



Scottish Law Commission
promoting law reform

Discussion Paper on Liability of Trustees to Third Parties

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The Commission would be grateful if comments on this Discussion Paper were submitted by 31 August 2008.

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Part 1 Introduction

The Trust Law Review

1.1 This discussion paper deals with the contractual, delictual and other liability of trustees to third parties. In Phase 1 of our review of trust law, which concentrates on trustees and their powers and duties, discussion papers have been published on breach of trust, on the allocation and apportionment of receipts and outgoings between various classes of beneficiary, and on trustees and trust administration.¹ The present paper is the third discussion paper to be published in Phase 2 which looks at trusts themselves, although to some extent the subject matter falls within the scope of Phase 1. It follows the publication of our discussion papers on the variation and termination of trusts in December 2005² and the nature and constitution of trusts in October 2006. It is our intention to publish further discussion papers under Phase 2 including papers on restraints on accumulation of income and on long-term private trusts, and on the ways in which beneficiaries may enforce their rights against the trustees and any third parties who have obtained property which is subject to the trust.

1.2 On 1 March 2005 we hosted a seminar to stimulate discussion about the concept of legal personality for trusts. The feasibility of creating a trust as an artificial legal entity with its own juristic personality, separate from that of the trustees, was considered. Unlike the present law, in terms of ownership, the trust itself - rather than the trustees - would be the owner of the trust property. Accordingly, title to heritable property for example, would be registered in the name of the trust and not the trustees. The trustees would provide the active capacity and would act as the managers or agents of the trust. The seminar was attended by some 24 participants consisting of a mix of both academics and practitioners. It was particularly useful in producing a clear answer – that conferring legal or juristic personality on trusts would not, in the opinion of a significant majority, be a useful or desirable reform. The participants felt that the operational disadvantages of conferring legal personality on trusts far outweighed any presentational advantages. In contrast, there was a great deal of support for the dual patrimony theory as advanced previously by Professor Gretton and Professor Reid.

The dual patrimony theory

1.3 A private patrimony³ is the aggregate of a person's legal rights and liabilities.⁴ It includes the property that a person owns, for example a house (corporeal heritable property) or books, jewellery and a car (corporeal moveable property). Also included is incorporeal moveable property such as shares and other investments. The rights that a person has to

¹ Discussion Paper No 123 on *Breach of Trust*, Discussion Paper No 124 on *Apportionment of Trust Receipts and Outgoings*, both published in September 2003, and Discussion Paper No 126 on *Trustees and Trust Administration*, published in December 2004.

² Discussion Paper No 129 on *Variation and Termination of Trusts*. Our *Report on Variation and Termination of Trusts* (Scot Law Com No 206) was published in April 2007.

³ It is also known as a general patrimony.

⁴ The concept of patrimony is, of course, similar to the concept of a person's "estate" familiar to Scots lawyers from the law of succession.

the performance of a contract, to the payment of a debt, to reparation for harm wrongfully caused, to a legacy under a will or to a benefit under a trust, all form part of this private patrimony. But obligations as well as rights form part of a person's patrimony. Therefore in assessing the net value of a person's patrimony, account must be taken of obligations incurred: for example, the loan taken out to purchase the house, money owed on credit cards and other debts, or reparation to be paid to a person injured as a result of negligent driving. As a consequence, a private patrimony is usually in a state of constant flux as the person engages in economic activity. While new property will be acquired and enter the patrimony, existing assets will leave if ownership is transferred to a third party. New rights will be acquired but new obligations will also be incurred.

1.4 A person who becomes a trustee acquires a second patrimony: the private patrimony as before and a trust patrimony.⁵ The trust patrimony consists of the trust property which is owned by the trustee and any obligations incurred in the proper administration of the trust. If as will usually be the case there are two or more trustees, the trust patrimony is owned by them jointly. Although owned by the same person the trustee's private patrimony is a separate legal entity from the trustee's trust patrimony. As Reid observes:⁶

"The two patrimonies are distinct in law, and should also be distinct in practice, by proper labelling and accounting. The assets of one patrimony cannot normally be transferred to the other. And if an asset is sold from one patrimony, the proceeds of the sale are paid into the same patrimony, each patrimony thus operating its own real subrogation."

1.5 When trust property is sold any value received by the trustee for it automatically becomes part of the trust patrimony, even if the sale was in breach of trust. The trustee is deemed to receive any proceeds into the trust – as opposed to the private – patrimony. This is also the case in respect of any profits that a trustee makes in breach of the principle against acting as *auctor in rem suam*. Accordingly if the dual patrimony theory is accepted, it would no longer be necessary to argue⁷ that in such situations the trustee is holding the profits or proceeds on a constructive trust for the beneficiaries of the original trust.

1.6 The dual patrimony theory also explains why the trust fund is not vulnerable to the claims of the trustee's personal creditors. As Reid has argued:⁸

"A trustee may incur liabilities either in a private capacity or in the capacity as trustee, and a creditor is thus a private creditor or a trust creditor. The difference is crucial... a creditor is, in principle, restricted to a single patrimony. A private creditor must claim from the private patrimony and a trust creditor from the trust patrimony. If that patrimony is empty, he must go without, for the other patrimony is not available. In this principle lies the most convincing explanation of a beneficiary's protection against [the trustee's private] insolvency. The reason why a beneficiary prevails against the

⁵ G L Gretton, "Trust and Patrimony" in *Scots Law into the 21st Century: Essays in Honour of W A Wilson* (ed H L MacQueen 1996) 182; K G C Reid, "Patrimony Not Equity: the Trust in Scotland" (2000) 8 *European Review of Private Law* 427; G L Gretton, "Trusts without Equity" (2000) 49 *ICLQ* 599.

⁶ K G C Reid, "Patrimony Not Equity: the Trust in Scotland" (2000) 8 *European Review of Private Law* 427 at p 432.

⁷ *Black v Brown* 1982 SLT (Sh Ct) 50; see generally Wilson and Duncan, paras 6-63ff.

⁸ K G C Reid, "Patrimony Not Equity: the Trust in Scotland" (2000) 8 *European Review of Private Law* 427 at p 432.

private creditors of the trustee is, quite simply, that each has a claim in respect of a different patrimony."

1.7 Thus the reason why the beneficiary's right prevails over the claims of the trustee's personal creditors is not because it is a quasi-real right or because the beneficiary and not the trustee is the "true" owner of the trust fund. It is simply because the claims of the trustee's personal creditors are restricted to the property in the trustee's private patrimony.

1.8 Conversely, it also follows from the dual patrimony theory that the beneficiary's right against the trustee to compel fulfilment of the trust purposes is restricted to the trust patrimony. Where obligations have been incurred in the trust patrimony,⁹ the claims of the trust creditors have to be satisfied before the trust purposes can be fulfilled. If having paid the trust creditors, the trust fund is exhausted, the beneficiaries will receive nothing.¹⁰ Put another way, the personal right of the beneficiary to compel the trustee to fulfil the trust is postponed to the personal rights of all the other creditors in the trust patrimony. And if the trust fund is used up satisfying the trust creditors, the beneficiaries are *not* entitled to go against the trustee's private patrimony to obtain what they were due under the trust. However, if the shortfall is the result of the trustee's breach of trust, then the property in the trustee's private patrimony is vulnerable to the beneficiaries' claims for an accounting and damages, though the beneficiaries rank as ordinary creditors *pari passu* with other creditors of the trustee's private patrimony.

1.9 Where, as is usual, there is more than one trustee, under the dual patrimony theory the trust patrimony is owned jointly between the trustees. If a trustee resigns, the trust patrimony is owned by the remaining trustees; there is no need for any formal transfer process.¹¹ Similarly, if a trustee dies, the trust patrimony accrues to the remaining trustees and does not fall to the executor of the deceased's private patrimony. If all the trustees die or resign, the assets and liabilities in the trust patrimony continue to exist and the court can appoint new trustees who will then become the owners of the trust patrimony.

