

TRUSTEE EXEMPTION CLAUSES

INTRODUCTION

1. The use of trusts in an increasing diversity of areas in ever more complex fields coupled with an escalation in the size of potential liabilities and the increased readiness of beneficiaries to litigate has inevitably led to the widespread use of trustee exemption clauses in trust instruments. The present position under English law, whilst not wholly clear, is generally considered to be that a properly worded exemption clause can, in principle, exclude liability for anything but dishonesty. If the Law Commission's proposals for reform are brought into force, however, the balance is highly likely to shift heavily in favour of beneficiary protection and against trustees and a fundamental review of the terms and operation of many existing trusts would invariably be required.

EXISTING POSITION

2. Putting exclusion clauses to one side, for the moment, a fundamental feature of a trust is the burden of relatively onerous duties and responsibilities which are automatically imposed by law upon trustees. It is well known, for example, that a trustee is subject fundamental fiduciary duties to act in good faith and in the interests of the beneficiaries, owes duties to take skill and care in the administration of the trust, and to act in accordance with the terms of the trust instrument.
3. The increased prevalence of conduct subject to the tort of negligence, in conjunction with the greater general public awareness and willingness to hold professional persons responsible for losses suffered, has invariably rendered the role of a trustee a daunting and to many, an unattractive task. Moreover, the role of trustees, particularly when the trust is involved with the operations of modern, international financial instruments, is increasingly complex and risky. A further hazard for trustees is that where loss is caused to a trust fund by a breach of trust, the trustees are generally liable to restore or compensate for the lost property without the court applying the common law rules of causation, foreseeability and remoteness. It is hardly surprising, therefore, that professionally drafted trust instruments customarily

include trustee exemption clauses in an effort to give the trustees protection against actions for breach of trust.

Types of Exclusion Clauses

4. The broad phrase ‘exclusion clause’ is often used to refer to a variety of types of clause, each with a different basis and implications:

(i) The most commonly employed kind, are those which exclude the liability of the trustee for committing a breach of trust. In other words, they do not limit the duty owed, but simply provide that trustees will not be financially liable for breaches.

(ii) Another form of clause is one which restricts the ambit of the trustee’s duty *per se*. Thus, the effect is not to limit liability, but to provide that there has been no breach¹ (“duty exclusion clauses”). An extreme attempt of this type of clause, but which would be highly unlikely to work, might be one that says:

“Where any sums are to be paid to the discretionary beneficiary and it falls to the Trustee to decide to whom the benefit is payable, in making any such selection or payment, the Trustee shall not be acting as a trustee and shall not be obliged to enquire or investigate and shall not be liable to account in any way to any person for any selection made.”

(iii) Some clauses confer wide powers on trustees, expressly authorising them to do acts which would normally be prohibited (“extended powers clauses” or “authorisation clauses”)².

(iv) Another variety, is a clause which gives the trustee an indemnity. The effect is that whilst the beneficiary is able to sue the trustee and the trustee may be held liable, other than any adverse implications for his reputation, the trustee

¹ See for example, *Hayim v Citibank NA* [1987] AC 730, where a will contained a clause providing that the trustee “...shall have no responsibility or duty with respect to [certain trust property] and the executor’s and trustee’s only duty and responsibility with respect thereto shall arise upon its receipt of the proceeds of the said residence....” The Privy Council held that clause absolved the trustee from any duty to the beneficiaries with regard to the property thus enabling him to disregard the interests of the beneficiaries without committing a breach of trust.

² See Law Commission Report “*Trustee Exemption Clauses*” (Consultation Paper No 171) at para.2.6 [Available on the internet on <http://www.lawcom.gov.uk>]

effectively suffers no financial loss because he can simply reimburse the amount due to the beneficiary from the trust fund. As the Law Commission points out, however, “[s]uch 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 upon the continuing solvency of the trust, but it can nevertheless operate to the prejudice of beneficiaries.”³

Trustee Act 2000

5. Despite the relatively recent review of the law relating to trustees, which culminated in the Trustee Act 2000, somewhat surprisingly there is nothing in the Act limiting the scope of the exemption clauses. That said, in the final stages of the Bill through the House of Lords the Lord Chancellor committed the government to reviewing the issue. As discussed in more detail below, in accordance with that promise, the Law Commission duly undertook a review and reported in December 2002.
6. Thus, the position following the incorporation of the Trustee Act 2000 is that although there is a *prima facie* statutory duty of care requiring trustees to exercise such care and skill as is reasonable in the circumstances, with a higher standard applying to professional trustees, the Act allows the duty to be excluded by an appropriately worded term in the trust instrument (Schedule 1, para.7).

