Trustee Exemption Clauses - a new rule of practice in England

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Introduction

1 In January 2003, the Law Commission of England and Wales published a consultation paper on trustee exemption clauses which sparked much debate and thought on whether and how trustee exemption clauses should be reformed.1 Three years on, in a report published in July 2006, the Law Commission has set out the results of its consultation on the 2003 paper and its recommendations.2

2 The Commission recommends that a paid trustee who causes a settlor to include a clause in the trust instrument which has the effect of excluding or limiting the trustee’s liability for negligence must take reasonable steps to ensure that the settlor is aware of the meaning and effect of the clause. However, this is to be a rule of practice only. This article will discuss the recommendations of the Commission as set out in the Consultation Paper and consider whether such recommendations will affect Jersey trustees.

Background

3 Trustees are bound by the duties and obligations that are set out in the trust instrument or are imposed by law. Failure to carry out any such duties and obligations will constitute a breach of trust by the trustee, and the beneficiaries of the trust will have a right to recover any loss caused by the breach from the trustee (among other potential remedies). It is common for settlors (or their advisers) to include express provisions in trust instruments protecting trustees from liability in respect of acts or omissions that would normally be regarded as being in breach of trust. These provisions are usually referred to in the trust industry as “trustee exemption clauses”.

4 It is well settled law in England and Wales that trustee exemption clauses can validly exempt trustees from liability for breaches of trust except those involving the trustee’s own fraud. In the leading English case of Armitage v Nurse,4 the Court of Appeal held that a trustee exemption clause which exempts a trustee from liability for all acts, omissions or breaches of trust except where the trustee has committed actual fraud is valid.5 Therefore,

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2 The Law Commission, Trustee Exemption Clauses, Law Com 301 (July 2006) (hereafter referred to as the “Consultation Paper”).
3 The Commission has limited the focus of its rule to exclusion of liability for “negligence” and not other breaches of trust for which liability can be legitimately excluded because it is of the view that negligence is the most common cause of loss to trust funds and that there is presently an expansion of professional liability for negligence.
5 This principle has recently been applied in the case of Barraclough v Mell [2005] EWHC 3387 (Ch), [2006] WTLR 203.
in the case of a widely drawn exemption clause, it is possible in England and Wales for a
trustee to be exonerated of liability even if he/she has failed to take reasonable care or
has been guilty of gross negligence, or even wilful default short of fraud.\(^6\)

5  Given that there is arguably a trend to broaden the scope of exemption clauses, and
a less restrictive judicial approach to their construction, in England the Law Commission
was of the view that the protection offered to beneficiaries is weaker than in the past.\(^7\)

The 2003 Report

6  The Law Commission expressed the view in the 2003 Report that reform in this area
is crucial, as the current law is too kind to trustees - in particular professional trustees who
hold themselves out as having special knowledge skills and experience, charge for the
services they provide and can insure themselves against liability for breach of trust.\(^8\)
However, on the other hand, the Commission did not favour any proposal which required
excessive regulation because of the importance of preserving a settlor’s autonomy to
negotiate the terms of the trust deed (including the exemption clause) with the trustee.
Further, over regulation could deter lay trustees from assuming the responsibility of
trusteeship in the first place.

Recommendations in the Consultation Paper

7  The Commission recommends that a “practice-based approach”, rather than
legislation, is the better means to bring about reform of the conduct of trustees. The
Commission has created a bespoke rule of practice, which the Commission suggests
should be incorporated into the regulatory framework of all the professional and regulatory
bodies that are involved in creating trusts. Non-compliance with the rule will not render
the exemption clause invalid, but the trustee will risk sanction in accordance with the
disciplinary procedures of the professional body in question.\(^9\)

8  This somewhat light-handed approach, as compared with the approach of some
jurisdictions such as Jersey and Guernsey (see below), ensures that settlor autonomy as
to the inclusion or the terms of exemption clauses is preserved. Statutory prohibition of
reliance on exemption clauses restricts the ability of settlors to determine the terms on
which assets are settled on trust and in turn may limit the flexibility of the trust. However,
it might be expected that if the rule of practice is not adopted voluntarily on a widespread
basis, statutory regulation may follow.

