

The Law Commission
Consultation Paper No 171

TRUSTEE EXEMPTION CLAUSES
A Consultation Paper

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The Law Commission was set up by section 1 of the Law Commissions Act 1965 for the purpose of promoting the reform of the law.

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This consultation paper, completed on 2 December 2002, is circulated for comment and criticism only. It does not represent the final views of the Law Commission.

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THE LAW COMMISSION
TRUSTEE EXEMPTION CLAUSES
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TRUSTEE EXEMPTION CLAUSES

EXECUTIVE SUMMARY

The Law Commission Consultation Paper “Trustee Exemption Clauses” examines the current law and practice relating to trustee exemption clauses in England and Wales, considers the economic implications of regulation of such clauses, sets out the options for reform and makes provisional proposals on which the views of consultees are invited.

In this project we are concerned with the extent to which trustees can exclude or restrict their liability to the beneficiaries for breach of trust.

THE PROBLEM

Trust duties are obligations contained in the trust instrument or imposed by law, which must be carried out by the trustees. The trustees’ failure to carry out their duties is a breach of trust and the trust beneficiaries (subject to the existence of an exemption clause) may take action to recover any loss caused to the trust by the trustees’ failure.

The relatively unrestricted nature of trustees’ liability for breach of trust has resulted in the use of common form clauses in trust instruments which exclude or restrict that liability. The terms of such clauses in early trust instruments were fairly narrow and they were strictly construed against trustees. However the changed nature of the trust assets, the use of the trust for purposes never before envisaged, the extended powers given to trustees and the fear of increasingly litigious beneficiaries has led to the inclusion of ever wider exemption clauses in trust instruments.

A typical trustee exemption clause may read as follows:

No Trustee shall be liable for any loss or damage which may happen to the Trust Fund...at any time or from any cause whatsoever unless such loss or damage shall be caused by his own actual fraud.

It is now relatively common to find express provisions in modern trust instruments inserted to protect trustees from their liabilities in respect of acts or omissions that would normally be regarded as breaches of trust. As the powers of trustees have increased as a result both of express provisions in trust instruments and by legislation, so has the breadth of trustee exemption clauses. When coupled with the less restrictive approach recently adopted by the courts to the construction of exemption clauses, it can be strongly argued that the protection offered to beneficiaries, one of the prime concerns of trust law, is weaker than in the past.

THE CURRENT LAW

The current law recognises that there is an irreducible core of obligations from which trustees cannot escape. However, as that core comprises little more than a duty to act honestly and in good faith it does not impact seriously on a settlor's freedom to exclude trustees' liability by express terms in the trust instrument.

In 1998 in *Armitage v Nurse* the Court of Appeal dispelled all doubts as to the validity of trustee exemption clauses which exclude liability for ordinary or even gross negligence. The court held that a clause (similar to that set out above) could exclude the trustee from liability for loss or damage to the trust property "no matter how indolent, imprudent, lacking in diligence, negligent or wilful he may have been, so long as he has not acted dishonestly". It is now settled law in England and Wales that trustee exemption clauses can validly exempt trustees from liability for breaches of trust except fraud.

In each case the court must construe the words of the exemption clause in light of the conduct complained of and decide whether liability has been excluded by the terms of the clause. In carrying out this exercise the clause must be construed fairly according to the natural meaning of the words used. Although there are restrictions on exemption clauses or duty modifying clauses in other areas of the law, there are currently no statutory provisions which are directed at all kinds of trustee exemption clauses.

THE ECONOMIC IMPLICATIONS OF REGULATING TRUSTEE EXEMPTION CLAUSES

The economic impact of any legal regulation of trustee exemption clauses is an important consideration in deciding whether reform should be recommended. Obtaining accurate information about trust practice is a difficult exercise, as trusts are not publicly recorded or registered. In an attempt to understand as fully as possible the current significance of trustee exemption clauses, we commissioned independent socio-economic research on the subject.

The research revealed that trustee exemption clauses are now widely used in trust instruments and that professional trustees in particular have come to rely upon them as affording a means of protection from liability for breach of trust. This trend is not by any means universally approved- even among professional trustees themselves, many of whom take the view that those who charge for their services should be properly accountable to the beneficiaries of the trust.

However many professional trustees consider trustee exemption clauses to be a necessary component in modern trust practice. They would argue that any regulation would lead to a greater reluctance to act and possibly to the transfer of trusts to jurisdictions which do not restrict reliance on trustee exemption clauses. We are not presently convinced that there is a significant risk of the latter. The most convenient jurisdictions, namely Jersey and Guernsey, have already imposed legislative controls on trustee exemption clauses, and it does not appear that this is an issue which is usually determinative of choice of jurisdiction for a settlor or for that matter a trustee.

Where a trust contains a trustee exemption clause, liability insurance premiums are likely to be lower. In so far as exclusion of liability is regulated, the trustee's degree of risk will increase, and the concomitant rise in premiums will be carried through to the settlor in the fees being charged by the trustee. There may also be higher operational costs which could be fairly attributed to regulation.

PROVISIONAL PROPOSALS

The Law Commission does not believe that an absolute prohibition on all trustee exemption clauses is justifiable at present. One of the advantages of the trust is its flexibility and its adaptability to different factual circumstances and to different kinds of relationship. To deny settlors all power to modify or to restrict the extent of the obligations and liabilities of the trustee would have a very significant impact on the nature of the trust relationship. The trust would inevitably become more inflexible. We are particularly concerned that excessive regulation of trustee exemption clauses may deter lay trustees from assuming the responsibility of trusteeship in the first place.

At the same time, the Law Commission does believe that there is a very strong case for some regulation of trustee exemption clauses. Their increased use in recent years has without doubt reduced the protection afforded to beneficiaries in the event of breach of trust. While there is a need to maintain a balance between the respective interests of settlor, trustee and beneficiary, we believe that the current law is too deferential to trustees, in particular professional trustees who hold themselves out as having special knowledge skills and experience, charge for the services they provide and insure themselves against the risk of liability for breach of trust.

We therefore propose to draw a distinction between the professional trustee and the lay trustee. "Professional" trustees would comprise trust corporations and any other trustees acting in a professional capacity. All others would be "lay" trustees.

As a matter of good practice, the draftsman of a trust should always bring the presence of a trustee exemption clause to the attention of the settlor, explain clearly its implications and discuss the alternatives which may be available for the protection of those who may be acting as trustees.

We make several provisional proposals which would require legislation:

- All trustees should be given power to make payments out of the trust fund to purchase indemnity insurance to cover their liability for breach of trust.
- Professional trustees should not be able to rely on clauses which exclude their liability for breach of trust arising from negligence.
- In so far as professional trustees may not exclude liability for breach of trust they should not be permitted to claim indemnity from the trust fund.

- In determining whether professional trustees have been negligent, the court should have power to disapply duty exclusion clauses or extended powers clauses where reliance on such clauses would be inconsistent with the overall purposes of the trust and it would be unreasonable in the circumstances for the trustee to be exempted from liability.
- Any regulation of trustee exemption clauses should be made applicable not only to trusts governed by English law but also to persons carrying on a trust business in England and Wales.
- Any legislation should apply to any breaches of trust which occur on or after the date when it comes into force but it should not apply to breaches of trust which precede that date.

The Law Commission also invites views of consultees on other possible options for reform of the law, for example:

- Whether a trustee should be able to rely on a trustee exemption clause to exclude or restrict his or her liability for breach of trust only where the clause satisfies the test of reasonableness.
- Whether professional trustees should not be able to rely upon a trustee exemption clause where it is not reasonable to do so by reference to all the circumstances including the nature and extent of the breach of trust itself.

We also invite comments from consultees on the economic implications of any regulation of trustee exemption clauses, including the regulatory impact of our provisional proposals.

All views expressed in the Consultation Paper are provisional only, and we look forward to hearing the views of those who have an interest in the subject. The consultation period ends on 30 April 2003. The postal and electronic addresses to which comments should be sent are shown on the inside front cover of this Consultation Paper.

PART I

INTRODUCTION

THE EXPANSION OF TRUSTEE POWERS

- 1.1 The traditional means of controlling trustees, and hence protecting beneficiaries, have been to restrict their powers and to impose strict duties. In recent years, it has become clear that a restrictive approach to trustees' powers can be detrimental to the interests of beneficiaries. Thus in 1999 the Law Commission stated:

...the law governing the powers and duties of trustees has not kept pace with the evolving economic and social nature of trusts- indeed the default powers which trustees have under the present law are generally regarded as seriously restrictive. The nature of trusts and the assets that are characteristically held by them are now very different from what they were when the present legislative provisions were enacted. Those provisions no longer give trustees the powers they need to administer a trust effectively and, unless the instrument creating the trust confers wider powers, make it very difficult for trustees to comply with their paramount duty to act in the best interests of the trust.¹

- 1.2 The Law Commission recommended the removal of many of these restrictions to facilitate the administration of the modern trust, and the Trustee Act 2000 was enacted to give effect to those recommendations.² It adopts what may be described as a permissive approach, conferring wider powers on trustees, and controlling their conduct by means of the imposition of a statutory duty of care.
- 1.3 The statutory duty of care (which is applied only when the trustee is exercising certain powers)³ expects those trustees who have, or hold themselves out as having, any special knowledge or experience, or who are acting in the course of a business or profession, to attain standards commensurate to the knowledge or experience which they have or purport to have and which it is reasonable to expect a person acting in the particular business or profession to have.⁴ This nuanced approach to the definition of duty distinguishes between different categories of trustee, who we shall refer to, in broad terms, as the lay trustee and the professional trustee.⁵
- 1.4 The Trustee Act 2000 does not, however, make any attempt to regulate the use of trustee exemption clauses, the inclusion of which in trust instruments has

¹ Trustees' Powers and Duties (1999) Law Com No 260; Scot Law Com No 172, para 1.1.

² The Trustee Act 2000 came into force on 1 February 2001.

³ Trustee Act 2000, s 2, Sched 1.

⁴ Trustee Act 2000, s 1(1).

⁵ See para 4.33 for further discussion of this distinction.

become more common in recent years. Indeed, the Trustee Act 2000 expressly states that the statutory duty of care does not apply:

if or in so far as it appears from the trust instrument that the duty is not meant to apply.⁶

TRUSTEE EXEMPTION CLAUSES

1.5 English law does not at present provide a readily available means for beneficiaries to claim that a trustee exemption clause should not be invoked by a trustee and, as a result, trustees have considerable scope to protect themselves from liability for breach of trust. The question arises whether reliance on trustee exemption clauses is seriously endangering the interests of those whom the trust relationship is directed to promote.

1.6 The present law governing trustee exemption clauses has been criticised on a number of grounds. In the leading case, *Armitage v Nurse*,⁷ Millett LJ, as he then was, noted that:

the view is widely held that these clauses have gone too far, and that trustees who charge for their services and who, as professional men, would not dream of excluding liability for ordinary professional negligence should not be able to rely on a trustee exemption clause excluding liability for gross negligence.⁸

1.7 In June 1999, the Trust Law Committee issued a Consultation Paper in which it provisionally recommended that the law should provide that a trustee remunerated for his services as trustee may not rely on an exemption clause excluding liability for breach of trust arising from negligence (and worse), in all cases where the trustee cannot prove that prior independent advice was given to the settlor. The Committee stated:

There is much to be said for trust corporations and professional individuals paid for their services as trustees, (like solicitors, barristers and accountants) to accept the price of liability for negligence in acting as a paid trustee and to insure against such risk, with the premiums being reflected in the fees for the services provided.⁹

1.8 One of the most important developments of the common law in the twentieth century was the development and incremental extension of the tort of negligence.¹⁰ This has had a profound impact on many areas of legal liability,

⁶ Trustee Act 2000, Sched 1, para 7.

⁷ [1998] Ch 241.

⁸ *Ibid*, at p 256.

⁹ TLC Report (1999) para 7.8.

¹⁰ A thorough account of this development can be found in *Jackson & Powell on Professional Negligence* (5th ed 2002) paras 2- 013 to 2- 124. The main cases include: *Donoghue v Stevenson* [1932] AC 562; *Hedley Byrne & Co Ltd v Heller & Partners Ltd* [1964] AC 465; *Dorset Yacht Co v Home Office* [1970] AC 1004; *Anns v Merton LBC* [1978] AC 728; *Smith v*

none more so than the liability of professional persons, not only to their clients but also to others who may be affected by their negligent acts or omissions. The effect of this development has been, unsurprisingly, to increase litigation and to incite professional persons, with the encouragement and sometimes by the direction of their regulatory bodies, to take out indemnity insurance for their own protection. It has also led to a general public awareness that professional persons are responsible for their mistakes and are expected to compensate those who suffer loss as a consequence. It is against this background that discontent with the widespread use of a device, such as an exemption clause, which seeks to eliminate, for the most part, the prospect of successful claims being made against professional trustees for breach of trust has led to the current reference being made to the Law Commission.

- 1.9 During debates in the House of Lords on the Trustee Bill, concerns were raised by Lord Goodhart¹¹ that the measure did nothing to restrict the inclusion of trustee exemption clauses in trust instruments:

In their usual form, trustee exemption clauses protect trustees from any liability for anything except personal and individual fraud in an action by the trust beneficiaries claiming damages against the trustees for breach of trust. However negligent, lazy or misguided the trustees may have been, they cannot be held liable for the loss that they have caused to the trust fund...there can be no justification, save in the most exceptional circumstances, for extending such an exemption to a paid professional trustee.¹²

- 1.10 He contended that:

...a paid professional trustee, or a corporation providing trustee services as part of its business, should be entitled to rely on an exemption clause only where it satisfies the test of reasonableness under sections 4 and 11 of the Unfair Contract Terms Act.¹³

- 1.11 In reply to Lord Goodhart's concerns, the Lord Chancellor gave an undertaking to refer the matter formally to the Law Commission for thorough examination. The terms of the reference, made in January 2001, were to:

examine the law governing clauses which restrict the liabilities of trustees either by excluding liability for breach of their duties or by limiting the duties to which the trustees are subject.

Eric S Bush [1990] 1 AC 831; *Caparo Industries plc v Dickman* [1990] 2 AC 605; *Murphy v Brentwood DC* [1991] 1 AC 398; and *White v Jones* [1995] 2 AC 207.

¹¹ A member of the Trust Law Committee, Lord Goodhart has written two prominent articles on the subject matter of trustee exemption clauses: "Trustee Exemption Clauses and the Unfair Contract Terms Act 1977" [1980] Conv 333; "Trust Law for the Twenty-first Century" (1996) 10 TLI 38.

¹² *Hansard* (HL) 14 April 2000, vol 612, col 383.

¹³ *Ibid.*

1.12 At the same time, two other matters were referred by the Lord Chancellor to the Law Commission:

- (1) The rules of apportionment concerning:
 - (a) the circumstances in which trustees may or must make apportionments between the income and the capital of the trust fund;
 - (b) the rights and duties of charity trustees in relation to investment returns on a charity's permanent endowment; and
 - (c) the circumstances in which trustees must convert and re-invest trust property; and the rules which determine whether money or other property received by trustees is to be treated as income or capital.
- (2) The rights of creditors against trust funds: to examine the law governing the rights of creditors against trustees and the trust fund for liabilities incurred by the trustees on behalf of the trust.

It is our intention to publish separate consultation papers dealing with these issues in due course.

1.13 We realise that the regulation of trustee exemption clauses may have a considerable impact on the use of trusts and that any reform of the law must take account of the potential economic implications. The major concerns are as follows:

- (1) regulation may result in significantly higher charges being made for the work of professional trustees;
- (2) lay trustees may be deterred from assuming the responsibility of trusteeship if they consider themselves exposed to greater liability from which they cannot secure protection; and
- (3) regulation may encourage professional trustees to move their operations to jurisdictions which have less restrictive controls and settlors may decide to transfer their trust funds out of England and Wales.

1.14 We are aware that there is some element of competition between trust jurisdictions and that any reform of trust law creates a potential risk to the jurisdiction which it affects. We are also aware that the range of trusts which are currently governed by English law is vast, and that certain trusts are more sensitive to change than others.

1.15 We commenced this project by distributing a preliminary questionnaire to trusts practitioners¹⁴ to ascertain views as to whether there were in practice real

¹⁴ With the assistance of the Society of Trust and Estate Practitioners.

concerns to be addressed in this area of the law. The majority of those who responded were dissatisfied with the current law. They considered it unacceptable that trustees were permitted to exclude liability for gross negligence and that reform of the law in this area was required. A majority, whilst acknowledging the possible difficulties, thought that a distinction should be made between lay and professional trustees, with the former being more leniently treated.

- 1.16 We then instructed Dr Alison Dunn, of the University of Newcastle-upon-Tyne, to conduct socio-economic research on the use of trustee exemption clauses, addressing in particular the concerns we have mentioned above.

THE CONSULTATION PAPER

- 1.17 In this Consultation Paper, we intend to explore the current law and practice of trustee exemption clauses in England and Wales and to consider the case for reform. In doing so we shall be drawing upon the experience of other jurisdictions, some of which have introduced legislation regulating the use of such clauses, and some of which are actively considering the case for legislative regulation.
- 1.18 **Part II** considers the current law of trustee exemption clauses.
- 1.19 **Part III** considers the economic implications of regulating trustee exemption clauses.
- 1.20 **Part IV** sets out the options for reform and seeks the views of consultees.
- 1.21 **Part V** summarises the questions for consultation.
- 1.22 We should emphasise that the nature of the trust- as an institution of private law- makes it extremely difficult to predict accurately the impact of regulation. We would therefore be particularly grateful for any comments which consultees may have on the factual background to the use of trustee exemption clauses.

ACKNOWLEDGEMENTS

- 1.23 We are very grateful to Dr Alison Dunn and her research assistant, Mrs Ann Sinclair, for the socio-economic research which they have conducted on our behalf. We are also very grateful to the Trust Law Committee, in particular Professor David Hayton, Mr John Dilger and Mr Simon Jennings, for its assistance in this project. As always, the Society of Trusts and Estate Practitioners has been extremely supportive- in this case in eliciting the views of its members by distribution of our preliminary questionnaire. We also express our gratitude to Mr Reg Brown, a recent former president of the Chartered Insurance Institute, for his advice on matters pertaining to trustee liability insurance.

PART II

THE CURRENT LAW

THE NATURE OF THE PROBLEM

- 2.1 The wide and relatively unrestricted nature of trustees' liability for breach of trust has resulted in the use of common form clauses in trust instruments purporting to exclude or restrict that liability. The terms of such clauses in the early trust instruments were relatively narrow and were strictly construed against trustees.¹ However, the changed nature of trust assets, the use of the trust for purposes never before envisaged, the endowment of increased powers on trustees and the fear of increasingly litigious beneficiaries has led to the inclusion of ever wider exemption clauses in trust instruments.²
- 2.2 It is now relatively common to find express provisions in modern trust instruments inserted to protect trustees from their liabilities in respect of acts or omissions that would normally be regarded as breaches of trust. As the powers of trustees have increased as a result both of express provisions in trust instruments and by legislation, so has the breadth of trustee exemption clauses. When coupled with the less restrictive approach recently adopted by the courts to the construction of exemption clauses, it can be strongly argued that the protection offered to beneficiaries, one of the prime concerns of trust law, is weaker than in the past.
- 2.3 In this project, we are concerned with the extent to which trustees can exclude or modify their liability to the beneficiaries for breach of trust. In the words of Sir Arthur Underhill:

A trust is an equitable obligation, binding a person (who is called a trustee) to deal with property over which he has control (which is called the trust property), for the benefit of persons (who are called the beneficiaries or cestuis que trust), of whom he may himself be one, and any one of whom may enforce the obligation.³

- 2.4 Trustees may seek protection from liability for actions and omissions that would normally be regarded as a breach of trust by terms in the trust instrument which exclude their liability. An *exemption clause* therefore typically provides that a trustee shall not be liable for loss to the trust resulting from a breach of trust (other than for fraud or wilful default).⁴

¹ For an example, see *Seton v Dawson* (1841) 4 D 310, considered below at para 2.23.

² See, for instance, the clause in *Armitage v Nurse* [1998] Ch 241, considered below at para 2.42 *et seq.*

³ *Underhill & Hayton, Law Relating to Trusts and Trustees* (15th ed 1995) p 3.

⁴ In *Re Vickery* [1931] 1 Ch 572, it was held that wilful default connotes a deliberate breach of trust. To be guilty of wilful default the trustee must be conscious that, in doing the act complained of or in omitting to do the act which it is said he ought to have done, he is

- 2.5 But that is only one means of restricting the exposure of trustees to legal accountability. Another approach may be to seek to limit the duties to which the trustee would normally be subject. By narrowing the scope of the obligations owed by the trustee to the beneficiaries, the same result can be achieved as by invocation of a trustee exemption clause which excludes liability for breach of trust. Where a *duty exclusion clause* is contained in the trust instrument, it will obviously be more difficult for a beneficiary to establish that the trustee is in breach of duty.⁵
- 2.6 Yet another possibility is for the trust instrument to confer wider powers on the trustees, expressly authorising the trustees to do acts which would normally be proscribed. For example it may be provided that the trustees may acquire wasting assets or assets which yield little or no income for investment purposes.⁶ Such clauses may be termed *extended powers clauses* or *authorisation clauses*.
- 2.7 Finally, the trust may contain a provision entitling the trustee to an indemnity out of the trust fund in respect not only (as one might expect) of costs and expenses incurred in the proper administration of the trust but also for any liability for breach of trust (save perhaps for liability arising out of the trustee's individual fraud). Such an *indemnity clause* is not as effective a protection for the individual trustee as a clause exempting his or her liability as its efficacy is dependent on the continuing solvency of the trust, but it can nevertheless operate to the prejudice of beneficiaries.
- 2.8 Any attempt to control the use of trustee exemption clauses must confront the argument that the trust, as an institution of private law, derives its terms from the directions of the settlor. It is for the settlor to decide whether the trustees should be granted exemption from liability in certain circumstances, whether the

committing a breach of his duty, or is recklessly careless whether it is a breach of his duty or not.

⁵ See, for example, the clause in *Wilkins v Hogg* (1861) 31 LJ Ch 41. The testator declared "that such trustee shall be answerable only for losses arising from his own defaults, and not for involuntary acts, or for the acts or defaults of his co-trustees or trustee, and, particularly, that any trustee who shall pay over to his co-trustee, or shall do or concur in any act enabling his co-trustee to receive any monies for the general purposes of my will, or for any definite purpose authorized by my will, shall not be obliged to see to the due application thereof, nor shall such trustee be subsequently rendered responsible by an express notice or intimation of the actual misapplication of the same monies; but this clause shall not restrict the power of any trustee to require from his co-trustee an account of the application of monies in his hands, or to insist on his replacing monies misapplied by him". See also the somewhat unusual clause in *Hayim v Citibank NA* [1987] AC 730 where the testator's will provided (in relation to a property situated in Hong Kong) that his American trustee "...shall have no responsibility or duty with respect to such property...and [the] executor's and trustee's only duty and responsibility with respect thereto shall arise upon its receipt of the proceeds of said residence...".

⁶ See, for example, the clause in *Bartlett v Barclays Bank Trust Co Ltd (Nos 1 & 2)* [1980] Ch 515 entitling the trustee to "act in relation to the Bartlett Trust Ltd or any other company and the shares securities and properties thereof in such way as it shall think best calculated to benefit the trust premises and as if it was the absolute owner of such shares, securities and property."

trustees' powers should be wider than is the norm, whether the trustees' duties should be rendered less onerous, and whether, and in what circumstances, the trustees should be entitled to indemnity from the trust funds. Any statutory regulation of the content of the trust instrument which might be proposed is susceptible to attack on the ground that it restricts the autonomy of the settlor to dictate the obligations which are to be imposed on the trustees in whom the trust property has been vested.

2.9 However, it is already recognised that there is some control over the settlor's freedom of action. If the terms of the instrument do not impose sufficiently stringent obligations on the persons referred to as trustees, it may be that the instrument cannot be accurately described as a trust at all. In the absence of such obligations, the disposition by the settlor will fail as a trust. It will take effect either as an out- and- out gift to the persons named as trustees, or the property will be held on resulting trust for the settlor.

