

The debate over trustee exemption clauses

On 10 April the Society for Advanced Legal Studies and the Law Commission held a joint seminar at Charles Clore House in which Law Commissioner Stuart Bridge and Professor David Hayton of Kings College, London, invited debate on the proposals contained in the Commission's consultation paper on trustee exemption clauses. A brief summary of these suggestions for reform is given below, followed by a response written by Mr Gregory Hill, who appeared in *Armitage v Nurse* (see further below).

THE CP 171 PROPOSALS

Law Commission Consultation Paper 171, *Trustee Exemption Clauses*, has set out to consider the extent to which trustees can exclude or restrict their liability to the beneficiaries for breach of trust. 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. In 1998 the Court of Appeal dispelled all doubts as to the validity of trustee exemption clauses which exclude liability for ordinary or even gross negligence in *Armitage v Nurse* [1998] Ch 241. Furthermore, the Trustee Act 2000, which came into force on 1 February 2001, expanded trustees' powers – but without making any attempt to regulate the use of trustee exemption clauses.

In CP 171 the Commission makes provisional proposals for the regulation of trustee exemption clauses. The Commission does not believe that an absolute prohibition on all trustee exemption clauses is justifiable at present, but believes there is a “very strong case” for some regulation – mainly because the increased use of trustee exemption clauses has reduced the protection afforded to beneficiaries in the event of breach of trust. There is also little doubt that the decision in *Armitage v Nurse* sits uneasily in today's society where consumers who suffer loss as a result of sub-standard goods or services expect the law to provide them with the means of redress.

The Commission proposes to draw a distinction between the professional trustee (who receives money for his/her services) and the lay trustee (defined by the paper as everyone else). The provisional proposals, which would require legislation, are:

- 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 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;
- 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 come into force, but it should not apply to breaches of trust which precede that date.

The views of consultees were sought on other possible options for reform, such as whether a trustee should be able to rely on a trustee exemption clause to exclude or restrict his/her liability for breach of trust only where the clause satisfies the test of reasonableness; and 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.

Law Commission Consultation Paper 171: a response

By Gregory Hill

What follows is my personal response only; no part of it is intended to be confidential, and if I have said anything of interest, I have no objection to it being quoted and attributed. My qualification to express views is that I have been in practice at the Chancery Bar since 1973, my practice including trusts work; and I have had particular experience of a trustee exemption clause, in that I was counsel for the successful, non-fraudulent and – as was averred in his pleadings but did not have to be resolved – non-negligent, trustee in *Armitage v Nurse*. Part of what follows is already known to the Commission, in that I attended (and harangued) the seminar at the Society for Advanced Legal Studies on 10 April 2003, and gave a copy of my notes to Mr Stuart Bridge. The Commission is welcome, if so minded, to ask for further comments on anything I have said; subject to professional commitments I will endeavour to reply.

This response is in three parts: (i) a summary of what I believe are the most important points; (ii) a slightly amplified version of my notes prepared for the 10 April seminar; and (iii) answers to the specific questions in part V of the consultation paper.

I SUMMARY

- (i) Paragraph 4.2 of the consultation paper (CP) rightly points out the wide variety of uses to which trusts can be put; in my view it is not necessarily appropriate for any regulation of trustee exemption clauses to apply – or to take the same form – in relation to all types of trust. (To an extent this is already the position, as noted in CP paras. 2.67-68.)
- (ii) As to traditional “family” trusts:
 - (a) The settlor/testator is the right person to strike the balance between beneficiaries’ expectations and protection of trustees; no interference with settlor autonomy is justified in this field.
 - (b) It is right for the law to insist that settlors/testators do apply their minds to the striking of that balance and do not insert exemption clauses (or professional trustee/trust corporation charging clauses, but they are a different problem) without understanding and considering them – particularly where the professional adviser preparing the instrument, or his firm/associates, will benefit from the clause in question.
 - (c) The appropriate mechanism of control for this purpose is the adoption/development of

principles similar to the probate principles applicable to a will prepared by or on instructions from someone taking a benefit under it. Such a person must affirmatively prove that the testator/testatrix *knew and approved* of the provision in question, and must establish “*the righteousness of the transaction*”, but a will draftsman is not legally disabled from taking a benefit if his client really wants to confer it. If the onus is discharged to the court’s satisfaction (the cogency of the evidence having to be appropriate to the significance of the gift), the will is effective as written.

