounts for the competing considerations.

2. ETHICAL INVESTING

[5] Addisu Lashitew, 'Corporate Uptake of the Sustainable Development Goals: Mere Greenwashing or an Advent of Institutional Change?' (2021) 4 J Intl Business Policy 184.

[6] Evidence has shown that reputation is a major driver of ESG integration: BNP Paribas, *The ESG Global Survey 2021* (2021), 25–27 <https://securities.cib.bnpparibas/app/uploads/sites/3/2021/09/the-esg-global-survey-2021.pdf> accessed 20 January 2024. Universities, for example, have increasingly been pressured to divest their fossil fuel holdings: see Naomi Oreskes and Sofia Andrade, 'Harvard and Other Schools Make a Choice on Fossil Fuels' (New York Times, 2 October 2021) <https://www.nytimes.com/2021/10/02/opinion/divestment-fossil-fuels-harvard.html> accessed 20 January 2024; Susan Svrluga, 'Student Climate Activists from Yale, Stanford, Princeton, MIT and Vanderbilt File Legal Complaints to Compel Divestment' (Washington Post, 16 February 2022) <https://www.washingtonpost.com/education/2022/02/16/college-fossil-fuel-divest-legal-action/> accessed 20 January 2024.

[7] [1985] Ch 270.

The term 'ESG' gained popularity following the publication of the 2004 Who Cares Wins report by the United Nations Global Compact. A joint initiative of financial institutions invited by then UN Secretary-General Kofi Annan, the goal was to 'develop guidelines and recommendations on how to better integrate environmental, social and corporate governance issues in asset management, securities brokerage services and associated research functions'.[8] The broad idea of ethical investing was certainly not new.[9] In the 18th century, the Religious Society of Friends (Quakers) led the anti-slavery movement by proscribing financial ties with the slave trade.[10] More recently, in the 1980s, the related idea of socially responsible investing gained prominence as part of a divestment campaign aimed at South Africa's apartheid regime.[11] The difference is that these earlier movements tended to be more specific and lacked a unifying framework with a view of creating a sustainable future.

However, one difficulty with the modern ESG movement is the very broad range of issues that can fall under each of its constituents. Environmental factors are perhaps the most familiar, with issues such as climate change, pollution and carbon footprint featuring prominently. Social factors include the impact of the business on the community, good labour policy, and fair compensation of parties along the supply chain. Governance factors mainly relate to the internal operation of the business such as the degree of transparency, oversight, and disclosure. However, while the core matters are generally clear-cut, there remains a lot of uncertainty at the fringes. For example, social factors are necessarily dependent on social norms which may differ from country to country. Although there are increasingly efforts to inject certainty by mapping ESG to UNSDG,[12] the lack of standardisation remains apparent with different ESG rating providers using different evaluation matrices.[13] Different rating systems may also accord greater emphasis to one (or more) component(s) over the other(s). What this means is that performing exceptionally well in one component does not guarantee a good overall rating. Tesla Inc's less-than-spectacular performance in the overall ESG ratings—ranking below many of the major tobacco and fossil fuel companies—is therefore hardly surprising if one looks beyond environmental sustainability alone.[14]

Fortunately, it is not always necessary to grapple with the amorphous concept in the abstract. In the context of investment strategy, one may, for example, decide to focus solely on the environmental impact of the businesses under consideration. In the rest of this article, we will

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8 The Global Compact, *Who Cares Wins: Connecting Financial Markets to a Changing World* (2004), i <https://www.unepfi.org/fileadmin/events/2004/stocks/who_cares_wins_global_compact_2004.pdf> accessed 20 January 2024.

9 David Uberti, 'ESG's Long History: 1700s to Today' (Wall Street Journal, 19 August 2023) <https://www.wsj.com/story/esgs-long-history-1700s-to-today-5ce73439> accessed 20 January 2024.

10 Julie L Holcomb, *Moral Commerce: Quakers and the Transatlantic Boycott of the Slave Labor Economy* (Cornell University Press 2016).

11 This formed the backdrop of the dispute in *Martin v City of Edinburgh District Council* (1988) SLT 329. See generally Vincent Harris, 'Divestment Hits Apartheid in the Pocketbook' (1985) 16 J Black Studies & Research 12.

12 See, for example, Betty Moy Huber, Michael Comstock and Hilary Smith, 'UN Sustainable Development Goals—The Leading ESG Framework for Large Companies' (Harvard Law School Forum on Corporate Governance, 14 October 2018) <https://corpgov.law.harvard.edu/2018/10/04/un-sustainable-development-goals-the-leading-esg-framework-for-large-companies/> accessed 20 January 2024.

13 Some of the major rating firms are Morgan Stanley Capital International (MSCI), Morningstar, Thomson Reuters, S&P Global and Bloomberg.

14 Leslie Norton, 'This is Why Tesla's ESG Rating Isn't Great' (Morningstar, 22 May 2022) <https://www.morningstar.co.uk/uk/news/221629/this-is-why-teslas-esg-rating-isnt-great.aspx> accessed 20 January 2024.

refer to 'ESG investing', 'ethical investing' and 'sustainable investing' interchangeably on the understanding that the precise scope is likely to be clarified in the specific contexts in which the issues arise.

Insofar as ethical investment strategies are concerned, there are a few notable methods.[15] The first method is known as *negative portfolio screening*, whereby an identified class of investment is excluded on the basis that it displays negative ESG characteristics. A classic example is by withholding investment in 'sin industries' such as businesses dealing with alcohol and tobacco. In recent years, due to increasing environmental awareness, fossil fuel divestment has increasingly become a prominent trend.[16] The popularity of this form of ethical investing is evidenced by its frequent examination in the case law.[17] The second method, which is the polar opposite of first, is *positive portfolio screening*, which entails actively seeking out investments that display positive ESG characteristics. Both positive and negative portfolio screening will seek to avoid investments with the worst ESG attributes, but the former goes further and tends to exclude investments with average ESG attributes from the investment portfolio.

Turning to the profitability of ESG investing, the available empirical evidence has been inconclusive and mixed.[18] The investors may be broadly divided into two camps.[19] The first camp holds on to the traditional view that ESG investing is contrary to the single-minded pursuit of profit maximisation.[20] ESG investing has traditionally been considered to be less profitable because it often excludes potentially lucrative industries or businesses. In particular, the evidence shows that investments in sin industries tend to yield greater financial returns.[21] A criticism of this observation, however, is that it considers only short-term profitability.[22] The second camp of investors, therefore, takes the view that businesses that are more ESG-compliant are likely to do better in the medium to long term. Increasingly, investors begin to move towards *ESG integration*, focusing on identifying opportunities and risks through the ESG lens,[23] with a medium to long term view.