Current position regarding Trustee Exclusion Clauses

7. In English law there is presently no statutory restriction generally applicable to all trusts. Moreover, since the law has not been conclusively determined by House of Lords, the present position is largely governed by cases decided in the Court of Appeal. Two cases are especially relevant in this area, *Armitage v Nurse* [1998] Ch 241 and *Walker v Stones* [2001] 2 WLR 623. In short, however, the current position is that it is still possible under English law to exclude liability for everything but fraud and 'dishonesty'.

³ Law Commission Report *ibid* at para.2.7 [Available on the internet on <http://www.lawcom.gov.uk>]

8. In *Armitage v Nurse*, Millett LJ at p 253 expressly reasserted the fundamental characteristic of the trust relationship: “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. If the beneficiaries have no rights enforceable against the trustees there are no trusts”. However, he held that under English law it is possible for a trustee exemption clause to exempt trustees from liability for all breaches of trust except fraud. The clause in question provided:

“No trustee shall be liable for any loss or damage which may happen to [the beneficiary’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 fraud.”

9. This clause, according to Millett LJ exempted the trustee from any liability for any loss or damage to the trust fund “no matter how indolent, imprudent, lacking in diligence, negligent or wilful he may have been, so long as he has not acted dishonestly.”⁴
10. The Court rejected the beneficiary’s argument that the word ‘fraud’ in the exclusion clause included ‘equitable fraud’, *viz*, any breach of duty to which equity attached a sanction. In Millett LJ’s opinion, the word ‘actual’ in the clause had been deliberately used to exclude equitable fraud and “actual fraud” required proof of dishonesty, that is to say, that the trustee acted “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.”⁵
11. The Court also rejected the beneficiary’s argument that the clause was void for repugnancy or as being contrary to public policy - that it had to be impermissible to exclude liability for breaches of trust that involved gross negligence. Millett LJ accepted the argument that there is an irreducible core of obligations owed by trustees to beneficiaries and enforceable by them which is fundamental to the concept of a trust, but he did not accept that these core obligations include the duties

⁴ [at p.251]

⁵ [at p.251]

of skill and care, 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 trust, but in my opinion it is sufficient.”

Walker v Stones [2001] 2 WLR 623

12. Another important case in this area is the Court of Appeal’s decision in *Walker v Stones* [2001] 2 WLR 623. The case concerned a discretionary trust set up in 1989 which had a trust fund comprised primarily of shares in a company J Ltd. J Ltd subscribed to a bond issue in a company owned by the beneficiaries’ father (the settlor) which was, in fact, valueless. Clause 15 of the trust deed excluded trustee liability for breach of trust if the trustees acted in good faith and not dishonestly.
13. The Court of Appeal held, *inter alia*, that the test for the dishonesty of a trustee must consider whether the belief that a deliberate breach of the trust was to the benefit of the beneficiaries was a belief so unreasonable that no solicitor-trustee could have held it. On the facts the belief was so unreasonable that one of the trustees was held to be acting dishonestly, and was not therefore covered by the exclusion clause⁶.
14. In the court below, Rattee J had preferred the dicta of Millett LJ in *Armitage v Nurse* to those of Lord Nicholls in *Royal Brunei Airlines v Tan* [1995] 2 AC 379⁷ - that 'honesty is an objective standard' not depending on the intellectual or moral obtuseness of the defendant - and concluded that a subjectively honest trustee could be protected by a clause exempting him from liability for anything 'other than wilful fraud or dishonesty'. However, Sir Christopher Slade giving the judgment of the Court of Appeal stated of the dicta of Millett LJ: “I think it most unlikely that he would have intended his dicta to apply to a case where [as here] a solicitor-trustee's perception of the interests of the beneficiaries was so unreasonable that no reasonable solicitor-trustee could have held such belief.”

