

STEP Bahamas Branch

Evaluating the Exposure and Liability of Professional Trustees

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12 February 2004

macfarlanes

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Duty of Care of Professional Trustees

λ Duty of care under general law:-

“A trustee is required to use the same degree of diligence and care in the execution of his office that a man of ordinary prudence would exercise in the management of his affairs.

“Lewin on Trusts”, Sweet & Maxwell, 2000

“[As] a general rule, a trustee sufficiently discharges his duty if he takes in managing trust affairs all those precautions which an ordinary prudent man of business would take in managing affairs of his own.”

Speight v Gaunt (1883) 9 App Cas. 1 HL

Duty of Care of Professional Trustees (continued)

- λ Duty of care under general law relating to investments

“The duty of care of a trustee is not to take such care only as a prudent man would take if he had only himself to consider; the duty rather 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.”

Re Whiteley (1886) 33 ChD 347 at 355

Duty of Care of Professional Trustees (continued)

- λ A higher standard of care applies to a professional trustee.

“A higher duty of care is plainly due for someone like a trust corporation which carries on a specialised business of trust management.”

Bartlett v Barclays Bank Trust Co Limited [1980] Ch 515

Duty of Care of Professional Trustees (continued)

- λ Statutory duty of care introduced by the Trustee Act 2000
 - Applies only to the exercise of powers and the performance of duties conferred or imposed by that Act and also to certain powers conferred by other statutes and by the terms of the trust
 - It does not apply to dispositive powers
 - The statutory duty of care is therefore not of general application
 - It can be modified by the terms of the trust instrument
 - Very unhelpful as different standards apply depending on nature of power being exercised

Duty of Care of Professional Trustees (continued)

λ Section 1 Trustee Act 2000 provides:

“Wherever the duty under this subsection applies to a trustee 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”.

Duty of Care of Professional Trustees (continued)

The statutory duty of care preserves this distinction in its approach towards family and professional trustees

- λ Only professional trustees subject to objective test.
- λ Subjective test will also raise standard of care expected of professional trustees above that of family trustees.

Duty of Care of Professional Trustees (continued)

- λ The statutory duty of care applies to the following:-
- λ Powers in relation to investment
 - Whenever trustees exercise the general power of investment under Section 3 or any other investment power however conferred (normally under the trust deed)
 - Whenever they carry out any duty under Sections 4 and 5 concerning the mode of exercise of those powers (the standard investment criteria) and review of investments (taking appropriate advice)
- λ Powers in relation to land
 - Under Section 8 of the Act or any other power to acquire land
 - Exercising powers in relation to land

Duty of Care of Professional Trustees (continued)

- λ Powers in relation to agents, nominees and custodians
 - Powers in relation to their appointment (Sections 11, 16, 17, 18)
 - When carrying out duty to review (Section 22)
- λ Exercising powers of compromise (Section 15)
- λ Exercising power to insure (Section 19)
- λ Exercising powers concerning reversionary interests or valuation (Section 22)

Duty of Care of Professional Trustees (continued)

λ Duty of care modified in trust deed but often in a way which preserves distinction

λ “No Trustee or Protector shall be liable for any loss to the Trust Fund or the income arising therefrom by reason of:

any breach of trust unless it involves his own fraud or wrongdoing, and;

in the case of a paid Trustee or Protector unless the breach involves his own negligence”.

Duty of Care of Professional Trustees (continued)

Application of Trustee Act 2000

- λ Applies to all family trusts wherever created and governed by English law but only to the exercise of powers and duties after the Act comes into force on 1 February 2001
- λ Application modified in relation to pension trusts, unit trusts and certain charitable funds
- λ Thus, in relation to pension trusts, the Act does not apply to trustees when exercising, say, investment powers as those matters are governed by Pensions Act 1995
- λ Act may apply to bare trusts and simple trusts if trustees of those trusts have occasion to exercise any of the functions to which duty attaches

Limitation of Liability Clauses

Re duties to beneficiaries there are three types:

- λ Enlarge the powers of the trustees
- λ Restrict their duties
- λ Exclude or limit their liability

Limitation of Liability Clauses (continued)