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15 See the influential 'Freshfields Report' commissioned by the United Nations Environment Programme Finance Initiative: Freshfields Bruckhaus Deringer, A Legal Framework for the Integration of Environmental, Social and Governance Issues into Institutional Investment (2005), 25 <https://www.unepfi.org/fileadmin/documents/freshfields_legal_resp_20051123.pdf> accessed 20 January 2024; OECD, *ESG Investing: Practices, Progress and Challenges* (2020), 32–34 <https://www.oecd.org/finance/ESG-Investing-Practices-Progress-Challenges.pdf> accessed 20 January 2024. See also Suzanne McGee, 'ESG Investors Face a Choice: Do You Use a Positive or Negative Screen?' (Wall Street Journal, 1 November 2022) <https://www.wsj.com/articles/esg-investing-companies-screening-11667226822> accessed 20 January 2024.

16 Benjamin Richardson, 'Fossil Fuels Divestment: Is It Lawful?' (2016) 39 UNSWLJ 1686, 1696. Increasingly more universities are making a commitment to divest from fossil fuel holdings to enhance their pro-environmental reputation: see Gregory M Mikkelson, Miron Avidan, Aleksandra Conevska and Dror Etzion, 'Mutual Reinforcement of Academic Reputation and Fossil Fuel Divestment' (2021) 4 Global Sustainability e20, 4.

17 See Part 3 below.

18 OECD (n 15), 36–58.

19 Freshfields Report (n 15), 27–29.

20 Sanjai Bhagat, 'An Inconvenient Truth About ESG Investing' (Harvard Business Review, 31 March 2022) <https://hbr.org/2022/03/an-inconvenient-truth-about-esg-investing> accessed 20 January 2024; Mike Edleson and Andy Puzder, 'Is ESG Profitable? The Numbers Don't Lie' (Wall Street Journal, 10 March 2023) <https://www.wsj.com/articles/is-esg-profitable-the-numbers-dont-lie-benchmarks-analytics-politics-neutral-fiduciary-duty-market-woke-5da4a533> accessed 20 January 2024.

21 Pieter Jan Trinks and Bert Scholtens, 'The Opportunity Cost of Negative Screening in Socially Responsible Investing' (2017) 140 J Business Ethics 193.

22 Paul Polman and Andrew Winston, 'Yes, Investing in ESG Pays Off' (Harvard Business Review, 13 April 2022) <https://hbr.org/2022/04/yes-investing-in-esg-pays-off> accessed 20 January 2024.

23 BNP Paribas (n 6), 15.

However, although there is empirical evidence to confirm the financial benefits of ESG integration, the existing studies tend to be highly generalised without distinguishing E, S and G in contributing towards value creation.[24] There is strong evidence to suggest that good governance (ie 'G') contributes significantly to the performance of a business.[25] The same may be argued for environmental and social (ie 'E' and 'S') factors.[26] Businesses that ignore environmental and social considerations are exposed to political, regulatory and litigation risks.[27] For example, a business with a large and unmanaged carbon footprint will take a financial hit with the introduction of carbon taxes. Similarly, a manufacturing business that produces large amounts of pollutants is increasingly at risk of being embroiled in environmental litigation. In contrast, a business that actively manages these risks, such as by improving operational efficiency and using less resources, is likely to perform better in the medium to long term. However, this argument is not very clearly confirmed by the available data.[28] This means that a trustee who prioritises environmental or social factors may be vulnerable to an accusation of pursuing an ethical agenda at the expense of profit-maximisation. As one report observed, '[i]t is in this form that the financial and social investing objectives can be blurred, as the theme often has a purpose that is distinct from maximising long-term financial value'.[29] Unsurprisingly, there are investors who remain on the fence, merely accepting that based on the available evidence ESG investments perform neither better nor worse than other investments.[30]

3. LESSONS FROM PENSION FUNDS AND CHARITABLE TRUSTS

The bulk of the existing case law and literature dealing with a trustee's general power of investment can broadly be divided into two categories: those relating to pension funds and charitable trusts.[31] There are valuable lessons to be drawn from the legal development in these two contexts, but it is necessary to bear in mind that they are often subject to rather complex legislative frameworks that do not apply to private express trusts.[32] In drawing comparisons across categories, we pay

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[24] See, for example, Gunnar Friede, Timo Busch and Alexander Bassen, 'ESG and Financial Performance: Aggregated Evidence from More than 2000 Empirical Studies' (2015) 5 J Sustainable Finance & Investment 210; Sakis Kotsantonis, Chris Pinney and George Serafeim, 'ESG Integration in Investment Management: Myths and Realities' (2016) 28 J Applied Corporate Finance 10.

[25] Max Schanzenbach and Robert Sitkoff, 'Reconciling Fiduciary Duty and Social Conscience: The Law and Economics of ESG Investing by a Trustee' (2020) 72 Stanford L Rev 381, 433–434; Susie Daykin, 'Pension Scheme Investment: Is it Always Just About the Money? To What Extent Can or Should Trustees Take Account of Ethical or ESG Factors When Investing?' (2014) 28 TLI 165, 166.

[26] Benjamin Richardson, 'Socially Responsible Investing for Sustainability: Overcoming Its Incomplete and Conflicting Rationales' (2013) 2 Transnational Environmental L 311, 328.

[27] Schanzenbach and Sitkoff (n 25), 435; Daykin (n 25), 166; Paul Watchman, Jane Anstee-Wedderburn and Lucas Shipway, 'Fiduciary Duties in the 21st Century: a UK Perspective' (2005) 19 TLI 127, 140.

[28] Schanzenbach and Sitkoff (n 25), 435–436.

[29] OECD (n 15), 31.

[30] Luke Broadway, '*Butler-Sloss v The Charity Commission*: ESG Investment Guidance in Need of Elaboration' (2022) 28 T&T 849, 853-854.

[31] Another category, which we do not cover, relates to divestment of fossil fuel holdings by universities. This is a special category because universities do not necessarily hold their funds on trust but also because they are often creatures of statutes and royal charters. See generally Richardson (n 16); Benjamin Richardson, 'Universities Unloading on Fossil Fuels: The Legality of Divesting' (2016) Carbon & Climate L Rev 62.

