Response of the Chancery Bar Association

To the Trust Law Committee's questions regarding the possible limitation of liability of trustees

1. This response has been prepared on behalf of the Chancery Bar Association by a working group comprising Nicholas Le Poidevin QC, Andrew Twigger QC, Kathryn Purkis, Nicole Langlois, Richard Dew and Thomas Fletcher. It has also been approved by the main Committee of the Association.

Q1 Does your body, or a significant section of its members, consider that the ordinary "default rule" of English law – that where a trustee enters into a transaction in his capacity as trustee with a third party ("TP"), the trustee is usually liable in his personal capacity – gives rise, in practice, to problems for your members or others?

2. So far as we are aware, the ordinary "default rule" of English law, to the effect that a trustee is usually personally liable to a third party with whom he enters into a transaction in his capacity as trustee, does not, in practice, give rise to any problems for our members or others involved with the administration of trusts in England and Wales.

3. None of the working group who prepared this response were able to think of any examples from their own practices in which the "default rule" had given rise to controversy or unfairness which would have been cured or ameliorated by the introduction of trust legislation to replace the "default rule".

4. It is of course acknowledged that those involved in the administration of trusts in jurisdictions with a more extensive trust industry than England and Wales may be aware of examples where the "default rule" has operated in a seemingly unfair way. That is arguably reinforced by the fact that the two recent examples where the effect of the "default rule" has been considered, namely the Z Trusts litigation and Investec, both originated from the Channel Islands.

5. Notwithstanding this, we believe it is rare to find examples of contracts containing terms by which trustees have expressly sought to limit their personal liability, which might suggest

that there is no general perception amongst trustees that they might be exposed to undue risk. Further, the facts of Investec were somewhat unique and we suspect that it is unusual for trustees in this jurisdiction (or other jurisdictions) personally to be "trading" in a way which involves them in incurring significant liabilities in their personal capacity. It is of course not uncommon for trading activities to be carried out as part of a trust structure. However, when such trading does occur, it is, in our experience, generally conducted through a corporate vehicle, thereby eliminating (or at least minimising) the risk of personal liability.

6. The working group also consider it significant that not all jurisdictions with an extensive and developed trusts industry have considered it appropriate or desirable to enact provisions equivalent to those in the Channel Islands which were considered by the Privy Council in the Investec case (e.g Bermuda and the Cayman Islands). Legislation of this character would currently seem to be the exception rather than the norm in such jurisdictions, although it is acknowledged that legislation with the same purpose has been introduced in the BVI and the Turks and Caicos Islands.[1] Indeed, the rationale for introducing such provisions in Jersey and Guernsey is unclear to us. It is not obvious that limitations of this kind on the liability of trustees necessarily attracts more business to a jurisdiction (which, in any case, could not sensibly be a reason for introducing such limitations in England).

7. It is possible to imagine some limited circumstances in which the "default rule" may operate harshly. That would most clearly arise in the case of an unincorporated association such as a club, where one or two private individuals sign a lease or mortgage of premises to be used for the purposes of the club, as happened in Marston Thompson & Evershed Plc v Benn [1998] C.L.Y. 4875. Those individuals will be acting by virtue of their status as members of the club but will be assuming obligations under the terms of that lease or mortgage in their personal capacity. In those circumstances, it might be thought harsh for those individuals, who have not charged for their services and may not have received legal advice, to incur personal liability to the landlord if, for example, subscriptions to the club cease to be

[1] Trustee Ordinance, ss. 94 – 104 (BVI); Turks & Caicos Trusts Ordinance 2016, s.36 (TCI). The working group is not aware of any authorities considering any part of those provisions.

sufficient to cover the cost. In practice, however, we have no personal experience of any examples where such difficulties have arisen. It arguably may be inferred from this that those who sign a lease or other commitment in such circumstances have some awareness of the risks and take appropriate steps to ensure that they are adequately protected, for example by ensuring in advance that there is an appropriate flow of liquid funds to satisfy ongoing liabilities and/or ensuring (in the case of a lease) that there is an appropriate break clause. If that is the case then, although the theoretical risk of unfairness may exist, it seems rather unlikely that there would be any significant unfairness in reality.

Q2 **If so, could you provide examples of such problems that arise in practice as a result of the "default rule"?**

8. Not applicable

Q3 **If your body, or a significant section of its members, consider that the "default rule" does not in practice cause problems for them, could you please explain why this is thought to be so.**

9. See Q1 above.

Q4 **Does your body, or a significant section of its members, support or oppose the introduction of new statutory default rules, broadly along the lines found in the trust legislation of the Channel Islands which were examined in *Investec v Glenalla*, to replace the English "default rule" on a trustee's personal liability?**

10. For the reasons given above, we do not believe that new statutory default rules are required in England, in particular if drafted along the lines found in the trust legislation of the Channel Islands. We reach that view in light of our observations above on the absence of difficulties in practice with the "default rule" in England and Wales.

11. We are encouraged in that conclusion by the difficulties which the trust legislation of the Channel Islands has posed to date, as reflected in the Investec case itself and the Z Trusts legislation. One of the principal difficulties with such legislation is achieving the objective

of protecting trustees while balancing the competing rights of creditors and beneficiaries. It is relevant to note in this regard that the legislation of the Channel Islands has been interpreted as, in effect, protecting trustees at the expense of creditors. This is apparent from the Privy Council's observation in the Investec case that creditors may be able to protect themselves in various ways (at [102]) and the Court of Appeal of Jersey's view in Z Trusts that the purpose of that legislation is to give the trustee an advantage over its creditors (at [233]). The introduction of legislation drafted along the same lines in England and Wales would inevitably start from the same premise and this appears to us to give rise to serious problems, as well as potentially raising policy considerations.