- (iii) In relation to trusts with a “commercial” function, the proposal in the CP to exclude entirely a professional trustee’s ability to rely on an exemption clause in relation to (alleged) negligence contrasts incongruously with the proposals in Consultation Paper 166 on contractual exemption clauses. There it is not suggested that any class of contracting party should be wholly debarred from relying on clauses exempting from liability for negligence causing purely economic loss, but a “*fair and reasonable*” test is preferred. Where the economic functions of trusts and contracts are similar, it seems likely that similar controls on “contracting out” will be appropriate.
- (iv) If there are any situations where settlor autonomy (properly protected) has to be displaced in favour of control of exemption clauses by substantive rules of law, a requirement of reasonableness is less objectionable than completely outlawing reliance on such clauses in relation to negligence. Insurance is not

a panacea, not least because professional negligence indemnity cover in the full amount of the funds of a large trust (eg the value of the property held by the security trustee in a mortgage securitisation) may not be available at an affordable cost (and even if available now, may not remain so over the life of the trust). A reasonableness test would at least enable a trustee to negotiate for appointment on terms that his/its negligence liability was to be limited to a specified sum, capable of being insured.

- (v) The suggestion in CP para 4.101 that any legislative reform should apply to subsequent breaches of existing trusts is wrong in principle, particularly in relation to a reform disabling any class of trustees from relying on an exemption clause so far as applicable to (alleged) negligence. Unless (perhaps) there was an absolute right for a trustee to retire (with provision for the Public Trustee or the Chancery Division to take over any trust where all the trustees did so), reform in the terms suggested would amount to forcing the affected trustees to continue in office on terms significantly more onerous than they had agreed (particularly if the size of the fund were such that full insurance cover could not realistically be obtained). Without pretending to any particular human rights expertise, I should expect arguments to be advanced which relied on Convention principles of “legal certainty” and “security of possessions” (possibly even “forced labour”, though that may be a far-fetched speculation).

II NOTES OF POINTS MADE AT 10 APRIL SEMINAR

- (i) The CP starts (para 4.3) from a false premise. Trustees do not exclude or limit their liability: the settlor does so.
- (ii) In a family trust, there may be excellent reasons for giving the trustees a high degree of protection – not only to protect them, but to protect silly beneficiaries from themselves. The purpose of a trust is to have the trustees rather than the beneficiary(ies) looking after the fund – for example because a beneficiary is spendthrift/bad at managing money/liable to be led astray by spouse/partner/other close associate. In those circumstances a settlor may feel bound to say to his solicitor and accountant something along the lines of:

“I am very fond of my daughter and her children are lovely, but her new husband is a menace. He will try to lean on her, and on you if you agree to act as trustees of my will, to get whatever I leave her into his hands, when it will vanish in some harebrained scheme of his. I dare not give money directly to her; I trust you to look after her and the children and I want you to do so, but if you act, you will need to have something in the will to enable you to see off summarily

all the ridiculous threats she, under his influence, will inevitably make”.

[Note: In this context consider, for example, the numerous mortgage cases in which a wife has established as against her husband that he used undue influence to procure a security from her in aid of his or his business’s obligations. I suggest that trustees holding property for such a wife and her children should not be deprived of any protection their settlor/testator may have seen fit to give them against the blandishments or threats the husband may bring to bear, and the settlor/testator should not be prevented from making and giving effect to a judgment on that issue].

Whether a “not liable for anything except fraud” clause is appropriate is a matter of judgment; the right person to make that judgment is the settlor.

[Note: CP para 4.16(3) is, with respect, misconceived: the settlor could retain the fund himself and use it to make periodic gifts for specific purposes, or leave it by will to a friend beneficially with a precatory expression of wishes in favour of the “beneficiaries”, who would not in either case have any ground for complaint over how it was invested/administered; there is no sufficient reason for not allowing the settlor to decide also to give the beneficiaries the right to an account and payment of whatever there may be left at some future date, but no more].