⁶ Another important finding for trustees in the case was that the acts of a trustee partner fell outside the ordinary course of business of a firm of solicitors and consequently the firm could not be vicariously liable for the actions of the partner-trustee.

⁷ At 389-91

15. The affect of the case is to qualify the law on trustee exemption clauses as set out by Millet J in *Armitage v Nurse* by finding that in the case of a solicitor-trustee (any by extension any professional trustee), he cannot claim a breach of trust is honest, and therefore within the ambit of an appropriately worded exclusion clause, if it is so serious that no reasonable trustee could hold such a belief.

Gross Negligence

16. Thus, following *Armitage v Nurse*, it is has generally accepted that so long as the trustee has not been dishonest, he may be protected by an exclusion clause against liability for gross negligence as well as ordinary negligence.

17. This differs from the position in many other jurisdictions. In Scotland, for example, it was said in *Seton v Dawson* (1841) 4 D 310⁸: "...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*⁹."

18. In Jersey, likewise, it is not possible to exclude liability for gross negligence. The case of *Midland Bank Trustees (Jersey) Limited -v- Federated Pensions Services Limited* [1996] Pensions Law Reports 179, is interesting, however, not only on this point but more broadly because of the retroactive effect of legislation restricting the scope of exclusion clauses. The defendant in the case was the trustee of a pension scheme for nursing staff in Jersey, the rules of which contained the following exclusion:

"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 shall not be liable for anything other than a breach of trust knowingly and wilfully committed".

⁸ Cited in the Law Commission Report paras.2.23 & 2.24

⁹ ie gross negligence. The Clause in question read: "...[the trustees] shall not be liable for omissions, neglect of diligence, or any kind, nor singuli in solidum, but each only for his own actual intrusions...."

19. The Jersey Court of Appeal, after a review of authorities of various jurisdictions, concluded that they did not establish a rule of law preventing the exemption of a trustee from liability for gross negligence¹⁰. As a matter of construction, the exclusion clause in question denied exemption of liability for acts which were knowingly and wilfully committed and the Court held that the defendant had failed to establish that he did not commit the breach knowingly and wilfully: he had taken a deliberate and intentional decision on the basis of a mistaken understanding of the legal position but with full knowledge of the potential consequential loss to the pension scheme.
20. The Court also considered the effect of Article 26(9) of 1989 Jersey Trusts Law, which provides that: "Nothing in the terms of a trust shall relieve a trustee from liability for breach of trust arising from his own fraud, wilful misconduct or gross negligence". The provision came into force in July 1989, many years after the relevant trust was established and after the defendants had acted in alleged breach of the trust. However, the Court said that the 1989 Law was intended to operate retrospectively, save in circumstances where it would be "unfair" to those concerned and concluded that there was nothing "unfair" about preventing a trustee from taking advantage of immunity from liability for his gross negligence and there was, on the facts of this case, gross negligence. The Court said that it was not mere negligence consisting of a departure from the normal standard of conduct of a paid professional trustee, but a serious, unusual and marked departure from the standard which, on the correct interpretation of the words, amounted to "gross negligence".
21. In Canada¹¹ and most American States, case-law establishes that 'a trustee must be held responsible for any loss resulting from his gross negligence, regardless of any provision in the trust instrument relieving him from such liability'¹².

¹⁰ In its opinion, at common law, whether or not a trustee is protected by an exclusion clause is determined by construing the clause in question in as restrictive a manner as permissible in the context of the trust instrument and the facts of the case.

¹¹ Re Poche [1984] 6 DLR (4th) 40.

¹² 'Journal of International Trust and Corporate Planning (June 2000) *'Trustee Liability: Exculpations and Indemnities'* David Hayton

Summary

22. In summary, the existing position under English law is that a suitably worded exemption clause can effectively exempt a trustee from liability where acting consciously in breach of trust, but in good faith in the honest belief it is in the best interests of the beneficiaries¹³, provided that such belief is not so unreasonable that no honest reasonable person in the trustee's shoes could have held such belief. It is now seemingly regarded as unconscionable to allow a professional trustee to get away with conduct that no honest reasonable professional trustee could justify.

LIMITATIONS

23. The apparent leniency in favour of trustees, however, is not wholly watertight and various lines of attack have been attempted, some successfully, others not. More significantly, however, trustees need to be fully aware of the proposed changes likely to be introduced if the Law Commission's proposals are passed into law.