Enlarging Powers of Trustees

- λ Powers of trustees can be expanded to authorise the trustees to do something they would otherwise not be entitled to do
- λ If trustees act outside scope of their powers that is automatic breach of trust. NB: “The main duty of a trustee is to commit judicious breaches of trust” (Perrins v Bellamy [1899] 1Ch 797)
- λ But trustees must still act with care and prudence in relation to exercise of powers

Limitation of Liability Clauses (continued)

Restricting duties of trustees

- λ The terms of the trust may reduce/modify the ordinary duties of trusts
- λ Common example is “anti-Bartlett clause” – limiting duty of trustees to interfere in management of a company in which trustee is substantial shareholder unless on notice of dishonesty or misappropriation
- λ Often coupled with restrictions on power to sell or voting powers either by reference to performance or consent of some third party (whose power to consent is a personal not a fiduciary power) and on flow of information

BUT:

- Trustees often retain power to get information
- Overriding duty to exercise powers to safeguard beneficiaries’ interests
- λ This is duty of care of trustee (see below) and cannot be ousted

Limitation of Liability Clauses (continued)

Restricting duties of trustees

- λ Exception might be if use non-UK company and transfer in asset which has been constructed to prevent changes of control
- λ Example: bye-laws provide that managing director (settlor) cannot be removed unless and until mentally incompetent and directors can only be removed and appointed by managing director. Trustees therefore unable to interfere in management of company and assuming company does not need external financing which would inevitably require their involvement, their role is limited to collecting dividends.
- λ Beware that trustees have something to do – otherwise trust could be regarded as sham.
- λ BVI VISTA trusts seek to address these sort of issues.

Limitation of Liability Clauses (continued)

Excluding/Limiting Liability

- λ Difference is the approach on the extent to which a provision in a trust deed can exclude or restrict a trustee's liability for breach of trust.
- λ In *Armitage v Nurse* [1997] 3 W.L.R. 1046 (followed by *Walker and Others v Stones and Others* [2001] QB 902), Millett LJ said.

“In my judgment, [the exclusion clause] exempts 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”

- λ Dishonesty was defined as

“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”.

Limitation of Liability Clauses (continued)

Excluding/Limiting Liability

- λ In *Bogg and Others v Raper and Others* (1998/99) 1 T.E.L.R. 267 the Court went even further and upheld an execution clause in a will even though one of the executors/trustees had drafted the will. There was no obligation to advise the testator to take separate independent advice on the effects of the execution clause. It was only necessary to show that the settlor knew and approved the clause.
- λ *Armitage v Nurse* probably represents high watermark of trustees' ability to protect themselves against liability.
- λ The terms of trust could not negate the duty of trustees to act in good faith but a duty of care can be excluded altogether so as to excuse negligence, even gross negligence. It is enough for trustees to be left with a duty to perform trust honestly and in good faith for the benefit of the beneficiaries. macfarlanes

Limitation of Liability Clauses (continued)

Excluding/Limiting Liability

Millett LJ also noted as follows:-

“There is a 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”

“It must be acknowledged 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”.

Limitation of Liability Clauses (continued)

Excluding/Limiting Liability

Law Commission Report (No.171, December 2002) made a number of recommendations including:-

- λ It should continue to be possible to exempt an unpaid trustee from any liability other than dishonesty
- λ It should not be possible to exempt a paid trustee for negligence, gross negligence, recklessness, wilful default, dishonesty or fraud
- λ The settlor should be advised on the scope of the exemption clause

Limitation of Liability Clauses (continued)

Excluding/Limiting Liability

- λ In common with most other countries, courts in England and Wales construe exemption clauses narrowly. Doubt or ambiguity is resolved against the person who is seeking to rely on the exemption clause
- λ In *Wight v Olswang* there were two exemption clauses:-
 - The first exonerated the trustees from liability for anything other than “the wilful fraud or wrongdoing of the trustees”
 - The second was narrower and exempted the trustees from liability for anything other than “wilful misconduct or breach of trust” and this was limited to unpaid trustees
- λ The Court resolved the conflict between these two clauses by concluding that the professional trustee was not exempt from liability

Liability of a professional trustee who is liable for breach of trust

- λ A beneficiary's civil remedy against a trustee personally to put right a breach of trust is an action to recover money compensation from the trustee.
- λ If a defaulting trustee has died compensation can be claimed from the estate, or if bankrupt, in the bankruptcy
- λ In an action for compensation the trustee's liability is essentially to restore the trust property as it was before the breach. Then the trustee must restore the assets which have been lost or pay compensation for the loss
- λ If specific restitution is not possible then the liability is to pay sufficient compensation to the trust estate to put it back to what it would have been had the breach not been committed
- λ The loss is assessed at the trial with the full benefit of hindsight and compensation is not limited by common law principles of causation, foreseeability or remoteness

Can one trustee be held liable for acts of co-trustee?