[32] As the Law Commission observed, '[t]here is … a growing recognition that pension trusts are 'different', and that they may merit separate consideration': Law Commission, 'Fiduciary Duties of Investment Intermediaries' (2014) (Law Com No 350) ('**LC 350**'), [6.34]. On proposed reforms specific to pension trusts, see Law Commission, 'Pension Funds and Social Investment' (2017) (Law Com No 374).

particular attention to the degree of freedom enjoyed by the trustees, which is invariably determined by the purpose for which the trust is created.

3.1 Pension funds

The basic rule that a trustee must exercise its general power of investment in the best financial interest of the trust is frequently attributed to *Cowan v Scargill.*[33] In that case, half the trustees of the mineworkers pension scheme, who were appointed by the National Union of Mineworkers, refused to endorse an investment plan which included an increase in overseas investment and investments in energy companies that were in direct competition with coal. The argument was that such investments would be contrary to the policy and principles of the union. Deciding against the opposing trustees, Sir Robert Megarry VC held that this being a trust for the financial benefits of the beneficiaries, the trustees were under a duty to act in their best interest. As the learned judge explained:

> 'When the purpose of the trust is to provide financial benefits for the beneficiaries, as is usually the case, the best interests of the beneficiaries are normally their best financial interests. In the case of a power of investment, as in the present case, the power must be exercised so as to yield the best return for the beneficiaries, judged in relation to the risks of the investments in question; and the prospects of the yield of income and capital appreciation both have to be considered in judging the return from the investment.'[34]

The policy of the union, which was to ensure the general prosperity of coal mining, was irrelevant because that has no direct bearing on the benefits that the beneficiaries expected to receive under the pension scheme. The scheme being fully funded, it would not be impacted by the performance of the coal mining industry. Moreover, the prosperity of the industry is unlikely to be of concern to retired members.[35]

As the Law Commission observed, '*Cowan v Scargill* has sparked great debate' on whether trustees are precluded from taking into account ethical issues when making investment decisions.[36] As observed in the Freshfields Report, some members of the investment community understood the decision to have strictly prohibited consideration of factors other than the maximisation of financial returns.[37] Indeed, some of the leading texts regard this as representing the legal position.[38]

But there have been considerable efforts to downplay the strictness of the rule. Notably, the Freshfields Report explicitly cast doubt on *Cowan v Scargill* as reliable legal authority for the

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[33] *Cowan v Scargill* (n 7).
[34] *Cowan v Scargill* (n 7), 287.
[35] *Cowan v Scargill* (n 7), 292.
[36] LC 350 (n 32), [4.42].
[37] Freshfields Report (n 15), 88.
[38] Lynton Tucker, Nicholas Le Poidevin, and James Brightwell, *Lewin on Trusts* (20th edn, Sweet & Maxwell 2020), [35-061]: '… the trustees must put aside, not only their personal interests, but also their views about social and political issues'; John McGhee QC (ed), *Snell's Equity* (34th edn, Sweet & Maxwell 2022), [29-007]: 'The trustees must not … allow their own social or political views to affect their investments'. Cf Jamie Glister and James Lee, *Hanbury & Martin: Modern Equity* (22nd edn, Sweet & Maxwell 2021), [19-020]: 'Where the trust instrument is silent on the matter, trustees may include ethical considerations in the policy statement, subject to their general law duties'.

strict rule.[39] Three of the 15 reasons given in the Report deserve special mention: (i) '[t]he case involved a blanket prohibition of certain investments'; (ii) '[t]he investment plan in dispute bore little or no resemblance to a modern ESG investment policy'; and (iii) '[t]he case was decided … before legal acknowledgment of modern portfolio theory'.[40] These are consistent with the existing literature[41] that highlights the potential of ESG investment for medium to long term profitability,[42] its usefulness in identifying opportunities and risks in investments,[43] and its relevance to the need for portfolio diversification.[44] Taken in totality, the suggestion appears to be that although negative portfolio screening may not be allowed due to the expected financial detriment, ESG integration should be allowed due to its focus on financial returns. Indeed, the Law Commission recognised that ethical issues can be 'financially material factors' and if so trustees 'should' take them into account when making investment decisions.[45]

However, ethical issues that are not financially relevant should not be considered. Negative portfolio screening with a view of showing disapproval of certain industries would run afoul of this general rule. However, the Law Commission proposed that an exception can be made if the following 'two tests' are met: '(1) trustees should have good reason to think that scheme members would share the concern; and (2) the decision should not involve a risk of significant financial detriment to the fund'.[46] Although the exception has recently received the approval of Lord Carnwath in *R (Palestine Solidarity Campaign Ltd) v SSCLG (SC(E))*,[47] the difficulty in satisfying the two tests is all too apparent.[48] In the first place, it would almost be impossible for every beneficiary to agree on any matter. Even where the beneficiaries are united by faith, the trustees will likely meet with 'endless argument and debate'.[49] Therefore, the Law Commission rightly conceded that there might be difficult situations where a minority disagrees strongly with the views of the majority and that in such cases, trustees should focus on financial factors rather than becoming embroiled in disagreements between the members.[50]

Even in the rare event that the first test is satisfied, there remains uncertainty as to what degree of financial detriment can be tolerated. As the precise loss is often difficult to quantify, the focus has been on the degree of exclusion or divestment based on non-financial factors.[51] As Sir Robert Megarry VC opined in *Cowan v Scargill*:

> 'I find it impossible to see how it will assist trustees to do the best they can for their beneficiaries by prohibiting a wide range of investments that are authorised by the terms of the trust. Whatever the position today, nobody can say that conditions tomorrow cannot

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39 Freshfields Report (n 15), 89.
40 Freshfields Report (n 15), 89.
41 See generally Part 2 above.
42 Luke Broadway, Toby Graham and David Russell QC, 'Trustee Investment: Ethical Investing' (2021) 27 T&T 597; Schanzenbach and Sitkoff (n 25), 436.
43 Daykin (n 25), 166.
44 Pursuant to the Trustees Act 2000, s 4(3)(b); see Schanzenbach and Sitkoff (n 25), 409.
45 LC 350 (n 32), [6.24]–[6.32].
46 LC 350 (n 32), [6.34].
47 [2020] UKSC 16, [43].
48 See Law Commission, 'Pension Trustees' Duties when Setting an Investment Strategy: Guidance from the Law Commission' (1 July 2014) ('**Law Commission (2014)**').
49 *Harries v Church Commissioners for England* [1992] 1 WLR 1246 (Ch) 1251.
50 Law Commission (2014) (n 48), [1.31].
51 Law Commission (2014) (n 48), [1.31], citing *Harries* (n 49), 1251 (but this case concerned a charitable trust).