2.10 This important concept is sometimes explained by reference to the principle that there is a minimum "core content" of a trust.⁷ In its absence, no trust will be held to have been created. In *Armitage v Nurse*, the leading English decision on the efficacy of trustee exemption clauses, Millett LJ accepted that there is an "irreducible core of obligations owed by the trustees to the beneficiaries and enforceable by them which is fundamental to the concept of a trust".⁸ However, the core obligations did not include the duties of skill and care, or of prudence and diligence:

The duty of the trustees to perform the trusts honestly and in good faith for the benefit of the beneficiaries is the minimum necessary to give substance to the trusts, but in my opinion it is sufficient.⁹

2.11 As we shall explain in this Part, the current English law allows settlors considerable latitude in restricting the potential liabilities of their trustees, in conferring wide powers and in imposing narrow duties on them. The question to which we shall return in Part IV is whether it is justifiable to control the autonomy of settlors in this respect.

2.12 We are concerned in this project with one potential liability- liability for breach of trust. It is important, before we consider the current law on trustee exemption clauses, to explain what we mean by breach of trust. For, as has recently been observed:

To say that trustees are liable for breach of trust is not all that meaningful unless we can also say what they are liable to do.¹⁰

⁷ See D Hayton, "The Irreducible Core Content of Trusteeship" in A J Oakley (ed), *Trends in Contemporary Trust Law* (1996) p 47.

⁸ [1998] Ch 241, 253.

⁹ *Ibid.*

¹⁰ R Chambers, "Liability" in P Birks & A Pretto (eds), *Breach of Trust* (2002) p 1.

BREACH OF TRUST

- 2.13 A breach of trust is a breach of any obligation owed by the trustee. Such obligations may be imposed expressly by the trust instrument or impliedly by law. As Millett LJ explains in *Armitage v Nurse*:

Breaches of trust are of many different kinds. A breach of trust may be deliberate or inadvertent; it may consist of an actual misappropriation or misapplication of the trust property or merely of an investment or other dealing which is outside the trustees' powers; it may consist of a failure to carry out a positive obligation of the trustees or merely of a want of skill and care on their part in the management of the trust property; it may be injurious to the interests of the beneficiaries or be actually to their benefit.¹¹

Breach of fiduciary duty

- 2.14 Trustees stand in a fiduciary relationship with their beneficiaries and as such are subject to the fiduciary obligation of loyalty. From the fundamental obligation of loyalty there have evolved specific duties which trustees must observe. These duties are that trustees:

- (a) must act in good faith;¹²
- (b) must not make an unauthorised profit from their trust;¹³
- (c) must not place themselves in a position where their duty and interest conflict;¹⁴ and
- (d) must not act for their own benefit or for the benefit of a third party, without the informed consent of the beneficiaries of the trust.¹⁵

Breach of duty of care

- 2.15 The most common breach of duty occurs where a trustee breaches his or her duty to act with care and skill in the administration of the trust, which causes loss to the trust fund.¹⁶ This duty of care may be imposed by statute, or by common law. The duty of care is not a fiduciary duty as such and should therefore be

¹¹ [1998] Ch 241, 251.

¹² *Re Second East Dulwich* (1899) 68 LJ Ch 196.

¹³ *Bray v Ford* [1896] AC 44.

¹⁴ *Keech v Sandford* (1726) 2 Eq Cas Abr 741.

¹⁵ *Boardman v Phipps* [1967] 2 AC 46.

¹⁶ *Bartlett v Barclays Bank Trust Co Ltd (Nos 1 & 2)* [1980] Ch 515. For the statutory duty of care, see Trustee Act 2000, s 1.

distinguished from those duties, peculiar to fiduciaries, which are mentioned above.¹⁷

- 2.16 The Trustee Act 2000 introduced a statutory duty of care which applies to the exercise of powers and the performance of duties conferred or imposed by that Act, as well as to certain powers conferred by other statutes and powers conferred by the terms of the trust.¹⁸ It is not, however, of general application. The duty of care “under the general law” applies therefore to those powers and duties that are not expressly covered by the 2000 Act.

Duty of care under the general law

- 2.17 Under the general law, at least three standards of care may be imposed upon a trustee:

- (1) First, a trustee is generally required to take all those precautions which an ordinary prudent man of business would take in managing similar affairs of his own.¹⁹ This is an objective test. It does not require the court to consider the standard which the individual has in fact adopted in relation to his own affairs.²⁰
- (2) This duty has however never applied to the exercise by trustees of their powers of investment. In such circumstances, the duty under the general law is to take such care as an ordinary prudent man would take if he were minded to make an investment for the benefit of other people for whom he felt morally bound to provide.²¹
- (3) Finally, where the individual is a specialist, for example a trust corporation carrying on the business of trust management, the standard which it will be expected to achieve when exercising any power will be higher.²²

Statutory duty of care

- 2.18 The statutory duty of care requires the trustee to exercise such care and skill as is reasonable in the circumstances, having regard in particular to any special care and knowledge or experience that he has or holds himself out as having. If he acts as trustee in the course of a business or profession, regard must also be had to any special knowledge or experience that it is reasonable to expect of a person acting in the course of that kind of business or profession. The higher standard

¹⁷ *Lewin on Trusts* (17th ed 2000) para 34- 01.

¹⁸ For the cases where the statutory duty applies, see Trustee Act 2000, s 2, Sched 1; *Lewin on Trusts* (17th ed 2000) para 34- 01F.

¹⁹ *Speight v Gaunt* (1883) 22 Ch D 727.

²⁰ *Lewin on Trusts* (17 ed 2000) para 34- 01A.

²¹ *Re Whiteley* (1886) 33 Ch D 347, 355, per Lindley LJ.

²² *Bartlett v Barclays Bank Trust Co Ltd (Nos 1 & 2)* [1980] Ch 515, 534, per Brightman J.

which is expected of so-called professional trustees replicates the way in which the general law developed the duty of care by reference to the type of trustee.

Negligence not necessary

- 2.19 It is important to emphasise that liability for breach of trust is not restricted to acts or omissions which can be characterised as negligent. Where the trustee acts outside the powers conferred upon him or her (*ultra vires*), it is not necessary for the claimant beneficiary to prove negligence. As has been stated by one commentator, there is as a result in the law of trusts:

...a strong element of strict liability in the sense of liability which is not dependent on showing negligence or unreasonableness on the part of the trustee.²³

The nature of trustees' liability

- 2.20 Where the loss to a trust fund is caused by a breach of trust, the trustees of the fund are liable to restore the lost property, or to pay compensation for the loss.²⁴ When assessing the loss to the trust fund following a breach of duty, the court does not apply the common law rules of causation, foreseeability and remoteness. This is because the trustees' liability is to restore the trust property.²⁵ Even if the immediate cause of the loss to the trust fund is the dishonesty or failure of a third party, the trustees are liable to make good that loss if it would not have occurred had there been no breach of trust.
- 2.21 The position was summarised as follows in the case of *Caffrey v Darby*:²⁶

...if they have been already guilty of negligence, they must be responsible for any loss in any way to that property: for whatever may be the immediate cause, the property would not have been in a situation to sustain that loss, if it had not been for their negligence...If the loss had happened by fire, lightning, or any other accident, that would not be an excuse for them, if guilty of previous negligence. That was their fault.²⁷

²³ R Ham QC, "Trustees' Liability" (1995) 9 TLI 21, 21.

²⁴ *Caffrey v Darby* (1801) 6 Ves 488; *Target Holdings Ltd v Redfems* [1996] AC 421. R Chambers, "Liability" in P Birks & A Pretto, *Breach of Trust* (2002) pp 1- 40.

²⁵ *Bartlett v Barclays Bank Trust Co Ltd (Nos 1 & 2)* [1980] Ch 515, 545 per Brightman LJ; *Target Holdings Ltd v Redfems* [1996] AC 421, 434, per Lord Browne-Wilkinson.

²⁶ (1801) 6 Ves 488, where trustees were charged with neglect in failing to recover possession of part of the trust asset. The asset was lost and it was argued by the trustee that the loss was not attributable to their neglect.

²⁷ *Ibid*, at p 495.

THE SCOPE OF EXEMPTION CLAUSES AT COMMON LAW

The nineteenth century cases²⁸

- 2.22 Until the recent decision in *Armitage v Nurse*²⁹ there were doubts as to whether liability for gross negligence could ever be validly excluded by the terms of the trust, some academics and practitioners taking the view that the exclusion of gross negligence was void as being repugnant to the nature of a trust or contrary to public policy.³⁰ This view was based on the nineteenth century English decisions in *Wilkins v Hogg*³¹ and *Pass v Dundas*,³² and a number of Scottish cases decided in the House of Lords.

The Scottish cases

- 2.23 In *Seton v Dawson*,³³ the exemption clause (which was in terms almost identical to those in all the other cases) provided that the trustees:

...shall not be liable for omissions, neglect of diligence, of any kind, nor singuli in solidum, but each only for his own actual intromissions... .

- 2.24 The trustees in this case allowed one of their number to control the management of the trust funds. The managing trustee was permitted to receive trust money and no meeting took place between them for over eight years. The managing trustee became bankrupt indebted to the trust. The court held the trustees guilty of gross negligence. The majority of the judges took the view that:

...the general principle of our law is that neither the protecting clause which occurs in this particular deed, nor any of the usual clauses framed for the same object, can be held to liberate trustees from the consequences of negligence as amount to *culpa lata*.³⁴

- 2.25 In *Knox v Mackinnon*,³⁵ the trustees of a family trust lent substantial funds on inadequate security to a family member whom they ought to have known would be unable to repay the loan. The trustees were held to have been grossly negligent

²⁸ This is a term of convenience, referring to the older series of decisions culminating in *Clarke v Clarke's Trustees* [1925] SC 693.

²⁹ [1998] Ch 241.

³⁰ See A Kenny, "Living up to Expectations" (1996) 146 NLJ 348, 349; P Matthews, "The Efficacy of Trustee Exemption Clauses in English Law" [1989] Conv 42; *Hanbury & Martin Modern Equity* (14th ed 1993) pp 473- 474; *Underhill and Hayton, Law of Trusts and Trustees* (14th ed 1987) p 792.

³¹ (1861) 31 LJ Ch 41.

³² (1880) 43 LT 665.

³³ (1841) 4 D 310.

³⁴ *Ibid*, at p 316.

³⁵ (1888) 13 App Cas 753.

and liable for the loss to the trust. After quoting the exemption clause in the trust instrument, Lord Watson said:

...it is settled in the law of Scotland that such a clause is ineffectual to protect a trustee against the consequences of culpa lata, or gross negligence on his part...³⁶

- 2.26 In *Rae v Meek*,³⁷ the trustees speculatively loaned trust money on the security of houses being built without an independent valuation or personal inspection of the building. The standard form exemption clause in this case was extended to provide that “the trustees shall not be answerable...for the insufficiency of securities insolvency of debtors, or depreciation in the value of purchases...”. Notwithstanding this, the House of Lords held the trustees to be grossly negligent and that they were not protected by the exemption clause. A finding of gross negligence on the part of trustees, for which they were held liable despite the inclusion of the standard form exemption clause, was reached in a number of subsequent Scottish cases.³⁸

The English cases

- 2.27 The two nineteenth century English authorities in this area were both concerned with duty exclusion clauses. In *Wilkins v Hogg*,³⁹ the trustees permitted one of their number to receive and retain trust money without ascertaining that the funds had been properly invested. The trustee misappropriated the funds he received. The innocent trustees were held not liable for the loss to the trust. The clause was in standard form for its time, but it went on to provide:

that any trustee who shall pay over to his co- trustee, or shall do or concur in any act enabling his co- trustee to receive any monies for the general purposes of my will, or for any definite purpose authorized by my will, shall not be obliged to see to the due application thereof.

- 2.28 It was reported that the Lord Chancellor, Lord Westbury:

...would have been glad to find any principle upon which it could be decided that where a general duty was imposed, and then directions were given generally repugnant to that duty and contradictory, the words which followed should be discarded. But he doubted whether public policy would justify this. The testatrix was at liberty to say, “Your duty shall require no more of you than this”. The Court could not extend the office, or invest it with greater obligation.⁴⁰

³⁶ *Ibid*, at p 765.

³⁷ (1889) 14 App Cas 558.

³⁸ *Carruthers v Carruthers* [1896] AC 659; *Wyman v Paterson* [1900] AC 271; *Clarke v Clarke's Trustees* [1925] SC 693.

³⁹ (1861) 31 LJ Ch 41.

⁴⁰ *Ibid*, at p 43.

- 2.29 In *Pass v Dundas*,⁴¹ the testator authorised his two trustees to carry on his business. The business was carried on by one of the trustees with the consent of the beneficiaries. The trustees authorised the bank to honour cheques signed by the trustee managing the business. Under this mandate the trustee withdrew substantial sums of money which he then misappropriated for his own purpose. The court had to construe an exemption clause phrased in similar terms to the one in *Wilkins v Hogg*.⁴² Bacon VC, applying *Wilkins v Hogg*, held that in the absence of gross negligence or personal misconduct the indemnity clause protected the trustees from liability.
- 2.30 The cases considered above were interpreted by some commentators to the effect that a trustee exemption clause could never be invoked so as to exclude the trustee from liability for gross negligence (as well as fraud).⁴³ Subject to this, it was a matter of construction in each case whether the particular clause covered the particular activities, conduct or omissions of the trustees.

The late twentieth century

- 2.31 By the time the issue of trustee exemption clauses came before the courts once more in the final decade of the twentieth century, there had been a highly significant development which cannot go unremarked- the advent and proliferation of the paid trustee. Whereas the cases considered above all concerned, so far as can be ascertained, the propriety of the conduct of amateur trustees, who were not being remunerated for their services, the cases which follow were to delineate the liability of the professional.⁴⁴
- 2.32 In 1996, the Jersey Court of Appeal heard *Midland Bank Trustee (Jersey) Ltd v Federated Pension Services Ltd*.⁴⁵ In a judgment subsequently described as “masterly” by the English Court of Appeal,⁴⁶ Sir Godfray Le Quesne QC, having reviewed the nineteenth century authorities, denied that their combined effect was to prohibit the exclusion of liability for gross negligence:

The suggestion that there is a rule of law to that effect, which cannot be overridden by an exculpatory or duty- defining clause however widely drawn, is in our judgment not supported by the authorities we have cited, except that liability for fraud cannot be excluded.

⁴¹ (1880) 43 LT 665.

⁴² (1861) 31 LJ Ch 41.

⁴³ See in particular P Matthews, “The Efficacy of Trustee Exemption Clauses in English Law” [1989] Conv 42.

⁴⁴ This point is noted by Sir Godfray Le Quesne QC in *Midland Bank Trustee (Jersey) Ltd v Federated Pension Services Ltd* [1996] PLR 179, 193.

⁴⁵ [1996] PLR 179.

⁴⁶ *Armitage v Nurse* [1998] Ch 241, 254, per Millett LJ.

Otherwise all turns on the true construction of the exculpatory clause in its proper context...⁴⁷

Midland Bank Trustee (Jersey) Ltd v Federated Pension Services Ltd⁴⁸

2.33 The defendant, Federated Pension Services (FPS) was the sole trustee of an occupational pension scheme. Rule 27 of its trust instrument gave FPS a wide power to invest the fund. Rule 29 contained an indemnity and exclusion clause in the following terms:

The Trustee shall be indemnified against all liabilities incurred by it in the execution of the trusts hereof and the management and administration of the Scheme and shall have a lien on the fund for such indemnity and the Trustee shall not be liable for anything whatever other than a breach of trust knowingly and wilfully committed.

2.34 FPS and Hambros agreed that with effect from December 1988 Hambros would act as investment manager of the Scheme. However, following encashment of the scheme's investments, FPS failed to transfer the fund (amounting to over £12 million) to Hambros as agreed. FPS erroneously believed that, in order to comply with the Investment Management Regulatory Organisation requirements it was necessary to have in place a customer agreement with the pension provider (the States) before the transfer could be made. FPS did not take legal advice on this issue or warn the States or Hambros of any perceived problem of proceeding without a customer agreement despite the potentially serious consequences of a failure to transfer. As a result of that failure, Hambros was unable to start the process of investment in a market which was rising in the early part of 1989. This caused a loss of over £793,000 to the scheme.

2.35 FPS accepted that it was in breach of trust for failing to transfer the Scheme fund to Hambros as agreed, but on a claim for compensation FPS sought relief from liability under the indemnity and exclusion clause in Rule 29 of the deed.

2.36 The Jersey Court of Appeal considered the main Scottish, English, Canadian and New Zealand cases on trustee exemption clauses and concluded that they did not establish a rule of law preventing the exemption of a trustee from liability for gross negligence. The court took the view that at common law all turns on the true construction of the exemption clause in its context after applying as restrictive an interpretation of the exemption clause as is permissible and appropriate. The court accepted the contention that the scope of duties imposed on trustees and the performance of those duties must vary according to the category of trustee concerned.

2.37 As a matter of construction, the court decided that the effect of Rule 29 was to deny exclusion of liability for acts which were knowingly and wilfully committed

⁴⁷ [1996] PLR 179, 196.

⁴⁸ [1996] PLR 179.

and amounted to a breach of trust. It was not necessary for those acts to be known to the trustees to constitute a breach of trust.

- 2.38 The court held that FPS had failed to establish that it did not commit the breach “knowingly and wilfully” so as to come within the scope of Rule 29. FPS had taken a deliberate and intentional decision on the basis of a mistaken understanding of the legal position. The decision was taken with full knowledge of the potential consequences in terms of loss to the Scheme, though not of the legal implications for FPS. Rule 29 did not therefore afford FPS a defence to the claim for breach of trust.
- 2.39 In so far as Rule 29 purported to protect the trustee from liability for all forms of negligence, the court held that the amended Article 26(9) Trusts (Jersey) Law 1984⁴⁹ was applicable. The Article provides:

Nothing in the terms of a trust shall relieve, release or exonerate a trustee from liability for breach of trust arising from his own fraud, wilful misconduct or gross negligence.

- 2.40 The court held FPS to be guilty of gross negligence for the purposes of the amended Article 26(9). FPS’s failure to transfer the trust moneys was considered to constitute a serious, unusual and marked departure from the normal standard of conduct of a paid professional trustee, which amounted to “gross negligence” within the meaning of the statute.
- 2.41 Accordingly, FPS was held liable for the loss to the trust fund and was not protected by the exemption clause in the trust deed. Although FPS took active steps to seek leave to appeal to the Judicial Committee of the Privy Council, the appeal was compromised.

Armitage v Nurse⁵⁰

- 2.42 The English Court of Appeal in *Armitage v Nurse* held that in English law trustee exemption clauses can validly exempt trustees from liability for all breaches of trust except fraud.
- 2.43 *Armitage v Nurse* concerned a marriage settlement which was varied by order of the court in 1984 under the Variation of Trusts Act 1958.⁵¹ The settled property consisted largely of land farmed by a company, the directors of which were the mother and grandmother of Paula, the claimant beneficiary. Following a substantial fall in the value of the land between 1984 and 1987, Paula claimed that the trustees were in breach of trust as regards the management and investment of the fund, as a result of which substantial loss had been caused.

⁴⁹ Added by Trusts (Amendment)(Jersey) Law 1989, Article 5.

⁵⁰ [1998] Ch 241.

⁵¹ Thus there could be no suggestion of impropriety. The principal beneficiary was legally represented and the settlement containing the trustee exemption clause was sanctioned by a judge of the High Court.

2.44 Clause 15 of the settlement provided:

No trustee shall be liable for any loss or damage which may happen to Paula's fund or any part thereof or the income thereof at any time or from any cause whatsoever unless such loss or damage shall be caused by his own actual fraud... .

2.45 The court held that clause 15 exempted the trustee from liability for loss or damage to the trust property "no matter how indolent, imprudent, lacking in diligence, negligent or wilful he may have been, so long as he has not acted dishonestly".⁵² It was contended by Paula that the word "fraud" in clause 15 included "equitable fraud", in other words any breach of duty to which equity had attached its sanction.⁵³ However, this contention was rejected by the court. Construing clause 15, Millett LJ considered that the word "actual" had been deliberately used to exclude equitable fraud.⁵⁴ He held that "actual fraud" required proof of dishonesty, and he accepted a formulation put forward by counsel for the trustees to the effect that fraud in this context:

...connotes at the minimum an intention on the part of the trustee to pursue a particular course of action, either knowing that it is contrary to the interests of the beneficiaries or being recklessly indifferent whether it is contrary to their interests or not.⁵⁵

2.46 The beneficiary claimed that clause 15 was void for repugnancy or contrary to public policy. Reviewing the nineteenth century authorities which, it was contended, underpinned this argument, Millett LJ held that *Wilkins v Hogg*⁵⁶ had decided that an appropriately worded clause could limit the scope of the trustee liability in any way the settlor chose. He also held that the statement of Bacon V-C in *Pass v Dundas*⁵⁷ that an exemption clause only protected trustees from liability unless gross negligence was established was merely obiter. Of the Scottish authorities he concluded that:

...none of them are authority for the proposition that it is contrary to public policy to exclude liability for gross negligence by an appropriate clause clearly worded to have that effect.⁵⁸

The construction approach

2.47 The approach advocated by Millett LJ requires the court to construe the words of the exemption clause in the light of the conduct complained of and to decide

⁵² [1998] Ch 241, 251.

⁵³ *Nocton v Lord Ashburton* [1914] AC 932, 953, per Viscount Haldane LC.

⁵⁴ [1998] Ch 241, 250.

⁵⁵ [1998] Ch 241, 251.

⁵⁶ (1861) 31 LJ Ch 41.

⁵⁷ (1880) 43 LT 665.

⁵⁸ [1998] Ch 241, 256.

whether any potential liability has been effectively excluded by the terms of the trust. In carrying out this exercise, while the court should construe the clause restrictively, it must do so fairly, according to the natural meaning of the words used.⁵⁹ Thus, liability can be excluded only by clear, unequivocal and unambiguous terms.⁶⁰ However, it should be borne in mind that the trust instrument has been created by the settlor, not by the trustees acting as such. Accordingly, a strict *contra proferentem* approach is not justified.⁶¹

2.48 In *Wight v Olswang* (No 2),⁶² the trust contained two exemption clauses which were inconsistent. One clause was limited in its application to trustees not charging remuneration for acting; the other was not. It was held that the inconsistent clauses created an ambiguity and the trustees were not protected from liability by either of them.

2.49 In *Bogg v Raper*⁶³ the Court of Appeal considered whether these principles of construction were applicable where the trustees seeking exemption from liability had been involved in the creation of the settlement containing the trustee exemption clause. The trust fund comprised shares which represented a controlling interest in a private limited company. Beneficiaries claimed that the trustees failed to exercise proper control over the business and the activities of the company thereby causing loss to the trust. However, the trustees successfully argued that they were protected by the exemption in clause 12 of the will, which provided:

In the professed execution of the trusts and powers hereof, no trustees (other than a trust corporation) shall be liable for any loss to the trust premises arising by reason of any improper investment made in good faith...or by reason of any mistake or omission made in good faith...by any trustee hereof or by reason of any other matter or thing except wilful or individual fraud or wrongdoing on the part of the trustee who is sought to be made liable.

2.50 The trustees, being the testator's solicitor and accountant, were responsible for the inclusion of the exemption clause in the will. However, that did not prevent them from relying on it on the basis that they would be deriving a benefit arising out of a breach of their fiduciary duty to the testator (not to put themselves in a position of conflict of interest and duty). Millett LJ held that such an exemption clause did not confer a benefit on the trustees but simply defined the extent of

⁵⁹ *Bogg v Raper* (1998/99) 1 ITEL 267, 281.