- λ Basic principle: if more than one trustee is liable for a breach of trust, a beneficiary can satisfy liability from any one of them, although that trustee may have right of contribution from the others who are also liable
- λ Right to contribution arises principally under Civil Liability (Contributions) Act 1978 and if that does not apply Courts also have (narrow) inherent, equitable jurisdiction to order a contribution

Can one trustee be held liable for acts of co-trustee? (continued)

- λ Trustees are not liable for the acts or defaults of their co-trustees (Townley v Sherborne (1633) Bridg.35)
- λ Supported by Section 30(1) Trustee Act 1925.

“A trustee shall be answerable and accountable for his own acts, receipts, neglects or defaults, and not for those of any other trustee... unless the same happens through his own wilful default”
- λ Section 30(1) repealed by Trustee Act 2000 and replaced it with provisions regulating responsibility for agents, custodians and nominees. But did not reinstate provisions relating to co-trustee. However, removal does not affect historic principle.

Can one trustee be held liable for acts of co-trustee?

But:

- λ Section 47(1) The Trusts Law 2001 (Cayman Islands). A trustee “shall be answerable and accountable only for his own acts, receipts, neglects and defaults, and not for those of any other trustee”. See also Section 22 Bermuda Trustee Act 1975 and Section 36 Bahamas Trust Act 1998
- λ Practical importance of this is limited by fact that trusteeship is a joint office and trustees act jointly. Trustee has burden of proving that he acted properly
- λ If one trustee knows of breach by another and conceals it or takes no active measures to protect beneficiaries, he is liable

Can professional trustees whose employees act as directors of Private Trust Companies be held liable?

When carrying out their duties, their duty is to protect the interests of the company

In considering what are the company's interests directors must consider the interests of the following groups:-

- λ Shareholders – all of them, not just the majority shareholder
- λ Creditors
- λ Employees – not just financial interests of shareholders
- λ Third parties – normally a duty not to mislead, misinform or cause loss

Can professional trustees whose employees act as directors of Private Trust Companies be held liable? (continued)

- λ Historically, the position was that directors do not owe any duty to the beneficiaries of a trust but this principle is no longer absolute.
- λ HR & Others v JAPT & Others (1997) PLR 00

There can be situations where a director can be personally liable to beneficiaries. This is if

- the director purported to act as a trustee rather than a director;
- where he has received trust money and is liable as a constructive trustee;
- when the duties which he owes to the company can be regarded as a trust asset and therefore enforceable by the beneficiaries.

Can professional trustees whose employees act as directors of Private Trust Companies be held liable? (continued)

- λ See also *Cross v Benitrust International (CI) Limited & Others (OFLR)*
- λ Beneficiaries of trust alleged that funds had been lost through imprudent investment. Claimed against directors under Section 70 Trusts (Guernsey) Law 1989 (as amended) for breach of fiduciary duty and in tort
- λ Section 70 applies where breach of trust committed by corporate trustee which is either a trustee of a Guernsey trust or resident in Guernsey, or is carrying on business in Guernsey or from a Guernsey address. Section 70 deems every director of the corporate trustee at the time of the breach a guarantor of the corporate trustee in respect of any damages or costs

Can professional trustees whose employees act as directors of Private Trust Companies be held liable? (continued)

Trust directors argued that Section 70 liability arose only after the trust company had been found liable and that they owed no fiduciary duties to beneficiaries of that trust.

The Court held:-

- λ Section 70 did not mean that proceedings could not be brought against directors until Court had made an award against company
- λ A trust company director does not owe fiduciary duties to beneficiary but he may nevertheless be liable to the beneficiary

Can professional trustees who commit a breach of trust escape liability?