> possibly make it advantageous to invest in one of the prohibited investments. It is the duty of trustees, in the interests of their beneficiaries, to take advantage of the full range of investments authorised by the terms of the trust, instead of resolving to narrow that range.'[52]

Although this suggests that a narrow exclusion can be tolerated, precisely where the line is to be drawn remains a highly uncertain matter. Just recently, in *McGaughey and Davies v Universities Superannuation Scheme Ltd*, Leech J cited *Cowan v Scargill* for the proposition that the trustees were under no duty to divest the trust's fossil fuel investment because to do so would be contrary to the best financial interest rule.[53] While not directly addressing the legality of fossil fuel divestment, the case perpetuates the strict(er) reading of *Cowan v Scargill.* In the face of lingering uncertainty, many trustees are expected to adopt a cautious attitude.[54]

One important lesson from this legal development is how law reform of such a nature should be carried through in implementation. Although the Law Commission was supportive of allowing ethical investing, it stopped short of recommending statutory clarification, as it recognised that fiduciary duties, which underpin the best interest rule, are 'difficult to define and inherently flexible'.[55] Instead, the Law Commission was prepared to embrace the uncertainty, opting for the issuance of a general guidance to trustees.[56] Indeed, considering the fact-sensitivity of disputes relating to ethical investing, it is argued that the only practical way of mitigating the uncertainty, at least to a level where trustees do not shun ethical investing, is to address the matter head-on when drafting the trust. This is where the literature on pension funds provides little guidance except to recognise that the focus ought to be on the trust deed: 'Looking at the deed, trustees should ask: what is the purpose of the investment power we have been given, and how can we use that power to promote the purpose of the trust?'[57] As to what precisely this means, it would be helpful to examine the recent developments in the law on charitable trusts

3.2 Charitable trusts

A charitable trust is simply defined as a trust created for public benefit. The recognised categories of charitable purpose, now set out in the Charities Act 2011, are aligned with many of the sustainability goals. Although there are no (direct) human beneficiaries awaiting the distribution of trust assets, growing the trust fund is nonetheless an important matter. As Nicholls VC observed in *Harries v Church Commissioners for England*, '[m]ost charities need money; and the more of it there is available, the more the trustees can seek to accomplish'.[58] In general, therefore, the profit-

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[52] *Cowan v Scargill* (n 7), 295. Cf Law Commission (2014) (n 48), [1.34].

[53] [2022] EWHC 1233 (Ch), [188].

[54] Although a recent survey revealed that many asset managers have been engaging in negative screening before shifting towards ESG integration: BNP Paribas, ESG Global Survey 2023 (December 2023) <https://securities.cib.bnpparibas/app/uploads/sites/3/2023/12/esg-global-survey-consolidated-report.pdf> accessed 20 January 2024. However, it is not clear if such negative screening was conducted with financial (or non-financial) considerations in mind. The literature also alludes to the possibility of trustees 'quietly' taking non-financial factors into account when investing: Broadway (n 30), 859.

[55] LC 350 (n 32), [7.37].

[56] Law Commission (2014) (n 48).

[57] Law Commission (2014) (n 48), [1.6].

[58] *Harries* (n 49).

maximisation rule is aligned with the advancement of the charitable purpose. However, the learned judge also recognised an exception:

> 'when the objects of the charity are such that investments of a particular type would conflict with the aims of the charity… [if] trustees were satisfied that investing in a company engaged in a particular type of business would conflict with the very objects their charity is seeking to achieve, they should not so invest. Carried to its logical conclusion the trustees should take this course even if it would be likely to result in significant financial detriment to the charity.'[59]

Rare as it may be, this exception arose squarely for consideration before Michael Green J in *Butler-Sloss v Charity Commission for England and Wales*.[60] The case concerned two charities, the principal purposes of which included environmental protection. The trustees sought the court's blessing of their proposed investment policy, which sought to exclude potential investments that were not aligned with the goals laid down in the Paris Climate Agreement for limiting the increase in global temperatures, notwithstanding the risk of financial detriment from excluding such investments. Echoing Nicholls VC in *Harries*, Green J stressed that the trustee's 'primary and overarching duty is to further the purposes of the trust'.[61] However, if the trustee is of view that a certain class of investments may potentially conflict with the charity's purpose, the trustee may decide to exclude it from the investment portfolio after carefully balancing the competing interests, in particular the degree of conflict, the potential financial detriment from the exclusion, the potential reputational damage to the charity and, relatedly, the risk of losing support from donors.[62] This discretion may be exercised whether the conflict between the investment class and the charitable purpose is direct or potential. In conducting the balancing exercise, the trustee is expected to act honestly and reasonably, in the best interest of the charity and its purpose. Importantly, if the balancing exercise has been properly conducted, the trustee would have discharged its legal duties and 'cannot be criticised, even if the court or other trustees might have come to a different conclusion'.[63]

Turning to the facts of the case, Green J held that the trustees had, with proper financial advice, properly assessed the competing considerations in proposing the restrictive investment policy, and therefore judicial blessing was given. This was notwithstanding the anticipated financial detriment. As the trustees themselves recognised, there might be 'risk of short term financial detriment because of the substantially more limited investable universe and sectors in which the [new policy] permits investments'.[64] They further conceded that '[e]xcluding investments that are not aligned with the Paris Agreement would reduce the investable universe by a much greater extent than the exclusion of fossil fuels'.[65] It is also interesting to note that the new policy has specified a relatively modest investment objective: 'to generate capital growth in excess of inflation over the long term whilst generating a sustainable spending level to support the trust's ongoing

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59 *Harries* (n 49), 1246.
60 [2022] Ch 371.
61 *Butler-Sloss* (n 60), [78].
62 Although what degree of conflict is required for the exception to be invoked may require further judicial clarification: Rebecca Fry, 'Ethical Investments by Charity Trustees: Some Answers, New Questions' (2023) 82 CLJ 9. See also Broadway (n 30).
63 *Butler-Sloss* (n 60), [78].
64 *Butler-Sloss* (n 60), [86].
65 *Butler-Sloss* (n 60), [32].

grant making activities'. This provides a useful benchmark for measuring the financial sustainability of the trust against which other relevant factors—in particular the anticipated financial detriment—must be balanced. In this case, the trustees also convinced the court that the likelihood of the return objective being achieved is higher if the matter is assessed over a longer term.[66]

The Charity Commission welcomed the decision for offering 'clarification of how existing legal principles should be interpreted by trustees in a modern context', thus prompting it to update its investment guidance issued to charitable trustees.[67] Compared to the exception recognised in *Cowan v Scargill*, the new exception is obviously broader and better delineated, owing to the focus on the charitable purpose. However, it bears noting that the investment policy to which the court's blessing was given was in form a negative portfolio screening. As Green J's judgment was directed at this specific investment policy, it does not explicitly endorse positive portfolio screening.[68] As explained in Part 2 above, it is important to recognise that there are 'neutral investments' that would be excluded through positive but not negative portfolio screening. In short, although Green J's judgment confirms that ethical investing of some form is permissible, it leaves open the debate of how far ethical investing can be pursued.