⁶⁰ *Midland Bank Trustee (Jersey) Ltd v Federated Pension Services Ltd* [1996] PLR 179, 192; *Armitage v Nurse* [1998] Ch 241, 255; *Bogg v Raper* (1998/99) 1 ITEL 267, 280; and *Wight v Olswang* (No 2) (1999/2000) 2 ITEL 689.

⁶¹ *Bogg v Raper* (1998/99) 1 ITEL 267, 281. See also the discussion of this issue by the Jersey Court of Appeal in *Midland Bank Trustee (Jersey) Ltd v Federated Pension Services Ltd* [1996] PLR 179, 192.

⁶² (1999/2000) 2 ITEL 689.

⁶³ (1998/99) 1 ITEL 267.

their liability. In so far as a benefit was conferred, it was a benefit which could be enjoyed by any person assuming the role of trustee in relation to the trust and was not exclusive to those who had participated in the preparation of the testator's will.⁶⁴

- 2.51 This aspect of *Bogg v Rape* has been criticised on the ground that the solicitor did obtain a benefit in saving the expense of insurance premiums which would otherwise have been payable to protect him from liability.⁶⁵

The fraud exclusion

- 2.52 Although *Armitage v Nurse* gives considerable latitude to the use of trustee exemption clauses, the line is drawn at actual fraud, on the basis that to permit a trustee to act dishonestly would be to derogate from the "irreducible core of obligations" of honesty and good faith. A trust instrument which allowed the trustee to act fraudulently without giving the beneficiaries any recourse would fail as a trust.⁶⁶
- 2.53 Further consideration of the meaning of 'fraud' was given in *Walker v Stones*.⁶⁷ Where a solicitor-trustee honestly believed that he was acting in the best interests of the trust, his actions could nevertheless be held to be fraudulent if no reasonable solicitor-trustee would have thought that what was done was for the benefit of the beneficiaries. In such circumstances the trustee would not be protected by a trustee exemption clause.⁶⁸ It may be that the courts will extend this stricter approach to the effect of trustee exemption clauses to other paid professional trustees. Permission to appeal the decision in *Walker v Stones* to the House of Lords has been given.

The effect of Armitage v Nurse

- 2.54 It must be admitted that the authority of *Armitage v Nurse* (as a decision of the Court of Appeal not the House of Lords) is not entirely free from doubt. The view taken of the nineteenth century Scottish cases does not accord with the understanding of these decisions north of the border, where it is generally believed that trustees cannot invoke an exemption clause to escape liability for gross negligence, or, as it is there termed, *culpa lata*.⁶⁹ While there is no reason

⁶⁴ *Ibid*, at p 285. It would have been open to the claimant to have challenged probate on the basis that the testator did not "know and approve" of the contents of the will, thereby putting the solicitor to proof that advantage had not been taken of their position of influence: *ibid*; and *Wintle v Nye* [1959] 1 WLR 284.

⁶⁵ Hayton & Marshall, *The Law of Trusts and Equitable Remedies* (11th ed 2001) para 9- 311. See also cases cited at para 9- 310: *Baskerville v Thurgood* (1992) 100 Sask LR 214; and *Rutanen v Ballard* (1997) 424 Mass 723, 733.

⁶⁶ See further paras 2.9 and 2.42 above.

⁶⁷ [2001] QB 902.

⁶⁸ *Armitage v Nurse* [1998] Ch 241.

⁶⁹ *Lutea Trustees Ltd v Orbis Trustees Guernsey Ltd* 1998 SLT 471.

why the English and Scottish law should be identical in this respect, the reliance placed by Millett LJ on the Scottish cases was clearly an important part of his reasoning, and should that reliance be shown to have been misplaced, the authority of the decision may thereby be called into question.

- 2.55 The English Court of Appeal was influenced by the decision of the Jersey Court of Appeal in *Midland Bank Trustee (Jersey) Ltd v Federated Pension Services Ltd*, where Sir Godfray Le Quesne QC, having considered the Scottish authorities, adopted a construction approach to trustee exemption clauses. This was not necessary for the decision in the case, as Jersey’s legislative regulation of such clauses operated to deny the trustees recourse to the clause.

THE SCOPE OF TRUSTEE EXEMPTION CLAUSES UNDER ENGLISH STATUTES

- 2.56 There are no current statutory provisions which are directed specifically at all kinds of trustee exemption clause.

The Unfair Contract Terms Act 1977

- 2.57 The Unfair Contract Terms Act 1977 restricts the extent to which civil liability for breach of contract, negligence or other breach of duty can be avoided by means of contract terms. The Act prevents a person from excluding or restricting his liability for negligence “by reference to any contract term or to a notice”, unless the term or notice “satisfies the requirement of reasonableness”.⁷⁰

- 2.58 The reasonableness test differs according to whether the term is a contract term or a notice which has no contractual effect:

- (1) Where it is a contract term, it must have been “a fair and reasonable one to be included having regard to the circumstances which were, or ought reasonably to have been, known to or in the contemplation of the parties when the contract was made”.⁷¹
- (2) Where it is a notice, the question is whether “it should be fair and reasonable to allow reliance on it, having regard to all the circumstances obtaining when the liability arose or (but for the notice) would have arisen”.⁷²

- 2.59 Schedule 2 to the 1977 Act sets out “guidelines” to which regard must be had where the reasonableness test is applied to certain contracts.⁷³ These include the relative strengths of the parties’ bargaining positions, any inducement made to the customer to agree to the term and the extent of the customer’s knowledge of the term.

⁷⁰ 1977 Act, ss 2(2), 3(2), 4(1), 6(3), 7(3), 7(4).

⁷¹ 1977 Act, s 11(1). See further s 24(1).

⁷² 1977 Act, s 11(3). See further s 24(2A).

⁷³ Those contracts governed by ss 6(3) and 7(3) only: see s 11(2).

- 2.60 It seems that a trustee exemption clause is not a contract because it is extremely unlikely that an English court would consider a trust instrument containing a trustee exemption clause to be a “contract”. The appointment of the trustees is consensual, the trust instrument a form of contract under seal. But while it must be conceded that there are some similarities between a contract and a trust, the contract derives its enforceability from the vital factors of agreement and consideration, whereas the trust is based firmly on the grant of property. Although the terms of the trust may in certain circumstances be negotiated and agreed between the settlor and the trustees, and the trustees may be remunerated for the services which they provide, these are not necessary components of the trust relationship.
- 2.61 Moreover, the trust has a proprietary impact which transcends the ordinary principles of contract law. This can indeed be exemplified by reference to the trustee exemption clause which is intended to benefit not only those persons who assume the obligation of trusteeship immediately following execution of the trust, but also their successors.
- 2.62 While there may be a stronger argument that a trustee exemption clause is a form of “notice”, this may also be somewhat speculative in that it would seem that “notice” within the 1977 Act is primarily intended to cover attempts to exclude liability by reference to a sign outside the confines of a formal legal document.
- 2.63 Another difficulty for those seeking to invite the court to strike down trustee exemption clauses by reference to the 1977 Act is the nature of the liability which is being asserted. The Act controls the use of contract terms or notices which seek to exclude liability for negligence, as defined in the Act. While this includes, by section 1(1)(b) of the Act, “any common law duty to take reasonable care or exercise reasonable skill”, it is not by any means clear that these words cover breach of trust. The duty of which the trustee is in breach is not a common law duty, but an equitable duty. Although in recent cases there has been some judicial acknowledgement of concurrent liability for negligence in tort and equity,⁷⁴ this line of argument has never been taken in any of the recent cases on trustee exemption clauses. This may be attributed to the traditional position in English law that equitable wrongdoing should not be assimilated to the law of tort.
- 2.64 The Unfair Terms in Consumer Contracts Directive 1993/13 of the European Economic Community implemented by the Unfair Terms in Consumer Contracts Regulations 1994⁷⁵ strikes down any unfair terms in consumer contracts of sale and supply of services. While it has been suggested⁷⁶ that the European Court might take an autonomous view of the meaning of “contract”

⁷⁴ *Henderson v Merrett Syndicates Ltd* [1995] 2 AC 145; and *Bristol and West Building Society v Mothew* [1996] 4 All ER 698.

⁷⁵ Now revoked and replaced by the Unfair Terms in Consumer Contracts Regulations 1999.

⁷⁶ *Chitty on Contracts* (28th ed 1999) para 15- 020.

such as to include some trust relationships, we consider that this is but a remote possibility.

Specific statutory controls

- 2.65 There are three sets of statutory provisions, dealing respectively with companies, financial services and pensions, which may have an impact on certain types of trustee exemption clause.
- 2.66 Two provisions of the Companies Act 1985 have the effect of restricting the use of trustee exemption clauses. Any provision contained in a trust deed for securing an issue of debentures (or in any contract with debenture holders secured by a trust deed) is void in so far as it would have the effect of exempting a trustee 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 trustee.⁷⁷ Any provision contained in a company's articles or in any contract with the company or otherwise for exempting any officer or person employed as auditor from (or indemnifying him against) liability in respect of inter alia breach of trust in relation to the company is void.⁷⁸
- 2.67 Financial services legislation has since 1986 rendered void any provision of a trust deed of an authorised unit trust scheme in so far as it would have the effect of exempting the manager or trustee from liability for failure to exercise due care and diligence in the discharge of his functions in respect of the scheme.⁷⁹
- 2.68 Liability for breach of any obligation (under any rule of law) to take care or exercise skill in the performance of any investment functions, where the function is exercisable by a trustee of a pension trust scheme or by a person to whom the function has been delegated, cannot be excluded or restricted by any instrument or agreement.⁸⁰

TRUSTEE EXEMPTION CLAUSES IN CHARITABLE TRUSTS

- 2.69 It is becoming increasingly common for modern charitable trust instruments to contain an exemption clause exempting trustees from liability for wilful default or gross negligence, or an indemnity clause providing that the trustees are to be indemnified from the trust assets against personal liability for breach of trust. The general law relating to the scope and validity of exemption clauses applies equally to charitable trusts, and therefore an exemption clause similar to that

⁷⁷ Companies Act 1985, s 192(1). Regard is to be had to the provisions of the trust deed conferring on the trustee any powers, authorities or discretions.

⁷⁸ Companies Act 1985, s 310. For exceptions, see s 310(3).

⁷⁹ Financial Services and Markets Act 2000, s 253, replacing the almost identical s 84 of the Financial Services Act 1986.

⁸⁰ Pensions Act 1995, s 33(1).

upheld in *Armitage v Nurse*⁸¹ could in principle be included in the governing instrument of a charity.⁸²

- 2.70 There are however considerations which have specific relevance to charities arising from the different range of powers enjoyed, and duties owed, by charitable trustees, and the role of the Charity Commission in policing the charities sector. We shall discuss these considerations prior to examining the impact of trustee exemption clauses in relation to charitable trustees.
- 2.71 The powers of charity trustees are to be found in their trust instrument, the general trust law and statutes, notably the Trustee Acts of 1925 and 2000. However, the exercise of some of these powers (such as the power to deal with land, and to amalgamate or alter the trust) are strictly circumscribed by the Charities Acts of 1992 and 1993. The duties of charity trustees are more or less the same as trustees of private non-charitable funds.⁸³ The primary duty of a trustee of a charitable fund, as with other trustees, is to carry out the trust in accordance with the terms of its governing instrument. Charitable trustees must act in the best interests of the fund and ensure that the assets are applied exclusively for its charitable purposes. However, trustees of charitable funds have additional duties and administrative controls imposed by the Charities Acts of 1992 and 1993, such as the duty to apply for registration as a charity,⁸⁴ to prepare and submit annual returns to the Charity Commission,⁸⁵ to retain accounting records for at least six years⁸⁶ and generally to comply with the rules for the preparation of annual accounts and their submission to the Charity Commission.
- 2.72 The liabilities of charitable trustees differ in some respects from those of trustees of private funds as a relatively lenient approach may be taken. In the words of Lord Eldon LC:

With respect to the general principle on which the court deals with the trustees of a charity, though it holds a strict hand over them when

⁸¹ [1998] Ch 241. The clause in this private trust, which was held to be valid by the Court of Appeal, exempted the trustee from liability for loss or damage to the trust fund or its income from any cause whatsoever unless such loss or damage shall be caused by his own actual fraud.

⁸² An example of the type of exclusion clause used in charitable trust deeds can be found in *Butterworth's Encyclopaedia of Forms & Precedent* (5th ed 2001 Reissue) vol 6(2), p 115:

In the execution of the trusts and powers of this Deed no Trustee shall be liable for any loss to the Charity arising by reason of any improper investment made in good faith (so long as he shall have sought professional advice before making such investment) or any mistake or omission made in good faith by him or any other Trustee or any other matter other than wilful default and individual fraud wrongdoing omission on the part of the Trustee who is sought to be made liable.

⁸³ See *Tudor on Charities* (8th ed 1995) p 244.

⁸⁴ Charities Act 1993, s 3(7).

⁸⁵ Charities Act 1993, s 48.

⁸⁶ Charities Act 1993, s 41(3). This does not apply to exempt charities, on which see Charities Act 1993, s 46.

there is wilful misapplication, it will not press severely upon them, where it sees nothing but mistake...If the administration of the funds, though mistaken, has been honest, and unconnected with any corrupt purpose, the Court, while it directs for the future, refuses to visit with punishment what has been done in time past. To act on any other principle would be to deter all prudent persons from becoming trustees of charities.⁸⁷

Consequently, slight irregularities will not attract punishment where there exists no corrupt motive.⁸⁸ The scope of trustees' liability is effectively reduced to actions or omissions falling somewhere between those which can be excused as honest and reasonable mistakes⁸⁹ and those omissions which amount to deliberate or reckless breaches of trust.⁹⁰ In the absence of evidence to the contrary it is presumed that charitable trustees have faithfully discharged their duty.⁹¹

2.73 Notwithstanding the more lenient treatment by the court of charity trustees, so that historically they have rarely been called upon personally to restore losses to the trust fund, in recent years the actions of charity trustees have become more vulnerable to legal challenge. One commentator from the charity sector⁹² has observed that there has been a considerable number of claim notifications (to insurers) resulting from a variety of circumstances such as:

- (1) corporate donors asking for their donations back when a charity ceased to operate due to financial difficulties;
- (2) an ex- member of a charity alleging that actions of certain trustees had been responsible for the failure of his business; and
- (3) the Charity Commission requiring the trustees personally to reimburse the charity for a considerable sum, as they had allowed the charity to undertake an action which the Charity Commission considered was outside the objects of the charity so that the trustees were in breach of trust.

In such cases the assets of the charity could not be used to reduce the liability of the trustees.

⁸⁷ *A-G v Exeter Corporation* [1826] 2 Russ 45, 54.

⁸⁸ *A-G v Joliffe* (1822) 2 Coop Temp Cott 229.

⁸⁹ See *Benett v Wyndham* (1862) 4 De GF & J 259 and *Re Raybould* [1900] 1 Ch 199, where it was held that the trustees were entitled to be indemnified from the charitable funds for loss resulting from their actions which were found to be diligent and reasonable.

⁹⁰ See *A-G Brandreth* (1842) 1 Y & C Ch cas 200; and *Re St John the Evangelist; D'Aungre's Charity* (1888) 59 LT 617 where the trustees diverted funds intended for a charitable object to another and were held liable to reimburse the trust fund.

⁹¹ *A-G v Earl of Stamford* (1843) 1 Ph 737, per Lord Cottenham LC.

⁹² Roger Jenkinson, director of Stuart Alexander St Olaf and risk manager of the NSPCC.

2.74 Although the possibility of charity trustees being held personally to account following a breach of trust is relatively remote, any prospect of such liability being incurred is of great concern to charity trustees, and is claimed to comprise a major discouragement to assuming the office of trusteeship in relation to a charity.⁹³ The risk of personal liability for a charitable trustee varies not only according to the kind of charitable activity but also according to the type of the charitable structure, namely whether the individual is a trustee of a charitable trust, a director of a charitable company or a manager of an unincorporated association.

Incorporated charities

2.75 Many charities are established as limited companies. These may take one of two forms: those limited by guarantee or those limited by shares, the first being far more prevalent than the second. One of the principal reasons for establishing a charity as a company is that it is considered to give protection to those running the charity from personal liability to creditors and other third parties. Nonetheless the duties which are imposed on such persons as trustees by the general law and by the Charities Acts are fully binding and unaffected by any limited liability which that incorporation may otherwise incur.⁹⁴

2.76 The choice between a limited company or trust structure is largely dependent on the function of the charity, a consideration of the required levels of flexibility⁹⁵ and the applicable formality requirements.⁹⁶ In general, a company limited by guarantee is the most effective machinery for a large “functional” national charity which owns property, whereas a trust is far more appropriate for a charity whose main activity is the making of grants, where the trustees have an endowment fund the capital of which they invest, distributing the income in accordance with the requirements of the trust.

2.77 Section 310 of the Companies Act 1985 has particular significance in relation to trustees of an incorporated charity. It renders ineffective any provision contained in the company’s articles or in any contract with the company or otherwise for exempting, among other things, any officer of the company from, or indemnifying him against, any liability which by virtue of any rule of law would

⁹³ See C Cornforth, *Recent Trends in Charity Governance and Trusteeship* (2001) p 9.

⁹⁴ In *Re The French Protestant Hospital* [1951] Ch 567, 571, Danckwerts J said:

...[directors] who are already in the same position of trustees, and therefore so far as they exercise their powers at all, bound to exercise them in a fiduciary manner on behalf of the charitable trusts for which they act... .

⁹⁵ The Memorandum and Articles of Association of a company are far more flexible than the terms and provisions of a Trust Deed. Frequently in a charitable company the members will be the same as the directors. However there are possibilities within the format of a company’s Memorandum and Articles of Association for structuring the powers rights and obligations of these two groups and their relationship to one another that are not available to a trust.

⁹⁶ There are seven different formalities required of a charitable company as opposed to only two which apply to an unincorporated charity.

otherwise attach to him in respect of any negligence, default, breach of duty, or breach of trust of which he may be guilty in relation to the company.

- 2.78 One effect of section 310 is to create an inequality between those charities which are incorporated and those which are not. In the latter case, trustee exemption clauses are only constrained by the requirements of good faith and honesty expounded by Millett LJ in *Armitage v Nurse*.⁹⁷ This inequality is tempered by the fact that companies are able to purchase indemnity insurance against loss occasioned by a director's negligence, default, breach of duty or breach of trust.⁹⁸
- 2.79 The effect of the different legal rules does not appear to be based on any rational policy choice, as trustee exemption clauses do not affect relationships external to the trust. The way in which a particular charity is constituted should not matter when it comes to defining the capacity of the founder to modify the normal standards of care applicable to the administration of the charity.

Control by the Charity Commission

- 2.80 The Charity Commission adopts a rigorous approach to trustee exemption clauses. In its 1989 Report, it stated that any attempt to limit the liability of trustees in receipt of remuneration would be scrutinised very closely on the basis that such clauses would in effect permit the application of charitable funds for non-charitable purposes.⁹⁹ Any reduction in the standard of care to be expected of a trustee would therefore be antithetical to the purposes of charity.
- 2.81 It is therefore open to argument that a clause in a charitable trust which satisfies the general *Armitage v Nurse* criteria might nevertheless fail as being incompatible with the requirement of exclusively charitable purposes because of the private benefit which it confers on trustees. However, such argument may fail if the court were to adopt the approach of Millett LJ in *Bogg v Raper*,¹⁰⁰ that they are to be considered not as conferring a benefit on the trustees, but merely as laying down the extent of their potential liability.
- 2.82 It is understood from the Charity Commission that a wide "duty exclusion" clause of the type considered in *Hayim v Citibank NA*,¹⁰¹ is rarely encountered in practice, although the duty to have regard to the need for diversification of investments is sometimes excluded. More common are clauses which prescribe a lower standard of care for charity trustees than that which would otherwise be applied by the general law. There is no decided case which considers the compatibility of such clauses with the principle that a charity has to be established

⁹⁷ Leaving aside the exclusively charitable considerations.

⁹⁸ Companies Act 1985, s 310(3).

⁹⁹ [1989] Ch Com Rep 25, para 90.

¹⁰⁰ (1998/99) 1 ITELR 267.

¹⁰¹ [1987] 1 AC 730.

for exclusively charitable purposes, nor have the Charity Commissioners explicitly considered the point.

2.83 Prior to 1991, the Charity Commission was reluctant to authorise charity trustees to purchase indemnity insurance out of the funds of the charity, as it was perceived that this would benefit the trustees and not the trust fund. However, the Commission's policy has now changed, and an order under section 26 of the Charities Act 1993 is now often granted for this purpose.¹⁰²

2.84 The *pro forma* section 26 order authorising the purchase of indemnity insurance is expressed as follows:

(1) Being satisfied that it is expedient in the interests of the charity that the trustees should do so, the Commissioners authorise the trustees to provide indemnity insurance for themselves out of the funds of the charity.

(2) The Commissioners direct that the insurance must not extend to

(a) any claim arising from any act or omission which:

(i) the trustees knew to be a breach of trust or breach of duty;
or

(ii) was committed by the trustees in reckless disregard of whether or not it was a breach of trust or breach of duty;
and

(b) the costs of an unsuccessful defence to a criminal prosecution brought against the trustees in their capacity as trustees of the charity.

2.85 Under section 29 of the Charities Act 1993, charity trustees may apply in writing to the Charity Commissioners for advice on any matters affecting their duties. If the trustees act in accordance with the advice given they will be protected from claims for breach of trust. The section is helpful where the trustees are unclear as to whether their proposed course of action is within the terms of their trust instrument.

Conclusion

2.86 Control of trustees is crucial to ensure that the purposes of the trust are properly carried out, and therefore trust law and statute impose wide ranging liability on trustees for breach of trust. Despite the fact that the court adopts a more lenient

¹⁰² This provision confers power on the Charity Commissioners to authorise any transaction (subject to certain limitations) whether or not it is within the terms of the trust if they consider it to be expedient in the interests of the charity. Charity trustees who act in accordance with such an order will be deemed to have acted properly and within the scope of their powers. In 1995, 324 orders to this effect were made.

approach to charity trustees compared with ordinary trustees, it remains possible for charity trustees to be personally liable for an unlimited amount.

- 2.87 The protection of an exemption clause or the availability of trustee liability insurance has therefore increasingly become a pre-requisite to the acceptance of the trusteeship of a charitable trust. The Charity Commission has seen the undesirability of extensive use of exemption clauses in charitable trusts, and has sought to prevent their expansion. It has at the same time imaginatively presented incentives to those considering whether to assume trusteeship by changing its policy so as to facilitate the purchase of indemnity insurance.
- 2.88 Regulation of trustee exemption clauses would not therefore have as significant an impact on the charities sector as in relation to private trusts. If regulation were to be restricted to professional trustees,¹⁰³ its impact on charity trustees would be further restricted as the majority of charity trustees are not remunerated.

SUMMARY

- 2.89 Unless or until the efficacy of trustee exemption clauses is argued before the House of Lords, the current English law is to be found in the judgment of Millett LJ in *Armitage v Nurse*. A trustee exemption clause may exempt a trustee from liability for all acts, omissions or breaches of trust save where the trustee has committed actual fraud. It is therefore possible for a settlor to create an effective trust which does not impose on the trustee a duty to take reasonable care. Even gross negligence on the part of the trustee may not result in legal liability in the event of a widely drawn exemption clause. Only if the instrument seeks to free the trustees from the core obligations of honesty and good faith will it fail as a trust.
- 2.90 Although Scots law may appear to adopt a similar position, its recognition of the civil law maxim *culpa lata dolo quiparatur* means that liability for gross negligence, being treated as equivalent to fraud, cannot be effectively excluded by provision in the trust instrument.¹⁰⁴ The Scots law is therefore stricter in its control of trustee exemption clauses.
- 2.91 Some jurisdictions have already enacted legislation to restrict the invocation of trustee exemption clauses. Most notably, the Jersey trusts law has provided, since 1989, that the terms of a trust cannot relieve, release or exonerate a trustee from liability arising from his own fraud, wilful misconduct or gross negligence. This position, which applies irrespective of whether the trustee is a professional or lay trustee, has been replicated in Guernsey.¹⁰⁵ The current position, therefore, is that the trust law of England and Wales accords greater latitude to its trustees, and

¹⁰³ For the distinction between professional and lay trustees, see paras 4.33 to 4.39 below.