- λ If a beneficiary requested or consented to a particular course of action resulting in a breach of trust, he is prevented from proceeding against the trustee for the consequences of that act.
- λ The beneficiary must:-
 - be of full age and capacity;
 - have the requisite degree of knowledge;
 - not have consented under duress
- λ See also Article 74 Bahamas Trustee Act 1998, Section 53 Bermuda Trustee Act 1975 and Section 68 The Trusts Law 2001 (Cayman) - beneficiary indemnity

Can professional trustees who commit a breach of trust escape liability? (continued)

- λ Consent may be given in advance or after the event has taken place
- λ Mere delay (even up to 12 years) has been held not to disentitle a beneficiary from bringing a claim
- λ There is no statutory limitation where there is fraudulent breach of trust or where the trustee has misappropriated trust property for his own benefit. In other cases, there is a 6 year time limit
- λ It is not necessary that a beneficiary should know that what he is concurring in is a breach of trust provided that he fully understands what he is concurring in. It is not necessary that the beneficiary has to benefit directly
- λ The court will take into account all the circumstances and will conclude whether or not it is fair and equitable that the beneficiary can sue.

Can professional trustees who commit a breach of trust escape liability? (continued)

The courts may absolve the trustee from personal liability for breach of trust where the court is satisfied that

- λ the trustee has acted honestly and reasonably;
- λ the trustee ought fairly to be excused for the breach;
- λ and for omitting to apply for directions prior to committing the breach.

Section 61 Trustee Act 1925 [Similar provisions in Guernsey (Section 50; Section 70(2)); Bahamas (Section 73), Cayman (Section 67) and Bermuda (Section 52)]

Can professional trustees who commit a breach of trust escape liability? (continued)

- λ If a document amending the terms of the trust does not reflect what the trustees intended, the trustees can apply to court for rectification of a document or with the agreement of all the parties to the document where the error is as a result of ignorance or mistake
- λ Rectification may be awarded notwithstanding the fact that its object was to secure tax avoidance and where mistake not purely factual but is instead as to its legal effect

Can professional trustees who commit a breach of trust escape liability? (continued)

Trustees may also be able to apply to court to correct their mistakes under the Hastings Bass principle (Re Hastings Bass [1975] Ch 25.)

“Where by the terms of the trust a trustee is given a discretion as to some matter under which he acts in good faith, the court should not interfere with his action notwithstanding that it does not have the full effect which he intended, unless:-

- λ what he has achieved is unauthorised by the power conferred upon him; or
- λ it is clear he would not have acted as he did:-
 - had he not taken into account considerations which he should not have taken into account; or
 - had he not failed to take into account considerations which he ought to have taken into account.”

Can professional trustees who commit a breach of trust escape liability? (continued)

- λ Principle has been developed and applied in a number of areas
- λ In *Mettoy Pension Trustees v Evans* [1990] 1 WLR 1587 the judge was worried that some limitation had to be placed round the principle. Trustee would not have done what they did had they been aware of the consequences of the action
- λ In *Green V Cobham* [2000] WTLR 1101 the court held void the deed of appointment on to sub-trusts which triggered a substantial tax liability

Can professional trustees who commit a breach of trust escape liability? (continued)

- λ In *Breadner v Granville Grossman* [2001] Ch 523 the court refused to apply the principle in reverse to put in place something the trustees should but did not do
- λ The Revenue are watching these cases with alarm and it is not yet clear what attitude they will take. If they feel that the trustees and the beneficiaries are getting off lightly and there is nothing they can do, then we are likely to face correcting legislation

Liability to Third Parties

- λ Trustees can also be liable to third parties (e.g. by contract or statute)
- λ If they act properly, they have a right of indemnity out of the trust assets but the trust assets must be sufficient and available
- λ The obvious solution is to enter contracts which limit the liability of the trustee to the assets of the trust
- λ The other party will try and impose some restrictions on trustees' ability to deal freely with assets by restricting distributions or investments
- λ The trustee must consider the extent to which it is acceptable to fetter dealings with trust assets. The general rule is that the trustees must not fetter the future exercise of powers but this may be acceptable if there is a specific power in the trust deed or the existence of such a power can be implied

Liability to Third Parties (continued)