Construction

24. One potential area of vulnerability for trustees is the restrictive approach to construction to exclusion clauses applied by the courts: A clause will only be effective to exclude liability if clear, unequivocal and unambiguous terms are used.

25. In *Wight v Olswang* (No.2) (1999/2000) 2 ITELR 689, for example, the Court of Appeal held that a paid trustee could not rely on a clause construed in context as covering only an unpaid trustee. It also held that a clause stating 'every discretion or power shall be an absolute and uncontrolled discretion or power and no trustee shall be held liable for any loss accruing as a result of the trustee concurring or failing to concur in the exercise of any discretion or power' did not cover a solicitor-trustee,

¹³ Millett LJ, in *Armitage v Nurse* said; 'If [such a trustee] consciously takes the risk in good faith and with the best of intentions, honestly believing the risk is one which ought to be taken in the interests of the beneficiaries there is no reason why he should not be protected by an exemption clause which excludes liability for wilful default,'

And 'By consciously acting beyond their powers the trustees may deliberately commit a breach of trust; but if they do so in good faith and in the honest belief that they are acting in the interests of the beneficiaries their conduct is not fraudulent.'

who in breach of trust failed to implement the decision of a trustees' meeting to sell certain shares¹⁴. The Court of Appeal made it clear that trustees should not be permitted to wriggle out of their obligations by relying on unclear ambiguous clauses¹⁵.

26. On the other hand, since the trust instrument is, in theory, created by the settlor and not by the trustees acting as trustees, a strict *contra proferentem* construction is not applied. Thus, in *Bogg v Raper* (1999/2000) 1 ITELR 267, Millett LJ reaffirmed that exemption clause in question should be restrictively construed and that anything which was not clearly within it should be treated as falling outside it but rejected the beneficiaries' contention that the Court to go further and invoke a principle taken from the law of contract that in situations of ambiguity the words of a document are to be construed more strongly against the party who made the document. Millett LJ noted that in a contractual setting this makes perfect sense because the party seeking to rely on the clause will typically be the party who has drafted the document in which it is contained, but considered that it was not so in the trust setting where the clause is, in theory, created by the settlor. He held that since trustees accept office on the terms of a document for which they are not responsible they are entitled to have the document fairly construed according the natural meaning of the words used.

27. In the case itself, the trustees were the testator's solicitor and accountant, and as such were responsible for the inclusion of the clause in the will. Nonetheless, they were not precluded from relying upon it on the ground that they would be benefit from a breach of their fiduciary duty to the testator not to put themselves in a position of conflict of interest and duty. The benefit of protection by the clause was not exclusive to the solicitor and accountant but was one which any person taking the role as trustee could, in theory, have taken advantage. In the circumstances, Millett LJ concluded that the clause did indeed give protection to the trustees and found that the phrase 'omissions made in good faith' extended to negligent breaches of trust by omission.

¹⁴ Shortly after the meeting, he mistakenly believed that information then acquired by him as a solicitor for another client meant that the Company Securities (Insider Dealing) Act 1985 prevented him from involvement in selling any of the shares until the end of a 'purdah' period.

¹⁵ 'Trustee Liability: Exculpations and Indemnities' *ibid* David Hayton (2000)

Unfair Contract Terms Act 1977

28. A contractual attempt to exclude liability for negligence would be subject to the Unfair Contract Terms Act 1977. As the Law Commission discussed, however, the Act has no application to trustee exemption clauses. The bases for the two concepts are different: a contract derives from agreement and consideration whereas a trust is founded on the grant of property. Moreover, whilst in practice the terms of the trust are often the product of negotiations between the settlor and trustees, it is not necessarily so. Other differences are; the nature of the liability which is being asserted, and the potential succession of persons taking on the obligations of trusteeship under a particular trust.¹⁶

Bailment Cases

29. The Court in *Armitage v Nurse* took the view that English lawyers (unlike civil lawyers) 'have always had a healthy disrespect for the distinction' between gross and ordinary negligence. Thus, the court had to permit trustees to exempt themselves from liability from all degrees of negligence, it being 'far too late to suggest that the exclusion in a contract ["equally true of a settlement"] of liability for ordinary negligence is contrary to public policy'¹⁷. David Hayton, however, has argued that the decision of the Court of Appeal in *Armitage v Nurse* is open to challenge using an analogy with bailment cases in which the distinction is made between 'gross' negligence (relevant for gratuitous bailees) and ordinary negligence (relevant for bailees for reward)¹⁸.