¹⁰⁴ *Lutea Trustees Ltd v Orbis Trustees Guernsey Ltd* 1998 SLT 471.

¹⁰⁵ See further para 4.56 below, *et seq.*

hence confers more restricted rights on its beneficiaries, than those jurisdictions which are often considered the most attractive in which to establish trusts.¹⁰⁶

2.92 The remainder of this Paper will consider the case for reform of the law of England and Wales. In Part III, we shall consider the economic implications of introducing statutory regulation of trustee exemption clauses. In Part IV, we shall consider whether reform is necessary or desirable, and we shall set out the various options for reform.

¹⁰⁶ Legislation has also been enacted in Belize, the Turks and Caicos Islands, and various states in the USA, most notably New York. Legislation has been proposed in Ontario (albeit in 1984) and, very recently, New Zealand and British Columbia (both in 2002): see further paras 4.54 and 4.58 respectively below.

PART III

THE ECONOMIC IMPLICATIONS OF REGULATING TRUSTEE EXEMPTION CLAUSES

- 3.1 The economic impact of any legal regulation of trustee exemption clauses is an important consideration in deciding whether reform should be recommended.
- 3.2 Obtaining accurate information about trust practice is a difficult exercise, as trusts are not publicly recorded or registered. Although it is possible to seek information and the views of those who hold themselves out as professional trustees, it is much more difficult to ascertain the views of settlors, and (even more so) beneficiaries. In an attempt to understand as fully as possible the role of trustee exemption clauses in practice, we commissioned independent socio-economic research on the subject.
- 3.3 There are several major issues which need to be addressed:
- (1) The prevalence of trustee exemption clauses in practice;
 - (2) The attitude of both trustees and settlors to the existing law;
 - (3) The attitude of both trustees and settlors to regulation of trustee exemption clauses;
 - (4) The unique position of lay trustees;
 - (5) The perceived consequences of regulating trustee exemption clauses; and
 - (6) The perceived availability and effectiveness of alternative protections from liability, in particular indemnity insurance.
- 3.4 Having conducted a preliminary survey of views of trusts practitioners concerning the use of trustee exemption clauses, we commissioned Dr Alison Dunn of the University of Newcastle-upon-Tyne to conduct research into the economic implications of trustee exemption clauses and the potential consequences of regulation of such clauses.
- 3.5 In this Part we outline the research conducted by Dr Dunn between February and May 2002, and the results obtained from that research.
- 3.6 The research focused on four different types of trustee. For ease of reference these types of trustee are denoted in this Part by group names:¹

¹ This categorisation of trustee was found convenient for the purposes of the socio-economic research. It was not intended to provide a definitive classification of professional and lay

- (1) *Group one* refers to professional trustees in a trust corporation or company, representing those groups of trustees who work specifically as trustees in an incorporated trust organisation;
- (2) *Group two* refers to professional trustees in private practice, representing those groups of trustees who work specifically as trustees, but are not in an incorporated trust organisation;²
- (3) *Group three* refers to professionals holding a trusteeship, representing those who are professionals in their own right and work in a professional field other than the trust field, but who have been appointed to a trusteeship; and
- (4) *Group four* refers to lay trustees, representing those who are not professionals and do not work in a professional field, but who have been appointed to a trusteeship.

METHOD OF RESEARCH

3.7 For the research, the specialist knowledge and views of two target groups were sought:

- (1) trustees;³ and
- (2) legal advisers to trustees and settlors.

3.8 The investigators employed both a quantitative and a qualitative approach to data collection.

Quantitative approach

3.9 Quantitative data was collected through the use of two main questionnaires. Each questionnaire was tailored specifically for one of the two target groups.

Trustees

3.10 As regards the trustees (the first target group), questionnaires were sent to a sample group of 2,050. Of the questionnaires, 276 were returned, representing a 13 per cent response rate. Given the low response rate the questionnaire responses cannot be regarded as representative of the group taken as a whole. However, the survey was useful in indicating trends within current trust practice.

trustees on which provisional proposals would be based. As will be seen in Part IV, our provisional proposals adopt the categorisation employed in the Trustee Act 2000.

² This group includes solicitors, barristers and accountants not employed by trust corporations.

³ This target group comprised professional representative bodies, institutions and banks as well as professional and lay trustees.

- 3.11 There was anecdotal evidence that some members of the target groups were reluctant to contribute towards research which they saw as a threat to their legal position and which might remove a critical element of trustee protection. This may have contributed towards the low response rate.
- 3.12 Despite the low response rate, the actual number of trusteeships held by the trustee respondents totalled 14,455. The trusteeships held included 10,938 pension trusts,⁴ 203 charitable trusts, 26 non-charitable purpose trusts, 1,254 private family trusts, 56 private trusts of a different nature,⁵ 4 unit trusts, 605 debenture trusts, 226 employee benefit trusts and 1,103 trusts of other types.
- 3.13 The trustee respondents fell into each of the four groups: 18 per cent of the respondents belonged to group one; seven per cent belonged to group two; 27 per cent belonged to group three; and 42 per cent belonged to group four.
- 3.14 Although on the bare statistics, the highest proportion of trustee respondents were lay trustees, it should be noted that those respondents falling into group one (professional trustees in a trust corporation or company) responded on behalf of their organisation as a whole, and so are representative of a much larger number of individual trustees.

Legal advisers

- 3.15 As regards the legal advisers to settlors and trustees (the second target group), questionnaires were sent to a sample group of 400. Of the questionnaires, 69 were returned, representing a 17 per cent response rate. Again, as a result of the low response rate, the results of the questionnaires cannot be regarded as representative of the group taken as a whole and therefore must be treated with some caution.⁶
- 3.16 The trustee clients whom the respondents advised fell into each of the four groups. Almost all respondents advised more than one group: 44 per cent of the respondents advised trustees in group one; 68 per cent advised trustees in group two; 68 per cent advised trustees in group three; and 92 per cent advised trustees in group four.
- 3.17 The questionnaires to both target groups contained a mix of close- ended and open- ended questions. The close- ended questions sought both factual and attitudinal information in order to generate statistical data about respondent characteristics, attitudes and perceptions. The open- ended questions gave the

⁴ The high number of pension trusts resulted from the fact that many professional trustees in trust corporations tended to specialise in this area of trust law and information about trustees in this area was more readily available.

⁵ For example, a will trust.

⁶ A number of respondents suggested that the response rate was low as a result of the survey coinciding with the busiest time of year for trust solicitors (that is, the end of the tax year and the budget) and following too closely the Law Commission's own questionnaire, which had already been completed by the majority of the target group.

respondents the opportunity to raise specific socio- economic issues regarding trustee exemption clauses.

Qualitative approach

- 3.18 Qualitative data was collected through interviews with respondents in both target groups. A total of 65 interviews, ranging in length from 10 to 90 minutes, were conducted. Although the interviews were partially structured, they were designed to allow the interviewee respondents the freedom to explore their attitudes to trustee exemption clauses and the socio- economic effect of such clauses.

THE PREVALENCE OF TRUSTEE EXEMPTION CLAUSES IN PRACTICE

Sources of trustee exemption clauses

- 3.19 Trustee exemption clauses are an integral part of the modern trust and respondents indicated that as such they are to be found in many standard trust precedents. Those precedent books referred to included: *Butterworth's Encyclopaedia of Forms and Precedents* (5th ed 1998); *Sweet & Maxwell's Practical Trust Precedents* (issued annually); J Kessler, *Drafting Trusts and Will Trusts A Modern Approach* (5th ed 2000); and *Kelly's Draftsman* (18th ed 2002). A large proportion of regional solicitors indicated that they used the Society of Trust and Estate Practitioners [STEP] Standard Provisions.

The frequency of trustee exemption clauses

- 3.20 Respondents of both questionnaires and interviewees thought that trustee exemption clauses were very frequently included in trust instruments. Many respondents suggested that this is because so many of the standard trust precedents include trustee exemption clauses.⁷
- 3.21 Although trustee respondents indicated that less than half of their trusts contained a trustee exemption clause, there was a significant difference in frequency as between the various types of trustee. Trustee exemption clauses were much more commonly experienced by trustees in groups one and two than by those in groups three and four.
- 3.22 The legal adviser respondents thought that trustee exemption clauses were in practice very common. A substantial majority of these respondents believed that a majority of trusts contain a trustee exemption clause.

Types of clause

- 3.23 Trustee exemption clauses which exclude liability are much more common than those which exclude a duty. The former were encountered in three times as many trusts as the latter.

⁷ See para 3.19 above.

- 3.24 In response to the quantitative survey, nearly half of trustee respondents with clauses excluding liability said that their clause excluded liability for mere negligence; a somewhat smaller proportion said that their clause excluded liability for gross negligence; and, surprisingly, nearly half said that their clause excluded liability for fraud or wilful misconduct. This view was, however, contravened by the impression gained in interviews with legal advisers who claimed that since *Armitage v Nurse*⁸ virtually no trust instruments contain clauses excluding liability for fraud. It may be that some trustee respondents misunderstood the question in the questionnaire to mean that their clause did not cover fraud or wilful misconduct.
- 3.25 Trustee respondents indicated that about half of their trusts had an indemnity clause, and indemnity clauses were most common where trustees in group one were concerned. The frequency of indemnity clauses in trust instruments was closely related to the frequency of trustee exemption clauses. An overwhelming majority of those trusts that included an exemption clause also had an indemnity clause. In contrast, of those trusts without an exemption clause, less than half had an indemnity clause.

Reliance on trustee exemption clauses

- 3.26 Despite their frequent inclusion in trust instruments, the questionnaire responses highlighted the fact that very few trustees ever rely in practice on exemption or indemnity clauses. The vast majority of trustee respondents with the benefit of an exemption or indemnity clause had never had cause to invoke it. The impression of trustee exemption clauses being very rarely called upon was reinforced by the responses from legal advisers, an overwhelming majority of whom indicated that trustees would never or only occasionally rely on an exemption clause.
- 3.27 The key reason given by interviewees for trustees' reluctance to take advantage of exemption clauses was the damage it could cause to the trustee- client relationship. Some trustees suggested that it was simply uneconomical always to rely on a trustee exemption clause because it would result in the loss of too much business. However, actions for breach of trust are comparatively rare and it is impossible to assess the deterrent effect of the presence of a trustee exemption clause on those beneficiaries who may have otherwise been contemplating action against the trustees.

THE ATTITUDE OF TRUSTEES AND SETTLORS TO THE EXISTING LAW

Trustees

- 3.28 Legal adviser respondents indicated that the extent to which their trustee clients would know about trustee exemption clauses before seeking legal advice varied widely. About three quarters of legal advisers stated that they advised their

⁸ [1998] Ch 241. See para 2.42 above.

trustee clients always to use an exemption clause,⁹ and more than half indicated that, following such advice, most trustees would wish to have an exemption clause included in the trust instrument. However, the likelihood of a trustee requesting the insertion of a trustee exemption clause was not uniform as between the different types of trustee. In particular, lay trustees (that is, trustees in group four) were considerably less likely to request the protection of a trustee exemption clause.

- 3.29 In the opinion of the legal adviser respondents, the main reasons why a trustee would insist upon the inclusion of an exemption clause in the trust were that these clauses were accepted as part of the modern trust and that trustees were often advised to use such a clause or had used a similar clause before.
- 3.30 Professional trustees were somewhat polarised in their attitudes to the necessity and propriety of trustee exemption clauses. Most professional trustees were either in favour of or opposed to such clauses, with very few equivocating or failing to form a view. Notwithstanding this polarisation of attitudes, it may be noted that virtually all the professional trustees were agreed on two points: first, that knowledge, awareness and acceptance on the part of the settlor, coupled with clarity and transparency in the trust instrument, constitute an appropriate basis for the insertion of an exemption clause in the trust; secondly that the scope of trustee exemption clauses cannot be entirely unrestricted, for there should be no exclusion of liability in the case of fraud or wilful default.
- 3.31 Generally trustee exemption clauses were considered necessary by a much higher proportion of professional trustees than lay trustees. A similar trend was identified by legal adviser respondents who, when asked about the general attitude of their trustee clients towards trustee exemption clauses, indicated that around two thirds of professional trustees (that is, trustees in groups one to three) viewed exemption clauses as necessary or very necessary. In contrast only about one half of lay trustees were regarded by legal adviser respondents as viewing trustee exemption clauses as necessary or very necessary.
- 3.32 Those professional trustees who opposed the use of trustee exemption clauses gave several reasons in support of their view. Many emphasised the professional nature of the services they were providing and the fact that a fee was being charged. It was argued that the use of trustee exemption clauses resulted in inadequate protection for beneficiaries and allowed trustees' conduct to fall beneath the standard of accountable care that beneficiaries should be entitled to assume. Finally many trustees opposed to the use of trustee exemption clauses noted that for commercial reasons it was appropriate to stand by the trustee obligations that were expected by the beneficiary at the outset, and that frequent reliance on trustee exemption clauses would result in a loss of business.

⁹ Furthermore, almost all legal adviser respondents noted that there were no types of trust for which they would advise a trustee not to use an exemption clause.

3.33 Those professional trustees in favour of the use of trustee exemption clauses took the view that, in allocating risk, a balance must be struck between all the parties, particularly in the commercial circumstances in which trusts operate. They contended that protection was needed from circumstances which are beyond the trustees' control. Two examples were often cited:

- (1) Where a trustee becomes fixed with liability for the acts of other trustees;¹⁰ and
- (2) Where so- called "operational constraints" give rise to trustees' liability. The trustee respondents gave this term a wide definition so as to include unforeseen circumstances or new regulation,¹¹ as well as the conduct of external actors, which can often cause problems for trustees.¹²

3.34 Additionally, many trustee respondents argued that the presence of a trustee exemption clause provides comfort to trustees, especially from the threat of litigation. Most trustee respondents seemed acutely aware of this threat, a majority agreeing that beneficiaries are becoming more litigious. Professional trustees considered themselves a particular target for litigation because their status induced higher expectations and they were seen as having deep pockets.

3.35 Finally, some trustee respondents noted that trustee exemption clauses afford protection to trustees in circumstances where they are put in a position of potential conflict.

Settlors

3.36 The research sought to take account of settlors' views by reference to their legal advisers. Three broad themes concerning settlors' attitudes to trustee exemption clauses were identified.

3.37 First, the legal adviser respondents felt that generally settlors are not well informed about trustee exemption clauses, less than half knowing about trustee exemption clauses before seeking advice on establishing a trust. Several of these respondents also noted the difficulties of explaining the trust concept to their clients.

3.38 Secondly, the respondents took the view that the vast majority of settlors are not particularly interested in the issue of trustee exemption clauses. Settlors are primarily concerned with achieving a specific goal, not the means by which that

¹⁰ Whilst most professional trustees were aware of the right of the innocent trustee to seek contribution or indemnity from those trustees whose actions had caused the breach of trust, this solution was deemed too uncertain and inadequate.

¹¹ For example, the liability imposed under environmental legislation (eg Environment Act 1995) for environmental damage clean- up costs.

¹² For example, in the pension sector, the liability which may result from late payments by the company, or reliance upon the veracity of information from the company.

goal is achieved, and so their concern with trustee exemption clauses is only incidental.

- 3.39 Thirdly, the majority of respondents suggested that settlors tend to accept trustee exemption clauses as part of the package of the modern day trust, especially if they have received advice to this effect. Moreover it was felt that many settlors regard the choice of trustee as more important than the presence of a trustee exemption clause; about a third of legal adviser respondents thought that settlors include a trustee exemption clause in trusts either in order to attract professional trustees or because the clause was requested by the trustee.
- 3.40 Very few respondents were able to identify any reasons why a settlor would not include a trustee exemption clause in their trust. Virtually all the respondents emphasised that in practice the issue of non-inclusion of trustee exemption clauses rarely arises. The main explanation for a settlor's failure to include a trustee exemption clause was that the settlor would be unaware of the availability of such clauses.
- 3.41 This seems to indicate that there is considerable indifference- but also little opposition- by settlors to the use of trustee exemption clauses.

THE ATTITUDE OF TRUSTEES AND SETTLORS TO REGULATION

Necessity of trustee exemption clauses

- 3.42 It is clear that many trustees, in particular those operating in highly specialised markets,¹³ regard trustee exemption clauses as a pre- requisite to acting as a trustee. Indeed, the majority of trustee respondents either agreed or strongly agreed that in the current economic climate trustee exemption clauses are a necessity for trustees. Support for this attitude came from a substantial majority of legal adviser respondents, who considered that professional trustees see trustee exemption clauses as a pre- requisite to their assumption of trusteeship. Reaction to any potential regulation of trustee exemption clauses was not, however, consistent across the various kinds of trustees. Whereas more than half of respondent trustees in groups one and two stated that they would not have taken up their appointment if the trust instrument did not include an exemption clause, among trustees in groups four, a considerably less intransigent attitude was displayed. Indeed only one fifth of lay trustee respondents considered a trustee exemption clause to be a pre- requisite to acceptance of appointment.
- 3.43 Interviews indicated, somewhat unsurprisingly, that for the majority of professional trustees, their decision to act as a trustee is a purely commercial one which balances the rewards for acting against the risks incurred- the higher the risk, the lower the return and the greater the likelihood that the trustee will refuse to act.

¹³ For example, the global securities market.

Willingness to act following regulation

- 3.44 Concern was expressed by interviewees that regulation of trustee exemption clauses would increase the risk on trustees, thereby altering the risk:reward ratio so that fewer trustees would be prepared to act. Nearly two thirds of trustee respondents predicted that prohibition of trustee exemption clauses would cause the number of people choosing to accept trusteeship to decrease. Very few forecast no decline in the numbers of willing trustees.
- 3.45 That said, the majority of trustees expressed the view that the decision to become a trustee was not based solely on the substantive clauses contained in the trust instrument, but on an assessment of the overall risk which was being undertaken in all the circumstances.¹⁴ Moreover, the majority response to potential prohibition of trustee exemption clauses was to seek better protection by means of indemnity insurance. Only a third of those trustees interviewed intimated that they would respond by resigning their trusteeship.
- 3.46 Most legal adviser respondents agreed or strongly agreed with the proposition that regulation of trustee exemption clauses would cause the number of professional trustees to decrease. Some trustees surmised that when predicting the effect of regulation on professional trustees a distinction can be drawn between the different types of trustee. In their opinion it is the professional trustee in private practice who is likely to regard regulation as a barrier to trusteeship, whilst professional trustees in trust corporations and companies would continue to work in the market, perhaps selecting their work more carefully. There was some support for this thesis among legal adviser respondents.

The attitude of settlors

- 3.47 Interviewees and questionnaire respondents were agreed that in general settlors do not consider trustee exemption clauses a pre- requisite to appointment of a trustee, but regard them merely as part of the package. However, it was noted that settlors may increasingly consider trustee exemption clauses essential to the appointment of a trustee in order to ensure that they are able to appoint the trustee of their choice.

THE PERCEIVED CONSEQUENCES OF REGULATION

Movement of operations to less restrictive jurisdictions

What factors influence the location of the activity of trustees

- 3.48 The overwhelming majority of trustee respondents were trustees of a trust located in England and Wales. Likewise, an overwhelming majority of legal adviser respondents advised trusts that were based in England and Wales.

¹⁴ That assessment may be made, for example, by consideration of the nature and value of the trust assets or the characteristics and experience of the other trustees.

- 3.49 Two key factors were highlighted as influencing the location of trustee operations.¹⁵ First, most respondents considered that the settlor's home or base was the primary influence upon the location of a trust, for it is with that jurisdiction that the settlor will have most commercial familiarity. Particularly in respect of smaller private trusts, it was thought that both settlors and beneficiaries felt more comfortable with trustees based in their own jurisdiction for reasons of convenience and accessibility. Moreover it was noted that many settlors tended to be highly suspicious of off- shore jurisdictions.
- 3.50 Secondly, the majority of legal adviser respondents considered that financial or taxation reasons influenced the location of a trust. For example, a number of trusts are established in England and Wales for certain Inland Revenue taxation authorisations or approvals. Such trusts include UK pension trusts, employee benefit trusts, unit trusts, small self- administered schemes and charitable trusts. In contrast, very few trustee respondents thought that the location of trusts was influenced by financial or taxation considerations.
- 3.51 Finally, it was noted by some respondents that the location of a trust may be influenced by regulatory factors.
- 3.52 However, very few respondents regarded the availability of a trustee exemption clause as a reason for the location of a trust; indeed the majority of legal advisers opined that no trusts were in fact located in a particular jurisdiction because of the efficacy (or otherwise) of trustee exemption clauses in that jurisdiction.
- 3.53 For professional trustees working in the global securities market, very different factors influence the location of their trustee operations. Interviewees working in this specialised field identified two main reasons for the location of such trusts in England and Wales. First, the flexibility of the English trust renders it much more attractive than other trust concepts¹⁶ which more narrowly define the role of the trustee. Secondly, as a result of its security and stability, the City of London is regarded as a world- wide capital market in which investors have confidence.

The availability of alternative jurisdictions

- 3.54 Many legal adviser respondents already advise trustees administering trusts located in other jurisdictions. Most commonly the trust is located in a low tax jurisdiction.¹⁷ Very few other jurisdictions were mentioned by legal adviser respondents: those worthy of note are Eire, Scotland and New Zealand.

¹⁵ It must be noted that virtually all respondents stated that only exceptionally would a trustee operate in a jurisdiction other than that in which the trust was located. Thus those factors influencing the location of trusts will also influence the location of trustee operations.

¹⁶ Such as the US trust under the Trust Indenture Act 1939.

¹⁷ Such jurisdictions include the Channel Islands, the Cayman Islands, Bermuda and Switzerland.

Whether trustees would in fact operate in another jurisdiction

- 3.55 The vast majority of trustee respondents expressed reserve about moving their operations to another jurisdiction, even if trustee exemption clauses were to become regulated. Overall less than one fifth of trustee respondents thought that regulation of trustee exemption clauses would affect their decision to operate in England and Wales.¹⁸ However, nearly one third of trustees in groups one and two indicated that their choice of jurisdiction would be affected by regulation of trustee exemption clauses.
- 3.56 The trustee respondents indicated that the reason for their unwillingness to relocate trust operations in another jurisdiction upon regulation of trustee exemption clauses was because the potential consequences of regulation failed to outweigh the two primary reasons for the location of trusts in England and Wales: specifically the status of the trust in respect of taxation privileges and the familiarity of settlors with the English trust.¹⁹
- 3.57 A third reason for the view that settlors would not move their trusts to another jurisdiction is that for many trusts (and certainly for small family settlements) the cost would be prohibitive.
- 3.58 Although generally trustees would be reluctant to relocate, those trustees operating in the field of global securities constitute a significant exception to this trend. The majority of trustees working in these markets have the ability and infrastructure to move their operations abroad. New York was identified as a particularly attractive jurisdiction as the main actors in the global securities trust field are US banks and so already have a presence in the US.

Impact of regulation on charges made for the work of trustees

- 3.59 Two thirds of legal adviser respondents considered that the regulation of trustee exemption clauses would affect the general level of charges being made for the work of the trustees. The majority identified the need for insurance as the greatest reason for an increase in charges, though some also mentioned increased costs attendant upon the need for greater supervision of trustees.²⁰
- 3.60 The extent to which, in the opinions of the trustee respondents, regulation would affect the charges made to a trust can be looked at from three perspectives.

¹⁸ It is notable that a slightly larger proportion of those trustee respondents currently with the benefit of a trustee exemption clause than of those without indicated that their decision to set up a trust in England and Wales would be affected.

¹⁹ Some respondents did suggest that as the practice of using an off-shore jurisdiction becomes less of an unknown quantity, settlors' use of that jurisdiction would rise and this would encourage more trustees to operate there.

²⁰ For example, this would include costs incurred through increased resort to legal advice.