1.10 In the light of the March 2005 seminar,¹² our Discussion Paper on *The Nature and Constitution of Trusts* published in October 2006 rejected conferring legal personality on trusts and instead suggested that the dual patrimony theory should be placed on a statutory footing. The discussion paper elicited few responses, perhaps because most of the potential respondents had attended the earlier seminar and had made their views known there. Our provisional rejection of legal personality was confirmed; none of those responding was in favour of this approach. But there was support for the dual patrimony theory, although the need for its enactment by legislation was questioned.

1.11 We consider that the dual patrimony theory provides a principled theoretical basis for the rules of trust law, especially in the field of liability of trustees to third parties – the subject matter of this discussion paper. Civilian jurisdictions in Europe which have enacted

⁹ By the trustees in the course of the administration of the trust or, in the case of a *mortis causa* trust, by the trustor before death. Unless the trustees make it clear that they are contracting only in their capacity as trustees, their private patrimonies are liable for the claims of trust creditors; but the trustees are then indemnified from the trust patrimony if the obligations were properly incurred in the course of their administration of the trust, see Part 2 below.

¹⁰ This rarely happens in a standard *inter vivos* trust. But it may arise in a *mortis causa* trust where the whole estate can be used up in paying the deceased trustor's debts.

¹¹ The rule is now statutory: Trusts (Scotland) Act 1921, s 20.

¹² See para 1.2 above.

legislation introducing trusts have used the concept of the trust estate being held by the trustees as a patrimony separate from their own patrimonies.¹³

Outline of the discussion paper

1.12 Part 2 starts by examining the liability of trustees to third parties with whom they have contracted. Most of the common law in this area comes from 19th century cases when the types of trust and the way in which business was conducted were very different from today. This leads to the law not being in keeping with modern practice. Under the existing common law, trustees may put their private patrimonies at risk by entering into contracts on trust business. Unless it is clear from the terms and nature of the contract that only their trust patrimony is bound, trustees will be personally liable, albeit that they have the right to use their trust patrimony first before resort is made to their private patrimonies. Lay trustees of public trusts, such as charities¹⁴ and kirk sessions, are particularly at risk as insurance is difficult to obtain and even if it is available the cover is often limited. We discuss whether only the trust patrimony should be liable in all cases where the third parties know that they are entering into a contract with trustees who are acting within their powers. We also ask for views on whether if the trustees are personally liable but have a right of relief against the trust patrimony the third party creditor should be able to claim directly against the trust patrimony.

1.13 The next section looks at *ultra vires* contracts, viz contracts that the trustees have no power to enter into or contracts that are at variance with the terms and purposes of the trust. Section 2 of the Trusts (Scotland) Act 1961 provides that certain specified onerous contracts are unchallengeable on the ground of lack of *vires*, but does not require the third party to have been in good faith. We ask for views on whether only *bona fide* third parties should be protected, but we suggest extending the scope of section 2 to include all onerous contracts. At present contracts between the trustees and one of their number or a beneficiary are not unchallengeable. We think this rule should continue to apply for a contract with a trustee but ask whether it should be retained for one with a beneficiary. Trustees who enter into an *ultra vires* contract are personally liable without any right of relief from the trust estate. This may prejudice a third party who contracted in good faith and without knowledge of the lack of *vires* and would therefore assume that recourse would be available against the trustees' trust patrimony as well. We consider the existing law to be satisfactory but in order to elicit views we put forward a negative proposal that there should be no change in this area.

1.14 The final section of Part 2 considers the execution of deeds by trustees. It was unclear at common law whether all the trustees had to sign or whether the deed was valid if signed by a quorum. Section 7 of the Trusts (Scotland) Act 1921 which was enacted to dispel such doubt has failed to achieve its purpose. We propose that execution by a quorum should be valid and that a deed in favour of a *bona fide* third party should not be invalid by reason of a failure by the trustees to follow any procedural requirements in making the decision or granting the deed implementing it.

¹³ Luxembourg, Law of 27 July 2003 Relating to the Trust and to Fiduciary Contracts, art 6(1); France, Code Civil, art 2011 added by Law of 19 February 2007.

¹⁴ The provisions for Scottish Charitable Incorporated Organisations in the Charities and Trustee Investment (Scotland) Act 2005 are not yet in force and will only be an option, as is the existing company limited by guarantee.

1.15 Part 3 considers the delictual and similar liabilities of trustees. There is an almost complete absence of authority in Scots law as to whether the trustees are liable in their private or trust patrimonies for damages for delict. We suggest that a trustee's private patrimony should be liable only if that trustee has been personally at fault. A related area is liability of trustees arising from their ownership of trust property. A major source of liability is in the environmental field, especially causing pollution. The legislation imposing liability on owners or occupiers rarely, if ever, stipulates whether the trustees are personally liable or whether it is only the trust estate, ie their trust patrimony, that is liable. Our approach is that in general only their trust patrimony should be liable, but that a trustee's private patrimony would be liable where he or she had been personally at fault.

1.16 Part 4 deals with the expenses of civil litigation where trustees are unsuccessful pursuers or defenders. The form of the interlocutor for expenses, which is at the discretion of the court, governs which patrimony is liable and whether trustees who are personally liable can pay out of their trust patrimony before resort is made to their private patrimonies. We suggest that the rules of liability for expenses be set out in legislation and that the discretion of the court be limited to exceptional cases after hearing representations from the beneficiaries and the trustees. In view of this we suggest that there is no need to introduce new pre-litigation procedures (court-based or otherwise) to protect trustees from personal liability for expenses.

1.17 A list of the proposals and questions on which we invite views forms Part 5. Appendix A sets out the relevant law in some other jurisdictions that we have studied. Appendix B lists the membership of our Advisory Group.

Advisory Group

1.18 We continue to be assisted by an Advisory Group consisting of both academics and practitioners. The members of this group are listed in Appendix B. Members of the group attended our seminar on the legal personality of trusts and commented on earlier drafts of this discussion paper. We are very grateful to them for their input and constructive comments at these earlier stages.

Legislative competence

1.19 The proposals in this discussion paper relate to the contractual and delictual liability of trustees to third parties which are not reserved matters under the Scotland Act 1998. They therefore lie within the legislative competence of the Scottish Parliament.

1.20 In our view our proposals, if enacted, would not give rise to any breach of the European Convention on Human Rights or of European law.

Part 2 Contractual liability of trustees

Introduction

2.1 In this Part we look at the liability of trustees who enter into contracts with third parties, either directly or indirectly via their agents.¹ The discussion will focus on the trustees rather than the contract itself or the third party. Thus it is assumed that the contract is free from any vice of consent such as a party's mental incapacity, force and fear or essential error which would make the contract void or voidable. We also do not deal with contracts between one of the trustees as an individual and the trustees as a body. These breach the "*auctor in rem suam*" principle and are voidable at the instance of the beneficiaries. They were examined in our previous Discussion Paper on *Breach of Trust*.²

2.2 The legal consequences for trustees of a contract entered into by them in the course of their administration of the trust depends on whether they had power to enter into such a contract and in what capacity they entered into it. In the vast majority of cases trustees will act within their powers as set out in the trust deed, legislation and the common law; ie they will act "*intra vires*". Occasionally, they will contract in an "*ultra vires*" manner, for example buying investments of a prohibited kind or selling assets that were to be retained for fulfilment of the trust purposes. Trustees may enter into contracts in a number of ways. First, they may contract "as trustees" or "*qua* trustees", ie expressly in their capacity as trustees. Second, they may simply describe themselves as trustees. Finally, the fact that they are trustees may not have been made known to the third party at all. The law as stated in the following paragraphs 2.3 to 2.12 is widely accepted as correct although there is not much authority and the position cannot be regarded as entirely settled.

A: *INTRA VIRES* CONTRACTS

Contracting as trustees

2.3 When trustees enter into a contract on trust business with a third party the presumption is that they are personally liable, ie the third party may claim against the trustees' private patrimonies.³ As Lord Fullerton said in *Cullen v Baillie*.⁴

"...in regard to debts contracted by the trustees themselves, although it may be bona fide for the trust purposes, they will be personally bound to third parties, unless it appear clearly from the terms of the transaction that the creditor expressly took the trust-estate, as distinct from the individual trustees, as his debtor."