Specific Areas

30. In certain areas, specific statutory restrictions on the use of exclusion clauses have been enacted:

¹⁶ See Law Commission Report, paras.2.60-2.64.

¹⁷ *Armitage v Nurse* [1998] Ch 241, at p 254.

¹⁸ 'Trustee Liability: Exculpations and Indemnities' ibid David Hayton (2000)

- (i) In the pensions context, section 33 of the Pensions Act 1995 prohibits attempts to exclude liability so far as investment duties are concerned.
- (ii) Under s. 310 of the Companies Act 1985, any term in a trust deed for securing an issue of debentures 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; and pursuant to s.33(1) of the 1985 Act, any provision in a company's articles or in any contract with the company or otherwise exempting any officer or person employed as auditor from, or indemnifying him against, liability for breach of trust is void.
- (iii) Section 253 of the Financial Services and Markets Act 2000 provides that any term of a trust deed of an authorised unit trust scheme is void 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.

LAW COMMISSION REPORT

31. The Law Commission published its Consultation Paper No.171 "*Trustee Exemption Clauses*" in December 2002. The overall conclusion was that it was unsatisfactory for professional trustees to be able to exempt themselves from liability for all but dishonesty with the result that many beneficiaries find themselves with no remedy against a trustee who has caused loss to the trust fund by his or her actions or omissions¹⁹.

32. The research undertaken by the Law Commission demonstrated that despite the prevalence of exemption clauses in trust instruments, the views of professional trustees as to the desirability of exemption clauses were polarised: Those against

¹⁹ The Report stated that 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." page viii

considered that it is not acceptable that professional trustees, who advertised their skills and expertise and took a fee in return for their services, are free to exclude liability for all conduct, including gross negligence, except dishonesty. Those in favour of exemption clauses took the view that in allocating risk, a balance had to be struck between all the parties, particularly in the commercial circumstances in which trusts operated, and they also pointed to the fact that trustees were at risk of being held liable for the acts of others and as a result of changes in regulations and the like.

33. A further interesting finding was that even where exclusion clauses were present, the evidence was that most trustees did not actually rely on them. A dominant reason was, inevitably, the damage it would invariably cause to the trustee / client relationship: “Some trustees suggested that it was simply uneconomical always to rely on trustee exemption clauses because it would result in the loss of too much business.”²⁰

34. As for settlers, in reality, it seems that most were not well informed about, or even particularly interested in, trustee exemption clauses and many simply accepted them as part of the package of the modern day trust²¹.

Law Commission’s Proposals

35. The Commission considered that whilst exemption clauses may well be justified in the case of lay trustees and have an important role to play in ensuring that lay trustees continue to be willing to act as such, there should be regulation in relation to professional trustees. The Paper made the following key provisional proposals for reform of trustee exemption clauses, all of which require legislation:

Distinction between lay and professional trustees

36. Lay trustees should be treated differently from professional trustees: “The contrast between the professional and the lay trustee is stark. Not only is the lay trustee

²⁰ Law Commission Report, para.3.27

²¹ Law Commission Report, paras. 3.37-3.40

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. 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.”²²

Indemnity Insurance

37. 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; “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.”²³

Non-exclusion of liability for negligence by professional trustees

38. Professional trustees should not be able to rely on clauses that exclude their liability for breach of trust arising from negligence. No distinction is made between gross and ordinary negligence – both would be caught. One justification the Commission gave for this was the difficulty in distinguishing between gross and ordinary negligence, and the consequent risk that such distinction would generate more litigation and uncertainty²⁴.