Operational costs of trustees

- 3.61 Most trustee respondents stated that in their role as trustee they incurred general operational costs.²¹ However, less than one third of trustees thought that in the event of a prohibition of trustee exemption clauses these costs would rise.
- 3.62 A distinction was made by professional trustees between trustee exemption clauses that exclude duties and those that exclude liabilities. In general it was thought that the former could reduce the operational costs of trustees as time and resources would be saved in not having to fulfil the excluded duty. Most professional trustees considered that the latter had no effect upon their operational costs at present. However, a minority took the view that the presence of a clause excluding liability does not reduce operational costs but the absence of the clause would increase operational costs. In particular, the need for more extensive insurance cover would lead to an increase in premiums; indeed nearly one half of trustee respondents identified a rise in insurance premiums as the single most important factor in the increase in operational costs.

Administration fees charged by trustees

- 3.63 Less than one third of all the trustee respondents received a fee or remuneration for their work as a trustee. The overwhelming majority of trustees in groups one and two charged a fee or remuneration for their work as a trustee, whereas less than one third of trustees in group three, and a very small proportion of trustees in group four charged a fee or received remuneration.
- 3.64 The administration fees charged by the trustee respondents ranged from less than £10,000 to more than £100,000. The reason for the differences in the administration fees was not readily apparent. In general the quantum of the administration fees could be broadly categorised neither by type of trust nor by type of trustee. Most surprisingly the size of the administration fee charged to a trust seemed independent of whether the trust instrument contained a trustee exemption clause.
- 3.65 Notwithstanding this, of those trustee respondents that charged a fee or received remuneration, more than half predicted that the fee charged would rise if trustee exemption clauses were regulated.²² There were different views as to the level of any increase in fees though most trustees thought it would be less than 25 per cent. The reasons given for the anticipated increase in fees were the increased cost of insurance premiums and the costs of additional audit trails.

²¹ Such operational costs include travel and basic office costs.

²² It is notable that a majority of trustee respondents having the benefit of a trustee exemption clause predicted an increase in their administration fee if such clauses were prohibited. Less than one third of trustee respondents without the benefit of a trustee exemption clause predicted an increase.

Other administrative costs

- 3.66 Most trustee respondents stated that their trust incurred other administrative costs beyond the operational costs or the fees of the trustee.²³ About one third of trustee respondents predicted that these other administrative costs would rise if trustee exemption clauses were prohibited.

Impact of regulation on investment of wealth in England and Wales

- 3.67 In the short term the regulation of trustee exemption clauses was not seen by trustees or their legal advisers as having a direct effect on the use of the trust unless other equally effective vehicles could be used to achieve the settlors' objectives of financial planning and asset protection. Furthermore, the trust was also seen to endure in other areas, such as pensions, as a result of legislative requirements.
- 3.68 However, a significant proportion of trustee and legal adviser respondents had definite concerns over the longer term use of the trust in England and Wales based on the broader economic consequences of regulating trustee exemption clauses.
- 3.69 First, respondents predicted that there would be an increase in the cost of administering trusts if trustee exemption clauses were subject to regulation.²⁴ This would reduce the economic viability of many trusts.
- 3.70 Secondly, many respondents emphasised that regulation of trustee exemption clauses would lead to an increase in over- cautious or defensive trusteeship. It was contended that this defensive trusteeship would lead to excessive use of lawyers, accountants and other professionals- thereby rendering decision making slower and more expensive- as well as encouraging investment in low risk entities- thereby leading to reduced investment in new industries.
- 3.71 Overall, when asked whether the current availability of trustee exemption clauses encouraged the investment of wealth in England and Wales and whether the prohibition of trustee exemption clauses would discourage the investment of wealth in England and Wales, the overwhelming majority of trustee respondents were unsure.
- 3.72 However, professional trustees were much less reluctant to form an opinion. Many, albeit not the majority, considered that the current availability of recourse to trustee exemption clauses encouraged the investment of wealth by the creation of trusts, and that the prohibition of trustee exemption clauses would discourage the investment of wealth in England and Wales. A similar view was taken by many legal adviser respondents.

²³ For example, the salary costs of administrative support and the fees of advisers to the trusts.

²⁴ See paras 3.63 to 3.66 above.

- 3.73 Generally respondents noted that in three particular areas the regulation of trustee exemption clauses and the resulting discouragement of investment could have particularly serious ramifications.
- 3.74 First, trustee respondents in the pensions sector highlighted the current onerous nature of trusteeship, with the complexity of legislation and the burden of compliance costs. These respondents expressed concern that further regulation would severely impede the running of pension schemes.
- 3.75 A contraction in pension provision would, for at least two reasons, have negative implications. In 20 to 30 years people may be in the situation where they begin retirement without an adequate pension. Moreover, reduced investment in pensions could also affect the stability of the market, and may even lead to its stagnation.
- 3.76 Secondly, some trustee respondents in the charity sector felt that regulation of trustee exemption clauses would have a negative effect on charitable trusts, leading to a contraction in the size of the sector. They predicted this would have an immediate effect upon the investment of wealth regionally in England and Wales.
- 3.77 Respondents foresaw that the main difficulty with which charities would have to contend was the recruitment of trustees. Charity trustees have an increasing awareness of the risks attendant upon their responsibilities and so, especially those with a professional background, would be unwilling to act without the benefit of an exemption clause.
- 3.78 Thirdly, some trustee respondents operating in the global securities market expressed the view that investors were attracted by the flexibility of the English law trust and that any change endangering this flexibility may have a serious impact on the utility of the trust in these markets and the willingness of these trustees to operate in this jurisdiction. It should, however, be noted that the other jurisdiction with which such investors are already most familiar- New York- itself controls trustee exemption clauses and that this particular form of regulation may not therefore be seen as being a serious incursion into trustee autonomy.

Wider financial implications

- 3.79 Many trustee respondents believed that regulation of trustee exemption clauses would not only lead to a reduction of investment of wealth through the creation of settlements in England and Wales, but would also affect the market as a whole. It was pointed out that the administration of trusts generates an income for a number of service industries. This led trustees to argue that prohibition of trustee exemption clauses would have a negative effect on the commercial and financial climate of England and Wales.
- 3.80 Overall, the legal adviser respondents were more optimistic in their predictions. Only one fifth of those respondents agreed or strongly agreed that regulation of trustee exemption clauses would detrimentally affect other sectors of commerce

in England and Wales. A slightly larger proportion disagreed or strongly disagreed that regulation would have any effect on other sectors of commerce.

AVAILABILITY AND EFFECTIVENESS OF ALTERNATIVE PROTECTIONS FROM LIABILITY

- 3.81 Many respondents, both trustees and legal advisers, stated that if trustee exemption clauses were prohibited, they could envisage alternative methods by which a trustee could be protected from liability. While we now proceed to examine the role of insurance and the utility of indemnity clauses we should note that there was little consensus as to the effectiveness of such alternatives. Indeed, the majority of respondents were of the view that trustee exemption clauses were the only truly effective method of protecting trustees.

Insurance

- 3.82 Both trustee and legal adviser respondents suggested liability insurance as the main alternative to trustee exemption clauses. Nearly one half of all trustee respondents indicated that they already had the benefit of personal indemnity insurance, though the proportion of trustees with insurance varied as between the different types of trustee. Insurance was more common among trustees in groups one and two. Less than one half of lay trustees had insurance.
- 3.83 Of those trustee respondents without insurance, the majority indicated that, in certain circumstances, they would consider taking out insurance in the future, and a small number said unconditionally that they would take out insurance. Over one third said that they would take out insurance if the premiums were paid for directly by the trust fund; others said that they would take out insurance if they could incorporate the premiums into the fee charged to the trust.
- 3.84 One fifth of trustee respondents thought that the need for insurance would have deterred them from accepting their trusteeship, but over one half would not have been deterred from acting by the need for insurance alone.
- 3.85 Overall, about one half of trustee respondents believed that personal indemnity insurance was a viable alternative to trustee exemption clauses: less than one fifth regarded it as unworkable. The legal adviser respondents were divided on this issue, being split between those who agreed or strongly agreed that personal indemnity insurance would be a viable alternative to trustee exemption clauses, and those who disagreed or strongly disagreed.
- 3.86 Nonetheless, many trustee respondents, including some of those who had recommended it, had serious concerns as to the effectiveness of insurance as a solution to the regulation of trustee exemption clauses. These respondents highlighted four main drawbacks to the widespread use of insurance.
- 3.87 First, many respondents thought that the cost of insurance would not just be an extra burden to bear, but that it would be prohibitive to the running of many trusts, especially small family and small charitable trusts.

- 3.88 Secondly, it was noted that insurance is not available for all types of trust or for all types of trustee. Respondents highlighted lay trustees and trustees of small family trusts as frequently encountering difficulties in obtaining individual insurance because of the problems involved in assessing their risk and the lack of any previous claims history.
- 3.89 Thirdly, many trustee respondents opined that insurance was insufficiently secure or consistent to offer adequate protection. It is not uncommon for insurers to include exceptions in their policies, and so in this way even an insured trustee may be exposed to liability. Furthermore, typically insurance policies cover only current claims and yet a trustee may still incur liability after retirement. Thus a trustee would require insurance indefinitely, and many respondents doubted whether sufficient and effective policies would be available upon the retirement of trustees.
- 3.90 Fourthly, doubts were raised by the trustee respondents about the capacity of the insurance market to cover the trust industry, particularly in the global securities market where the insurable risks would be extremely high.

Indemnity clauses

- 3.91 Many trustee respondents expressed no concern with a prohibition of trustee exemption clauses because they advocated an increased use of indemnity clauses in the trust instrument. The source of the indemnity would depend upon the nature of the trust.
- 3.92 Other respondents, however, were more reluctant to accept the viability of indemnity clauses. It was noted that any indemnity was only as strong as the person or entity contracted to provide it. Although some trustees, in response to this point, proposed that indemnity clauses should be backed by a bank guarantee, concerns were raised as to the prohibitive cost to some settlors of establishing such an indemnity. It was argued that further difficulties would be encountered in arranging for indemnity when a trustee retires.

SUMMARY

- 3.93 We have found the research extremely helpful in identifying current trust practice and attitudes to regulation of trustee exemption clauses held by trustees, in particular by professional trustees, and settlors. It has also assisted us in assessing the potential economic impact of any regulatory control.
- 3.94 It is clear that trustee exemption clauses are now widely used in trust instruments and that professional trustees in particular have come to rely upon them as affording a means of protection from liability for breach of trust. This trend is not by any means universally approved even among professional trustees themselves, many of whom take the view that those who charge for their services should be properly accountable to the beneficiaries of the trust. While settlors are generally indifferent on the subject, not being themselves at risk, it would be reasonable to assume that beneficiaries would support greater regulation.

- 3.95 It is nevertheless the case that many professional trustees consider trustee exemption clauses to be a necessary component in modern trust practice. They would argue that any regulation would lead to a greater reluctance to act and possibly to the transfer of trusts to jurisdictions which do not restrict reliance on trustee exemption clauses. We are not presently convinced that there is a significant risk of the latter. The most convenient jurisdictions, namely Jersey and Guernsey, have already imposed controls on trustee exemption clauses, and it does not appear that this is an issue which is usually determinative of choice of jurisdiction for a settlor or for that matter a trustee. It may be that there are certain trusts markets where regulation may have a greater impact than others.
- 3.96 The insurance perspective (which we discuss further below in Part IV) is important. We realise that liability insurance premiums are reduced where the trust contains a trustee exemption clause. In so far as exclusion of liability by such means is regulated, the trustee's degree of risk will increase, and the concomitant rise in premiums will be carried through to the settlor in the fees being charged by the trustee. There may also be higher operational costs which can also be fairly attributed to regulation.
- 3.97 It is clear that regulation would have some impact on the level of charges being demanded by professional trustees. In so far as regulation affects lay trustees, they may seek to have their own insurance costs paid out of the trust fund. The question, to which we shall now turn in Part IV, is whether in the light of these circumstances there is a strong case for intervening with the freedom of the settlor and the trustee to stipulate the terms of the trust.

PART IV

OPTIONS FOR REFORM

4.1 The Law Commission has been asked to examine the law governing trustee exemption clauses as a result of the increased presence of such clauses in modern trusts and the relative freedom accorded to trustees by the current law as stated in *Armitage v Nurse*¹ to invoke such clauses in order to protect themselves from the consequences of their acts or omissions. In this Part we intend to set out the arguments in favour of reform of the current law and the various options for effecting such reform which appear to us to be available. We begin, however, by outlining the problems with which we consider any reform of this area must deal.

THE FACTUAL BACKGROUND

4.2 The trust is a device which is now used in many different situations and with many different objectives. Traditionally employed in relation to wills and family settlements, it is now of increasing relevance in more commercial contexts such as international finance and corporate investment, and it is central to the management of pension and similar funds. It remains of particular significance to charities. In relation to these very different kinds of trust, the legitimate interests and expectations of the beneficiaries may vary considerably, from the beneficiaries of pension trust funds, who may be receiving benefits arising from and commensurate to their contribution, to beneficiaries of family settlements who, while they may come to rely upon trust income over a period of time, are essentially recipients of a gift.

4.3 As has already been noted, various types of clause can be used by trustees in an attempt to secure exemption from liability. As well as clauses which seek simply to exclude or restrict liability for breach of trust, there can be clauses which limit the scope of the trustees' duties (in particular the duty of care), clauses which extend the trustees' powers and clauses which entitle the trustees to indemnity from the trust fund. All such clauses can have the same practical effect from the point of view of the beneficiary who is seeking compensation as clauses which exclude or restrict liability simpliciter.

4.4 As there is almost an infinite variety of types and terms of trusts, the same can be said of the trustees who are obliged to administer them. The lay trustee is still of immense importance in relation to family trusts (where he or she will often be a family member) and in relation to charitable trusts. Such trusts often rely on the sense of duty and public-spiritedness of individuals to take on the responsibilities of trusteeship altruistically. Elsewhere, particularly where trusts are being used for commercial purposes, the professional trustee, who acts in order to obtain remuneration for services rendered, is now pre-eminent. Some of these are large trust corporations, such as banks and other financial institutions;

¹ [1998] Ch 241.

some are individuals who may be employed by trust companies or who may be in private practice possibly as financial advisers, accountants or solicitors. There will be certain trusts which will be administered by a combination of professional and lay trustees.

- 4.5 Although the practical ramifications of the trust can be extremely complicated, the underlying concept is extremely simple. Indeed it is the very simplicity of the trust which facilitates its use in the wide range of circumstances which we have only been able to sketch here and which gives it its inherent attractiveness and popularity. These factors are enhanced by the freedom which is afforded to those promulgating the trust to stipulate the terms on which the trustees are to hold the property and to mould their powers and duties to fit the circumstances of the particular case. For instance, a rational settlor may well seek to restrict the potential liability of the trustees on whom reliance is placed on the basis that to do so will result in reduced insurance charges being met out of the trust fund.

ANALYSIS OF THE PROBLEM

- 4.6 The current law as set out in *Armitage v Nurse* recognises that the consequence of the creation of a trust is that there is an irreducible core of obligations from which the trustees cannot escape, else the legal relationship will no longer be that of a trust at all. However, as that core of obligations comprises no more than a duty to act honestly and in good faith, it does not seriously impact upon the freedom of settlors to restrict trustees' liability by reference to trustee exemption clauses.
- 4.7 In seeking to identify what the objectives of the law should be in relation to the exemption of trustees from liability for breach of trust, it is important to recognise the various conflicting interests which are at stake. To consider first the parties to the trust relationship, there is the settlor who wishes to ensure that the trust which is being created is properly and effectively administered according to its terms, but who at the same time seeks to retain the widest possible freedom to stipulate what those terms are. There are the trustees who, as the likely focus of any enforcement action, would wish their liabilities to be carefully and clearly proscribed. Then there are the beneficiaries- the Attorney General in the case of charitable trusts- who do not want their rights to enforce the terms of the trust to be curtailed in any way. Any reform must balance the interests of the settlor, the trustees and the beneficiaries. We shall now look at each of these interests in turn.

The settlor

- 4.8 Paradoxically, a trust may well arise without there being an identifiable settlor. Furthermore, the dynamic of the trust is the relationship between the trustee and the beneficiary. Nonetheless, one of the most acute tensions which pervades modern trust practice emanates from the desire of the settlor to retain control over property which he or she, in order to constitute the trust, is necessarily transferring outright into the hands of the trustees. There are various means available to the settlor which may be used in an attempt to retain some residual power over the trust property. The settlor may declare him or herself to be the

trustee or one of the trustees, or may direct that the settlor's consent is required for certain transactions by the trustees, or may appoint him or herself a "protector" with prescribed rights of consultation and possibly powers of intervention. However, it is important to realise that once the trust has been properly constituted, the status of settlor is an irrelevancy, a matter of no more than historical record.² Any residual rights which the settlor enjoys thereafter will not be by virtue of being settlor. When we say, then, that the settlor has an interest in performance of the trust obligations, we mean no more than that if the integrity of the trust is to be maintained, the intentions of the settlor as declared in the trust instrument should be given effect to, at least in so far as they are consistent with the general notion of trust.

- 4.9 Although the settlor is the architect of the trust, it is artificial to assume that the settlor has in all cases absolute freedom to dictate the terms on which the trustee or trustees are to hold the trust property. First, the very existence of the trust means that the settlor must have transferred title in the property to the trustees who are then holding that property subject to the fiduciary obligations owed to the beneficiaries. As we have observed, those obligations must have the "core content" of a trust relationship. Secondly, although the settlor may be extremely reluctant to do so, current market conditions may make it prudent for the settlor to include a trustee exemption clause in the trust instrument. The settlor may intend to employ the services of a professional trustee, who may refuse to act unless a sufficiently broad clause is included in the trust. Even if the settlor does not contemplate the appointment of a professional trustee at the moment of execution of the trust, it may be highly advisable to include such a clause to cater for the eventuality of the retirement or resignation of the trustees whom the settlor appoints, and for the possibility, at that stage, of the recruitment of professional trustees to take over the responsibilities of trusteeship. It may be that it is becoming customary for trusts draftsmen to include trustee exemption clauses, much as charging clauses have become standard in the majority of trust instruments, so as to facilitate the appointment of professional trustees should that become necessary or desirable at some future date.

The trustee

- 4.10 The obligations of trusteeship are voluntary, but onerous. A breach of trust may occur through the negligence or even fraud of the trustee, but it may also occur where the trustee has acted entirely innocently, albeit outside his powers (*ultra vires*). There is no doubt that the chance incurrment of liability for breach of trust does not accord with the modern acceptance of fault- based liability and that it has led to the reluctance of those who appreciate and recognise the legal consequences of trusteeship to act without the comfort of either or both indemnity insurance and an exemption clause.

² See, for example, Hayton & Marshall, *The Law of Trusts and Equitable Remedies* (11th ed 2001) para 1- 29(7)(a).

- 4.11 There is clearly a public interest in encouraging lay trustees to act. It is particularly evident in charities, but in relation to family trusts it is often more suitable to use the good offices of those who know the various individuals than to employ professional expertise. The threat of strict liability for breach of trust, or even liability for negligence, is likely to deter precisely those who would otherwise be ready to assume the role of trusteeship for reasons other than remuneration for the services provided. While it is possible for lay trustees to take out indemnity insurance, it is very difficult for individual trustees to obtain such insurance, as the usual means of securing protection is for a policy to be written for the trust as a whole.
- 4.12 Very different considerations apply where professional trustees are concerned. They are providing trustee services on a commercial basis. They are holding themselves out as being competent, experienced and prudent- indeed that is the basis upon which they justify charging the trust for the services which they provide. They will almost always have the protection of indemnity insurance, and if they do not, this is likely to be the result of a conscious commercial decision. As trustee exemption clauses have become more prevalent, it has no doubt become possible for certain professional trustees to require, as a condition of appointment, that the trust being executed contains such a clause. But in such cases, the professional trustee has “belt and braces” coverage- exemption from liability for breach of trust at least in so far as the trustee does not act fraudulently, plus indemnity insurance in any event.

The beneficiary

- 4.13 Of the three protagonists, the beneficiary is the least able to secure adequate protection of his or her interests. It is not simply a case of an inequality of bargaining power (such as supports the regulation of exemption clauses in consumer contracts). The beneficiary is not part of a “bargain” at all. The trust is created by the settlor, and its terms are accepted by the trustee on assumption of the trusteeship. The beneficiary has no right whatsoever to be consulted about the terms of the trust. Indeed, it is often the case that the beneficiary will be unaware of the detail of the terms, including the presence of a trustee exemption clause, until he or she seeks recompense for the misconduct of the trustees.³
- 4.14 As with trustees, beneficiaries may encompass a very wide range of persons. There will be some who have made a significant financial contribution to the money now represented by the trust fund and who see the benefits which ultimately accrue to them through the trust as their entitlement. Then there are others who are essentially objects of largesse, being distributed among members of a family. It may be felt that such individuals should not be entitled to complain about the terms attached to acts of benevolence of which they are the fortunate recipients. They may however be relying on payments from the trust, perhaps towards their school or university education.

³ For the beneficiary’s right to trust information, see *Lewin on Trusts* (17th ed 2000) para 23-03 *et seq.*

- 4.15 The trust obligations are those owed by the trustee to the beneficiary. Unless those obligations can be enforced against the trustee by the beneficiary, they are without meaning. The trustee exemption clause makes the enforcement of those obligations more difficult. The trustee may invoke the clause to argue that although he or she has been in breach of trust liability should not ensue. Reliance, or at least excessive reliance, on such clauses threatens the integrity of the trust relationship.

THE OBJECTIVES OF REFORM

- 4.16 The broad objectives which we have identified can be listed as follows:
- (1) It is essential to achieve a satisfactory balance between the rights and interests of the settlor, the trustees and the beneficiaries of the trust.
 - (2) In principle, the settlor should be free to make whatever lawful disposition of his or her property he or she wishes to make. However, the settlor should be aware not only of the existence of any provisions in the trust instrument which exclude trustees from liability for breaches of trust, but also of their legal consequences.
 - (3) In so far as the settlor creates a trust, it is appropriate to curtail the settlor's freedom by reference to the interests of the beneficiaries, in particular to recognise the right of the beneficiaries to enforce the terms of the trust by remedial action against the trustees.
 - (4) There is a public interest in encouraging lay persons to act as trustees without expectation or receipt of remuneration.
 - (5) At the same time, those who act as trustees in the course of their business or profession, while being entitled to receive fair recompense for their services, should be expected to achieve reasonable standards of competence for those services and should be accountable for their conduct.

APPROACHES TO REGULATION OF TRUSTEE EXEMPTION CLAUSES

- 4.17 The options available range from imposing an absolute prohibition on all trustee exemption clauses to conferring total freedom on settlors to include such clauses in their trust instruments and on trustees to rely upon them to defend actions for breach of trust, limited only by the concept of the irreducible core of obligations. Between these options lies a wide range of possible methods of regulation.
- 4.18 We do not believe that an absolute prohibition on all trustee exemption clauses is justifiable at present. One of the advantages of the trust is its flexibility and its adaptability to different factual circumstances and to different kinds of relationship. To deny settlors all power to modify or to restrict the extent of the obligations and liabilities of the trustee would have a very significant impact on the nature of the trust relationship. The trust would inevitably become more

inflexible and we are convinced that many who are at present willing to take up the duties of trusteeship would cease to be so. It must be emphasised that an absolute prohibition of trustee exemption clauses would result in trustees being liable for breaches of trust which could not be characterised as negligent and would have the practical effect of imposing a single, indefeasible standard of care on all trustees irrespective of the circumstances surrounding the particular trust and the specific wishes of the settlor.

- 4.19 As we shall explain in due course,⁴ it is more satisfactory, in our view, for trustees to be able to rely upon trustee exemption clauses in such cases than to be expected to apply to the court for exculpation under a provision akin to section 61 of the Trustee Act 1925. The latter jurisdiction, being dependent upon the exercise of judicial discretion by the court, does not offer trustees the requisite degree of certainty to which we believe they have a reasonable entitlement.

