The Chancery approach to trustee liability

Received: 29th June, 1999

The Hon. Mr Justice Lightman

was called to the Bar in 1963 and appointed as Queen's Counsel in 1980. In 1994 he was appointed Judge to the Chancery Division of the High Court.

Abstract The paper is concerned with the role of and need for exoneration clauses, the permissible scope of such clauses and the approach to them by the Court.

Keywords: *trustee liability; exoneration clauses; their permissible scope*

Introduction

A distinguished English author in a leading work on pensions quoted as an object lesson to pension trustees a newspaper report of the case of one pension trustee who fell out with his beneficiaries. The report read as follows:

'The body of Al Bramlet, the leading trustee of the troubled union pension here [in Las Vegas] was found in the desert 40 miles southwest of Las Vegas on March 17. He had mysteriously disappeared [on] February 24. Mr Bramlet, 59, had been chairman of the board of trustees for the \$43 million Southern Nevada . . . Bartenders' Pension Trust . . .

The reason for his murder is not completely clear, but at the time of his disappearance Mr Bramlet had been quarrelling with the Mafia about using pension fund money to set up a clinic-pharmacy for union members, according to an investigator . . . The Mafia and Mr Bramlet would skim off the profit from the clinic and split it . . . Mr Bramlet was reportedly unsatisfied with his share.'

It may perhaps be implied that the Mafia were also not entirely happy with their share. In the UK, we do not have the

Mafia — Mr Maxwell's case is an example of a successful looting of £450m from the *Daily Mirror* pension funds by more conventional means. But perhaps a no less frightening sanction than the Mafia exists here in case of dissatisfied beneficiaries — in the form of an investigation by the Pensions Ombudsman. Facing this threat and perhaps the lesser threat of the scrutiny of the Court, pension trustees may be pardoned for seeking 'protektisia' — even if it is only in the form of an exoneration clause in the Pension Trust Deed.

Kinds of trusteeship

The office of trustee is onerous; the duties are numerous. As long ago as 1747, Lord Hardwicke¹ said:

'It is an act of great kindness in anyone to accept it.'

(Anyone, if this includes Mr Maxwell, may be an exaggeration.) Equity places a blanket prohibition (unless the trust instrument otherwise provides) on a trustee placing himself in a position where his personal interest and his duty

The Hon. Mr Justice Lightman
(Royal Courts of Justice,
Strand, London WC2A 2LL.
Tel: 0171 936 6671; fax:
0171 936 6291)

to his beneficiaries are in conflict; but his greatest predicament, his recurrent (if not principal) duty, is the resolution of conflicting duties to the beneficiaries, or conflicting duties to different beneficiaries or classes of beneficiaries. A trustee can rarely satisfy every beneficiary, and often can satisfy none. In performing his duties a trustee may inadvertently commit a breach of duty but the single fact that he acted in good faith is no defence. As Staughton LJ said in *Nestlé v National Westminster Bank plc*:²

‘Trustees are not allowed to make mistakes in law; they should take legal advice and if they are still left in doubt they can apply to the Court for a ruling.’

(Thankfully there is more leeway to those giving legal advice and to the Judges.) There are occasions where the commission of an advertent (but technical) breach of trust may be in the best interests of all the beneficiaries but (subject to one qualification) that is no reason in law why he should not be held liable for all the consequences of the breach. The one qualification is that a trustee will not be held liable for an unauthorised act if it is one that the Court would have authorised.

Accordingly, even the most honest and conscientious of trustees may be faced with an action for breach of trust. It only takes one disgruntled beneficiary, often with nothing to lose because legally aided or without means (most dangerously often a disgruntled beneficiary acting in person), and the trustee can be exposed to ever expanding and increasingly expensive litigation. His reputation and his pocket are in jeopardy.

Lord Hardwicke in the passage quoted had in mind a voluntary and gratuitous trusteeship where trusteeship was accepted because of the personal relationship between trustee and

beneficiaries (often out of a sense of duty). Because it was such an act of kindness (if not folly) to accept such a trusteeship, the Courts inclined to be less demanding in the duties imposed and generally to be tender to the trustee when things went amiss. Jessel MR in *Re Speight* spoke of the need to lean to the side of the honest trustee who is not paid for the performance of an unthankful office. The Courts gave the greatest leeway to settlors to make provision in the Trust Deed for protecting trustees from claims. Sargant LJ in *City Equitable*⁴ explained the reason for the Court’s approach to such exoneration clauses:

‘It might as well be said that a clause of this kind in trust deeds should be inoperative because it would tend to induce trustees to be negligent of the interest of their *cestui que trust*. The truth is that such restrictions on liability may, and I think often do, operate to protect rather than harm beneficiaries because they prevent honest and responsible persons from being frightened away from accepting an office which might otherwise involve them in various unmerited and unexpected losses notwithstanding perfect honesty on their part.’