39. As for ordinary negligence, (which is the most common cause of loss to trust funds) it was argued that denying professional trustees the right to exemption from liability for ordinary negligence would cause them to adopt a defensive approach to their duties, for example, in the choice of investments, to the detriment of beneficiaries²⁵. The Commission nevertheless considered it to be “particularly inequitable that the risk of loss through negligence of professional trustees should be borne by

²² Law Commission Report para.4.29

²³ Law Commission Report para.4.32

²⁴ See Law Commission Report paras.468-78

²⁵ Law Commission Report Para.4.79

beneficiaries.”²⁶ Reference was made to the statement of the Trust Law Committee in 1999:

“There is must 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, accounts and doctors, proud of their expertise accept liability for negligence in exercising their professions and insure against such risk.”²⁷

Indemnity clauses

40. In so far as professional trustees may not exclude liability for breach of trust the Commission concluded that it followed that they should not be permitted to claim indemnity from the trust fund²⁸.

The reasonableness requirement

41. 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 trustees to be exempted from liability.

42. The Law Commission recommended adopting a “consumerist” approach by analogy with the policy of the Unfair Contract Terms Act. The benefit would, it argued, be “flexibility, sophistication and adaptability to the circumstances of each trust.”²⁹ The Commission suggested that the legislation should list the factors to which the court should have regard when determining whether a clause is reasonable for these purposes, and that this list would guide settlors and their advisers as to the steps which should be taken and the circumstances in which restrictions on liability are likely to be upheld. Similar to UCTA 1977, matters such as the availability of

²⁶ Law Commission Report Para.4.81

²⁷ TLC Report (1999) para.7.8

²⁸ Law Commission Report Para.4.88

²⁹ Law Commission Report Para. 4.47

liability insurance, the range of other options, if any, offered to the settlor, the value of the trust fund and the nature of the trust, are likely to be relevant.

43. In view of the experiences of the operation of similar provisions in UCTA 1977, the Commission did not consider that the introduction of a reasonableness requirement would result in undue uncertainty, and whilst in the early stages, it will inevitably be difficult for those involved in litigation to anticipate the approach the courts will take on this issue, the Commission envisaged that a body of case law would soon be established which would then provide guidance.

44. The Commission also recommended that in determining the question of reasonableness, court should focus on the conduct of the trustee rather than, for example, the circumstances prevailing at the date of the execution of the trust.

Duty exclusion clauses and extended powers clauses

45. The Commission recognised the point that if the law simply prohibited trustee exemption clauses: settlers would invariably use duty exclusion clauses or extended power clauses (see paragraph 4 above) to achieve the same result.

46. Such clauses are useful for trusts, providing flexibility and respecting settlor autonomy. The Commission consequently said: “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.”³⁰

47. For similar reasons as identified above under the present law in relation to exemption clauses, duty exclusion clauses are not always as effective as intended, in particular, a clause may fail to apply because as a matter of construction it does not cover the act of the trustee in question.

³⁰Law Commission Report Para.4.89

48. The Commission, however, whilst noting the tension between settlor freedom and beneficiary protection, did not consider restriction by construction to be sufficiently protection for beneficiaries, especially where the clause provides that the trustee does not have to take any care whatsoever, striking at the very heart of the trust relationship. The solution reached was to give the court a discretion to strike down duty exclusion and extended powers clauses that are “excessively wide in circumstances where the trustee is abusing his or her fiduciary position.”³¹

Rejected suggestions

49. Whilst the Law Commission noted that it was “clearly the responsibility of the settlor’s legal advisers to bring [exemption clauses] to the attention of their client and to explain their implications”³² and discuss alternatives, the Commission recognised that it would effectively be impossible to impose an enforceable obligation on such advisors to do so³³. Even if the settlor is made fully aware of the clause, it would not necessarily protect beneficiaries, and there would in any event be evidential difficulties in proving whether or not the settlor had sufficient advice.

Future of the proposals

50. The Law Commission has now completed the analysis of the responses to the Consultation Paper, including detailed comments from a Working Group of the Financial Markets Law Committee, on the impact of the provisional proposals on trusts in financial markets, and as at December 2004, was in the process of formulating final policy recommendations. The Commission anticipates being in a position to instruct Parliamentary Counsel in “early 2005”

³¹ Law Commission Report Para.4.95.