We do not consider that an outright prohibition of trustee exemption clauses is justified or necessary.

Do consultees agree?

- 4.20 At the same time, we do believe that there is a very strong case for some regulation of trustee exemption clauses. Their increased use in recent years has without doubt reduced the protection afforded to beneficiaries in the event of breach of trust. While there is a need to maintain a balance between the respective interests of settlor, trustee and beneficiary, we believe that the current law is too deferential to trustees, in particular professional trustees who hold themselves out as having special knowledge, skills and experience, charge for the services they provide and insure themselves against the risk of liability for breach of trust. It is on these trustees that this Paper will ultimately focus. However, we also believe there are important reforms to trust practice which should be considered, and which would impact on lay trustees as well.

We do consider that some legislative regulation of trustee exemption clauses is justified and necessary.

Do consultees agree?

- 4.21 We propose to consider three broad approaches which could be employed to restrict the use which could be made of trustee exemption clauses. They should not be viewed as being necessarily mutually exclusive. They are:

- (1) Reforming trust practices with a view to ensuring that the settlor is aware of the existence and the legal consequences of any trustee exemption clause contained within the trust instrument.

⁴ See para 4.62 below *et seq.*

- (2) Imposing a reasonableness requirement on trustee exemption clauses such that a professional trustee is only permitted to rely upon such a clause in so far as the clause satisfies the requirement of reasonableness.
- (3) Subjecting the conduct of the trustee in respect of the breach of trust to a regime of accountability by means of:
 - (a) prohibiting professional trustees from relying on trustee exemption clauses but permitting them to apply for exculpatory relief from the court; or
 - (b) prohibiting professional trustees from relying on trustee exemption clauses only in so far as they have been guilty of “gross negligence”; or
 - (c) prohibiting professional trustees from relying on trustee exemption clauses only in so far as they have been negligent in their conduct or dealings with trust property.

4.22 In due course, we shall consider each of these approaches in detail, and make provisional proposals. Before doing so, however, we intend further to consider the justification for distinguishing between lay and professional trustees, and the means by which such distinction should be made.

LAY AND PROFESSIONAL TRUSTEES

The professional trustee

4.23 It will already be apparent that we consider that any analysis of the possible regulation of trustee exemption clauses must take account of the wide range of persons who may assume the responsibility of trusteeship.⁵ The twentieth century witnessed the expansion of liability for negligence on the part of many professional persons such as solicitors, barristers, accountants and financial advisers.⁶ Such persons would not expect to be able to exclude themselves from all liability for any mistakes they might make in providing their professional services. Yet that is not far removed from the current legal position of those who charge remuneration for their services as trustees and who can rely upon a clause contained in the trust instrument excluding them from all liability for breach of trust save where they have been guilty of fraud. As we noted in Part I above, the most serious concerns about the utilisation of trustee exemption clauses have focussed on the professional trustee.⁷

4.24 Not only is the professional trustee holding him or herself out as having special knowledge skills and expertise, he or she is also likely to be insured against the

⁵ See para 4.4 above.

⁶ See para 1.8 above.

⁷ *Armitage v Nurse* [1998] Ch 241, 256, per Millett LJ, quoted at para 1.6 above; *Hansard* (HL) 14 April 2000, vol 612, col 383 (Lord Goodhart), at para 1.10 above.

risk of professional liability. The cost of this insurance can be reflected in the fees charged. The New Zealand Law Commission, which recently recommended that professional trustees should not be able to rely upon any clause in the trust instrument which purports to exonerate them from liability for failure to exercise the degree of care, diligence and skill required by law, considered that the insurance perspective was extremely important:

The issue is whether losses should be borne by trustees or beneficiaries. It is appropriate in considering loss allocation, as between two classes, to take into account which class is in a better position to insure against the loss. The professional can be expected to insure (usually in practice as part of cover for all his professional activities) but the lay trustee may well either not realise the need to insure or find it difficult to obtain cover.⁸

- 4.25 As professional trustees are likely to be covered by liability insurance, the effect of a trustee exemption clause is to lighten the burden on the trustees' insurer.⁹ The cost of such insurance policies is of course reflected in the administration fees which professional trustees charge. We should add, by way of parenthesis, that although there would seem to be no need for statutory provision to be made enabling professional trustees to fund liability insurance premiums from the trust fund as this can be, and is, already achieved through the administration fee, it may be a useful power for professional trustees to have.
- 4.26 If trustee exemption clauses were to be controlled by legislation, trustees would be more vulnerable to successful action before the courts, insurance premiums would presumably rise, and the cost would no doubt be carried through to the beneficiaries in terms of the trustees' administration fee. Although the trust fund may be diminished in order to meet insurance premiums, the beneficiaries nevertheless stand to gain where the trustees are insured, in that the trustees have recourse to the insurance company to finance any judgement for damages which may be obtained against them.
- 4.27 Distinction is already made between professional and lay trustees in defining their respective duties of care. In our Report on Trustees' Powers and Duties we stated:

Professional trustees should be held to the high standard of skill and care which befits their qualifications and experience...

Every trustee should be required to exercise such care and skill as is reasonable in the circumstances. However, the level of care and skill which is reasonable may *increase* if the trustee has special knowledge or skills, (or holds him or herself out as having such knowledge or

⁸ Some Problems in the Law of Trusts (2002) NZLC Report No 79, para 14.

⁹ J Kessler, *Drafting Trusts and Will Trusts A Modern Approach* (5th ed 2000) p 77.

skills), or if the trustee is acting in the course of a business or profession.¹⁰

4.28 In that Report, we considered that the existing law may have recognised a gradation as to standards according to whether the trustee was an unpaid layman, a paid professional or a professional trustee,¹¹ but in casting the statutory duty to be imposed on trustees in carrying out specific functions we considered it desirable to put the matter beyond doubt by expressing the subjective element on the face of the statute.¹² Accordingly, the scope of the statutory duty of care imposed upon trustees in these circumstances now depends upon their level of knowledge or experience:

he must exercise such care and skill as is reasonable in the circumstances, *having regard in particular-*

- (a) to any special knowledge or experience that he has or holds himself out as having, and
- (b) if he acts as trustee in the course of a business or profession, to any special knowledge or experience that it is reasonable to expect of a person acting in the course of that kind of business or profession.¹³

The lay trustee

4.29 The contrast between the professional and the lay trustee is stark. Not only is the lay trustee professing no special expertise, he or she is unlikely to be aware of the opportunity of taking out indemnity insurance, and it would seem unreasonable to expect a lay trustee to pay for cover out of his or her own pocket.¹⁴ As the lay trustee is not being remunerated and acts out of good will, there is a real concern that excessive regulation of trustee exemption clauses may deter lay trustees from assuming the responsibility of trusteeship in the first place.

4.30 It is essential that any reform we propose takes account of the special importance of lay trustees. Although it is a particular problem with charities, which frequently rely on the altruism of individuals who give freely of their time, many other trusts, in particular family trusts, depend on the voluntary assumption of trusteeship by those who do not expect to be paid. The task of finding lay trustees can be arduous, and the presence of a trustee exemption clause in the settlement may provide some solace for the vacillating individual. Any proposed reform should not make it any less attractive for lay persons to take on the burdens of trusteeship.

¹⁰ (1999) Law Com No 260; Scot Law Com No 172, para 3.24.

¹¹ *Re Waterman's Will Trusts* [1952] 2 All ER 1054; *Bartlett v Barclays Bank Trust Co Ltd (Nos 1 & 2)* [1980] Ch 515, 531.

¹² (1999) Law Com No 260; Scot Law Com No 172, para 3.25.

¹³ Trustee Act 2000, s 1(1), italicised here for emphasis.

¹⁴ See TLC Report (1999) para 7.10 (see para 4.39 below).

- 4.31 We should state here that if we propose restrictions on the use of trustee exemption clauses which would be applicable only to professional trustees, it would nevertheless be our intention that lay trustees remain subject to the general law. In other words, a lay trustee could not invoke a trustee exemption clause where he or she had been guilty of fraud: the reasoning of *Armitage v Nurse* would still apply.
- 4.32 We believe that consideration should be given to the introduction of provisions authorising lay trustees to finance liability insurance cover from the trust fund. Looking at the issue from the point of view of the beneficiaries, there is no doubt that the widespread use of professional indemnity insurance would be to their general benefit.

We provisionally propose that all trustees should be given power to make payments out of the trust fund to purchase indemnity insurance to cover their liability for breach of trust.

Do consultees agree?

The distinction between professional and lay trustees

- 4.33 Our approach to the subject of trustee exemption clauses, and hence our provisional proposals, builds upon the distinction between professional and lay trustees. That distinction itself is not, however, altogether straightforward. As Dr Dunn's research has indicated, there are several kinds of trustee who might fall within the ordinary meaning of the term "professional trustee", and it is important that we make some attempt to clarify how we would make a distinction between professional and lay trustees in any future legislative proposals.
- 4.34 There is the trust corporation. There are individual trustees who may be employed by trust corporations or others, or who may be in private practice. In either case, they will normally charge for their services as trustees. Then there are professionals (such as solicitors or accountants) who are not working in the trustee field as such but who will also charge for their services.
- 4.35 We have little doubt that it is appropriate to consider trust corporations as "professional trustees" in all circumstances. Individual trustees who are carrying on business as trustees we would expect to carry insurance covering their liability for professional negligence, and again it would seem proper that they too fall within the definition of "professional trustees". In relation to other professional persons, it may be necessary to examine more carefully the nature of their retainer.
- 4.36 We believe that the existing legislative definitions contained in section 28 of the Trustee Act 2000 would lend themselves adequately to these purposes. Indeed, unless a strong case can be made for some other definition, the interests of consistency should prevail. Section 28 sets out to distinguish "lay trustees" from

others for the purposes of remuneration. A person acts as a lay trustee if he is not a trust corporation and does not act in a professional capacity.¹⁵

4.37 Although not referred to as such in the legislation, a “professional trustee” would therefore comprise:

- (1) a trust corporation; and
- (2) any other trustee “acting in a professional capacity”.

A trustee acts in a professional capacity if he acts in the course of a profession or business

which consists of or includes the provision of services in connection with-

- (a) the management or administration of trusts generally or a particular kind of trust, or
- (b) any particular aspect of the management or administration of trusts generally or a particular kind of trust,

and the services he provides to or on behalf of the trust fall within that description.¹⁶

4.38 This definition requires there to be a close nexus between the profession or business in the course of which the trustee acts and the services provided as trustee. A solicitor, accountant or banker would meet the condition, as it is not necessary for the trustee’s profession or business to have the management or administration of trusts as its primary focus.¹⁷

4.39 The Trust Law Committee has proposed a rather more restricted definition based on whether the trustee was being remunerated in the particular circumstances for his or her services as trustee.¹⁸ If no remuneration was being received, the trustee would not be subjected to the same regulation, on the basis that it would not be reasonable to expect the trustee who was not being remunerated to pay for insurance cover.¹⁹ We understand the logic of this argument, but we consider that the proposal may have undesirable consequences. There may, for example, be circumstances in which a person whom one would normally consider a professional trustee is not charging remuneration in the expectation of receiving other work from the client in question. Making regulation dependent on the consideration passing to the trustee may even act as

¹⁵ Trustee Act 2000, s 28(6).

¹⁶ Trustee Act 2000, s 28(5).

¹⁷ See Trustees’ Powers and Duties (1999) Law Com No 260; Scot Law Com No 172, p 115.

¹⁸ TLC Report (1999) para 7.7. See also Some Problems in the Law of Trusts (2002) NZLC Report No 79, para 14, restricting its proposals to “trustees for reward”.

¹⁹ TLC Report (1999) para 7.10.

an incentive to trustees not to receive remuneration for the services rendered in relation to the trust but to charge the client more for other services being provided. We therefore believe that there should be a wider definition of “professional trustee” which does not depend on the fact of payment being made.

We consider that the case for regulation of the use of trustee exemption clauses by professional trustees is very strong, but that lay trustees should in general continue to be able to rely upon trustee exemption clauses. We provisionally propose therefore that any statutory regulation of such clauses should make a distinction, in broad terms, between professional trustees and lay trustees.

Do consultees agree?

Consultees are asked whether they agree with the provisional proposal that any distinction between lay trustees and professional trustees be made on the basis set out in paras 4.36 and 4.37 above.

- 4.40 We shall now consider the various forms regulation of trustee exemption clauses might take, drawing upon proposals which have been made and reform which has been effected in other jurisdictions.

REFORMS TO TRUST PRACTICE

- 4.41 One criticism of the current law is that settlors may sometimes include a trustee exemption clause in their trust instrument without being fully aware of its consequences for the enforcement of the trust obligations by the beneficiaries. Lord Millett, speaking extra-judicially after *Armitage v Nurse*, wished:

to emphasise the heavy responsibility that the draftsman undertakes when he includes a trustee exemption clause in a trust instrument and to stress that the clause should not be taken from the nearest precedent book without considering the alternatives and discussing them with the client.²⁰

- 4.42 While it is clearly the responsibility of the settlor’s legal advisers to bring such clauses to the attention of their client and to explain their implications, there is some evidence that in practice settlors are not well informed on trustee exemption clauses.²¹ It is therefore felt that many settlors do execute trusts

²⁰ “Trustee exemption clauses and other trusts subjects” (1999) *Trusts & Estates Law Journal* 6.

²¹ Dr Dunn’s report found that a number of respondents who advised settlors on setting up trusts have difficulties explaining the concept to their clients. A number of such respondents said that settlors are primarily concerned with achieving a specific goal with a trust and will take advice on the vehicle to be used to achieve that purpose. The end is what is important not the means. Additionally settlors accept the clauses as part of the package of the modern day trust.

without giving serious consideration to the effect of those clauses in the instrument which appear to be of a largely “administrative” content and that, in particular, they may not realise the significance of an exemption clause in so far as the rights of the beneficiaries to enforce the obligations of the trustees are concerned. The problem was highlighted in *Bogg v Raper*²² where solicitor trustees successfully invoked the protection of a trustee exemption clause in circumstances where they had themselves advised the settlor at the time of execution of the trust.²³

- 4.43 The Trust Law Committee considered a proposal that special formalities be prescribed by law to support or establish the validity of trustee exemption clauses.²⁴ For example, settlors and testators could be required to sign a form verifying that the trust instrument had been executed after the exemption clause had been brought to their attention and its effect fully explained. Alternatively or additionally, rules could provide that such clauses are invalid unless the trustees can show that the settlor was offered an option that did not include the clause in question (albeit possibly at a higher rate of remuneration). It would be possible to prohibit a trustee from invoking a trustee exemption clause save where it could be shown that prior to execution of the trust instrument the settlor had received legal advice explaining the effect of the provision.²⁵ It could also be required that the advice was given independent of the trustee.²⁶
- 4.44 However, as the Trust Law Committee observed, this kind of reform has serious limitations. It would in itself provide no protection for beneficiaries in those cases (assumed to be the majority) where the legally advised settlor is made fully aware of the existence of the trustee exemption clause and consents to its inclusion in the trust instrument.²⁷ There is a risk that the use of such formalities could degenerate into a charade, with settlors merely going through the motions of signing the form of verification, but still not giving full informed consent to the exemption being given.
- 4.45 We accept that, as a matter of good practice, the draftsman of a trust should always bring the presence of a trustee exemption clause to the attention of the settlor, explain clearly its implications and discuss the alternatives which may be available for the protection of those who may be acting as trustees. We realise, however, that there would be considerable evidential difficulties facing a beneficiary who wished to prove that the settlor had not been made aware of the inclusion of the clause. This highlights the limitations of an approach based on the imposition of specific formality requirements in relation to trustee exemption

²² (1998/99) 1 ITELR 267.

²³ See para 2.49 above *et seq.*

²⁴ TLC Report (1999) para 7.3.

²⁵ TLC Report (1999) para 7.17 *et seq.*

²⁶ *Ibid*, thereby dealing with the issue raised in *Bogg v Raper*, explained at para 2.49 above.

²⁷ *Ibid.*

clauses. It is only the settlor's consent to the inclusion of the clause which is material. The beneficiary has no say. To focus on the settlor is unlikely to achieve the desired objective of balancing the rights of trustees and beneficiaries.

While we consider that those advising a settlor (whether or not they are also the trustees) should be expected, as a matter of good practice, to bring the attention of their client to any trustee exemption clause and to explain its legal consequences, we do not consider that it is appropriate that this should be a statutory requirement.

Do consultees agree?

AN ASSESSMENT OF THE REASONABLENESS OF THE CLAUSE

- 4.46 We have already made reference to the Unfair Contract Terms Act 1977 in Part II, where we came to the conclusion that it does not generally apply to trustee exemption clauses.²⁸ It would however be possible to introduce legislation specifically directed at trustee exemption clauses which imposes a requirement that all such clauses satisfy a test of reasonableness. Adopting the consumerist analogy from the Unfair Contract Terms Act, such legislation could be restricted in its application to "professional trustees" as defined.
- 4.47 There is no doubt that such an approach would have the benefits of flexibility, sophistication and adaptability to the circumstances of each trust. The professional trustee would be permitted to rely on a trustee exemption clause contained in the trust instrument save and in so far as the clause was unreasonable or unfair. Legislation could indicate those factors which should be taken into account in determining the question of unreasonableness, setting out relatively sophisticated statutory guidance which would assist settlors and their advisers as to the steps which should be taken, and the circumstances in which restrictions of or exemptions from trustee liability would be likely to be upheld. The court could be required to have regard to matters such as the availability of liability insurance, whether different options were offered to the settlor, the value of the trust fund and the nature of the trust.
- 4.48 There is no doubt that it would take time for a meaningful body of precedent to build up in view of the various factors involved in each case. However, over a period of time, the courts would be able to indicate which clauses are likely to be upheld and which are likely to be struck down, and gradually some clarity would be introduced. This has been the experience of the application of the reasonableness requirement in relation to contracts under the 1977 Act. For these reasons, we are not overly concerned that introduction of a reasonableness requirement would cause excessive uncertainty.
- 4.49 An argument in favour of an approach focused on the wording of the specific clause is that once it becomes clear which clauses are viewed as excessively wide,

²⁸ See para 2.57 above.

settlers and trustees will be encouraged to modify the terms of their trusts so as to ensure compliance with the statutory requirements. The legislation would therefore have a salutary, “deterrent”, effect on trusts draftsmanship. In due course, we shall invite views of consultees on the merits of legislation to such effect.

- 4.50 However, we do have certain reservations about this approach. First, we question whether it is appropriate, albeit logical, to confine application of the test to the circumstances prevailing at the date of the execution of the trust, by analogy to the “contract” model in the 1977 Act.²⁹ A trust may last for very many years, indeed for generations. It is expected not only that the trustees will change from time to time, but also that the identity of the beneficiaries will not remain constant as old ones die and new ones qualify as members of the defined class. It may be unrealistic and anachronistic to ask whether a trustee exemption clause is reasonable without any reference to the conduct which it is sought to impugn.
- 4.51 Secondly, we also note the transitional difficulties associated with such an approach. If provision were to be made (as would be desirable) that the reasonableness requirement would have to be met in relation to all trusts irrespective of their date of execution, there would be considerable difficulties with regard to existing trusts which contain trustee exemption clauses which might now be vulnerable to attack. Aware that the clause which purports to protect the trustee from liability might be struck down, trustees may be disinclined to continue to act without some form of lesser protection which may be extremely difficult to effect. It would of course be possible, although not we think desirable, to provide that the legislation should be limited in its application to trusts which are executed subsequent to its coming into force.³⁰
- 4.52 For these reasons- but also, and most significantly, because we consider the better approach is to focus on the conduct of the trustee- we do not think that strict application of a reasonableness requirement to trustee exemption clauses by reference to the circumstances prevailing at the date of the execution of the trust is the best way forward.

We invite views on statutory regulation of trustee exemption clauses such that a clause can only be relied upon by a trustee to exclude or restrict his or her liability for breach of trust in so far as the clause satisfies a requirement of reasonableness.

In so far as consultees support the imposition of a reasonableness requirement, do they consider it desirable that there be a list of matters to which regard is to be had in determining whether a particular clause satisfies the requirement?

If so, could they indicate the matters which they consider should be included in such a list?

²⁹ See para 2.57 above.

³⁰ See further para 4.100 below.

AN EVALUATION OF THE CONDUCT OF THE TRUSTEE.

- 4.53 The question whether a trustee should be able to rely upon a particular trustee exemption clause may be asked in the abstract, or it may be asked in the light of the trustee's conduct which the claimant beneficiary is seeking to impugn. The obvious advantage of the latter approach is that it enables the court to take account of all relevant factors and to assess whether in those circumstances the trustee should be able to avoid the consequences of breach of trust by reference to a trustee exemption clause. It is an approach which has proved attractive both to other legislatures and to law reform bodies in other jurisdictions. We shall first summarise three particular approaches which have been adopted or proposed, and then consider the merits of regulation along similar lines in England and Wales.

Other jurisdictions

New Zealand

- 4.54 In April 2002, the New Zealand Law Commission recommended the adoption of a new approach to trustee exemption clauses.³¹ It proposed an amendment to its trust law, which would apply in relation to future breaches of trust only, stipulating that:

A provision of a trust instrument purporting to exonerate a trustee who acts as such for reward from liability for failure to exercise the degree of care, diligence and skill required by law, shall have no effect.³²

- 4.55 The proposal is limited in its effect to trustees "for reward". But while it prohibits such trustees from invoking exemption clauses in order to escape liability for breach of trust, it does not mean that the trustee has no way out. The trustee who has acted "honestly and reasonably" and who "ought fairly to be excused" for the breach of trust may be relieved of liability by the court pursuant to its statutory power.³³

Jersey and Guernsey

- 4.56 The Jersey trust law was amended in 1989 by what is now Article 26(9) of the Trusts (Jersey) Law 1984:

³¹ Some Problems in the Law of Trusts (2002) NZLC Report No 79, para 14.

³² This would comprise section 73(2) of the New Zealand Trustee Act. It is proposed that the amended provision would come into effect 12 months after Royal Assent to enable existing professional trustees protected by an exculpation provision either to insure or to resign.

³³ New Zealand Trustee Act 1956, s 73, modelled on the Judicial Trustees Act 1896, s 3.

Nothing in the terms of a trust shall relieve, release or exonerate a trustee from liability for breach of trust arising from his own fraud, wilful misconduct or gross negligence.³⁴

- 4.57 In 1990, Guernsey amended its trust law to prohibit the exclusion of gross negligence and thereby to bring it into line with that of Jersey.³⁵

British Columbia

- 4.58 In March 2002, the British Columbia Law Institute published a Report on Exculpation Clauses in Trust Instruments.³⁶ The substance of the proposals was as follows. Prima facie, a trustee exemption clause would be effective according to its terms to relieve a trustee of liability for a breach of trust. However, in the event of a breach by the trustee, a beneficiary would be able to apply to the court for a declaration that the exemption clause is ineffective in relation to that breach. They proposed that such a declaration may be made:

Where it appears to the court that the conduct of a trustee

- (a) would constitute a breach of trust, and
- (b) has been so unreasonable, irresponsible or incompetent that, in fairness to the beneficiary, the trustee ought not to be excused.³⁷

- 4.59 This approach would require the court to focus upon the breach of trust committed by the trustee rather than the terminology of the exemption clause. It would be a retrospective exercise. The penalty for excessively “unreasonable, irresponsible or incompetent” conduct is that the trustee will be unable to rely on the clause, and the trustee’s liability will be determined as if the clause was not contained in the trust instrument.

Discussion

- 4.60 The common feature of the above proposals and reforms is that all require the court to examine and evaluate the conduct of the trustee. The New Zealand proposals deny efficacy to trustee exemption clauses as a matter of principle but permit trustees to make application to the court for exculpatory relief. The Jersey

³⁴ This provision was inserted by Article 5 of the Trusts (Amendment) (Jersey) Law 1989. Jersey has taken note of the principles of English trust law for some time, but it was only in 1984 that legislation was passed to regulate the position. See generally Matthews & Sowden, *The Jersey Law of Trusts* (3rd ed 1994) and the decision in *Midland Bank Trustee (Jersey) Ltd v Federated Pension Services Ltd* [1996] PLR 179.