3.3 Comparative observations

In drawing lessons from the recent legal developments on pension funds and charitable trusts for the structuring of private express trusts, it is helpful to first unpack their similarities and differences. Identifying the purpose of the trust is a good starting point considering how this has been prominently featured in the discussion. Like pension funds, a private express trust is almost always for the financial benefit of the beneficiaries. In the case of a family trust, for example, the purpose is generally to make financial provisions for family members. By analogy, therefore, the profit-maximisation rule ought to feature prominently in the trustee's exercise of its general investment power. However, unlike public pension funds that are statutorily regulated, there is greater flexibility in the drafting of express private trusts.[69] Although the investment power in pension funds, which is usually phrased in general terms, may technically be amended, this is not always easy to achieve especially where the trustees are at loggerheads.[70] It is for this reason that we prefer to begin with a blank slate, focusing on how private express trusts can be drafted in a way that empowers trustees to engage in ethical investing. In this regard, we may derive some inspiration from charitable trusts, in particular to pay greater attention to specifying the purpose(s) of the trust. However, considering the fact that an express private trust has human beneficiaries, the interaction between the beneficiary's interest and a non-financial purpose of the trust, assuming they are not entirely aligned, is a matter that deserves careful analysis. Lastly, it may be observed that the existing legal authorities have dealt only with negative portfolio screening. They are silent

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66 *Butler-Sloss* (n 60), [86].

67 The Charity Commission, 'Update on investment guidance following Butler-Sloss case' (15 November 2022) <https://www.gov.uk/government/news/update-on-investment-guidance-following-butler-sloss-case>accessed 20 January 2024.

68 Even though Green J accepted the Charity Commission's definition of ethical investment, which includes both negative and positive screenings: *Butler-Sloss* (n 60), [39].

69 For example, the Local Government Pension Scheme (Management and Investment of Funds) Regulation 1998 does appear to envisage a general power of investment restricted only by what's explicitly provided for in the regulation.

70 Hence the deadlock among the trustees in *Cowan v Scargill* despite the scheme containing a clause allowing amendment to its terms. See also Freshfields Report (n 15), 88.

on the legality of positive portfolio screening. This legal lacuna needs to be accounted for in drafting the express private trust.

4. STRUCTURING EXPRESS PRIVATE TRUSTS TO ALLOW ETHICAL INVESTING

4.1 Revisiting trustees duties and risks

An express trustee is under a duty to invest trust assets.[71] To facilitate this, the Trustee Act 2000 confers on the trustee a broad power to invest[72] but also imposes safeguards on its exercise, in the forms of a general duty of skill and care,[73] as well as the duties to invest by considering the standard investment criteria and with proper advice.[74] The profit-maximisation rule as set out in *Cowan v Scargill* may be understood to fall within this general framework of trustee duties.[75] Indeed, the common law requires the trustee to act like a 'prudent man of business'.[76] However, others have characterised the rule more specifically, either as a fiduciary duty to act in the best interest of the trust[77] or a duty to act in accordance with the purpose of the trust.[78] The duty of skill and care has also been regarded as a relevant aspect of the rule.[79] Regardless of how the rule is characterised, the focus on purpose is necessary , as the purpose for which the trust is created determines whether the trustee can have regard to ethical considerations, and to what extent, when making investment decisions. Thus, if the purpose of the trust is principally for the financial benefit of the beneficiaries, a trustee applying negative or positive portfolio screening to the blanket exclusion of the most profitable sin industries will likely commit a breach of trust, whereas the use of ESG integration with a focus on medium to long term financial returns will likely be acceptable.[80] However, even ESG integration is not necessarily risk-free. The available empirical data is inconclusive, and it may not always be easy for the trustee to find an expert witness who is willing to openly defend the investment scheme in question. Therefore, the onus is on a settlor who wants the trustee to engage in ethical investing to mitigate risks through careful drafting of the trust deed. After all, default rules are subject to modification by the trust instrument.[81]

In this article, we will pay particular attention to portfolio screening, be it positive or negative, as these forms of ethical investing appear most at odds with the profit-maximisation rule

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71 *Re Wragg* [1919] 2 Ch 58.
72 Trustee Act 2000, s 3.
73 Trustee Act 2000, s 1.
74 Trustee Act 2000, ss 4(1) & 5(1). There is also the duty to review the investments from time to time having regard to the standard investment criteria and with proper advice: Trustee Act 2000, ss 4(2) & 5(2).
75 *Hanbury & Martin* (n 38), [19–019].
76 *Speight v Gaunt* (1883-84) LR 9 App Cas 1 (HL).
77 Lloyd Brown, '*Cowan v Scargill* and the Fiduciary Duty of Investment: Has the Nature of the Investment Duty Changed and What is Currently Driving 'Socially Responsible Investing' in Pension Schemes?' (2020) 26 T&T 756; Alastair Marke, 'Establishing the Legal Obligations of Pension Fund Trustees to Divest from Climate-Unfriendly Portfolios' (2018) 12 Carbon & Climate L Rev 297; Schanzenbach and Sitkoff (n 25).
78 *Snell's Equity* (n 38), [29-007]: 'The trustees' investment powers must be exercised in accordance with the purpose of the trust. Prima facie the purpose of the trust is best served by seeking the maximum return consistent with commercial prudence'. See also Daykin (n 25).
79 John Kay, *The Kay Review of UK Equity Markets and Long-Term Decision Making* (Third Report of Session 2013-14) (House of Commons) (2012), Ev 97; Freshfields Report (n 15), 85–86.
80 *Hanbury & Martin* (n 38), [19–019].
81 Trustee Act 2000, s 6(1)(b).

due to the nature of blanket exclusion. To better contextualise the discussion, let us consider a hypothetical trust created by John the environmentalist who hosted a widely acclaimed documentary series on saving the planet. The trust takes the form of a discretionary trust with the primary goal of making financial provisions for John's family members. However, to uphold John's good reputation, he also wants to ensure that the trust is ESG-friendly, at least in regard to how the fund is grown. In deciding how best to structure John's trust, regard must be had to a range of competing considerations, in particular how to balance flexibility with accountability. In the remaining parts of this article, we propose a range of structuring solutions, of which each may prioritise one (or more) consideration(s), and therefore, whether the right balance has been struck necessarily depends on what precisely John wants to achieve.