- (iii) When such a clause is appropriate, its purpose is not to allow the trustees to be negligent and get away with it (any more than the purpose of diplomatic immunity is to allow diplomats to get away with criminal conduct): it is to protect the trustees from what the settlor assesses is a more serious risk in the particular case, that they will be harassed by unfounded accusations from a silly or malicious beneficiary.
- (iv) The need for that form of protection against that sort of risk is a modern phenomenon, arising from the widening of trustees’ investment and other powers. That is in general a useful development, but it does mean that trustees who are asked to invest the fund in the beneficiary’s husband’s project to extract (and sell) moonbeams from cucumbers cannot say “*Sorry but our investment clause does not allow it*”.

[Note: see for example Birrell, The Duties and Liabilities of Trustees, 1896, pp 22–24].

- (v) Nipping misconceived litigation in the bud is something the settlor may reasonably consider a benefit to the beneficiaries (particularly the income beneficiary’s children if they eventually take capital) as well as to the trustees. If the trustees are sued for alleged breach of trust and win, they are entitled to their costs out of the fund on the indemnity basis so far as not recovered from the unsuccessful claimant, and the costs of striking out a silly claim on the basis that “*these allegations do not support a charge of fraud so the claim will inevitably fail*” will be nowhere near the

amount the trustees may have to spend to fight on the facts and then not get back from the claimant or by impounding his/her interest.

[Note: I think I can properly say, simply on the basis of the extent of the pleaded factual issues which appear from the published report of Armitage v Nurse, that if those issues had been fought and the trustee defendants had won, the cost to the beneficiaries/fund would have greatly exceeded the costs of the proceedings which actually took place, even including the appeal to the Court of Appeal. That will usually be the case, because a trial which has to go over the detailed administration of a trust for years or decades will not be cheap (consider what Nestlé v NatWest may have cost). Of course this is not a conclusive argument: some viable breach of trust claims will be barred if “no liability except for fraud” clauses are used – but that is not a reason to stop settlors using their judgment to decide that such a risk is worth taking for the purpose of stifling hopeless or even blackmailing claims which particular beneficiaries will otherwise be likely to bring, or for any other purpose which they think sufficient].

- (vi) Of course it is not right for advisers who are going to be trustees to prepare documents which give them an advantage (lower insurance premiums) at the possible expense of the beneficiaries, unless the settlor properly understands and desires that result. If that is an abuse, the means to control it are ready to hand in the probate rules of “*want of knowledge and approval*” and the onus placed on someone who is instrumental in procuring a will in his own favour to establish “*the righteousness of the transaction*”. As the law now stands those principles could be invoked on a trustee exemption clause in a will in favour of the solicitor who drew it and is an executor and trustee (procedurally it would be necessary under the current law to apply to revoke common-form probate and obtain a grant in solemn form omitting the objectionable clause; but reforming legislation could adopt the substantive principle without carrying over the procedural complexities). The appropriate way of reforming the law is to extend those principles to *inter vivos* settlements; and perhaps to cast a similar onus not just on the draftsman but also on other trustees in his firm or with some other economic connection; or even to all paid trustees. The onus would be on the trustee: there would be a strong interest in ensuring, and preserving evidence, that the settlor’s adoption of such a clause was understood and intended, and not a charade.

[Note: This is the answer, so far as one is needed, to the “limitations” mentioned in CP paras 4.44–45; the requirement being one of substance not of form, with the onus on the trustee, would ensure that an exemption clause was not inserted unless the settlor/testator understood it and wanted it; if that is the position, there is no reason to tell a donor he cannot give on the terms he wishes, but must give either something more or nothing at all].

(vii) The objection to the proposal “*no reliance on clauses excluding liability for negligence*” is that it unnecessarily outlaws what may sometimes be the appropriate way of holding the balance between beneficiaries and trustees, and deprives the settlor of the power to make that judgment.