³⁵ Trust Law 1990 s 1(f). The trust law of the Turks and Caicos also prohibits exclusion of liability for negligence.

³⁶ (2002) BCLI Report No 17, p 11. The only Canadian authority on trustee exemption clauses, a decision of the Alberta Surrogate Court, holds that a clause cannot exclude a trustee from liability for gross negligence: *Re Poche* (1984) 6 DLR (4th) 40.

³⁷ Proposed amendment to Trustee Act (RSBC 1999 C 464) s 96.

and Guernsey legislation, and the British Columbia proposals, allow limited effect to trustee exemption clauses (irrespective of the type of trustee) but restrict their invocation once the conduct of the trustee crosses a certain threshold. In the case of the Channel Islands, this threshold is set at fraud, wilful default or gross negligence; in the case of British Columbia, the conduct must be so unreasonable irresponsible or incompetent that in fairness to the beneficiary it should not be capable of being excused.

- 4.61 We shall now consider the possible adoption of approaches along similar lines in England and Wales.

Exculpatory relief

- 4.62 It would be possible to adopt the New Zealand model, denying efficacy to trustee exemption clauses where professional trustees are concerned but permitting such trustees to apply to the court to obtain relief at its discretion from liability for breach of trust where certain conditions are satisfied.

- 4.63 Section 61 of the Trustee Act 1925 already gives the court a discretion to relieve trustees from personal liability for breach of trust where they have acted “honestly and reasonably, and ought fairly to be excused”. It is well known, however, that courts have been reluctant to relieve trustees under section 61, adopting a narrow construction of their jurisdiction and applying a high standard to the test of reasonableness.³⁸ Moreover, they have deliberately refrained from laying down rules or general principles as to which acts are “honest, reasonable and ought fairly to be excused”, considering these to be questions of fact to be determined in each case. Relief under the section appears to be limited to cases of honest mistake made notwithstanding every reasonable care.³⁹ Trustees are normally denied relief under the section where there has been some element of carelessness in their conduct.⁴⁰ Professional trustees are not treated generously:⁴¹

...it would be a misconstruction of the section to say that it does not apply to professional trustees, but, as was pointed out in the Judicial Committee of the Privy Council in *National Trustees Company of Australasia Ltd v General Finance Company of Australasia Ltd*, “...without saying that the remedial provisions of the section should never be applied to a trustee in the position of the appellants, their

³⁸ For a recent case where partial relief was ordered, see *Re Evans* [1999] 2 All ER 777.

³⁹ *Perrins v Bellamy* [1899] 1 Ch 797; *Re Houghton* [1904] 1 Ch 622.

⁴⁰ See *Re Turner* [1897] 1 Ch 536; *Re Stuart* [1897] 2 Ch 583; *Re Barker* [1898] 77 LT 712; and *Chapman v Browne* [1902] 1 Ch 785.

⁴¹ In *National Trustees Co of Australasia Ltd v General Finance Co of Australasia Ltd* [1905] AC 373, the fact that trustees acted under the wrong advice of their counsel or solicitor was held not to justify relief. Although the trustees acted honestly and reasonably, relief did not automatically follow. For three reasons it was held they ought not fairly to be relieved. First, the work was done for profit. Secondly, no effort was made to recover the property. Thirdly the trustees made no attempt to replace the funds.

Lordships think it is a circumstance to be taken into account...". Where a banker undertakes to act as a paid trustee of a settlement created by a customer, and so deliberately places itself in a position where its duty as trustee conflicts with its interest as a banker, we think that the court should be very slow to relieve such a trustee under the provisions of the section.⁴²

4.64 Unless there is a change of culture among the judiciary towards applications under section 61, professional trustees are unlikely to consider its invocation as a satisfactory alternative to the use of trustee exemption clauses.⁴³ If the view is taken that professional trustees should be entitled to some protection by way of exclusion of certain liabilities, then it may be necessary to make clearer provision than is possible solely by resort to section 61.

4.65 A serious objection to vesting a discretionary power of this kind in the court is that it requires litigation to discover whether, in the circumstances which have happened, liability is to be incurred by the trustee. It would not be conducive to certainty or predictability. The Trust Law Committee considered a similar approach and concluded:

The problem with such a sophisticated system is that it is not only complex to operate and therefore puts up the cost, it also requires every case to be argued because professionals will not be able to advise in advance what will be the result of the application.⁴⁴

4.66 Given the current judicial attitude to applications under section 61 of the Trustee Act, we doubt that there is any real merit in seeking to expand the jurisdiction to grant relief to trustees. We also accept that to adopt and to develop such an approach would only increase uncertainty in the law.

We do not consider it satisfactory to combine an outright prohibition of trustee exemption clauses with the exercise of a judicial discretion to exculpate trustees who have acted honestly and reasonably and who ought fairly to be excused for their breach of trust (the New Zealand model).

Do consultees agree?

Denying exemption from liability for gross negligence

4.67 It would be possible to enact legislation which follows the example of Jersey and Guernsey and to invalidate any clause in a trust instrument which excludes or restricts the liability of trustees for gross negligence in the conduct of trust business. Such a reform would represent a compromise between the current law expounded in *Armitage v Nurse*⁴⁵ (which permits exclusion of liability for

⁴² *Re Pauling's Settlement Trusts* [1964] Ch 303, 338, *per* Willmer LJ.

⁴³ Fiduciary Duties and Regulatory Rules (1995) Law Com No 236, para 15.10.

⁴⁴ TLC Report (1999) para 7.2.

⁴⁵ [1998] Ch 241.

anything except actual and individual fraud), and a reform outlawing trustee exemption clauses which excludes liability for any act of negligence. It would have the advantage of protecting beneficiaries' financial interests from the consequences of the most objectionable instances of trustees' negligence as well as giving trustees some protection and respecting, to some degree, the autonomy of settlors.

4.68 However, in order to be workable, such a reform would require the distinction between gross and ordinary negligence to be clear. In *Armitage v Nurse*, Millett LJ said of English law:

[While] we regard the difference between fraud on the one hand and mere negligence, however gross, on the other as a difference in kind, we regard the difference between negligence and gross negligence as merely one of degree. English lawyers have always had a healthy disrespect for the latter distinction.⁴⁶

4.69 It is true that gross negligence has a greater significance in civil law jurisdictions such as Scotland, where reliance is placed upon the maxim *culpa lata dolo aequiparatur* (gross negligence is equivalent to fraud). The classic formulation was enunciated by Lord Watson in *Knox v MacKinnon*: "It is settled in the law of Scotland that such a clause is ineffectual to protect a trustee against the consequences of *culpa lata*, or gross negligence on his part".⁴⁷ In Scots trust law, the distinction between negligence and gross negligence is a difference in kind. Although, as, according to Millett LJ in *Armitage v Nurse*, "there is no room for the [*culpa lata*] maxim in the common law",⁴⁸ the extent to which gross negligence has had significance in the common law remains unclear. Bailment cases dating from the eighteenth and nineteenth centuries (not cited to Millett LJ in *Armitage v Nurse*) tend to support the view that the gratuitous bailee's duty of care was based on notions of *culpa lata*.⁴⁹

4.70 However the question which must be asked is whether "gross negligence" is a sufficiently clear concept such that courts would be able to establish whether a trustee's conduct in any particular case has crossed the border from the merely negligent to the grossly negligent. There is a risk that the adoption of this distinction as the basis of regulation of trustee exemption clauses would generate more litigation and uncertainty. As stated by the British Columbia Law Institute, it may be a matter of concern that:

⁴⁶ *Ibid*, at p 254.

⁴⁷ (1888) 13 App Cas 753, 765.

⁴⁸ [1998] Ch 241, 254.

⁴⁹ Hayton & Marshall, *The Law of Trusts and Equitable Remedies* (11th ed 2001) para 9- 308. The seminal judgment is that of Holt CJ in *Coggs v Barnard* (1703) 2 Ld Raym 909, 913, asserting that a bailee "is not answerable, if they [the bailed goods] are stolen without any fault in him, neither will a common neglect make him chargeable, but he must be guilty of some gross neglect...". See, for a detailed analysis of this decision and its subsequent impact, J Getzler, "The Duty of Care" in P Birks & A Pretto (eds), *Breach of Trust* (2002) ch 2.

...too often whether negligence so found is to be perceived as “gross” or “ordinary” lies in the eye of the beholder.⁵⁰

- 4.71 It has been argued that although “gross negligence” does not lend itself easily to definition, it is instantly recognisable when facts arise which fall within its scope and that although degrees of care are not definable, they are with some approach to certainty distinguishable. Before the demise of the jury trial in civil cases, this kind of question was perceived as one of fact and degree which the jury was expected to decide. In every case of this description, in which the evidence was left to the jury they were led by the cautious and discriminating direction of the judge to distinguish degrees of things which run more or less into each other.⁵¹ Although the function of the jury in civil cases has now been almost entirely usurped by the judge, it may still be that a slightly flexible rule based on good policy is preferable to a clear cut rule which is undesirable on policy grounds as being too lenient or too restrictive in its application.
- 4.72 It is remarkable, however, how lacking in consistency the definitions which have been made are. Some judges have refused to gloss the term itself, stating for instance that gross negligence is “some sort of carelessness which would appear to the plain man of common sense as being gross”.⁵² Others have simply sought to emphasise the “vituperative epithet”.⁵³ The phrase “means nothing more than a great and aggravated degree of negligence, as distinguished from negligence of a lower degree”.⁵⁴ A more considered definition of the negligence for which a gratuitous bailee is liable is that degree of negligence which is “such as to involve a breach of confidence or trust, not arising merely from some want of foresight or mistake of judgement, but from some culpable default”.⁵⁵ Reference to “breach of trust” is hardly of assistance in the context of the current project. Reference to “want of foresight” seems to be leading the courts down the path to recklessness, and one of the leading practitioners’ texts on Negligence accedes to that invitation, taking the view that “gross” negligence “is intended to denote a high degree of careless conduct, such as where a defendant did not intend a particular consequence to happen but nevertheless must have been able to foresee its occurrence”.⁵⁶
- 4.73 This interpretation of gross negligence can be contrasted with the view of Sir Godfray le Quesne QC, defining the term for the purposes of Jersey law in *Midland Bank Trustee (Jersey) Ltd v Federated Pension Services Ltd*,⁵⁷ where he

⁵⁰ Consultation Paper on Exculpation Clauses in Trust Instruments (2000) BCLI, p 10.

⁵¹ J Getzler, “The Duty of Care” in P Birks & A Pretto (eds), *Breach of Trust* (2002) ch 2.

⁵² *Martin v London County Council* [1947] KB 628, 631, per Henn-Collins J.

⁵³ *Grill v General Iron Screw Collier Co* (1866) LR 1 600, 612, per Willes J.

⁵⁴ *Doorman v Jenkins* (1834) 2 Ad & E 256, 262, per Taunton J.

⁵⁵ *Giblin v McMullen* (1868) 5 Moo NS 434, 461, per Lord Chelmsford.

⁵⁶ *Charlesworth & Percy on Negligence* (10th ed 2001) para 1- 11.

⁵⁷ [1996] PLR 179, 206.

rejected the notion that gross negligence required any *mens rea* or an intentional disregard of danger or recklessness and concluded that it means no more than “a serious or flagrant degree of negligence”. This approach is similar to that of the Scots law,⁵⁸ where in relation to professional negligence it was held to indicate “so marked a departure from the normal standard of conduct of a professional man as to infer a lack of that ordinary care which a man of ordinary skill would display”.⁵⁹

- 4.74 Gross negligence is of course an extremely important component of English criminal law, being one of the bases of liability for involuntary manslaughter. In this context, the issue whether the conduct which caused the death is to be characterised as grossly negligent has been held to be “supremely a jury question”:

...having regard to the risk of death involved, [was] the conduct of the defendant...so bad in all the circumstances as to...amount to a criminal act or omission.⁶⁰

- 4.75 We doubt, however, the usefulness of comparisons with the criminal law. The jury in a criminal trial does not have to give reasons for its verdict, and in determining whether the defendant’s conduct crosses the line of criminality, it is able to concentrate solely on the circumstances of an individual case without fear of setting a precedent for future occasions. The judge in a civil trial is charged with very different responsibilities. Moreover, the type of behaviour with which the criminal court is concerned is likely to be very far removed from the world of ill-judged investments of trust assets and ill-informed distributions of trust funds.

- 4.76 The potential complexity of gross negligence in civil claims was clearly appreciated by Mance J in *The Hellespont Ardent*,⁶¹ where he considered at length the effect of certain indemnity and exemption clauses contained in commercial contracts:

“gross” negligence is clearly intended to represent something more fundamental than failure to exercise proper skill and/or care constituting negligence. But, as a matter of ordinary language and general impression, the concept of gross negligence seems to me capable of embracing not only conduct undertaken with actual appreciation of the risks involved, but also serious disregard of or

⁵⁸ In many respects, the modern Jersey trust is closer to the English trust than to the Scots trust. In particular, it accords the beneficiary a right *in rem* whereas Scots law confers on the beneficiary no more than a personal right to sue the trustees. See Matthews & Sowden, *The Jersey Law of Trusts* (3rd ed 1994) paras 1.4 to 1.24, where the authors conclude that “a Jersey trust is essentially the same animal as is found in English law, subject to certain local modifications”.

⁵⁹ *Hunter v Hanley* 1955 SC 200, 206, *per* the Lord President (Clyde)

⁶⁰ *Adomako* [1995] 1 AC 171, 187, *per* Lord Mackay of Clashfern LC. See also *Legislating the Criminal Code: Involuntary Manslaughter* (1996) Law Com No 237.

⁶¹ (1997) 2 Lloyd’s Rep 547.

indifference to an obvious risk...I see no difficulty in accepting that (a) the seriousness or otherwise of any injury that might arise, (b) the degree of likelihood of its arising and (c) the extent to which someone takes any care at all are all potentially material when considering whether particular conduct should be regarded as so aberrant as to attract the epithet of “gross” negligence.⁶²

- 4.77 We believe that any legislative provision denying professional trustees resort to exemption clauses where they have been guilty of gross negligence would have to reflect the fact that the definition is at best imprecise, and that the courts would inevitably be afforded an element of latitude in determining when trustee misconduct is sufficiently severe as to be termed gross negligence. This would lead once more to uncertainty as to the circumstances in which a professional trustee would be able to rely upon an exemption clause.
- 4.78 An alternative, albeit similar, approach would be to deny professional trustees resort to an exclusion clause where they have committed a particularly serious breach of trust. For the reasons we have explained above, this would not be characterised as “gross negligence”. Adopting the proposals of the British Columbia Law Institute, it would be possible, for example, to provide that a professional trustee could not rely on a trustee exemption clause where his or her conduct has been so “unreasonable, irresponsible or incompetent” that, in fairness to the beneficiary, the trustee should not be excused. While this is not our currently favoured approach, we should be grateful to have the views of consultees on this alternative.

We do not consider that the concept of gross negligence is sufficiently clear or distinctive as to form the basis of regulation of trustee exemption clauses. We do not therefore propose that those who wish to claim for breach of trust should be obliged to establish that the trustees were guilty of gross negligence in order to deny them resort to any exemption clause in the trust instrument.

Do consultees agree?

We invite views of consultees on the proposal that professional trustees should be unable to rely upon a trustee exemption clause where their conduct has been so unreasonable, irresponsible or incompetent that in fairness to the beneficiary the trustee should not be excused.

Denying exclusion of liability for “ordinary” negligence

- 4.79 It can be argued that denying professional trustees the right to exemption from liability for ordinary negligence, which we now turn to consider, may result in more “defensive” trusteeship as professional trustees would tend to be more cautious in the manner of exercise of their powers, for example in their selection of appropriate trust investments. To allow professional trustees to rely upon

⁶² *Ibid*, at p 586.

exemption clauses in the trust instrument in so far as their conduct could not be described as “grossly negligent” would give trustees greater latitude and would prove more acceptable both to professional trustees and their insurers. As the Trust Law Committee has commented:

...in these litigious times a professional trustee will prefer only to be liable for gross negligence (and dishonesty) so that there is a certain amount of “clear water” between the trustee and any disgruntled beneficiary.⁶³

4.80 As stated above, however, we are not in favour of proposing reform based upon a distinction between ordinary and gross negligence. Not only do we consider that there are very real problems in defining the latter concept, but as a matter of consistency of principle we feel that if an approach based on an assessment of the trustee’s conduct is to be adopted, it is appropriate to set the boundary of acceptability at ordinary negligence.

4.81 Negligence is the most common cause of loss to trust funds. It is in our view particularly inequitable that the risk of loss through the negligence of professional trustees should be borne by beneficiaries. As we have already noted, the expansion of professional negligence in relation to many areas makes it logical and consistent to visit professional trustees with liability for negligence and to deny them resort to exemption clauses when their conduct can be so characterised.

4.82 The argument was convincingly put by the Trust Law Committee in 1999:

There is much to be said for trust corporations and professional individuals paid for their services as trustees (like solicitors, barristers and accountants) to accept the price of liability for negligence in acting as a paid trustee and to insure against such risk, with the premiums being reflected (like other overheads) in the fees for the services provided. After all, solicitors, barristers, accountants and doctors proud of their expertise accept liability for negligence in exercising their professions and insure against such risk.⁶⁴

4.83 As we have already indicated, professional trustees for the most part benefit from liability insurance. The inclusion of a trustee exemption clause provides them with additional protection. This has the effect that many professional trustees pursue a “belt and braces” policy, being both insured and protected by an exemption clause. The current freedom to invoke wide trustee exemption clauses means that the likelihood of the insurer incurring any liability to the insured is low, and this is no doubt reflected in the level of premium which is charged. It would therefore follow that legislative restriction of the extent to which professional trustees can rely on trustee exemption clauses would be likely to

⁶³ TLC Report (1999) para 7.8.

⁶⁴ TLC Report (1999) para 7.8.

result in increased premiums, and therefore higher administrative costs being carried forward and being paid out of the trust fund.

- 4.84 The case for prohibiting professional trustees from relying on trustee exemption clauses where they can be shown to have been guilty of negligence is in our view very strong. It may be that indemnity insurance premiums, and therefore the cost of employing professional trustees, would rise, but we believe that most beneficiaries would nevertheless consider the price to be one worth paying.
- 4.85 We accept that to hold all trustees, whether lay or professional, accountable for negligence and to deny them resort to trustee exemption clauses where negligence is established would be to transform the nature of the trust obligation in English law. But professional trustees- who hold themselves out as possessing special expertise, and as being proficient in fulfilling the obligations of trusteeship, and who are being remunerated for their services which they give on a commercial rather than gratuitous basis- should be expected to live up to the expectations which they have themselves engendered. The trust expertise which they offer is being paid for, as is, in most cases, indemnity insurance to cover the risks they are assuming. Where such trustees fail to act with reasonable care in the exercise of their fiduciary duties, there is in our view a very strong case that they should not be permitted to hide behind exemption clauses contained in the trust instrument.

We provisionally propose that a professional trustee should not be able to rely on any provision in a trust instrument excluding liability for breach of trust arising from negligence and that clauses purporting to should not be given effect.

Do consultees agree?

- 4.86 We believe, nevertheless, that it is useful to explore the level of support for a scheme whereby the question would be asked whether, in all the circumstances, including the conduct of the trustee which comprises the breach of trust, it is reasonable for the trustee to rely upon the exemption clause contained in the trust instrument. Not only would the court be able to take account of the nature of the trust and the type of trustee, it would also be able to consider all the other circumstances. The attractiveness of such a proposal is that it would confer very considerable flexibility in determining whether trustees should be rendered fully accountable for their conduct or should be able to invoke the protection of an exemption clause.

We invite views as to whether professional trustees should not be able to exclude liability for breach of trust where it is not reasonable for the trustees to rely upon a trustee exemption clause contained in the trust instrument by reference to all the circumstances including the nature and extent of the breach of trust itself.

DUTY EXCLUSION, EXTENDED POWERS AND INDEMNITY CLAUSES

4.87 In Part II we explained how trustees may obtain protection from liability for breach of trust by other means than the simple expedient of a trustee exemption clause.⁶⁵ The duties to which the trustee is subject may be limited by means of a duty exclusion clause. The powers exercisable by the trustee may be expressed more widely than is usual in the form of an extended powers clause, thereby permitting the trustee a greater latitude than would be normally expected. The trust instrument may also provide that the trustee is entitled to indemnity out of the trust fund in respect of any liability arising for breach of trust.

Indemnity clauses

4.88 Indemnity clauses do not pose a particularly difficult problem. It is strongly arguable that if the invocation of trustee exemption clauses by professional trustees is regulated, then it should follow that such trustees should not be able to obtain recompense from the trust fund in respect of their liabilities to the same extent. If, for example, our provisional proposal that professional trustees should not be able to exclude liability for breach of trust arising from negligence were to be adopted, it would follow that such trustees should not be able to be indemnified against such liability from the trust fund.

Duty exclusion clauses and extended powers clauses

4.89 There is a risk that limiting any regulation to clauses which expressly exempt a trustee from liability for breach of trust will simply lead to settlors utilising duty exclusion clauses or extended powers clauses to achieve the same ends. At the same time, however, the use of these clauses may be a perfectly reasonable expression of settlor autonomy. The trust is in essence a flexible device, and it should be open to settlors to restrict the scope of the duties owed by trustees in particular cases and to confer very wide powers on them. To date, English law has resisted the temptation to set the duties owed by trustees to beneficiaries in stone, and we do not consider that there is yet a very strong case to succumb to that temptation. The duties of the trustee are not absolute, they are variable within certain parameters at the behest of the settlor, and so we would wish it to remain.

4.90 The Trust Law Committee found the problem of duty exclusion clauses particularly difficult. They considered the viability of striking down clauses which purported to negative a positive duty to the extent that the trustee could not rely on an exemption clause purporting to relieve from liability for breach of such a duty. The justification for restricting regulation to clauses negating positive duties was “to reduce as far as possible the area of settlor freedom of action with which it is necessary, in the public interest, to interfere”. But ultimately, accepting the difficulties of making a somewhat artificial distinction between positive and negative duties, the Committee doubted its utility. The problem, as succinctly identified by the Committee, is that:

⁶⁵ See para 2.5 above *et seq.*

The circumstances of each trust can be so various that what normally cannot be justified can be justified in special circumstances.⁶⁶

- 4.91 In some cases, a trustee will be unable to rely upon duty exclusion clauses as a matter of construction of the particular clause. For example, the terms of a trust may provide that the trustee shall not be obliged to supervise or interfere in the management of any company in which he holds the majority shareholding. This duty exclusion clause does not prevent the trustee from supervising or interfering in the management of the company. It does mean that the trustee who fails to supervise or to interfere is not automatically in breach of trust. But if the failure to supervise amounts to negligence on the part of the trustee, the duty exclusion clause should not save the trustee from liability. A trustee who fails to exercise a power when he or she should do so commits a breach of trust. In this example, liability is incurred by the trustee without any need to strike down the duty exclusion clause. As a matter of construction, the clause does not apply where the trustee has acted negligently.
- 4.92 There may however be duty exclusion clauses which are of wider impact and which cannot simply be circumvented by reference to the rules of construction and interpretation. For example, a clause may simply provide that a trustee shall not be obliged to take reasonable care in the conduct of the affairs of the trust. It wholly excludes any duty of care. However negligent the trustee may be, that will not in itself comprise a breach of trust. Clearly, invocation of such clauses, in particular by professional trustees, would strike at the very heart of the trust relationship as they would deny the beneficiaries any remedy despite the failure of the trustees to conform to ordinary standards of reasonable conduct. Such clauses would provide a means whereby the impact of a rule that professional trustees should not be able to exclude liability for negligence could be avoided by a simple drafting expedient.
- 4.93 Extended powers clauses may also fail to protect the trustees on their true construction. As Lewin states, "It does not follow that because some act or transaction is of a kind which comes within the scope of an extended power, the trustee is necessarily authorised to perform that act or enter into that transaction".⁶⁷ In the exercise of administrative powers, the trustee must act with care and prudence, and a failure to do so will result in liability for breach of trust even though the act complained of is within the scope of the power.
- 4.94 But difficulties may also arise here, such as where the trust clearly allows the trustee to act in a manner which is objectively irresponsible. An example given by the Trust Law Committee is the provision that the trustee should be able to speculate freely with the assets of the trust. In some circumstances reliance on such a clause may be perfectly acceptable, in others it may be quite outrageous.⁶⁸

⁶⁶ TLC Report (1999) para 7.15.