¹ Trustees are liable as principals for trust obligations entered into by agents acting on their behalf.

² No 123 (2003), Part 4.

³ However, trustees who enter into a contract with solicitors who act for them in relation to trust business are presumed to do so in their capacity as trustees so that only their trust patrimony is liable; *Ferme, Ferme and Williamson v Stephenson's Tr* (1905) 7F 902, see also M'Laren, pp 1233-1237.

⁴ (1846) 8D 511 at 522.

To avoid their private patrimonies being liable the trustees have to make the position clear to the third party.⁵ Limiting liability to their trust patrimony is usually done by the trustees stating their representative capacities and expressly contracting "as trustees" or "qua trustees".

2.4 In the case of *Gordon v Campbell*⁶ testamentary trustees were held to have contracted only in their representative, ie trust capacities. They borrowed £7,000 from Colonel Gordon and granted a heritable bond over the trust estate containing the following obligation:

"... we, as trustees foresaid, bind and oblige ourselves, and the survivors or survivor of us, and such other person or persons as may be assumed by us in virtue of the powers committed to us in the said trust deeds ... [to repay with interest]."

In the heritable security section the trustees granted warrandice "qua trustees only". Interest fell into arrears and Colonel Gordon called up the security and charged the trustees personally to pay under pain of imprisonment. One of the trustees presented a bill of suspension of this diligence which was passed. The House of Lords refused the appeal holding that the trustees had incurred liability only to the extent to which they were concerned with the trust fund. The trustees had carefully stated that they contracted in their character of trustee treating the trustees as a body, like a corporation, and so avoiding personal liability.

2.5 The mere use of the word "trustee" after a trustee's name is insufficient to prevent personal liability as it is regarded as a description rather than a qualification of liability.⁷ The Bills of Exchange Act 1882 follows this approach in drawing a distinction between capacity and description. Section 26(1) provides that:

"Where a person signs a bill as drawer, indorser, or acceptor, and adds words to his signature, indicating that he signs for or on behalf of a principal, or in a representative character, he is not personally liable thereon; but the mere addition to his signature of words describing him as an agent, or as filling a representative character, does not exempt him from personal liability."

In *Ritchie v Dickie*⁸ a decree for payment against Mrs Ritchie, executrix-dative was held to be a warrant for diligence against her private patrimony. In order to limit diligence to her executry patrimony the decree would have had to have been against her "as or qua executrix-dative".

2.6 Entering into a contract "as trustee" or "qua trustee" will generally prevent personal liability arising, while the mere addition of "trustee" after the party's name will not. However, the meaning of such words in a contract has to be construed in the light of the nature of the contract, the capacities of the parties and the background circumstances. Trustees who had contracted to take stock "as trustees" in the City of Glasgow Bank and who were entered as

⁵ *Lumsden v Buchanan* (1865) 3M (HL) 89, L C Cranworth at 95 (a Western Bank collapse case); *Muir v City of Glasgow Bank* (1879) 6R (HL) 21, L C Cairns at 22.

⁶ (1842) 1 Bell's App 428.

⁷ *Brown v Sutherland* (1875) 2R 615, Lord Gifford at 621. See also *Lord Advocate v Chung* 1995 SC 32.

⁸ 1999 SC 593. The action was one of count, reckoning and payment by a beneficiary rather than by a creditor for payment of a contract debt, but nothing turned on that.

such in the City of Glasgow Bank stock register were nevertheless held personally liable. The words "as trustees" could not be given their normal effect because the Bank had had no power to have entered into a contract limiting its recourse to the trustees' trust patrimony. In terms of the legislation governing the Bank, members were either individuals with unlimited personal liability or corporations which were liable to the full extent of their assets.⁹ The case of *Alexander's Trustees v Dymock's Trustees*¹⁰ is an illustration of this principle in reverse. Two men described as the surviving and acting trustees of John Alexander entered with the defenders into a reference to the Accountant of Court to state the balance of the account between the parties. They bound themselves and their respective heirs, executors and successors to implement the Accountant's award. They later died having assumed two new trustees. The Inner House held that the reference had not fallen by the death of the original parties, as is the general rule. The true party to the contract had been and remained Alexander's trustees as a body or the trust. The obligation to implement any award could not be read as a personal obligation; it was simply an obligation to make the trust funds forthcoming, so far as available. In modern terminology the trustees were regarded as having bound themselves so that only their trust patrimony was liable.

2.7 Where the trustees are liable only in respect of their trust patrimony the creditor has to claim against the present trustees. It is the present trustees who have title to the trust estate and who are able to make their trust patrimony available to the creditor. Trustees who have resigned or died have ceased to have any control over the trust estate. As the trustees are the joint owners of the trust estate, title to it accretes to the remaining trustees. Neither the private patrimony of a trustee who resigns nor the estate of one who dies¹¹ is liable for obligations under contracts by the trustees where only their trust patrimony is liable.

2.8 A consequence of obligations being enforceable only against the trustees' trust patrimony is that that patrimony may become insolvent. In *J & W Campbell & Co Petrs*¹² the testamentary trustees of a deceased merchant in Portree had carried on his business and had incurred post-death debts in their capacity as trustees. Sequestration was awarded against the trustees as such (ie not affecting their private patrimonies) when their trust

⁹ *Muir v City of Glasgow Bank* (1879) 6R (HL) 21, especially Cranworth L C at 22-23. Of course personal liability is limited by the size of the debtor's private patrimony. R G Anderson, "Contractual Liability of Trustees to Third Parties" 2003 JR 45 considers that this case and the preceding Western Bank case *Lumsden v Buchanan* (1865) 3M (HL) 89 were wrongly decided. He argues in particular that the liability of a limited liability company which held Bank stock would have been limited to the company's capital and that there would have been no personal liability on the shareholders of that company.

¹⁰ (1883) 10R 1189.

¹¹ The executors of a sole or last surviving trustee may confirm to the trust estate but this is purely for the purpose of handing it over to new trustees, or if the trust has come to an end to make it over to the beneficiaries: Executors (Scotland) Act 1900, s 6. The two Glasgow Bank cases dealing with the death of a trustee: *Oswald's Trs v City of Glasgow Bank* (1879) 6R 461 and *Low's Exs v City of Glasgow Bank* (1879) 6R 830 seem contradictory. In the first case Oswald was one of three testamentary trustees of a Mr Clinkscales and the three trustees were registered as such as holders of Bank stock. Oswald died shortly before the Bank went into liquidation and it was decided that his own testamentary trustees were not liable in respect of any liability which arose after his death. But very shortly afterwards in *Low's Exs* the personal estate of a deceased sole trustee was liable even though the Bank failed years after he had died. The apparent contradiction can be explained by the peculiar nature of the Glasgow Bank stockholders' liability in terms of which calls were made by the liquidator on stockholders by virtue of their ownership of stock at the date when the bank failed. Oswald's title as one of the owners of the trust holding had passed to the surviving trustees automatically as trustees have a joint title. Low was a sole trustee at his death but his executors were unaware of this trust holding and had not confirmed to it. The stock remained in the names of Low (and another trustee who pre-deceased him) up to the date when the bank failed. Low's testamentary estate was liable for the call on Low as the surviving registered stockholder.

¹² (1899) 6 SLT 406.

patrimony was insolvent.¹³ In our Report on *Bankruptcy and Related Aspects of Insolvency and Liquidation*¹⁴ we considered that the existing case law on the competency of sequestrating trust estates was not conclusive and recommended that legislation should make its competency clear. Where the debts had been incurred by the trustees as such, it seemed to us just and equitable that the trust estate should be capable of being sequestrated.¹⁵ This recommendation was implemented by section 6(1)(a) of the Bankruptcy (Scotland) Act 1985 which provides that:

"The estate belonging to or held for or jointly by the members of any of the following entities may be sequestrated –

(a) a trust in respect of debts incurred by it, ..."