4.2 Express duty to invest ethically

If the trustee is expected to engage in ethical investing by way of portfolio screening, presumably to signal a strong ESG commitment, a straightforward method is to mandate it in the trust deed. This can come in different forms and levels of specificity. The trustee may be required to set aside a certain percentage of the trust fund for ethical investments. The permissible ethical investments may or may not be expressly listed in the trust deed. If they are not, then it is desirable for the trust deed to also specify the permissible scope and method. In the case of John, who has a reputation to uphold, he may decide to focus solely on green investments and to require the trustee to conduct positive portfolio screening. This will facilitate the creation of an investment portfolio consisting of the best performers in terms of environmental attribute. Alternatively, to preserve greater investment freedom for the trustee, John may decide to mandate negative portfolio screening, which will weed out the most environmentally unfriendly investments but allow the trustee to invest in businesses that are average or neutral in their environmental attribute.

The advantage of this approach is that it allows for extreme forms of ethical investing while offering the trustee sufficient protection. For John's case, the evidence suggests that focusing solely on environmental factor may not yield the best financial returns. Yet the trustee is allowed to invest in this manner because the trust deed expressly mandates it. Although the trustee is still required to discharge their duty with skill and care, at least they cannot be alleged to have infringed the best financial interest rule purely because they have engaged in ethical investing. However, a notable problem with this approach is its rigidity. The specified list of ethical investments may deteriorate—either increasing in risk or decreasing in profitability—due to changing market conditions. Or growing the trust fund may become a pressing concern due to the immediate financial needs of the beneficiaries. In such circumstances, the trustee who has their hands tied to a very narrow investable universe will not be able to divert the trust fund towards more profitable (but ESG-negative) investments.[82] In short, expressly mandating a trustee to invest ethically would introduce some rigidity that settlors may not be comfortable with, especially if the provision of financial support to beneficiaries is an important function of the trust.

4.3 Broad power coupled with exemption clause

[82] Henry Wickham, 'All in the Balance: Sustainable Investment and the Role of the Fiduciary' (2020) 26 T&T 303.

A more flexible approach is to expressly state that the trustee has the power (instead of duty) to invest ethically. On the face of it, this would give the trustee the freedom to decide how much to allocate to ethical investing as well as how the ethical investing is to be performed. The trustee may scale back on ethical investing and allocate more of the trust funds towards fulfilling the financial needs of the beneficiaries should the circumstances require. The only problem is that, should the trustee decide to actively engage in ethical investing, the express power does not provide foolproof protection. Wickham has observed that merely giving trustees a power to make such investments without requiring them to exercise that power may still result in them being held accountable if losses arise from such investments.[83]

Indeed, even if ethical investing is expressly allowed, the trustee's duty to maximise financial returns may imply that the power is not to be exercised to the detriment of the trust. If the ethical investment results in a loss or yields less profit than other reasonable investment options, the trustee may be exposed to liability, either for having acted outside the purpose of the trust or for breach of a duty of care. In other words, it may be argued, on an objective basis, that another trustee in the same position would have chosen not to exercise the power to make the ethical investment but to invest in some other products. Put differently, the power is to be exercised only if the ethical investment product is reasonably profitable. In this regard, crude portfolio screening will likely attract considerable risks, whereas ESG integration is likely to be more defensible. Using John's example, if the trustee is expected to refrain from investing in sin industries, this structuring option would place the trustee in a precarious position, as fulfilling that expectation will expose the trustee to potential risks.

To mitigate this problem, John may consider incorporating an exemption clause in the trust deed. This exemption clause may be broadly worded to cover all the duties which the trustee may potentially breach in taking ethical factors into consideration. For example, the clause might state that the trustee is exempted from liability if they have acted in good faith in choosing ethical investments over non-ethical, even if this resulted in a loss. The only problem is that this appears to give the trustee a free pass in ethical investing without being constrained by a duty of care. Surely John would expect his trustee to exercise skill and care even when engaging in ethical investing. Yet, if the exemption clause were to be drafted more restrictively to not exempt liability for a breach of duty of care, this would not sufficiently protect the trustee from the risk alluded to earlier, which a trustee might be reluctant to bear. The challenge, in short, is to draft an exemption clause that will shield the trustee from any claim grounded *merely* on the fact that the trustee had engaged in ethical investing that resulted in a loss (or lower returns). The exemption clause must still leave room for trustee accountability; the trustee should still be liable if it is shown that the loss was caused by the trustee's negligence within the permissible realm of ethical investing. Although this solution may offer a good balance between empowering the trustee to engage in ethical investing while not giving them a blank cheque to invest howsoever they wish, much depends on the skill of the drafter to ensure that the exemption clause does indeed have this effect.

4.4 Ethical investment as a purpose

A slightly more subtle approach to allowing ethical investing may be to work ethical goals into the purpose of the trust, considering that a trustee's investment power must be exercised in

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[83] Wickham (n 82), 304-305.

furtherance of the trust's purpose.[84] In *Grand View Private Trust Ltd v Wen-Young Wong*, Lord Richards explained that the relevant intention is that of the settlor, to be 'objectively determined by the terms of the instrument, construed in light of the circumstances in which it was made'.[85] Besides the trust deed, other documents that can be taken into account include 'substantially contemporaneous documents which are intended to be read with the trust deed, such as a letter of wishes provided by the settlor' (although there was no letter of wishes in this case).[86]

Unlike charitable trusts, the primary purpose of a private express trust is more likely to financially provide for its beneficiaries. However, this does not mean that there cannot be multiple purposes. Using John's example, the other non-financial purpose—to ensure that the trust maintains an image of environmental responsibility—may be reflected in the preamble of the trust deed and reinforced with an express power to engage in green investments. To further replicate the conditions in the *Butler-Sloss* case, John may even consider specifying the financial goals of the trust, such as the minimum financial growth that would be required to maintain the beneficiaries' standard of living at a certain level. If John prefers, he may even explicitly allow positive portfolio screening so that he can boast to have created a 'dark green' trust.[87] For another settlor who may prefer to keep matters under the carpet, the same clauses may instead be included in a contemporaneously drafted letter of wishes.