(viii) The proposal also goes further than the control of approximately similar clauses in contracts, where the “*requirement of reasonableness*” or equivalent enables a judgment to be made on the circumstances of each case. That is a more appropriate approach for trusts which are in substance commercial transactions rather than gifts, eg pension funds.

[Note: Also mortgage securitisations; debenture stock deeds; any other forms of collective investment? See I(iv) above in connection with limitation of liability by reference to availability of insurance].

It is not essential for commercial and family transactions to be treated the same way. But if “*want of knowledge and approval*” principles were applied to pension funds and other “*commercial trusts*”, the effect would be in practice to eliminate exclusions of liability for negligence if the pensioners/investors were treated as settlors, as they should be: no professional pensioner trustee who wanted to stay in business would be likely to try to persuade each and every pension fund member that there was a good reason for agreeing that it should be exempt from that liability.

(ix) Over time, the result of trustees insuring (as professionals or directly out of trust funds) will be to throw on trust beneficiaries as a class, through premiums, the whole amount of negligence claims and costs, plus a margin for the insurance industry’s profit. That may be unavoidable; but insurance should not be regarded as the only way of keeping funds safe.

[Note: if reliance is placed on insurance, the effect will be that beneficiaries of trusts with competent trustees will fund the payouts by insurers of incompetent trustees to the beneficiaries of their trusts. Commercial insurers start by applying a set premium rate to all business of a particular class, and any adjustments by means of no-claims bonuses for good risks, or deductibles and weightings for bad ones, will not be enough to put the whole burden of payouts on those who incur them: that is the nature of insurance].

(x) If any change in the law were to be along the lines of “*no exemption from negligence liability*”, and were to apply to future alleged breaches of existing trusts with such clauses, any trustee of such a trust in office at the commencement of the legislation should have an unqualified right to bail out: he/it made the decision to accept office on that basis, and no-one else should have the power to make him/it continue in office exposed to liability on a different basis (particularly if the size of the fund is such that full insurance cover is not available or only at exorbitant cost). If all the

trustees of a trust resigned, the choice would have to be between the Public Trust Office taking over, and an administration action in the Chancery Division.

III CP PART V: CONSULTATION QUESTIONS

Please read these answers in the light of the comments above.

5.3/4.19: I agree trustee exemption clauses **should not be prohibited outright**.

5.4/4.20 **Legislative regulation?** *Family trusts and similar*, yes to the extent of ensuring that settlors/testators only insert exemption clauses when they understand and intend their effects (for consideration whether this should apply beyond clauses in favour of the settlor's draftsman and his firm/associates – on balance I would support applying such a rule to all paid trustees); *“commercial” trusts*, yes to the extent that such clauses are reasonable having regard (principally) to the extent to which beneficiaries have paid for their benefits (investment pooling or similar) and, following on from that, ordinary consumer protection considerations.

5.5/4.32 **Pay for indemnity insurance?** Insurance is nothing like the whole answer; but since paid trustees can insure and set their fees accordingly, it must be desirable, if possible, to facilitate insurance by unpaid trustees. Could the insurance market be persuaded to add identified lay trustees of specified trusts to the main professional trustee's indemnity insurance at an affordable rate – on the basis that they will have the advice and assistance of the main insured and are therefore unlikely to add greatly to the risk of covering him/her?

5.6/4.39 **“Professional” and “lay” trustees?** I agree there should be such a distinction; but I agree with the criticisms made on 10 April of the proposal to use Trustee Act 2000 as the means of drawing it, and I support the simple distinction between paid and unpaid trustees. The old-fashioned form of the *Armitage v Nurse* clause operates in favour of a trustee “*who gives his services gratuitously*”, which strikes the right balance.

5.7/4.45 **Explanations to settlor?** This should be the touchstone of validity of a trustee exemption clause in a family or similar settlement, i.e. one made by way of bounty; see above on adopting/adapting “want of knowledge and approval” principles.