Not contracting as trustees

2.9 The trustees may contract with the third party and either merely describe themselves as trustees or fail to mention their position as trustees at all. Unless the nature of the contract is such that the trustees are taken to have engaged only their trust patrimony,¹⁶ then they are personally liable. However, as long as the contract is one they may properly enter into, the trustees have a right of relief against the trust estate.¹⁷ As Mackenzie Stuart put it:¹⁸

"It is of the nature of the office of a trustee, as between him and the beneficiaries, that he shall receive out of the trust estate all the proper charges and expenses incurred by him in the execution of the trust. This is implied in every deed of trust. The right can only be lost or curtailed by such conduct on the part of the trustee as may amount to a violation or culpable neglect of his duty as trustee."

2.10 However, this right of relief is more than a right of reimbursement of the trustees' private patrimonies from their trust patrimony; it is a relief of obligation. This means that the trustees do not have to pay the creditor first and then claim the amount paid from the trust estate. They are entitled to use their trust patrimony first to settle the creditor's claim. As Lord President Inglis said in *Cunningham v Montgomerie*, one of the City of Glasgow Bank cases:¹⁹

"It is not mere reimbursement of money spent that the mandatory is entitled to have, but it is relief of obligation, and therefore before any call will have been made at all upon the failure of this bank, when it became perfectly obvious that these trustees would be made personally answerable for the payment of the calls that were certain to be made, they were in the condition at once to say to the trusters, 'You must stand between us and this liability; we must be protected, and protected at the expense of the trust estate'."

¹³ Cf *Bain, Petr* (1901) 9 SLT 14 where an executor's sequestration was recalled as it had been used improperly as an attempt to equalise pre and post-death debts.

¹⁴ Scot Law Com No 68, 1982.

¹⁵ Paras 5.5-5.6.

¹⁶ As in *Alexander's Trs v Dymock's Trs* (1883) 10R 1189; see para 2.6 above.

¹⁷ *Cunningham v Montgomerie* (1879) 6R 1333. In *Robinson v Fraser's Tr* (1881) 8R (HL) 127, the right of relief was limited to the part of estate in relation to which liability arose as investments had been allocated between two sets of beneficiaries.

¹⁸ Mackenzie Stuart, p 321.

¹⁹ (1879) 6R 1333, at 1338, using the now discredited notion that a trust is a deposit and mandate.

In short the trust patrimony stands in front of the trustees, not merely behind them. It is only when their trust patrimony is exhausted that the trustees become liable to the creditor in their private patrimonies. Another way of looking at the matter is that the trustees' private patrimonies include the right of relief against their trust patrimony.²⁰ Thus the creditor by arresting the right of relief in the trustees' private patrimonies can obtain payment from their trust patrimony.²¹

2.11 Where the trustees are personally liable to the third party then they are generally jointly and severally liable.²² But if the contract was entered into by only some of the trustees, then in the first place only those trustees incur personal liability. However, the other trustees may be personally liable if they agreed to the contract being entered into or adopted it afterwards.²³ Similarly, assumed trustees will become personally liable under a contract entered into by the previous trustees if they adopt it.²⁴ On resignation a trustee who was party to a contract ceases to be liable for future obligations under it but only if the fact of resignation was brought to the notice of the third party.²⁵

2.12 Where an individual who is party to a contract dies the general rule is that his or her executors remain liable under the contract.²⁶ This rule applies where the trustee is personally liable albeit the executors have a right of relief against the trust patrimony.

Proposals for reform

2.13 The present law is arguably too ready to impose personal liability on trustees who enter into contracts without expressly limiting liability to their trust patrimony. The trustees are potentially liable to pay from their private patrimonies should the trust estate prove insufficient. This means that trustees may be putting their personal funds at risk even where they are carrying out their duties properly. Suppose, for example, trustees running a business order a large quantity of raw materials for delivery in a few months' time. In that period, due to unforeseen external events, the business collapses and becomes worthless. The trustees will have to pay the supplier out of their own pockets, unless they had made it clear that only their trust patrimony would be liable. Creditors on the other hand benefit from the current law in that they have recourse to both the trustees' trust patrimony and their private patrimonies. People, especially lay persons, are increasingly reluctant to accept office as trustees because of potential personal liability. Insurance is difficult to obtain and even when it is available the cover is often limited.

2.14 We also doubt whether the present law reflects the expectations of creditors. Creditors who contract with trustees, especially trustees of substantial trusts, probably regard themselves as contracting with "the trust" and look to be paid from the trust estate. They are unlikely to rely to any great extent on the personal credit of the trustees, about which they will usually be ignorant. The law seems unduly formalistic: many people will not realise the difference in personal liability between a contract by "A, B and C as (or *qua*) trustees of X" and one by "A, B and C, the trustees of X".

²⁰ *Ibid*, per Lord Shand at 1340.

²¹ See paras 2.21-2.24 below.

²² *Gillespie and Paterson v City of Glasgow Bank* (1879) 6R 714, affirmed 6R (HL) 105.

²³ *Roberts v City of Glasgow Bank* (1879) 6R 805; *Cuninghame v City of Glasgow Bank* (1879) 6R 679.

²⁴ *Bell v City of Glasgow Bank* (1879) 6R 548, affirmed 6R (HL) 55.

²⁵ *Torchetti v City of Glasgow Bank* (1879) 6R 789; *Sinclair v City of Glasgow Bank* (1879) 6R 571.

²⁶ McBryde, para 26-02. There are exceptions, eg if *delectus personae* is involved.

2.15 We are attracted to the rule in Jersey, Guernsey, South Africa and the United States of America Uniform Trust Code whereby the trustees are not personally liable to a third party on a contract they have properly entered as long as the third party was aware that the trustees were acting in a representative capacity.²⁷ Personal liability arises only where the trustees' representative capacity was not disclosed or where the trustees expressly undertook personal liability. We envisage that these would be uncommon situations so that in most trust contracts the third party would be restricted to claiming against the trustees' trust patrimony. This solution would be in line with guardianship under the Adults with Incapacity (Scotland) Act 2000. Section 67(4) of that Act deals with this issue in a negative manner. It provides that a guardian:

"...shall be personally liable under any transaction entered into by him:

(a) without disclosing that he is acting as guardian of the adult; or

(b) which falls outwith the scope of his authority."

The underlying assumption is that disclosure of the representative capacity in an *intra vires* transaction results in liability falling exclusively on the adult's estate. The rule for judicial factors seems similar. There it has been held that provided the factor acts as such, in good faith and is not in breach of any duty, there is no personal liability. The third party's claim is then restricted to the estate under the factor's control.²⁸

2.16 The United States Uniform Trust Code requires disclosure, ie that the trustees have informed the third party that they were acting as trustees.²⁹ Jersey and Guernsey on the other hand negative personal liability not only in this situation but also whenever the creditor was aware that the trustees were acting as such. This latter situation was introduced in Jersey and Guernsey in 2006 in order to bring greater certainty to the law and to reduce barriers to the use of trusts there. We consider that personal liability should not arise if the trustees disclose that they are contracting as trustees. Disclosure could be done in the contract itself, in a separate document or orally. The trustees should have to disclose not just the fact that they were trustees but also the identity of the trust on whose behalf they were contracting.

2.17 We tend to think the advantages of also using the awareness criterion outweigh the disadvantages.³⁰ Many trustees or their agents will contract with the same third party on two or more occasions. If full disclosure was made in the first transaction then it would seem unduly formalistic for the law to require this to be done in every subsequent transaction. A possible drawback of awareness is that it could be difficult to establish and hence would encourage litigation. Unless the third party conceded that he or she had been aware it would have to be found to be a reasonable inference from the parties' prior dealings with each other. The fact that the onus of establishing the third party's awareness would lie on

²⁷ Quebec law is somewhat similar: see Appendix A, para 8. An administrator who binds himself in the name of the trust patrimony is not personally liable, but is so liable if he binds himself in his own name.