With the ethical consideration reflected in its preamble, this express private trust exhibits characteristics of both pension trusts and charitable trusts, with a greater leaning towards the latter. Importantly, this should have direct implication on the kind of investments the trustee could select, as one of the standard investment criteria is the *suitability* of the investments to the trust in question.[88] Moreover, it is at least arguable that the legal principles laid down by Green J in the *Butler-Sloss* case may be imported here. John's trustee would not be outrightly liable for engaging in ethical investment that results in a loss. Instead of pursuing maximum financial returns, the trustee is required to balance the financial and non-financial goals of the trust. Although the trustee is still required to exercise skill and care, any allegation that it has breached this duty is not easily established, as the focus is on the process rather than the outcome. The trustee may resist the claim by showing that professional advice was duly sought and that the ESG-friendly investment policy was based on a proper balancing of the competing interests, namely the beneficiaries' financial interest and the trust's reputation. If proper consideration was given to the conduct of this balancing exercise, the trustee would have discharged its duty of care, even if the court or a different trustee would have reached a different decision.[89] The advantage of this approach is that while the trustee is empowered to engage in ethical investing the duty of care is also preserved without having to resort to a very precisely drafted exemption clause.

4.5 Trust-corporate structure

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[84] *In re Courage Group's Pension Schemes* [1987] 1 WLR 495 (Ch); *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] AC 821 (PC); *Eclairs Group Ltd v JKX Oil & Gas plc* [2015] UKSC 71; *Grand View Private Trust Ltd v Wen-Young Wong* [2022] UKPC 47.

[85] *Grand View Private Trust Ltd* (n 84), [57].

[86] *Grand View Private Trust Ltd* (n 84), [63].

[87] Darker green denotes greater environmental impact: see Nadia Humphreys, Murat Bozdemir and Rokhsana Saddighzadeh, 'Shades of Green: Classifying ESG Funds' (Bloomberg, 1 February 2023) <https://www.bloomberg.com/professional/blog/shades-of-green-classifying-esg-funds/> accessed 20 January 2024.

[88] Trustee Act 2000, ss 4(1).

[89] See Part 4.5 below for comparison with the business judgment rule in company law.

We turn to a final structuring option that straddles trust and company laws. John may consider establishing a company tasked with investing the relevant assets. Thereafter, he would transfer the controlling shareholding in the company to his chosen trustee, thereby constituting the trust. The trustee is to retain these shares instead of converting them into money to be further invested.[90] Insofar as the company is concerned, John should consider appointing directors who have the expertise and experience to engage in ethical investing. They should ideally not be the same persons as the trustees so as to avoid any potential conflict between the duties owed by the trustees to the trust beneficiaries and the duty of directors to promote the success of the company. Through this trust-corporate structure, investment decisions are taken out of the hands of the trustees and placed in the hands of business savvy directors.[91] More importantly, it may be possible to draw on the warmer reception of ESG considerations within the corporate law context and greater freedom accorded to directors in making business and investment decisions.

Section 172(1) of the Companies Act 2006 requires a director to 'act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole' and in doing so have regard to, inter alia, 'the impact of the company's operations on the community and the environment'.[92] As Lord Briggs explained in *BTI 2014 LLC v Sequana SA*:

> 'This provision recognises that, as a separate entity from its shareholders, a company has responsibilities of a legal, societal, environmental and, in a loose sense, moral or ethical nature, compliance with which is likely to secure rather than undermine its success. These responsibilities are not those of its shareholders, even viewed as a whole.'[93]

This section gives statutory recognition to the concept of 'enlightened shareholder value', which represents a shift from the traditional focus on short-term profit maximisation to promoting long-term success of the company through the consideration of stakeholder interests.[94] It might be recalled that, in the case of ESG integration as an investment strategy, there is no clear evidence that focusing on the environmental and social aspects of ESG will lead to better financial returns.[95] In contrast, in the context of director's duties, this uncertainty is sidestepped with the specific reference to environmental and social considerations. Directors are in fact under a duty to consider these factors in making business and investment decisions, with the degree to be determined by the circumstances of each case. Moreover, unlike Green J's formulation in *Butler-Sloss*, the duty to promote the success of the company under section 172(1) does not appear to restrict the directors to negative portfolio screening.

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90 *Re Van Straubenzee* [1901] 2 Ch 779, 785.

91 On the trust-corporate structure, see Man Yip, 'Trust-owned companies: understanding the trustee's duties' (2017) 31 TLI 185.

92 For the legislative background of the section, see *BTI 2014 LLC v Sequana SA* [2022] UKSC 25, [371]–[386] (Lady Arden).

93 *BTI 2014 LLC* (n 92), [140] (Lord Briggs).

94 See generally Andrew Keay, *The Enlightened Shareholder Value Principle and Corporate Governance* (Routledge 2013), Chapter 4; Andrew Keay, 'Enlightened Shareholder Value, The Reform of the Duties of Company Directors and the Corporate Objective' [2006] LMCLQ 335; Virginia Harper Ho, "Enlightened Shareholder Value': Corporate Governance Beyond the Shareholder-Stakeholder Divide' (2010) 36 J Corporation L 59.

95 See Part 2 above.

However, because the emphasis is still on (enlightened) shareholder value, stakeholder interests remain subordinate to shareholder interest.[96] Therefore, whether section 172(1) can be safely relied upon by directors to actively pursue environmental and social interests at the expense of maximising financial returns remains doubtful.[97] But there is room for optimism with the rise of the 'shareholder stewardship' movement.[98] The latest edition of the UK Stewardship Code, sought to mainstream ESG factors into stewardship by promoting 'responsible allocation, management and oversight of capital to create long-term value for clients and beneficiaries leading to sustainable benefits for the economy, the environment and society'.[99] Principle 7 of the Code specifically requires signatories to 'systematically integrate stewardship and investment, including material environmental, social and governance issues, and climate change, to fulfil their responsibilities'. Whether reputational incentives and sanctions are sufficient to sustain the momentum remains to be seen, although the government is expected to actively lend its support with emphasis on combating climate change considering that it is a signatory to the Paris Agreement.[100]

Yet an obviously safer approach is to draft the company's constitution in such a way that permits the pursuance of ethical goal, as directors must act in accordance with the company's constitution and exercise powers for the purposes for which they are conferred.[101] Indeed, section 172(2) contemplates a case where 'the purposes of the company consist of or include purposes other than the benefit of its members'. In this regard, the Chancery Lane Project is notable for promoting its model clauses aimed at building ESG considerations into a company's articles of association.[102] The challenge, as we have explained earlier, is how best to balance flexibility and accountability.