⁶⁷ *Lewin on Trusts* (17th ed 2000) para 39- 78.

⁶⁸ TLC Report (1999) para 7.15.

Whether it should be permitted should depend essentially on whether its invocation to defend proceedings by beneficiaries is consistent with the purposes of the trust. Proper protection of the beneficiaries' interests would normally require some degree of control of the trustees' conduct where the trust has conferred on the trustees powers which are so wide that they imperil the very existence of the trust fund.

- 4.95 We accept that this is an area of formidable difficulty where the tension between settlor freedom and beneficiary protection is very great. We doubt that it is possible here to be overly prescriptive in terms of the limits to be set on clauses which provide for duty exclusion and extended powers, and we believe that any regulatory intervention must be sophisticated and responsive to the particular circumstances of each case. It may be that the appropriate degree of flexibility can only be achieved by a provision to the effect that a trustee cannot rely upon a duty exclusion clause or an extended powers clause where the actions or omissions of the trustee are inconsistent with the purposes of the trust and it is unreasonable in the circumstances for the trustee to be exempted from liability for breach of trust. This would give the court the power to strike down duty exclusion clauses and extended powers clauses which are excessively wide in circumstances where the trustee is abusing his or her fiduciary position.
- 4.96 We realise that this approach does give the court an element of discretion. It is tantamount to saying that the trustee can shelter behind a duty exclusion clause or an extended powers clause only where it is reasonable in the circumstances that it should do so. It may be argued that this element of flexibility, necessary in our view to deal with the immense variety of trusts, would introduce some uncertainty into the area. While we accept that this may be so, we do not consider this uncertainty excessive, and we do consider it justifiable. An element of uncertainty is inevitable wherever the court is called upon to examine the conduct of individuals, in this case trustees, after the event, in any attempt to discern whether they have been negligent.
- 4.97 We believe that adoption of this approach in relation to duty exclusion and extended powers clauses is consistent with the approach we have provisionally favoured in relation to trustee exemption clauses generally. We have made the distinction between an assessment of the reasonableness of the clause contained in the trust by reference solely to the circumstances existing at the date of its execution and an evaluation of the conduct of the trustee in the light of the provisions of the trust and the circumstances of the breach. We favour the latter approach, for the reasons we have outlined above.

We provisionally propose that in so far as professional trustees may not exclude liability for breach of trust they should not be permitted to claim indemnity from the trust fund.

We do not consider that duty exclusion clauses or extended powers clauses should be prohibited. However, we provisionally propose that in determining whether professional trustees have been negligent, the court should have the power to disapply duty exclusion clauses or extended

powers clauses where reliance on such clauses would be inconsistent with the overall purposes of the trust and it would be unreasonable in the circumstances for the trustee to be exempted from liability.

Do consultees agree?

JURISDICTION AND CHOICE OF LAW

- 4.98 The Recognition of Trusts Act 1987, enacting (with some modifications) the Hague Convention on the Law Applicable to Trusts and on their Recognition, allows the settlor to choose the law which is to govern the trust which he or she executes and does not require the chosen law to have any objective connection with the trust.⁶⁹ It would therefore be possible for any legislation regulating the use of trustee exemption clauses by professional trustees based in this jurisdiction to be circumvented by the settlor making express provision that the governing law of the trust is not that of England and Wales but that of some other country which has no, or less rigorous, regulation.
- 4.99 In order to prevent such steps being taken to avoid the impact of legislative regulation, we consider that any legislation concerning trustee exemption clauses should apply to all persons carrying on trust business in England and Wales (even though the particular trust may have a choice of law clause indicating that its governing law is that of some other jurisdiction).

We provisionally propose that any regulation of trustee exemption clauses should be made applicable not only to trusts governed by English law but also to persons carrying on a trust business in England and Wales.

Do consultees agree?

TRANSITIONAL PROVISIONS

- 4.100 We consider that any legislative reform of trustee exemption clauses would be prospective in effect. By this, we mean that it should apply only to breaches of trust which are committed after the date any legislation comes into force. As a matter of principle, a trustee should not incur liability for actions (or omissions) committed at a time when the trustee had every cause to believe that a trustee exemption clause would deny the beneficiaries a remedy.
- 4.101 We do not see any reason why legislative reform should not apply to clauses contained in trust instruments executed before the date any legislation comes into force. It is incumbent on the trustee to keep under review the terms of his or her appointment, and it would be open to a trustee who wishes to retire from trusteeship in view of the legislative reform to do so. Such marginal inconvenience as there might be is in our view heavily outweighed by the

⁶⁹ See generally *Lewin on Trusts* (17th ed 2000) para 11- 07 *et seq.*

undesirability of making legislation applicable only in relation to trusts which are created after the date it comes into force.

We provisionally propose that any legislative reform of trustee exemption clauses should apply to any breaches of trust which occur on or after the date when the legislation comes into force but that it should not apply to breaches of trust which precede that date.

Do consultees agree?

HUMAN RIGHTS

- 4.102 We do not consider that any of the options for reform discussed in this Consultation Paper would contravene any rights contained in the European Convention on Human Rights.

REGULATORY IMPACT

- 4.103 Any legislative regulation of trustee exemption clauses is likely both to confer benefits and to impose costs on businesses, organisations and individuals. Current Government practice is to consider the impact of changes to regulatory structures on businesses, particularly small businesses, charities and other voluntary organisations by means of a regulatory impact assessment.
- 4.104 While the Law Commission does not provide its own regulatory impact assessments, it does seek to collect information and views which may be of assistance to Government in this regard. Part III of this Consultation Paper provides fairly detailed information of the factual background, and also records views of many affected parties as to the potential effect of legislative regulation of trustee exemption clauses.

We would welcome comments on the substance of Part III of this Paper from consultees, and we would find any information or views about the regulatory impact of our provisional proposals extremely helpful.

PART V

CONSULTATION QUESTIONS

INTRODUCTION

- 5.1 In this Part we list the specific questions for consultees which we raised in Part IV. We welcome comments from readers on any, or all, of these questions. We would also be grateful for comments on any other issues raised by this consultation paper.
- 5.2 It would be very helpful if, when responding, readers could note the paragraph number of the summary that follows.

CONSULTATION QUESTIONS

- 5.3 We do not consider that an outright prohibition of trustee exemption clauses is justified or necessary. Do consultees agree?
- (Paragraph 4.19)
- 5.4 We do consider that some legislative regulation of trustee exemption clauses is justified and necessary. Do consultees agree?
- (Paragraph 4.20)
- 5.5 We provisionally propose that all trustees should be given power to make payments out of the trust fund to purchase indemnity insurance to cover their liability for breach of trust. Do consultees agree?
- (Paragraph 4.32)
- 5.6 We consider that the case for regulation of the use of trustee exemption clauses by professional trustees is very strong, but that lay trustees should in general continue to be able to rely upon trustee exemption clauses. We provisionally propose therefore that any statutory regulation of such clauses should make a distinction, in broad terms, between professional trustees and lay trustees. Do consultees agree?

Consultees are asked whether they agree with the provisional proposal that any distinction between lay trustees and professional trustees be made on the basis set out in paras 4.36 and 4.37 above.

(Paragraph 4.39)

- 5.7 While we consider that those advising a settlor (whether or not they are also the trustees) should be expected, as a matter of good practice, to bring the attention of their client to any trustee exemption clause and to explain its legal consequences, we do not consider that it is appropriate that this should be a statutory requirement. Do consultees agree?

(Paragraph 4.45)

- 5.8 We invite views on statutory regulation of trustee exemption clauses such that a clause can only be relied upon by a trustee to exclude or restrict his or her liability for breach of trust in so far as the clause satisfies a requirement of reasonableness.

In so far as consultees support the imposition of a reasonableness requirement, do they consider it desirable that there be a list of matters to which regard is to be had in determining whether a particular clause satisfies the requirement?

If so, could they indicate the matters which they consider should be included in such a list?

(Paragraph 4.52)

- 5.9 We do not consider it satisfactory to combine an outright prohibition of trustee exemption clauses with the exercise of a judicial discretion to exculpate trustees who have acted honestly and reasonably and who ought fairly to be excused for their breach of trust (the New Zealand model). Do consultees agree?

(Paragraph 4.66)

- 5.10 We do not consider that the concept of gross negligence is sufficiently clear or distinctive as to form the basis of regulation of trustee exemption clauses. We do not therefore propose that those who wish to claim for breach of trust should be obliged to establish that the trustees were guilty of gross negligence in order to deny them resort to any exemption clause in the trust instrument. Do consultees agree?

We invite views of consultees on the proposal that professional trustees should be unable to rely upon a trustee exemption clause where their conduct has been so unreasonable, irresponsible or incompetent that in fairness to the beneficiary the trustee should not be excused.

(Paragraph 4.78)

- 5.11 We provisionally propose that a professional trustee should not be able to rely on any provision in a trust instrument excluding liability for breach of trust arising from negligence and that clauses purporting to should not be given effect. Do consultees agree?

(Paragraph 4.85)

- 5.12 We invite views as to whether professional trustees should not be able to exclude liability for breach of trust where it is not reasonable for the trustees to rely upon a trustee exemption clause contained in the trust instrument by reference to all the circumstances including the nature and extent of the breach of trust itself.

(Paragraph 4.86)

- 5.13 We provisionally propose that in so far as professional trustees may not exclude liability for breach of trust they should not be permitted to claim indemnity from the trust fund.

We do not consider that duty exclusion clauses or extended powers clauses should be prohibited. However, we provisionally propose that in determining whether professional trustees have been negligent, the court should have the power to disapply duty exclusion clauses or extended powers clauses where reliance on such clauses would be inconsistent with the overall purposes of the trust and it would be unreasonable in the circumstances for the trustee to be exempted from liability. Do consultees agree?

(Paragraph 4.97)

- 5.14 We provisionally propose that any regulation of trustee exemption clauses should be made applicable not only to trusts governed by English law but also to persons carrying on a trust business in England and Wales. Do consultees agree?

(Paragraph 4.99)

- 5.15 We provisionally propose that any legislative reform of trustee exemption clauses should apply to any breaches of trust which occur on or after the date when the legislation comes into force but that it should not apply to breaches of trust which precede that date. Do consultees agree?

(Paragraph 4.101)

- 5.16 We would welcome comments on the substance of Part III of this Paper from consultees, and we would find any information or views about the regulatory impact of our provisional proposals extremely helpful.

(Paragraph 4.104)

APPENDIX

STANDARD TRUST CLAUSES AVOIDING TRUSTEE LIABILITY

CLAUSES EXEMPTING TRUSTEES FROM LIABILITY FOR BREACH OF TRUST

A.1 The following are a selection of typical trustee exemption clauses found in standard trust precedents:

- (1) No Trustee shall be liable for any loss or damage which may happen to the Trust Fund or any part thereof or the income thereof at any time or from any cause whatsoever unless such loss or damage shall be caused by his own actual fraud.¹
- (2) A Trustee shall not be liable for a loss to the Trust Fund unless that loss was caused by his own actual fraud or negligence.²
- (3) In the professed execution of this settlement no Trustee shall be liable for any loss to the Trust Fund arising by reason of any mistake or omission made in good faith or by reason of any other matter except wilful and individual fault or wrongdoing on the part of the trustee who is sought to be made so liable.³
- (4) No trustee being an individual [who gives his services gratuitously] shall be liable for any loss to the capital or income of the Trust Fund caused by any improper investment or purchase made by him in good faith or for the negligence or fraud of any agent employed by him or by any other Trustee although the employment of such an agent may not have been strictly necessary or resulting from any other cause whatever other than wilful and individual fraud or wrongdoing on the part of the Trustee who is sought to be made liable.⁴
- (5) In the professed execution of the trusts and powers hereof no Trustee shall be liable for any loss to the trust premises arising by reason of any improper investment made in good faith or for the negligence or fraud of any agent employed by him or by any other Trustee hereof although the employment of such agent was not strictly necessary or expedient or by

¹ *Butterworth's Encyclopaedia of Forms and Precedents* (5th ed 2001 Reissue) vol 40(1) p 473.

² J Kessler, *Drafting Trusts and Will Trusts: A Modern Approach* (5th ed 2000) p 76. Although here Kessler is of the opinion that liability for negligence should not be excluded, in previous editions of his book he deliberated over the use of wider exemption clauses: see para A.1(3) below.

³ J Kessler, *Drafting Trusts and Will Trusts: A Modern Approach* (2nd ed 1995) pp 60- 61.

⁴ *Butterworth's Encyclopaedia of Forms and Precedents* (5th ed 2001 Reissue) vol 40(1) p 473.

reason of any mistake or omission made in good faith by any Trustee who is sought to be made liable.⁵

- (6) No Trustee (being an individual) shall be liable for any loss or damage which may happen to the Trust Fund or the income thereof arising from any improper investment or purchase made by him in good faith or for the negligence or fraud of any agent employed by him or by any other Trustee hereof although his employment was not strictly necessary or expedient or by reason of any mistake or omission made in good faith by any Trustee hereof.⁶
- (7) In the professed execution of the trusts and powers hereof no trustee shall be liable for any loss to the trust premises arising by reason of any improper investment made in good faith, or for the negligence or fraud of any agent employed by him, or by any other trustee hereof, although the employment of such an agent was not strictly necessary or expedient, or by reason of any mistake or omission made in good faith by any trustee hereof, or by reason of any other matter or thing except wilful and individual fraud or wrongdoing on the part of the trustee who is sought to be made liable.⁷
- (8) Clause 12 of the Standard Provisions of the Society of Trust and Estate Practitioners (1st edition 1992)⁸ provides:

(1) A Trustee (other than a Professional Trustee) shall not be liable for a loss to the Trust Fund unless that loss was caused by his own fraud or negligence.

(2) A Trustee shall not be liable for acting in accordance with the advice of Counsel of at least five years standing, with respect to the Settlement, unless, when he does so:

(a) he knows or has reasonable cause to suspect that the advice was given in ignorance of the material facts; or

(b) proceedings are pending to obtain the decision of the court on the matter.

⁵ *Potter & Monroe's Tax Planning with Precedents* (10th ed 1987) pp 164- 165.

⁶ *Hallett's Conveyancing Precedents* (1965) p 801.

⁷ *Prideaux, Precedents in Conveyancing* (25th ed 1959) vol 3 p 158.

⁸ The Standard Provisions of the Society of Trust and Estate Practitioners (1st ed 1992) can be found in J Kessler, *Drafting Trusts and Will Trusts: A Modern Approach* (2nd ed 1995) p 339 *et seq* and *Butterworth's Encyclopaedia of Forms and Precedents* (5th ed 2001 Reissue) vol 40(1) p 274. For an annotated version of the STEP standard provisions see *Precedents for the Conveyancer* (Issue 151 1996) para 11- 18 *et seq*.

TRUSTEE INDEMNITY CLAUSES

A.2 The following are a selection of typical trustee indemnity clauses found in standard trust precedents:

- (1) A trustee shall be entitled to exoneration and indemnity out of the Trust Fund for any liability loss or expense incurred under this settlement and for any judgment recovered against and paid by such Trustee other than liability loss expense or judgment arising out of his own wilful and individual fraud wrongdoing or neglect.⁹
- (2) In this deed the following terms shall have the following meanings.

“Settlement” means a settlement created by a deed...

“Breach” means the breach described in the schedule of the Trustees’ duties under the Settlement.

The Beneficiaries shall compensate the Trustees in full on demand for all liability resulting from the Breach.¹⁰

CLAUSES EXCLUDING THE DUTIES OF TRUSTEES

A.3 The following are a selection of typical duty exclusion clauses found in standard trust precedents:

- (1) The duty of care contained in the Trustee Act 2000 section 1 shall not apply to the Trustees in the exercise of any of the powers conferred on them by this settlement nor to any duties relating to the exercise of such powers nor to the exercise by the Trustees of any powers contained in or duties imposed by the Trustee Act 2000 the Trustee Act 1925 the Trusts of Land and Appointment of Trustees Act 1996 or any other statute where that duty of care is expressed to be applicable.¹¹
- (2) The Trustees shall not be bound or required to interfere in the management or conduct of the affairs or business of any company or corporation in which the Trust Fund or any part of it may for the time being be invested (whether or not they have the control of such company or corporation) but so long as they shall have no notice of any act of dishonesty or misappropriation or misapplication of money or other property on the part of the directors or other persons having such management or conduct they may leave the same (including the payment or non-payment of dividends) wholly to such directors or other persons and no beneficiary shall be entitled as such beneficiary in any way

⁹ *Butterworth’s Encyclopaedia of Forms and Precedents* (5th ed 2001 Reissue) vol 40(1) p 475.

¹⁰ *Kelly’s Draftsman* (17th ed 1998) p 1249.

¹¹ *Butterworth’s Encyclopaedia of Forms and Precedents* (5th ed 2001 Reissue) vol 40(1) p 472. Since the Trustee Act 2000, which introduced the statutory general duty of care, was enacted only relatively recently, there are as yet few examples of this type of clause.

whatsoever to compel control or forbid the exercise or the exercise in any particular manner of any voting or other rights which may at any time be vested in the Trustees with regard to such company or corporation.¹²

- (3) The Trustees are under no duty to enquire into the conduct of a company in which they are interested, unless they have knowledge of circumstances which call for enquiry.¹³
- (4) The Trustees are under no duty to enquire into the use of income paid to a parent or guardian on behalf of a minor unless they have knowledge of circumstances which call for enquiry.¹⁴
- (5) The Trustees shall be responsible only for so much of the Trust Fund as shall be actually paid and transferred to them respectively and nothing contained in this settlement shall cast any obligation upon the Trustees or any of them to investigate the accounts of the trustees of the will of the [testator] or to recover or...sue for the money stocks funds securities and property forming part of the Trust Fund or any part or parts of it respectively as shall not have been paid or transferred to them by the trustees of the above will and no neglect or omission in that respect shall be chargeable as a breach of trust.¹⁵

CLAUSES EXTENDING THE POWERS OF TRUSTEES

A.4 The following are a selection of typical extended powers clauses or authorisation clauses found in standard trust precedents:

- (1) Money liable to be invested or any part thereof under the trusts hereof may be applied or invested in the subscription or purchase of or at interest upon the security of such stocks, funds, shares, securities, or other investments or property of whatsoever nature and wheresoever...and whether involving liabilities or not or upon such personal credit with or without security as the Trustees shall in their absolute discretion think fit to the intent that the Trustees shall have the same powers in all respects as if they were absolute beneficial owners.¹⁶
- (2) The purchase of or at interest upon the security of such investments and property of whatsoever nature and wheresoever situated as the Trustees shall in their absolute discretion think fit

¹² *Butterworth's Encyclopaedia of Forms and Precedents* (5th ed 2001 Reissue) vol 40(1) p 462.

¹³ J Kessler, *Drafting Trusts and Will Trusts: A Modern Approach* (5th ed 2000) p 80.

¹⁴ J Kessler, *Drafting Trusts and Will Trusts: A Modern Approach* (5th ed 2000) p 80.

¹⁵ *Butterworth's Encyclopaedia of Forms and Precedents* (5th ed 2001 Reissue) vol 40(1) p 474.

¹⁶ Prideaux, *Precedents in Conveyancing* (25th ed 1959) vol 3 p 150. It must be noted that section 3(1) of the Trustee Act 2000 provides for a "general power of investment" which is similar in scope to these traditional clauses expressly conferring wide powers of investment on trustees. Therefore it is likely that such clauses have now been rendered redundant.

PROVIDED that the Trustee in making any investment shall have regard to the need for diversification of investments so far as is appropriate to the circumstances of the trust created by this settlement and to the suitability to the trust of investments of the description of the investment proposed and that the investment proposed is an investment of that description

AND PROVIDED also that before exercising any power of investment authorised by this settlement the Trustees shall have obtained and considered proper advice on the question whether the investment is satisfactory having regard to the need for diversification and to the suitability.¹⁷

- (3) The purchase of a residential property or an interest in a timeshare scheme (whether villa apartment or otherwise) (“the property”) situated in any of the following countries...and in making such purchase the Trustees shall not be liable for any loss incurred as a result of the exercise of this power and the Trustees may expend trust capital or income on the improvement or maintenance of the Property and may either let the Property for such period on such conditions and at such rent as they think fit...or may permit any one or more of the Beneficiaries to occupy the same as a holiday residence...¹⁸
- (4) Chattels for the decoration furnishing and equipment of the residence of any of the Beneficiaries [which has been purchased pursuant to clause...].¹⁹
- (5) The Trustees may invest Trust Property in any manner as if they were beneficial owners. In particular the Trustees may invest in property in any part of the world and unsecured loans.

The Trustees are under no obligation to diversify the Trust Fund.²⁰

- (6) Clause 9 of the Standard Provisions of the Society of Trust and Estate Practitioners (1st edition 1992)²¹ provides:

(1) In this paragraph:

(a) “A Fiduciary” means a Person subject to fiduciary duties under the Settlement.

¹⁷ *Butterworth's Encyclopaedia of Forms and Precedents* (5th ed 2001 Reissue) vol 40(1) p 429. Although this clause is clearly derived from sections 3 to 5 of the Trustee Act 2000, it is submitted that the power to invest or to purchase property “of whatsoever nature and wheresoever situated” is wider than the power given by sections 3 and 8 of the Trustee Act 2000.

¹⁸ *Butterworth's Encyclopaedia of Forms and Precedents* (5th ed 2001 Reissue) vol 40(1) p 428.

¹⁹ *Butterworth's Encyclopaedia of Forms and Precedents* (5th ed 2001 Reissue) vol 40(1) p 430.

²⁰ J Kessler, *Drafting Trusts and Will Trusts: A Modern Approach* (2nd ed 1995) p 236.

²¹ See n 8 above.

(b) “An Independent Trustee”, in relation to a Person, means a Trustee who is not:

- (i) a brother, sister, ancestor, descendant or dependent of the Person;
- (ii) a spouse of the Person of (i) above;
- (iii) a company controlled by one or more of the above.

(2) A Fiduciary may:

- (a) enter into a transaction with the Trustees, or
- (b) be interested in an arrangement in which the Trustees are or might have been interested, or
- (c) act (or not act) in any other circumstances;

Provided that :

- (i) The Fiduciary first discloses to the Trustees the nature and extent of any material interest conflicting with his fiduciary duties, and
- (ii) There is an Independent Trustee in respect of whom there is no conflict or interest, and he considers that the transaction arrangement or action is not contrary to the general interest of the settlement.

(7) Notwithstanding any rule of law or equity to the contrary the Trustees may validly effect any of the following transactions PROVIDED that every trustee personally interested in the transaction shall have acted in good faith and that at least one of the trustees shall have no interest in the transaction save in his capacity as one of the trustees of the settlement:

0.1 the sale or other disposal of any property or any estate right or interest in or over any property to the Trustees as part of the Trust Fund

0.2 the purchase of any property forming part of the Trust Fund or any estate right or interest in or over such property

0.3 the loan of money to the Trustees as part of the Trust Fund on the security of the Trust Fund or otherwise and on such terms as to interest and repayment as may be agreed between the Trustees

0.4 the borrowing of money forming part of the Trust Fund on such terms as to interest and repayment as may be agreed between the trustees.²²

²² *Butterworth's Encyclopaedia of Forms and Precedents* (5th ed 2001 Reissue) vol 40(1) p 454.