In those idyllic times the expectations of beneficiaries were limited and the beneficiaries were respectful to and slow to launch attacks on the trustees. In *Nestlé v National Westminster Bank*⁵ Leggatt, LJ noted this and the recent change in expectations and attitude:

‘When trusts came into their own in Victorian times, they were no doubt intended to preserve capital while assuring beneficiaries of a steady, if conservative, income. Little was demanded of a trustee beyond the safeguarding of the trust fund by refraining from improvident investment. This process was no doubt also intended to save beneficiaries from trouble and anxiety, or

what is now called “hassle”. But during the 64 years for which the trust set up by the appellant’s grandfather endured, the contentment of the beneficiaries declined. The appellant’s uncle and father conducted with the [trustee] vigorous campaigns to improve their respective incomes, which, had the [trustee] not resisted them, would have worked to the ultimate detriment of the appellant, while the appellant herself is now locked in mortal financial combat with the [trustee].’

Since the time of Lord Hardwicke, the need has arisen for the appointment of trustees who have no such personal relationship with the beneficiaries or sense of their duty to accept the trusteeship, but who offer their services as trustee in return for a fee. Many institutions (including many pension funds) are today dependent on the availability of such services. These trustees are more exposed to complaints by disgruntled beneficiaries, for there is no personal relationship between trustees and beneficiaries and the bond is purely commercial. The legislature and the Courts have demonstrated a somewhat different attitude to claims against such professional trustees. As the Court of Appeal of Jersey said in *Midland Bank Trustee (Jersey) Ltd v Federated Pension Services Ltd*,⁶ the considerations referred to by Sargant, LJ do not apply to paid professional trustee companies or indeed other paid professional trustees. The principle stated by Brightman J in *Barlett v Barclays Bank*⁷ is applicable: a higher duty of care is to be expected of someone holding himself or itself as being above ordinary mortals and providing an expert service.

Exoneration clauses

There are two distinct categories:

— clauses which extinguish or limit the

duties or otherwise prevent them from arising and accordingly being assumed by the trustees. In respect of these clauses the question to be considered is how much leeway as a matter of trust law is there given to a settlor to limit the duties imposed on the trustees and thereby limit to breaches of those duties the occasions when liability can arise;

— clauses which exempt the trustees from the consequences of breach of a duty assumed by them. In respect of these clauses the question likewise to be considered is how far the law allows a settlor to exonerate trustees from liability for breach of a duty which they have assumed.

Views have been expressed until very recently that public policy precludes any far-reaching protection of trustees from liability in either of these ways and that trustees should as a matter of policy be required to find their protection in insurance. These views are no longer tenable.

Clauses which limit the duties of trustees

The general principle was stated as long ago as 1861 by Lord Westbury in *Wilkins v Hogg*:⁸

‘A testator could define the duty of his trustees and point out the extent of their liability, and the Court could not extend that responsibility.’

This proposition has been reaffirmed by the Court of Appeal in *Armitage v Nurse*.⁹ Clauses may exclude any duties on the part of trustees so long as the exclusion is compatible with the subsistence of a valid trust. The test of compatibility is that the surviving duties of the trustees are sufficient to impose a

trusteeship on the trustees; and for this purpose there must at all times exist the duty enforceable by the beneficiaries to act honestly and in good faith for the benefit of the specified beneficiaries. A freedom to act dishonestly or in bad faith or for the benefit of others is incompatible with the existence of a trust, as is a provision that only the settlor or the employers (but not the beneficiaries) can sue the trustee for breach, see *Jones v Shipping Federation of British Columbia*.¹⁰ In the absence of the core duty, there is no clear defining line between trusteeship and beneficial ownership; and any provision which purports to encroach on the core duty either negates the existence of the apparent trust or should be struck out as repugnant to the intended trust.