- λ Trustees can also be personally liable to meet tax liabilities in respect of trust assets
- λ Those liabilities can arise directly (a direct obligation on the part of the trustee to return and account for tax) or indirectly by way of reimbursement if, say, the settlor is liable
- λ The position of offshore trustees is unclear because of principle of international law that the tax liabilities of one country will not be enforced by another
- λ Quite often there will be provision in trust deed enabling trustees to pay tax liabilities and/or to apply trust property in the interests of beneficiaries. But it is possible to envisage a situation where settlor has right of reimbursement but is not a beneficiary

Liability to Third Parties (continued)

- λ Trustees will be keen to assist settlor but could be criticised
- λ Trustees could apply to court for permission to pay the tax. In the matter of the T Settlement, the Jersey court gave permission for the trust to be varied so the tax could be paid
- λ In *Kleinwort Benson (Guernsey) Trustees Limited v Wilson & Others* (31 December 2002), there were Guernsey trustees but the trust was governed by English law. The court indicated that it could see no defence to a claim by the settlor for reimbursement.

Offshore Jurisdictions

The position in many offshore jurisdictions mirrors that of the UK

Elsewhere liability has been adapted by statute

Offshore Jurisdictions (continued)

- λ See above references
- λ Statutory extensions of liability.
 - Article 70 Trusts (Guernsey) Law 1989 (as amended) re liability of directors of trust companies.
 - See also Article 52 of Trusts (Jersey) Law 1984 (as amended).

Offshore Jurisdictions (continued)

Statutory limitations on exclusions of liability

- λ Article 37(4) Trusts (Guernsey) Law 1989 (as amended)
“Nothing in the terms of the trust shall relieve, release or exonerate a trustee from liability for breach of trust arising from his own fraud or wilful misconduct or gross negligence”.
- λ Article 26(9) of Trusts (Jersey) Law 1984 (as amended)
 - As for Guernsey
- λ Section 50(6) of Belize Trustee Act 1992
 - As for Guernsey save restricted to fraud or wilful misconduct
- λ Article 29(10) of Turks and Caicos Trusts Ordinance 1990
 - As for Guernsey save extended to negligence

Removal of Trustees & Appropriateness of Fee-Charging – Parujan v Atlantic Western Trustee Limited

- λ Required reading for trustees.
- λ Use of mediation: non-binding mediation can still have an impact
- λ 3 examples of improper fee charging: where trust did not exist; where breach of trust alleged; where trustees trying to recover control
- λ Ultimate sanction: trustee removal

How does a professional trustee protect itself?

Pre-Trusteeship

- λ Determine purpose of trust
- λ Ensure trust deed drawn to provide adequate powers to discharge purpose
- λ Abridge duties where appropriate
- λ Incorporate broad exclusion clause
- λ Make sure settlor aware of all these provisions
- λ Consider scope of insurance

How does a professional trustee protect itself? (continued)

During administration

- λ Standards expected of professional trustee

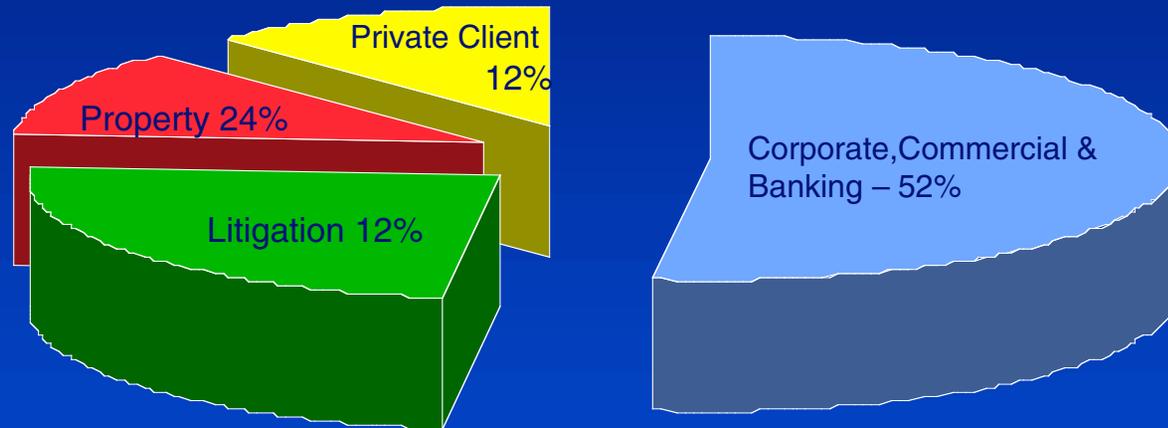
If something goes wrong that falls outside exclusion clause?