²⁸ *Scottish Brewers Ltd v J Douglas Pearson & Co* 1996 SLT (Sh Ct) 50. The situation of guardians and judicial factors is to some extent different from trustees in that they are managers not owners of the incapable adult's or factory estate. In *Lumsden v Peddie* (1866) 5M 34 a *curator bonis* who was registered as such as a stockholder in the Western Bank was held to be personally liable for calls on the Bank's failure, but this was due to stockholders being partners of the Bank.

²⁹ Appendix A, para 13.

³⁰ Awareness means actual, rather than constructive, awareness that the contracting parties were trustees.

the trustees would encourage trustees to make their status clear when entering into contracts with third parties.

2.18 The traditional justification for imposing personal liability on trustees is that third parties do not know the extent of the trust estate. In entering into a contract they therefore rely on the personal credit of the trustees and their assurances about the value of the trust estate.³¹ The special position of solicitors to the trust³² is because such creditors do know whether or not the trust estate is sufficient to meet their claims. Our proposal might be thought to encourage trustees to contract recklessly in the knowledge that their private patrimonies would not be at risk. But where the trustees, whether negligently or fraudulently, misrepresented the size of the trust estate and so led the third party to accept that only their trust patrimony would be liable, that third party would have a claim in delict for fraud or negligence against the trustees personally.³³ Moreover, the trustees owe a duty of care to the beneficiaries; knowingly to enter into a contract which would deplete completely the trust patrimony would usually be regarded as a breach of that duty and subject the trustees personally to a claim by the beneficiaries for damages. In both of these situations the trustees would have no right of relief against the trust patrimony.

2.19 It would of course remain open to third parties to stipulate that the trustees were to be personally liable even if the fact of trusteeship was disclosed or they were aware of it. But this stipulation would have to be a term of the contract as our proposed default rule would be that only their trust patrimony was liable.

2.20 We therefore propose that:

1. **Where trustees enter into a contract with a third party which is within their powers in the course of administering the trust and either:**
 - (a) **the fact that the trustees are acting in a representative capacity on behalf of a specified trust is disclosed at that time to the third party; or**
 - (b) **the third party was otherwise aware that the trustees were so acting,****then the third party's rights under the contract should be enforceable only against the trustees' trust patrimony, unless the contract provides otherwise.**

Direct recovery from the trust patrimony?

2.21 Even if Proposal 1 is accepted there will be cases where the trustees become personally liable under a contract, although they should be much less common than at present. The case of *Cunningham v Montgomerie*³⁴ discussed in paragraph 2.10 above established that trustees faced with personal liability were entitled to use their right of relief from the trust patrimony to meet their personal liability before having to make payment out of

³¹ While the trustees can give an assurance about the current sufficiency of the trust estate they cannot do the same as regards its value when the liability becomes due.

³² See para 2.3 above, fn 4.

³³ S 10(1) of the Law Reform (Miscellaneous Provisions) (Scotland) Act 1985 extends delictual liability to cases of negligent as well as fraudulent misrepresentation.

³⁴ (1879) 6R 1333.

their private patrimonies. Strictly the case is not authority for the proposition that trustees with a right of relief are bound to make it available to the creditor, but there are strong *obiter dicta* by Lord Deas and Lord Shand that the creditor is entitled to an assignation by the trustees of their right of relief and by Lord Shand that diligence against the trustees' private patrimonies will attach their right of relief against their trust patrimony. An assignation would enable the third party creditor to raise an action for payment against the trustees as holders of the trust patrimony (who may not be the same persons as the trustees who were found personally liable). But the source of the obligation to grant an assignation is not clear. Diligence attaching the right of relief could take the form of an arrestment of the obligation of the trustees as trustees to relieve the trustees as individuals. But since an action of furthcoming in respect of a contingent debt is sisted until the debt becomes payable, ie when the trustees personally paid the third party, the third party creditor would not be able to pursue the arrestment to a successful conclusion until such payment was made.³⁵ The right of relief is more than a right of reimbursement; it is an entitlement of trustees liable in a personal capacity to use the trust patrimony to pay creditors. It might be possible to use the residual diligence of adjudication,³⁶ to attach this entitlement, but adjudication is a very cumbersome and expensive diligence.³⁷

2.22 We tend to think that the law should be put on a more certain basis and that a third party creditor should have a more direct method of recovery from the trust patrimony as this is the patrimony that is ultimately liable where the trustees have been acting within their powers. One option would be to follow the undisclosed principal rule in agency. Where an agent enters into a contract with a third party but fails to disclose that he or she is acting on behalf of the principal, then the third party can elect to proceed against either the agent or the principal but not both, viz it is alternative liability.³⁸ The trust situation under discussion is factually very similar, but at present the third party can recover, albeit in a circuitous fashion, from the trust patrimony as well as the trustees' private patrimonies, viz it is potentially cumulative liability. Putting third party creditors of trustees to an election would therefore diminish their existing rights.

2.23 Making the trust patrimony and the trustees' private patrimonies potentially cumulatively liable would enhance rather than diminish a third party creditor's rights. The creditor would then be able to recover from either and where one failed to satisfy the debt the creditor could recover the balance from the other. Where the trustees had to pay the third party creditor from their private patrimonies they could still seek reimbursement from the trust patrimony. The trust patrimony would, however, have no right of reimbursement from the trustees' private patrimonies

2.24 In order to obtain views on this difficult problem we ask the following questions:

³⁵ *Boland v White Cross Insurance Co* 1926 SC 1066. The older and still competent practice was to grant decree of furthcoming but supersede extract until the debt became payable: J Graham Stewart, *The Law of Diligence*, p 229.

³⁶ Adjudication as the residual diligence will be replaced by residual attachment when s 129 of the Bankruptcy and Diligence (Scotland) Act 2007 is brought into force.

³⁷ In *Stewart v Forbes* (1888) 15R 383 a decree against the trustees personally was held to be enforceable against the trust estate. This case is of doubtful authority as it contains no explanation why a decree against the trustees personally warrants diligence against the trust estate.

³⁸ *David Logan and Son Ltd v Schuldt* (1903) 10 SLT 598. The election once made is irrevocable.

2. Where the trustees' private patrimonies are liable under a contract with a third party but the trustees have a right of relief in respect of that liability against their trust patrimony:

(a) should the third party have a direct right of recovery from the trust patrimony; and

(b) if so, what is the best way of achieving this?

B: ULTRA VIRES CONTRACTS

Introduction

2.25 We now turn to look at *ultra vires* contracts, ie contracts which the trustees had no power to make. The first issue is whether such contracts can be challenged on the grounds of lack of *vires*, and the second is which patrimony of the trustees, trust or private, is liable under an *ultra vires* contract.

2.26 At common law trustees' powers were limited to those expressed in the trust deed or implied from the purposes of the trust.³⁹ Section 4 of the Trusts (Scotland) Act 1921 confers power on all trustees subject to the Act to carry out any of the acts listed therein. Trustees may carry out any listed act provided it is not at variance with the terms and purposes of the trust. The truster may have expressly prohibited the exercise of a listed power⁴⁰ or have restricted the trustees in the exercise of such a power.⁴¹ If an act would be at variance the court may nevertheless, on application by the trustees, grant authority to carry it out if satisfied that it would be expedient for the execution of the trust.⁴²

2.27 Trustees can give a good title to any third party with whom they transact as they have capacity as owners of the trust patrimony. Before the Trusts (Scotland) Act 1961 under the common law an *ultra vires* transaction by trustees was voidable at the instance of the beneficiaries if it was gratuitous or the third party was in bad faith.⁴³ There is however a division of opinion about onerous transactions involving *bona fide* third parties. On one view they were and are unchallengeable.⁴⁴ Where the third party's title was unchallengeable the beneficiaries' remedy therefore lay against the trustees for breach of trust, rather than the third party. The contrary view is that *ultra vires* transactions were reducible where the third parties knew that the title to the property in question was held by trustees.⁴⁵ The extent of the divergence of these views depends on what is meant by good faith. If it means that third parties ought to have made enquiries as to whether the transaction was within the powers of the trustees and that they would have been in good faith only if they honestly believed that to be the case, then there is a considerable difference between the two views. But if third parties are in good faith unless they have actual knowledge of the lack of *vires* then the title of most onerous third parties will be unchallengeable as few will be in bad faith.⁴⁶ The pre-

³⁹ Bell's Commentaries on the Law of Scotland (7th edn, ed John M'Laren), Volume 1, Book 2, 1,37.