Clauses which exonerate trustees

Next are considered clauses which exonerate trustees from liability for breach of duties which they have assumed. The same test is, in the author's view, applicable. A trust deed may make any provision limiting liability for breach which the settlor chooses, so long as the duty to act in good faith for the benefit of the beneficiaries remains enforceable by the beneficiaries and the trustees are not exempt from liability for breach of this core duty.

Abrogation of liability for this breach (like abrogation of any duty to act in good faith for the benefit of the beneficiaries) eliminates a necessary condition for the existence of a trust, and again a clause to this effect either negates the apparent trust or must be struck out as repugnant to the intended trust.

Role of exoneration clauses

The exoneration clause has a triple role; in inverse order of importance:

- (1) it provides a defence at trial in proceedings for breach of duty
- (2) in many cases it enables an application to be made to halt the litigation prior to trial, often at the inception of the action
- (3) most frequently of all, it precludes or reduces the number of challenges to the trustees and the number of challenges which ever get to Court.

It is to be borne in mind that the threat of litigation, the cloud which litigation places overhanging the trustees' head, the adverse publicity which such litigation engenders, are all matters of the highest legitimate concern to trustees. It is often little consolation that at the end of a trial they may be entitled to a judgment for costs; these cannot compensate for the damage done and in any event may be unenforceable or unsatisfied.

Construction of exoneration clauses

There has been considerable litigation over the construction of variously formulated exoneration clauses. The overriding principle is that, as the settlor is free to determine the width of the exoneration so long as it does not impinge on the core trust obligation, the Court should seek to give effect to the words used (so long as the meaning is clear and no ambiguity exists) with no presumption either way. The only gloss is that if there is a genuine ambiguity, the Court will strictly construe the clause and resolve that ambiguity to give it the narrower (rather than the wider) application. For example in *Re Smith*,¹¹ the exoneration clause exonerated the trustee from liability in respect of acts done which he 'shall think fit'; the words 'shall think fit' were held to

mean 'shall honestly think fit'. It was inconceivable that it could have been intended to relieve the trustee in case of dishonesty; indeed this would have been legally impossible.

It is worth mentioning clauses exonerating save in case of wilful default. The meaning of wilful default (in this context at any rate) one would have thought was clear:

'An act or an omission to do an act, is wilful when the person of whom we are speaking knows what he is doing and intends to do what he is doing';

and equally clearly one would have thought that a trustee is guilty of wilful default if (and only if):

'he knows that he is committing, and intends to commit, a breach of his duty or is recklessly careless in the sense of not caring whether his act or omission is or is not a breach of his duty';¹²

The classic example of applications of this principle is to be found in cases when one trustee is sought to be held liable for fraudulent misappropriation of the proceeds of sale of trust property by a fellow trustee, usually (for reasons which it is unnecessary to explore) a solicitor. Knowledge that the fellow trustee is a dilatory and incompetent muddler does not occasion liability if there is no knowledge that the co-trustee is dishonest. Yet the Jersey Court of Appeal in the *Jersey* case took the view that a wilful default does not require knowledge that an act deliberately done is a default, and held that accordingly a clause exonerating save in case of wilful default, while it will protect against liability for negligence, will not protect against liability for gross negligence. This decision was indefensible and no doubt it was for this good reason that on the

hearing of the appeal to the Privy Council the disgruntled beneficiary who succeeded before the Court of Appeal agreed to a compromise. The decision cannot stand with *Armitage v Nurse* where (at p. 254) the Court reaffirmed that English lawyers have always had a healthy disrespect for the distinction between negligence and gross negligence, despite a continuing unhealthy preoccupation with it, eg, in Jersey and Guernsey.

Indemnity clauses

Distinct from exoneration clauses, but closely analogous to them, are indemnity clauses which supplement the implied right of trustees to an indemnity from the trustee fund in respect of liabilities properly incurred as trustees. The indemnity may extend to costs or liabilities incurred by reason of an allegation of a breach of duty or indeed by reason of a found breach. The settlor is free to include such a provision in any terms which he chooses, save only that no such provision can impinge on the core obligation and that it is not prohibited by legislation.

Legislation

It is useful to say a few words on the part played by statute in this area of law and in particular the ambit of provisions which may preclude or limit the application of exoneration clauses.