Rule of Practice

9  The rule of practice recommended by the Commission is as follows -

\(^6\) The laws of Jersey and Guernsey are different on this point, see later in this paper.
\(^7\) 2003 Report p 6.
\(^8\) Ibid, p viii.
\(^9\) Consultation Paper p 14.
“Any paid trustee which causes a settlor to include a clause in a trust instrument which has the effect of excluding or limiting liability for negligence must before the creation of the trust take such steps as are reasonable to ensure that the settlor is aware of the meaning and effect of the clause”.  

10 The effect of this rule of practice is that a burden is placed on a paid trustee to disclose to the settlor any exemption clause in the trust instrument which has the effect of excluding or limiting the trustee’s liability for negligence. This practice is likely to minimise the risk that a settlor will execute a trust instrument containing such exemption clause without any appreciation of the effect or existence of that clause. It is certainly not unusual in current practice for exemption clauses to be buried in the “boiler plate” provisions of a trust instrument or for them to be drafted in complex language so as to make them difficult for a lay settlor to understand.

11 The rule of practice can be analysed in two parts. First, the application of the rule is triggered where a paid trustee has caused a settlor to include a clause in a trust instrument which has the effect of excluding or limiting liability for the trustee’s negligence. The Commission intends that a trustee will “cause” an exemption clause to be included in a trust instrument in three situations: (i) where the prospective trustee has drafted the trust instrument in its capacity as the settlor’s adviser; (ii) where the prospective trustee provided the settlor with a standard form trust instrument; or (iii) where the prospective trustee has requested or required an exemption clause during the course of negotiations over its proposed trusteeship.

12 It is interesting to note that the Commission intends the rule of practice to apply to “paid” trustees as opposed to professional trustees (which was the Commission’s original proposal). The Commission states that in assessing whether a trustee is being “paid”, any indirect financial benefits must be taken into account.

13 The rule is also applicable where the exemption clause appears in testamentary trusts, in which case “settlers” should be read as including “testators” where appropriate. The rule applies equally to trustees of charitable trusts in relation to the original settlor of the charitable trust. The Commission observes that it would be impractical to apply the rule in respect of every subsequent donor to a charity, even though each donor could be argued to be a settlor of the trust. The rule of practice will not apply to commercial trusts in defined circumstances.

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10 Ibid p 73.
11 Ibid p 74.
12 Ibid p 74.
13 Ibid p 74.
14 Ibid p 77.
15 The Law Commission confirms that the rule of practice will not apply to the trustee of a commercial trust in two circumstances: (i) where the trustee is already subject of statutory regulation of trustee exemption provisions so that the exemption clause is rendered void by statute; and (ii) where the settlor acts in the course of business. The Law Commission further confirms that the rule of practice will not apply the context of pension trusts as pension trusts are already subject to the pensions regulator created by the Pensions Act 2004. (Consultation Paper, p 75-76.)
Once a paid trustee is of the view that the first part of the rule of practice is met so as to trigger the application of the rule, the trustee must take such steps as are reasonable to ensure that the settlor is aware of the meaning and effect of the clause. The Commission has helpfully explained in its report that “such steps as are reasonable” is a fluid requirement as it is intended that trustees should only be required to act so far as is practicable. In some circumstances, it may be reasonable for the trustees not to take any steps at all, in which case, they should not be sanctioned for failure to act. Such circumstances include where the settlor is independently advised.