- λ Determine whether co-trustee solely responsible
- λ Seek consent of beneficiaries
- λ Consider rectification or application under Hastings-Bass principle
- λ Application to court for relief
- λ Consider mediation/other forms of dispute resolution prior to court

Macfarlanes: Basic Facts

- λ 248 lawyers/other fee earners
 - 63 partners
 - 123 assistants
 - 45 trainees
 - 17 other fee earners
- λ 57th largest in the UK
- λ No 1 for Private Client
- λ Top 20 Corporate
- λ Top 4 Private Equity

Macfarlanes: The Departments



Macfarlanes: Chambers and Partners/ Legal 500

CORPORATE FINANCE: LARGER DEALS London

- 1 Freshfields Bruckhaus Deringer
Linklaters
Slaughter and May
- 2 Allen & Overy
Clifford Chance
Herbert Smith
- 3 Ashurst Morris Crisp
- 4 Lovells
MACFARLANES
Norton Rose
- 5 Simmons & Simmons

CORPORATE FINANCE: MEDIUM DEALS London

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Travers Smith Braithwaite
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Weil, Gotshall & Manges
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TRUSTS & PERSONAL TAX London

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Withers
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Charles Russell
Currey & Co
Lawrence Graham
- 3 Boodle Hatfield
Farrer & Co
Forsters
Speechly Bircham
Taylor Wessing

REAL ESTATE: MEDIUM DEALS London

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Denton Wilde Sapté
Lawrence Graham
MACFARLANES
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Gouldens
Norton Rose
- 3 Forsters
Mayer, Brown, Rowe & Maw
Slaughter and May

COMMERCIAL FIRMS 1-10

ALLEN & OVERY
CLIFFORD CHANCE LLP
FRESHFIELDS BRUCKHAUS
DERINGER
LINKLATERS
SLAUGHTER & MAY

HERBERT SMITH

LOVELLS

ASHURST MORRIS CRISP

NORTON ROSE

MACFARLANES

PRIVATE EQUITY: BUYOUTS & INVESTMENT London

- 1 Ashurst Morris Crisp
Clifford Chance
- 2 Allen & Overy
MACFARLANES
- 3 Dickson Minto WS
Lovells
Travers Smith Braithwaite
- 4 Freshfields Bruckhaus Deringer
- 5 CMS Cameron McKenna
Olswang
SJ Berwin
- 6 Nabarro Nathanson

UK COMMERCIAL OVERVIEW

The four departments at Macfarlanes – corporate, litigation, property and private client – are consistently ranked among the leaders in their fields. The quality of lawyer at the firm is superb, due to its high standards of recruitment and training.

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Macfarlanes: In the Press

LEGAL BUSINESS AWARDS 2002

LAW FIRM OF THE YEAR

Honourable mentions

Macfarlanes: Robert Sutton and Paul Phippen

If you are looking for a firm that consistently beats clients' expectations, you will not find a better candidate than Macfarlanes. The firm's relatively small but cohesive partnership means that it is better positioned than some of the larger firms to ensure quality control. In a year when some mid-sized firms were flailing, Macfarlanes worked on headline deals for a string of high-profile corporate and property clients.

Legal Week

Macfarlanes completes Anglian deal for Alchemy

Macfarlanes has closed a major deal for key client Alchemy in one of the few large domestic private equity-backed deals to hit the market this year.

SUNDAY BUSINESS

LAWYER M&A LEAGUE TABLES

January to March

House	Value	No of deals
1 Slaughter & May	£63.4bn	27
2 Linklaters	£58.9bn	46
3 Freshfields	£53.1bn	43
4 Clifford Chance	£50.3bn	46
5 Skadden Arps	£26bn	10
6 Shearman	£23.2bn	8
7 Cleary Gottlieb	£21.2bn	4
8 Macfarlanes	£20.1bn	6
9 Ashursts	£18.1bn	23
10 Allen & Overy	£14.5bn	28

Legal Week

Macfarlanes advises 3i on £100m Go purchase

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