5.8/4.52 **“Requirement of reasonableness”?** This is a possible appropriate alternative to “want of

knowledge and approval” in “commercial” trusts where the beneficiaries have contributed to the fund providing their benefits: in that situation there is a fairly close analogy with contractual exemption clauses, considered in Consultation Paper 166, and differences of treatment between trusts and contracts performing similar economic functions should be eliminated as far as possible. “So far as” is important – it may be more reasonable to exclude a strict liability than a fault-based one, and a clause should be capable of being a curate's egg.

It would be desirable, if this technique were adopted, to provide a non-exhaustive **list of relevant matters** (but also permitting regard to be had to anything else which appeared relevant in the particular case); I suggest they should include (in no particular order of importance)

- What insurance against the excluded liability is available to the trustee, and to the beneficiaries in respect of loss from the acts for which liability is excluded;
- Whether and how far the beneficiary has contributed to the fund or the part of it which supports his benefits;
- Whether and how far the beneficiary or anyone else had a choice whether to accept the exclusion of liability, and took an informed decision to accept it rather than deal with the counterparty on other terms or deal with someone else;
- Whether and how far the excluded liability is strict or fault-based; and where fault-based, whether and how far it arises from activities within any special expertise of the trustee – if an accountant and a land agent are trustees of a trust which includes land being farmed in hand, the accountant may be more deserving of protection than the land agent if the trustees take a wrong and arguably silly decision as to what crops to grow.

5.9/4.66 **Prohibition of exemption and judicial discretion to exonerate?** I agree that this would be unsatisfactory. The main practical use of Trustee Act 1925 s 61 is to encourage advisers to advise trustees to act sensibly, even in the face of residual doubts (but without actually mentioning the section), where the cost of a *Beddoe* application would be disproportionate. In cases of serious dispute the existence of s 61 is no real comfort, and does not enable litigation to be disposed of

summarily and costs to be saved; I emphatically agree with CP paras 4.64-66.

5.10/4.78 **“Gross” negligence?** I agree that this would not be a suitable test; the concept is not well-defined and would simply change and blur the line which trustees had to be shown to have crossed; it would increase the complexity of litigation, widen the range of issues for investigation, and increase costs. If trustee exemption clauses are to be permitted at all, the law should encourage clauses which are easy to apply without a full and costly trial, eg preliminary issues (as were used in *Armitage v Nurse*) or CPR Part 24.

“Unreasonable etc conduct such that exemption unfair to beneficiary”? This would not be satisfactory – it would probably, as a matter of statutory interpretation, be more or less a re-enactment of s 61, but (apparently) with the onus of proof on the beneficiary rather than the trustee; legislation in these terms would have all the disadvantages of s 61, and in the short to medium term the further disadvantage of creating doubts whether and in what ways the law had actually been changed.

5.11/4.85 **“Professional trustees unable to rely on clauses exempting from liability for negligence”?** I profoundly disagree, for reasons developed in more detail above; in brief

- Unjustified interference with settlor autonomy;
- Requiring trustees to accept a long-term commitment with potential liability which may be or become uninsurable;
- Ignoring the distinction between “family” and “commercial” trust relationships, and going far beyond the consumer protection measures used and proposed (CP 166) in commercial relationships constituted by contracts;
- The proposed transitional provisions would override what will in some cases (where there is known to be a likelihood of beneficiaries or their associates trying to put pressure on trustees) be significant reliance interests.

5.12/4.86 **“Unable to rely on exemption clause where that is unreasonable in all circumstances including the breach of trust in question”?** In my view this is no different in substance from the possible rewriting of s 61 mentioned in the second branch of question 5.10, and the same objections apply.

5.13/4.97 **Indemnity clauses?** I agree that if there is to be any limit on the right to rely on exemption

clauses, there should be a co-extensive limit on any right to be indemnified out of the trust fund – that must follow from the fact that the obligation of a trustee held liable for breach of trust is to reconstitute the trust fund as it ought to be (not to make payments to the beneficiaries).