⁴⁰ Eg, forbidding a sale of the family home or shares in the family company.

⁴¹ Eg, forbidding investment in "unethical" companies.

⁴² Trusts (Scotland) Act 1921, s 5.

⁴³ 18 Stair Memorial Encyclopaedia, para 691.

⁴⁴ *Ibid.*

⁴⁵ Halliday, para 1-25; Gordon, paras 16.30-16.31; McDonald, para 3.8.

⁴⁶ D L Carey Miller, "Good Faith in Scots Property Law" in *Good Faith in Contract and Property Law* (ed A D M Forte, 1999), p 122.

1961 Act practice was for persons transacting for value with trustees to investigate whether the proposed transaction was within the powers of the trustees and to proceed only if they were so satisfied.⁴⁷ In doubtful cases an application would have to be made to the court under section 5 of the Trusts (Scotland) Act 1921; the third party would get a good title whether the court dismissed the application since the trustees were acting within their powers, or the court granted the application authorising the transaction. The powers of trustees of non-Scottish trusts or old public trusts are often very difficult to ascertain.

Section 2 of the Trusts (Scotland) Act 1961

2.28 The Trusts (Scotland) Act 1961 contains provisions designed to avoid third parties who transact with trustees having to investigate the extent of the trustees' powers. Subsections (1) and (2) of section 2⁴⁸ make certain transactions immune from challenge on the ground of lack of *vires* by providing that:

"(1) Where, after the commencement of this Act, the trustees under any trust enter into a transaction with any person (in this section referred to as "the second party"), being a transaction under which the trustees purport to do in relation to the trust estate or any part thereof an act of any of the descriptions specified in paragraphs (a) to (eb) of subsection (1) of section four of the Act of 1921 (which empowers trustees to do certain acts where such acts are not at variance with the terms or purposes of the trust) the validity of the transaction and of any title acquired by the second party under the transaction shall not be challengeable by the second party or any other person on the ground that the act in question is at variance with the terms or purposes of the trust:

Provided that in relation to a transaction entered into by trustees who are acting under the supervision of the Accountant of Court this section shall have effect only if the said Accountant consents to the transaction.

(2) Nothing in subsection (1) of this section shall affect any question of liability between any of the trustees on the one hand and any co-trustee or any of the beneficiaries on the other hand."

The transactions that are protected from challenge on the ground of lack of *vires* are: a sale of trust property, a lease of trust property, an excambion of trust property, borrowing money on the security of trust property, acquiring property as an investment and acquiring heritable property other than as an investment.⁴⁹ Section 2(1) applies even if the trust deed expressly prohibits such a transaction; the phrase in parentheses, "(which empowers trustees to do certain acts where such acts are not at variance with the terms or purposes of the trust)", has to be read as merely a description of the effect of section 4(1). It would defeat the purpose of section 2(1), which is to obviate the need for third parties to be satisfied as to the trustees' powers, to read it as applying only where the trustees expressly or impliedly have the power to carry out the specified transactions. But as subsection (2) makes clear, although the transaction itself cannot be avoided by the beneficiaries, they remain entitled to sue the trustees for any losses to the trust estate arising out of the *ultra vires* contract.

⁴⁷ McDonald, para 3.8.

⁴⁸ As amended by para 3 of sch 3 to the Charities and Trustee Investment (Scotland) Act 2005.

⁴⁹ Being the transactions specified in s 4(1)(a)-(eb) of the Trusts (Scotland) Act 1921.

2.29 There is no express requirement that the parties to the transaction be in good faith. A sale of trust property would therefore be unchallengeable although the trustees knew that this was not authorised (or even that it was expressly prohibited) by the trust deed or the third party⁵⁰ was fully aware of the *ultra vires* nature of the transaction.⁵¹ Arguably having no requirement of good faith goes beyond what is necessary to protect third parties. It is out of step with the general law that a transaction is voidable where one contracting party was aware of an antecedent contract or obligation affecting the other party's ability to carry out the transaction. One option would be to amend subsections (1) and (2) of section 2 of the Trusts (Scotland) Act 1961 so as to target the mischief more precisely. A similar problem is faced by persons transacting with a company.⁵² Finding out whether the directors have authority to carry out the proposed transaction could be time-consuming and not lead to a certain result. Section 40 of the Companies Act 2006 serves to prevent third parties from having to make detailed enquiries as to the directors' authority:

"40 (1) In favour of a person dealing with a company in good faith, the power of the directors to bind the company, or authorise others to do so, is deemed to be free of any limitation under the company's constitution.

(2) For this purpose—

(a) a person "deals with" a company if he is a party to any transaction or other act to which the company is a party,

(b) a person dealing with a company—

(i) is not bound to enquire as to any limitation on the powers of the directors to bind the company or authorise others to do so,

(ii) is presumed to have acted in good faith unless the contrary is proved, and

(iii) is not to be regarded as acting in bad faith by reason only of his knowing that an act is beyond the powers of the directors under the company's constitution."

2.30 Section 40(2)(b) might be a model for a more targeted trust provision. Thus a third party transacting with trustees in good faith would be protected from any lack of *vires* by the trustees. The third party would be presumed to be in good faith and in particular would not be bound to investigate the terms and purposes of the trust, to enquire as to the trustees' powers or to apply to the court under section 5 of the Trusts (Scotland) Act 1921. But we would not be inclined to include the provision that persons are in good faith even if they know that the directors (or trustees) have no power to carry out the transaction. It seems that this means that:

⁵⁰ S 2(1) of the Trusts (Scotland) Act 1961 refers to the "second party" but for consistency with the rest of this Part we use the term "third party".

⁵¹ 18 Stair Memorial Encyclopaedia, para 691; Halliday, para 1-25, fn 43; cf Norrie and Scobbie, pp 157-158. The remarks on the possible need for good faith in *Brodie v Secretary of State for Scotland* 2002 GWD 20-68 relate only to the situation where one of the trustees gains a benefit from the transaction.

⁵² The situation is not quite the same because a transaction which is outwith the capacity of a company will be void.

"...some additional element must be present to turn knowledge into bad faith.....It may be that the subsection is attempting to draw the distinction between knowledge of the provisions of a company's constitution and understanding what they mean."⁵³

This seems oversubtle.

2.31 On the other hand the lack of any requirement of good faith protects those buying, selling and lending to trustees. It prevents any argument that a third party who has some knowledge of the trust deed or the trustees' powers was not acting in good faith. For example, third parties or their agents may examine the trust deed to check that the names and designations of the present trustees are correctly set out in the contract documents. Are they in good faith if they refrain from looking at the schedule of powers in the trust deed? It seems to us to be better to avoid these uncertainties by continuing with the present simple rule that good faith in any shape or form is not required. The lack of good faith on the part of the third party should not harm the beneficiaries. The unchallengeable transactions are all onerous so that the trust estate should not have suffered any substantial financial loss through such a transaction. Moreover, if there has been non-financial loss or minor financial loss this might be recoverable on delictual grounds from the third party who had transacted in bad faith, and a transaction at a substantial undervalue carried out in bad faith could amount to fraud. Finally, section 2 in its present form seems to have worked well in practice for the last 40 or so years.