12. In particular, the Privy Council's interpretation of the Jersey legislation potentially leaves the creditor's right of recovery dependent on the state of account between the trustee and the beneficiaries. A creditor might be aware that he is contracting with a trustee but, unless legally advised, he might not appreciate that the trustee's liability is limited at all, let alone that the extent of the trustee's liability might depend on claims by the beneficiaries of which the creditor has no knowledge, and no means of finding out. The position may be even worse for a foreign creditor, who may not realise that the trustee's liability is governed by the law of the trust, rather than that of the contract.

13. Nor would it assist, in our view, to introduce a variant of the Channel Islands' legislation permitting a direct claim by the creditor against the trust assets. We are aware that the view of the Chancery Bar Association in 1997/8 was that fundamental reform of that kind could bring the law into line with the reasonable expectations of parties dealing with trustees and of trustees themselves.[2] This seems, however, to have been envisaged as part of a wider package of reforms, which assumed that the default position would be that the trustee would remain personally liable, unless expressly contracting "as trustee". We are less convinced than our predecessors in 1997/8 that the expectations of non-lawyers in such situations are so clear (and are not sure whether there was any evidence to support their

[2] As recorded in the Trust Law Committee Report on Rights of Creditors against Trustees and Trust Funds produced in 1998.

view). In any event, we are not in favour of reform in which the *default* position is that the trustee's personal liability is limited, but which also gives a creditor a direct claim against the trust assets. This proposal still leaves a creditor with potential uncertainty (or else requires the creditor to conduct detailed due diligence) but also swings the balance significantly against the interests of the beneficiaries, if the trustee has acted in breach of trust but turns out to be insolvent. This seems to us to be replacing a theoretical unfairness towards trustees with a real unfairness towards beneficiaries.

14. Moreover, although the Investec decision concerned liability for debts, the legislation potentially also applies to other liabilities through the reference to the legislation applying to any "*matter or transaction*". Those words are wide enough in principle to embrace all other species of contractual liability (e.g. for breach of warranty), liability for misrepresentation or liability for tort. It is, at the very least, debatable whether trustees ought to be able to escape personal liability for those kinds of claim, which potentially involve the creditor relying on the trustee as an individual. There is nothing obviously fair in relieving trustees of personal liability for, say, warranties on a share sale, when the trustees have the opportunity to check their accuracy and the buyer does not. The width of the words in the legislation may also create perverse outcomes, as demonstrated in the Investec case itself where it was originally held by the Court of Appeal of Guernsey (albeit subsequently overturned by the Privy Council) that the Jersey legislation could apply to limit a trustee's liability for adverse costs orders.

15. The Channel Islands' legislation also leaves uncertain the time at which the extent of the trust property is to be assessed for the purpose of determining the scope of the trustee's liability. If the liability is assessed at the time the creditor enters into the relevant transaction, is the trustee justified in refusing to distribute any trust property thereafter? What if events outside the trustee's control mean the trust fund is considerably depleted by the time the claim is decided? But if the liability is assessed at the time the creditor demands payment, or when the claim is determined, how can the creditor assess the risk of non-payment at the time of the transaction? Could the trustee distribute all the trust property as

soon as he becomes aware that a claim could be made, and thereby avoid liability?[3] How would the liability of a former trustee be affected if he parted with the trust fund when it was adequate to meet any prospective liability (and who, under English law, appears to have no right to make a retention on ceasing to hold office) and it became inadequate only under the management of the new trustee?

16. For all these reasons, if a new statutory default rule were to be introduced, it would need to be significantly more sophisticated than the existing Channel Islands' legislation. If a new statutory default rule were to be considered at all then it seems to us that a vastly better model is to be found in the relevant BVI legislation, which is contained at ss. 94 – 104 of the Trustee Ordinance. It is particularly notable that the BVI legislation addresses some of the difficulties mentioned above concerning the scope of the protection for the trustee. For example, s. 99 of the Trustee Ordinance specifically provides that, in the case of tortious liability, a trustee will be personally liable for torts committed in the course of administering a trust, or for obligations arising from ownership or control of trust property, if the trustee is personally at fault.

Q5 **If your body, or a significant section of its members, support new statutory rules to replace the "default rule", please state the reasons why?**

17. Not applicable.

Q6 **If your body, or a significant section of its members, support new statutory rules to replace the "default rule", please indicate the principles or terms of such new statutory rules they would favour.**

18. This question does not technically arise. However, although we are not encouraging the introduction of any new statutory default rule, we consider that it might be possible to create a limited and flexible escape valve, if there is evidence that non-professional trustees

[3] Legislative provisions designed to reverse or mitigate the effect of steps taken by the trustee after the transaction with the creditor which have the effect of reducing the trust estate seem to us likely to involve a level of complexity and potential for injustice which are undesirable.

do incur personal liabilities in circumstances which seem unfair (such as in the above example of private individuals signing a lease of premises used by a club).

19. In circumstances where a creditor (a) knows that it is contracting with a trustee and (b) the trustee is neither being remunerated nor acting as trustee in the course of a business, the Court could be given a discretion (along the lines of the discretion under section 61 of the Trustee Act 1925) to relieve the trustee wholly or partially from liability. This would enable a fair outcome to be achieved in the light of the knowledge (including any legal advice) and appetite for risk of the parties, without affecting the position in relation to professionals who ought to be able to protect themselves.