Where the trustee takes the view that it should act, the Commission suggests that the trustee should bring the existence of the exemption clause to the attention of the settlor either by providing written advice to that effect or by discussing it with the settlor in person or on the telephone. For evidentiary reasons, the Commission discourages discussions in person or on the telephone. In addition, the trustee must consider the likely experience of the settlor with the use of trusts and must attempt to convey the meaning and legal effect of the relevant clause to the settlor. This step does not require the trustee to assess the settlor’s capacity to understand the meaning and effect of the exemption clause. The Commission is of the view that provided “that trustees have acted reasonably they will have satisfied the rule”.

It is intended that any person who is a member of a regulated body should take reasonable steps to procure any company or partnership in which they have an interest to comply with the rule. However, the rule is not intended to capture the trustees of any existing trusts.

Implications for Jersey trustees

Although the Commission’s proposal is currently intended to apply in England and Wales, there is food for thought as to whether the professional bodies in Jersey, in particular multi-jurisdictional bodies such as the Society of Trust and Estate Practitioners (STEP), should adopt a similar rule. There is a good argument that the terms of article 30(10) of the Trusts (Jersey) Law 1984, as amended, mean that there is less need for similar proposals to be introduced in Jersey. The same argument can be made in Guernsey as the Trusts (Guernsey) Law 1989 was amended in 1990 so as to be brought into line with Jersey.

Article 30(10) of the Trusts (Jersey) Law 1984 (which is similar to the Guernsey provision) provides that “nothing in the terms of a trust shall relieve, release or exonerate a trustee from liability for breach of trust arising from the trustee’s own fraud, wilful conduct or gross negligence”. A trustee exemption clause which attempts to do so will be invalid to the extent that it infringes this provision - the statutes in Jersey and Guernsey do not allow...
settlors or trustees to contract out of the statutory provisions by providing contrary terms in
the trust instrument.

19 However, it is submitted that, in order to encourage good practice, it may be
desirable for professional bodies in Jersey to adopt a similar rule of practice to that
proposed by the English Law Commission. Persuasive arguments can be made that
trustee exemption clauses, which still, as many do, exclude liability for negligence, should
not be hidden in the boiler plate provisions of a trust instrument, taking a settlor by
surprise when a trustee relies on such a clause to be exonerated from personal liability for
a breach of trust. The adoption of a rule of practice in the form discussed above would
address this issue.

20 Jersey and Guernsey trustees and trust practitioners should be careful where they
are members of an organisation in England and Wales that has adopted the rule of
practice. In such case, the trustee/practitioner may be obliged to comply with the rule and
to ensure that any company or partnership in which he/she has an interest complies with
the rule, even though he/she is practising in Jersey or Guernsey and the trust in which
he/she is trustee is involved is governed by Jersey or Guernsey law.

21 The England and Wales region of STEP has approved a rule similar to that
recommended by the Commission, which will only apply to instruments governed by the
law of England and Wales. It will be interesting to see whether the other professional
bodies impose a similar geographical limitation on the rule of practice they choose to
adopt.

Conclusion

22 The rule of practice recommended by the English Law Commission addresses the
issue that settlors of private trusts may not be aware of the existence of trustee exemption
clauses in the trust instruments executed by them, or of the extent to which trustee liability
is exonerated under such clauses. Although the Commission is only recommending the
rule of practice for professional bodies that are based in England and Wales, there may be
unexpected implications for Jersey and Guernsey trustees and trust practitioners. Jersey
and Guernsey trustees and practitioners who are members of professional bodies that
have adopted or are intending to adopt a rule of practice as recommended by the
Commission should ensure that they are aware of what the rule requires of them (if
anything), so that they do not expose themselves to disciplinary sanctions from those
professional bodies.

20 Consultation Paper, Appendix G, p 119.
The Jersey and Guernsey statutes offer much better protection for settlor and beneficiaries than English current law – preventing exclusion of liability for fraud, wilful default and gross negligence. Both Jersey and Guernsey law trust instruments still routinely exclude liability for simple negligence and it must be asked whether this is appropriate in the context of a professional paid trustee who has not explained the consequence of this exemption clause to the settlor, particularly in light of the new English practice described in this article.

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