2.32 In terms of section 2 of the Trusts (Scotland) Act 1961 only certain transactions, ie those in section 4(1)(a)-(eb) of the 1921 Act and set out in paragraph 2.28 above, are made unchallengeable. They are all onerous. Gratuitous *ultra vires* transactions are⁵⁴ and should remain challengeable as the trustees have no power to give trust property away except as directed by the trust deed. To make gifts unchallengeable would weaken the position of the beneficiaries to a very considerable extent. But there seems no reason why only certain specified onerous transactions are unchallengeable; it would be simpler to include all onerous transactions. Otherwise the pre-1961 common law and practice would continue to apply to all other transactions.

2.33 Section 2 of the 1961 Act does not extend protection to third parties who are co-trustees or beneficiaries. Co-trustees ought to be aware of their powers so that their exclusion from the statutory protection is justified. The case for excluding beneficiaries who have entered into an onerous transaction with the trustees seems weaker. They may have little information as regards the scope of the powers of the trustees and should not be expected to undertake detailed investigations.

2.34 Summing up we put forward the following proposals and questions:

3. (1) **Section 2(1) of the Trusts (Scotland) Act 1961 should be amended so that all onerous transactions relating to the trust estate between the trustees and a third party are unchallengeable on the ground that the transaction was at variance with the terms and purposes of the trust.**

⁵³ Palmer's Company Law, para 3.304.2 commenting on the identical provision in s 35B of the Companies Act 1985.

⁵⁴ See para 2.27 above.

(2) Should good faith on the part of the third party be made a requirement for the protection in section 2(1)? If so, how should good faith be defined?

(3) The protection in section 2(1) should continue to be unavailable to a third party who is one of the trustees, but should it be available to a third party who is a beneficiary?

Trust patrimony not liable in *ultra vires* contract

2.35 We turn now to consider another possible defect in the present law, viz that a third party creditor has no recourse against the trust estate for loss due to breach of contract by the trustees if the contract was one that was outwith the trustees' powers. For example, the trustees sell stock that they do not hold with the expectation of buying it in later at a lower price. If the price of the stock rises to such an extent that the trustees cannot afford to buy in sufficient stock they would be liable to the third party for damages for breach of contract. Another example is where the trustees agree to sell a large plot of land at its agricultural value, but the purchaser obtains planning permission for its residential development before settlement of the transaction. The trustees on learning of this refuse to sell and are sued by the purchaser for loss of planning gain. If the sales in the examples were *ultra vires* of the trustees the trustees are personally liable without any right of relief against their trust patrimony.⁵⁵ This is so whether or not they describe themselves as trustees or purport to contract solely in their capacity as trustees.⁵⁶ The third party's recourse is limited to the private patrimonies of the trustees. Section 2(1) of the Trusts (Scotland) Act 1961 merely prevents the transaction being challenged on grounds of lack of *vires*, so that neither the trustees nor the third party can have the transaction set aside on this ground.

2.36 It might be argued that third parties who transact with trustees should be able to claim against the trustees' trust patrimony as well as their private patrimonies, unless the third parties were in bad faith in that they knew that the transaction was outwith the trustees' powers. The present law protects the beneficiaries at the expense of third parties. The latter have to take the risk that the transaction turns out to be *ultra vires* of the trustees and that the trustees have insufficient funds in their private patrimonies to meet the claim. It might also be argued that the present law disadvantages beneficiaries in an indirect fashion. In view of the risk and the difficulties involved in obtaining sufficient information to decide whether any claim would be met, third parties may be reluctant to enter into contracts with trustees other than corporate trustees with a sound financial reputation.

2.37 The vast majority of contracts will proceed normally with the trustees paying the third party the amount due out of their trust patrimony. This will be challenged by the beneficiaries on the ground that the contract was *ultra vires* and they will then demand that the trustees reimburse the trust patrimony from their private patrimonies. The third party will not be concerned with this internal trust dispute. The situations where a third party claims

⁵⁵ In *Allen v McCrombie's Trs* 1909 SC 710, a case involving an action for breach of trust arising out of *ultra vires* investments against the then surviving trustees, Lord M'Laren observed at 719 that only those trustees who had been at fault should be sued.

⁵⁶ Approval or ratification by the beneficiaries of an *ultra vires* contract does not give the trustees a right of relief against the trust estate; *City of Glasgow Bank v Parkhurst* (1880) 7R 749. At best it prevents the trustees being sued by the beneficiaries for breach of trust. But s 31 of the Trusts (Scotland) Act 1921 enables the court to grant relief from the share of a beneficiary at whose instigation or request the transaction was entered into.

against the trustees all involve a breach of contract by the trustees and these will be rare. In these situations there will usually be two "innocent" parties, the third party and the beneficiaries. We think that the present law is right in providing that any loss arising out of an *ultra vires* contract should fall on the trustees personally rather than be passed on to the trust patrimony and hence the beneficiaries. Third parties enter into contracts voluntarily and should have to run the risk that the transaction was *ultra vires* and that the trustees will have insufficient private funds to meet any claim. The beneficiaries by contrast are not parties to the contract and would probably have little knowledge of the contracts being entered into by the trustees. They are in our view more deserving of protection, even if the third party was in the utmost good faith.

2.38 We therefore put the following negative proposition:

4. **A third party who acted in good faith in an onerous contract with the trustees which was outwith the powers of the trustees should continue to be restricted to claiming against the trustees' private patrimonies and should not be entitled to claim against the trustees' trust patrimony.**

C: EXECUTION OF DEEDS BY TRUSTEES

Introduction

2.39 We turn now to consider the execution of deeds by trustees implementing transactions between them and third parties. We use the term "deeds" generally and do not confine it to documents relating to heritable property. It will be assumed in the rest of this section that the transaction itself is unchallengeable so that the issue is how the deed should be executed so as to implement it effectively. It has long been a settled rule in Scotland that as a matter of business and administrative convenience unanimity between the trustees is not required in every decision relating to the administration of the trust property. A decision by a majority or quorum⁵⁷ of trustees will usually be sufficient regarding the business of the trust⁵⁸ except where there is a joint or *sine qua non* appointment.⁵⁹ A distinction however has been drawn between the powers of trustees in relation to the making of a decision on the one hand and the actual implementation of the decision via a juristic act on the other.⁶⁰ Thus, whilst it is clear that only a majority of trustees need to consent to the sale of trust property (this being an administrative decision of the trust) there is doubt as to how applicable this majority rule is in relation to the execution of a disposition.

The present law

2.40 The basic rule regarding the execution of deeds is that the owner of the property being conveyed must sign the disposition. Given that trust property is owned jointly by all the trustees,⁶¹ this might mean that all the trustees have to participate in the execution of the disposition in order to transfer title. In *Scott v Reid*⁶² an interdict preventing the sale of trust property was granted where the majority decided to sell and execute the deed without

⁵⁷ Trusts (Scotland) Act 1921, s 3(c).

⁵⁸ *Stewart's Trs v Evans* (1871) 9M 810.

⁵⁹ 24 Stair Memorial Encyclopaedia, para 192. Neither of these is common.

⁶⁰ *Ibid*, vol 18, para 36.

⁶¹ Reid, para 20.

⁶² (1822) 1S 332.

obtaining the consent of the applicant trustee. This case may serve as indirect authority for the proposition that a majority of trustees do not have the power to execute deeds but it seems more likely to relate to the duty incumbent on trustees to consult *all* trustees in matters relating to the administration of the trust.⁶³ In *Freen v Beveridge*⁶⁴ a disposition was reduced on various grounds, including its execution by only two out of the three trustees, without the consent of the remaining trustee. However, there was no provision for a quorum in the trust deed and at that time an act outwith ordinary administration required the concurrence of all the trustees. Some 70 years later it was held in the case of *Macrae & Ors v Gregory & Ors*⁶⁵ that a discharge of a heritable security by a majority of existing trustees was sufficiently executed. The Lord Ordinary (Kyllachy) also stated that whether a trustee participating in the majority was infeft or uninfeft⁶⁶ was immaterial to the question of competent execution.