The Unfair Contract Terms Act 1977

Lord Goodhart QC¹³ argues that exoneration clauses which give trustees a wider protection than is available under the Trustees Act 1925 s.30 may infringe the Unfair Contract Terms Act 1977. This argument turns on whether the

exemption is to be regarded as contractual. The Jersey Court of Appeal in the *Jersey* case at para 226(2) stated that the application of the Act to exculpatory clauses was 'arguable'. Though the language used and authorities cited on construction when exoneration clauses are under consideration are often contractual, there is no contract. There is only a unilateral decision by the settlor as to the terms of his settlement and a unilateral decision by the trustees whether to accept the office of trustee. Since there is no contract, the 1977 Act is irrelevant.

The Pensions Act

S.33 of the Pensions Act 1995 precludes any exoneration clause providing any protection to pension trustees in respect of their liability for breach of an obligation under any rule of law to take care or exercise skill in the performance of any investment functions (whether the functions are exercisable by a trustee of a trust scheme or a person to whom the function has been delegated under s.34 of that Act).

S.31 of the same Act prohibits indemnification out of the assets of a scheme of any trustee of the scheme in respect of (1) a fine imposed by way of penalty for an offence of which he is convicted; or (2) a penalty which he is required to pay under s.10 or s.168(4) of the Pension Schemes Act 1993. This prohibition is expressly extended to including payment of premiums in respect of a policy of insurance where the risk is or includes the imposition of such a fine or the requirement to pay such a penalty. The prohibition does not apparently extend to indemnifying against the costs of proceedings or paying any costs which he is ordered to pay; nor does it prohibit the employer from giving an indemnity.

Goode report

Paragraph 4.5.56 of the Goode Report reads as follows:

'We consider it undesirable that in the field of occupational pensions the law should remain uncertain on something as important as the core duties of trustees. We do not recommend a comprehensive restatement of the law on the duties of trustees, since this is a complex area in which equitable principles are highly developed and which does not lend itself to codification. This also was the conclusion reached by the Australian Law Reform Commission in its 1992 report on superannuation, [20] but like the Law Reform Commission we believe that certain of these duties should be specified as an irreducible core which should not be capable of exclusion or modification. In particular, trustees should not be permitted to obtain exemption from liability for dishonesty, wilful default or gross negligence. We also consider that professional trustees should not be able to exclude liability for the failure to exercise the degree of care and skill they possess or, by reason of their profession, business or calling, ought to possess.'

It is useful to comment briefly as follows:

- the core duties of trustees are (as had already been stated) clearly established
- there is no uncertainty as to the validity of exoneration clauses in respect of wilful default and gross negligence
- there is no sufficient reason why the settlor should not have the choice whether to exonerate trustees from liability for lack of skill and care. It is not apparently suggested that trustees should not be entitled to insure. If trustees can insure, the only question is whether the fund can pay the premiums either directly or (by some loading of the trustees fees) indirectly. Any trustee worth having is likely to require either a far-reaching

exoneration clause, or insurance at the cost of the fund or remuneration which enables the trustee to pay the premium himself and leaves him (after such payment) properly remunerated.

a heavy additional (and unnecessary) cost on the pension providers and the other beneficiaries. Exoneration clauses have their part to play in securing this goal.

Conclusion

The author has read that virtually every single leading decision in the last decade on the basic principles of trust law has involved a pension fund in one way or another, demonstrating that litigation involving pension funds has proliferated. Pensions are the lifeblood of a large party of the community; entitlement to pensions is for many the only security for an otherwise uncertain future. The highest standards have to be required of all those involved in the industry, and most particularly trustees. But they must be protected from unwarranted attacks and claims, which can only discourage attracting the best to this role and throw

© The Honourable Mr Justice Lightman, June 1999.

References

- 1 *Knight v Earl of Plymouth* (1747) Dick 120 at 126.
- 2 [1994] 1 All ER 119 at 133.
- 3 [1883] 22 ChD 727 at 746.
- 4 [1925] 1 Ch 517 at 528.
- 5 [1994] 1 All ER 118 at 139.
- 6 21 December 1995 ('the *Jersey Case*') at para 270.
- 7 [1980] 1 AER 139 at 152.
- 8 5 LT (NS) 467 at 470, 31 LJ Ch 41 at 43.
- 9 [1998] Ch 241.
- 10 [1963] 37 DLR (2nd) 273.
- 11 [1896] 1 Ch 71.
- 12 See *Re City Equitable Fire Insurance Co Ltd* [1925] Ch 407 at 434 per Romer J and in the Court of Appeal Pollock MR at p. 517 and Warrington LJ at 521–5.
- 13 [1980] Conv 333.