³² Law Commission Report Para. 4.42

³³ Law Commission Report Paras.4.42 –4.45

Wider Consequences

51. If the Law Commissions proposals are passed into law, various consequences seem inevitable, many of which the Commission considered, but decided were either a reasonable cost of increased protection in favour of beneficiaries, or lacking in foundation:

- (i) A decline in the numbers of trustees willing to act.
- (ii) A reduction of investment of wealth through the creation of settlements in England and Wales and a consequential negative effect on the commercial and financial climate of the country.
- (iii) A movement of trusts to less restrictive jurisdictions. However, the Commission took the view that factors such as England being the settlor's home or base and fiscal and other financial consideration were more influential than the availability of exemption clauses.
- (iv) Indemnity insurance premiums would invariably increase, and it is to be expected that those costs will be passed on to beneficiaries by means of increased administration charges.

52. The main consequence for trustees, if the use of trustee exemption clauses is prohibited, is that they will need to seek alternative means of protection, the most likely being an increased use of liability insurance. Relying on insurance, however, is not without its difficulties. For some trusts, particular small family and charitable trusts, the costs of insurance would be unduly prohibitive to the operation of trusts. Insurance may not be available for all variety of trust or trustee, there may be difficulties in assessing risk and disadvantage caused as a result of a lack of claims history. Further, insurance would not necessarily provide watertight cover, especially, as many insurance policies include exceptions in their policies or cover for an inadequate period of time (trustees remaining liable after their retirement).

53. Indemnity clauses are an alternative, but they are invariably far less secure, depending as they do, on the strength of the person or entity providing the indemnity. Some trustees indicated that they would seek to ensure that indemnity

clauses are supported by a bank guarantee, but, like insurance, the drawbacks are the cost and protecting trustees who have retired.

Transitional Provisions

54. The Commission proposed that legislation regulating trustee exemption clauses should be prospective in effect: that is to say, only applied in cases of breaches by trustees after the date the legislation comes into force.

55. That said, the effects would not be entirely prospective since the proposal is that the new legislation should apply to trusts established before the commencement of the legislation. The Commission's view is that this would not be unfair since 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 outweighed by the undesirability of making legislation applicable only in relation to trusts which are created after the date it comes into force."³⁴

56. In other words, the position would not be as bad as in the Jersey case of *Midland Bank Trustees (Jersey) Limited -v- Federated Pensions Services Limited* where the breach in question was committed before the relevant Act came into effect, but it would nevertheless cause real cost and inconvenience to many trusts.

CONCLUSIONS

57. Although the general approach of the Court of Appeal (and Millett LJ in particular) may be thought to be sympathetic and highly favourable to trustees, Millett LJ acknowledged in *Armitage v Nurse* that the view was widely held that trustee exemption clauses had gone too far and that trustees who charge for their services should not be allowed to rely on such clauses to relieve them of liability for gross negligence. Some restriction was imposed by the Court of Appeal's decision in *Walker v Stone*, but only to hold trustees responsible where their belief is so

³⁴ Law Commission Report Para.4.101

unreasonable that no honest reasonable person in the trustee's shoes could have held such belief.

58. The fact that many trust corporations or professional persons, demanding fees on the basis of how well they will manage the client's trusts are able to include protection against liability for grossly negligent breaches of trust, has been the subject of much criticism and calls have been made for legislative interference. To this end, the Law Commission, having undertaken an extensive review of the law and practice, advocates the prohibition of exclusion of liability for *any* type of negligence, not merely gross negligence. The proposals are radical and would have far reaching consequences for professional trustees. They go further than the approach urged on the Court of Appeal on behalf of beneficiary in *Armitage v Nurse*, further than the legislature in Jersey and Guernsey have gone, and further than the Unfair Contract Terms Act, which applies a test of whether it is reasonable to allow reliance on an exemption clause in the particular circumstances of the case. "What is contemplated by the Commission is a blanket prohibition."³⁵

59. Although it seems that any Act passed to implement the Commission's proposals will only apply to cases where the impugned act of the trustee occurs after the legislation comes into force, it is likely to apply to trusts which have been established prior to the commencement of the legislation. Trustees will consequently need to review the terms under which they operate and consider whether to seek amendment of the terms of the trust or to retire from office.

Charlotte Downes
Lincoln's Inn
16th February 2005

³⁵ The opdu Report - Issue 17, November 2004
Advisory Service Forum
Trustee Exemption Clauses – An Endangered Species”, Craig Monty