Possibility of disapplying duty exclusion/extended powers clauses? In my view this would be wrong. I agree with the reasons given by seminar participants on 10 April why duty definition/duty exclusion (or limitation)/extended powers clauses are necessary, particularly where the trust property includes all or part of an asset such as a farm or family business which requires specialist management or the continuing involvement of the settlor or other family members. Compare the farming example at the end of 5.8 above, or trustees who held, say, a 33% shareholding in a company run by their testator’s younger brothers who held the rest of the shares: if a “duty exclusion/extended powers” clause allowing them to leave the running of the company to the directors (absent actual knowledge of mismanagement) were liable to be disappplied in a breach of trust action, they could not in reality safely rely on it, and would have to spend the time and incur the expense of taking whatever steps were open to them to monitor and supervise the company – quite probably, if the brothers were honest and competent (as at least some businessmen are), for no actual financial benefit whatsoever.

5.14/4.99 **Apply reform to English-law trusts and also to trustee business “onshore”?** In my view the extension to all onshore trustee business would be wrong and in private international law terms excessive/exorbitant, without any sufficient justification of domestic public policy. The starting-point is that a reform of English trusts law should apply to trusts governed by that law, and comity requires that there be a strong justification for going further (and that any extension be no wider than that justification indicates). So far as any reform were seen as a “consumer protection” measure, it would properly be regarded as for the protection of “onshore” consumers, and I think the UK legislature could therefore properly apply the reform to the administration within the UK (including Scotland) of trusts satisfying the two criteria that (a) the governing law would be that of England and Wales but for any express choice of another law and (b) a majority of the

beneficiaries by value of their interests are ordinarily resident in the UK; but there is no reason to interfere with an express choice of (say) Jersey or Isle of Man law for what would otherwise be an English trust, run here wholly or in part, for beneficiaries in China and Peru (or places between). *A fortiori* it would be wrong to apply any reforms to a settlement constituted by a Ruritanian settlor under Ruritanian law in favour of beneficiaries then all resident in Ruritania, even if one of the beneficiaries later came to England and the trustees, operating the Ruritanian equivalent of the English Trustee Act 1925 s 37(1)(b), (but not a power to change the proper law if Ruritanian law allows that,) appointed separate trustees here to administer a share of the fund appropriated to that beneficiary.

5.15/4.101 **Include post-commencement breaches of existing trusts?** In my view this suggestion is wrong and misconceived, for reasons already

given: it would require trustees to take on liabilities which the settlor/testator had told them would not be imposed, and which might be or become uninsurable. At the very least, any such reform should be accompanied by an unqualified right for trustees of existing trusts to resign, even if all the trustees of a particular trust wanted to do so; and if the position were that serious, it would I suggest be impossible to say confidently that the interests of future beneficiaries would always be best served by appointing the existing beneficiaries as trustees (assuming there would in fact be adult beneficiaries capable and willing to act).

5.16/4.104 **Economic and regulatory consequences?**

I am not competent to express views on these issues and do not do so. 

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Matching expectations in computer contracts – what expectations?

by Ruth Atkins

The task of identifying the requirements of the customer is a pivotal stage in the procurement process.

The supply of a custom-made computer system which satisfies the requirements of the customer is unquestionably dependent upon an accurate identification of those requirements. Various approaches to identifying the customer's requirements may be adopted, ranging from the completion of a basic questionnaire, to lengthy and detailed discussions between the parties. Whichever methods are used to ascertain the customer's requirements, it is sound commercial practice to record them in written form.

The extent of that written information, which may be both technical and legal in nature, will vary considerably given the multitude of different transactions which may be undertaken by different suppliers. Nevertheless, it is to be hoped that the documentation will represent an accurate

and adequate reflection of the requirements of the customer, upon which basis the project may proceed. This may appear to be a relatively straightforward task. However, the failure to adequately identify the customer's requirements and therefore to have produced an accurate project specification, is a prevalent cause for disputes arising from the supply of computer systems.

NEED FOR ACCURATE IDENTIFICATION

This article begins from the viewpoint that the task of identifying the requirements of the customer is a pivotal stage in the procurement process. Only through an accurate identification of the customer's requirements will the supplier be in a position to provide a system that meets those requirements. Equally, only through an accurate identification of the requirements will it be possible for the