Where the director is expected to balance shareholder and stakeholder interests, a case may be made for applying the 'business judgement rule'. Although precise definition remains elusive, the basic idea is that, on account of directors being required to undertake entrepreneurial risk-taking, the court will generally defer to the director's business judgment unless they can be shown to have acted in bad faith or in an utterly unreasonable manner.[103] Indeed, compliance with section 172(1) is to be judged subjectively, based on what the director considers to be 'in good faith'.[104]

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96 Paul Davies, Sarah Worthington and Christopher Hare, *Gower: Principles of Modern Company Law* (11th) edn, Sweet & Maxwell 2021), [10-027]; John Birds, 'Chapter 15: Directors' Duties' in Alistair Alcock and Michael Todd (eds), *Gore-Browne on Companies* (Jordan Publishing 2023), [10B].

97 See *R on the Application of People and Planet v HM Treasury* [2009] EWHC 3020.

98 Dionysia Katelouzou and Dan W Puchniak (eds), *Global Shareholder Stewardship* (CUP 2022).

99 Financial Reporting Council, 'UK Stewardship Code', 4 <https://www.frc.org.uk/investors/uk-stewardship-code)> accessed 20 January 2024.

100 Paul Davies, 'The UK Stewardship Code 2010–2020: From Saving the Company to Saving the Planet?' in Katelouzou and Puchniak (n 98) Ch 2, 62–63.

101 Companies Act 2006, s 171.

102 'ESG Aligned Company Articles' (The Chancery Lane Project, 18 Jun 2022) <https://chancerylaneproject.org/climate-clauses/esg-aligned-company-articles/> accessed 20 January 2024.

103 Andrew Keay and Joan Loughrey, 'The Concept of Business Judgment' (2019) 39 LS 36, 38. See also *Gower* (n 96), [10–029] and [10-032]; Mary Arden, Dan Prentice and David Richards, *Buckley on the Companies Acts* (15th edn, LexisNexis 2023), [917]; Aurelio Gurrea-Martínez, 'Re-Examining the Law and Economics of the Business Judgment Rule: Notes for its Implementation in Non-US Jurisdictions' (2018) 18 JCLS 417, 418; Jenifer Varzaly, 'Protecting the Authority of Directors: An Empirical Analysis of the Statutory Business Judgment Rule' (2012) 12 JCLS 429.

104 This simply codifies the common law position as set out in *Re Smith & Fawcett Ltd* [1942] Ch 304 (CA), 306 (Lord Greene MR). For an example of a statutory formulation of the business judgment rule, see the Corporations Act 2001 (Commonwealth, Australia), s 180(2).

The business judgement rule would appear to share considerable similarities with the approach adopted in *Butler-Sloss*. Both approaches focus on the decision-making process and the requirement that it be made in a proper manner, instead of the results per se. They both accept that there are likely to be differences in what one might regard to be in the best interests of the company or trust, and that the directors or trustees should be given a broad discretion as to what decisions to make.

Finally, we turn to the protection of the trustee. The trustee, having been divested of the investment function, is instead subject to what is known as a *Bartlett* duty,[105] that is, a duty to supervise and intervene[106] if the company has not been properly run.[107] However, the duty to intervene is not necessarily relevant where the director engages in ethical investing, especially where that is expressly permitted in the company's constitution. In any event, it is possible to include an anti-*Bartlett* clause in the trust deed. In *Zhang Hong Li v DBS Bank (Hong Kong) Ltd*, the Privy Council upheld the validity of an anti-*Bartlett* clause to absolve the trustees from liability for not intervening when the company directors engaged in high-risk financial products.[108] Having said this, although this would come as a relief for trustees, it does raise the question of whether such a clause can be drafted in a way that maintains a minimum degree of trustee accountability, a point we have alluded to in Part 4.3 earlier.

5. CONCLUSION

Although the question whether a trustee may have regard to ethical considerations in making investment decisions has been amply debated in the existing literature, with the prevailing view being that *Cowan v Scargill* did not lay down a strict rule against ethical investing, the lack of follow up by way of statutory clarification meant that trustees are left to waddle in this complex and uncertain legal landscape. This article approaches the problem through the lens of structuring a new express private trust. We identified risks that may deter a trustee from engaging in ethical investing. Such risks obviously vary depending on the method of ethical investing. The use of ESG integration with an eye on long-term financial return is defensible but blanket exclusion through portfolio screening is more likely to encounter objections. With the relevant risks in mind, we introduced John the environmentalist to a range of structuring solutions with varying emphases. The challenge, clearly, is in balancing a range of competing considerations, in particular certainty, flexibility, and accountability. Rather than proposing any perfect solution, we recognise that much depends on what John wants to achieve and the kind of compromise that he (and his chosen trustee) is willing to accept. That said, we hope the structuring toolkit we proposed, which assists in identifying and managing risks, would give settlors (and trustees) more confidence to channel wealth into sustainability causes.

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[105] *Bartlett v Barclays Bank Trust Co Ltd* [1980] Ch 515. Depending on the governing law, it may well be that such a duty is imposed by statute: see, for example, the BVI Virgin Islands Special Trusts Act (Rev Ed 2020), ss 4, 5 and 8.

[106] In practise, the *Bartlett* duty is typically discharged by the appointment of a trustee or nominee onto the board of directors. However, as explained earlier, it is best to avoid any overlap between the office of trusteeship and the board of directors.

[107] See generally Toby Graham and David Russell, 'The *Bartlett* Duty Revisited- An Imperfect Fusion of Trust and Company Law and Practice' (2021) 27 T&T 850; *Hanbury & Martin* (n 38), [19-022]; and *Lewin* (n 38), [34-056].

[108] [2019] HKCFA 45. See Rebecca Lee and Man Yip, 'Exclusion of Duty and the Irreducible Core Content of Trusteeship: A Re-Assessment' (2020) 10 J Eq 131; David Hayton, 'Anti-*Bartlett* Clauses after *IQEQ* in the Hong Kong Court of Final Appeal' (2022) 28 T&T 294.