2.41 The most recent case on this point is *Harland Engineering Company v Stark's Trustees*.⁶⁷ Here A, B, C and D were the original infeft trustees. Subsequently A died, B was thought to have resigned whilst C and D assumed E as a new trustee, who remained uninfeft. The title conveyed to the pursuers was drafted in the names of C, D and E and signed by them accordingly. The Lord Ordinary (Ormidale) held that:⁶⁸

"...on the assumption that [B] has not resigned, that a title running in the names of the three surviving original trustees, and signed by two of them, that is by a majority of them, as well as by the assumed trustee, is all that the pursuers can reasonably demand."

But he opined that the trustee B who considered himself to have resigned should be asked to consent and sign the disposition to prevent any future challenge. Execution by a majority of the trustees therefore seems competent provided the deed is drafted in the names of all the acting trustees. But no distinction was made between infeft and uninfeft trustees leaving doubt as to whether the majority must be a majority of the infeft trustees or merely a majority of the trustees, whether infeft or uninfeft.

2.42 In the reclaiming note on expenses Lord Ormidale's judgment was doubted by Lord Johnston in the Inner House when he said:⁶⁹

"What I demur to is the idea that two out of three persons feudally vested jointly in a heritable property can give a good feudal title. This I doubt ..."

which seems to suggest that all the infeft trustees must execute the disposition.

2.43 Section 7 of the Trusts (Scotland) Act 1921 was enacted against this unsettled common law background. It provides that:

⁶³ 24 Stair Memorial Encyclopaedia, para 192.

⁶⁴ (1832) 10S 727.

⁶⁵ (1903) 11 SLT 102.

⁶⁶ An infeft trustee appears in the Land Register or the Register of Sasines as an owner of the trust property. An uninfeft trustee is a trustee who does not so appear as owner. Trustees who are assumed after the title to trust heritage has been registered are often not added as owners in order to save the trouble and expense of altering the title. Since the abolition of the feudal system "infefit" and "uninfefit" are no longer strictly appropriate, but they remain convenient shorthand expressions in common use.

⁶⁷ 1913 2 SLT 448, 1914 2 SLT 292.

⁶⁸ 1913 2 SLT 448 at 450.

⁶⁹ 1914 2 SLT 292 at 293.

"Any deed bearing to be granted by the trustees under any trust, and in fact executed by a quorum of such trustees in favour of any person other than a beneficiary or co-trustee under the trust where such person has dealt onerously and in good faith shall not be void or challengeable on the ground that any trustee or trustees under the trust was or were not consulted in the matter, or was or were not present at any meeting of trustees where the same was considered, or did not consent to or concur in the granting of the deed, or on the ground of any other omission or irregularity of procedure on the part of the trustees or any of them in relation to the granting of the deed.

Nothing in this section shall affect any question of liability or otherwise between any trustee under any trust on the one hand and any co-trustee or beneficiary under such trust on the other hand. This section shall apply to deeds granted before as well as after the passing of this Act, but shall not apply so as to affect any question which may, at the passing of this Act, be the subject of a depending action.

In this section the expression "quorum" means a quorum of the trustees under any trust entitled to act in terms of the trust deed or in virtue of this Act, or any Act repealed by this Act, as the case may be."

There has been no case law interpreting this provision and indeed its meaning is regarded as unclear.⁷⁰

2.44 One view is that a deed should be drafted in the name of all the currently acting trustees of the trust and executed by a majority of these trustees. Section 7 does not draw a distinction between infert and uninfert trustees, thereby inferring that execution by a majority, however composed, is valid. It also makes provision for the protection of onerous grantees who act in good faith from future challenge by a beneficiary or a dissenting minority seeking reduction. In this context good faith seems to mean that the grantee is unaware of any procedural defect in the granting of the deed or any irregularity in the process of deciding to carry through the transaction. Deeds by trustees in favour of one or more of their own number or in favour of one or more beneficiaries are excluded from this protection.

2.45 The alternative view is that execution must be by all infert trustees. This would mean that majority execution would not generally be valid. However, if a third party is acting onerously and in good faith then if a deed is executed by a majority of trustees in this particular circumstance, and in this circumstance only, the deed will not be challengeable. But it remains unclear whether the majority is simply a majority of the trustees or a majority of the infert trustees. There is also doubt whether good faith relates only to procedural irregularities or whether it means that the grantee believes that all the trustees are acting and signing.⁷¹ Although it is generally accepted that the first interpretation seems more likely,⁷² and indeed the second interpretation has been labelled "illogical",⁷³ the uncertainty

⁷⁰ G L Gretton, "Trusts and Executory Conveyancing" (1987) 32 JLSS 111 at p 118; Gretton and Reid, para 22-18; 18 Stair Memorial Encyclopaedia, para 36.

⁷¹ See G L Gretton, *Problems in Partnership Conveyancing* (1991) 36 JLSS 232, at p 235.

⁷² Burns, p 313.

⁷³ Norrie and Scobbie, p 99.

has led practitioners to adopt the safe approach of having deeds conveying trust property signed by all the trustees.⁷⁴

Proposals for reform

2.46 We think the present position is unsatisfactory and that clarification would benefit practitioners and trustees alike. In our view a deed should run in the names of all the currently acting trustees, but should require to be signed only by a majority of them in order to be formally valid. This would be without prejudice to the existing law which permits trustees to delegate administrative tasks, such as the execution of deeds, to agents.⁷⁵ As far as a deed relating to heritable trust property is concerned, no distinction should be drawn between trustees who are infeft or uninfeft. It has to be recognised that some organisations, such as registrars of public companies, will continue to demand that documents are signed by all the trustees.

2.47 Majority execution ought to follow from the general principle of majority decision making. If all the trustees were required to execute a deed implementing a transaction agreed to by the majority, the dissenting minority could thwart the will of the majority by refusing to sign. Likewise, drawing a distinction between infeft and uninfeft trustees as regards execution of deeds seems unnecessary if the rule is that a majority of trustees, whether infeft or uninfeft, can decide the substance of the transaction. Signature by a majority would make it easier to conduct trust business where there were absent or recalcitrant trustees. Public trusts often have a large number of trustees so that obtaining signatures from all of them can be time-consuming. The heritable property of a partnership is often held by certain partners as trustees for the partnership,⁷⁶ and it can sometimes be difficult to obtain the signature of a former partner whose departure from the firm was less than amicable and who by oversight has remained as a trustee.

2.48 We therefore propose that:

- 5. A deed bearing to be granted by all the acting trustees should be formally valid if it is executed by a quorum of them as defined by law or in the trust deed.**

Other issues with section 7 of the 1921 Act

2.49 Section 7 of the Trusts (Scotland) Act 1921 provides protection against procedural irregularities in relation to the granting of a deed by a quorum of trustees. Persons in whose favour a deed bearing to be granted by the trustees but in fact executed by a quorum and who have dealt onerously and in good faith are protected from procedural irregularities. The deed is not void or challengeable:

"...on the ground that any trustee or trustees under the trust was or were not consulted in the matter, or was or were not present at any meeting of trustees where the same was considered, or did not consent to or concur in the granting of the deed,

⁷⁴ Gretton and Reid, para 22-18.

⁷⁵ *Innes v Reid's Trs* (1822) 1S 518. The agent could be one of the trustees. We examined delegation by trustees in our Discussion Paper on *Trustees and Trust Administration* (No 126), paras 3.7 - 3.14.

⁷⁶ It is now competent for a Scottish partnership as a legal person to hold heritable property: Abolition of Feudal Tenure etc (Scotland) Act 2000, s 70.

or on the ground of any other omission or irregularity of procedure on the part of the trustees or any of them in relation to the granting of the deed."

The protection is not extended to grantees who are co-trustees or beneficiaries.

2.50 We think that these protective provisions serve a useful purpose and should be retained and indeed extended. Third parties transacting with trustees should not be required to investigate the internal administration of the trust. They should be entitled to assume that when the trustees tender an *ex facie* formally valid deed that the trustees have complied with all the necessary internal procedural requirements. At present the protective provisions apply only where a deed is signed by a quorum of the trustees. Some of the protections are specific to this situation (eg the other trustees did not consent to or concur in the granting of the deed) but others seem more general (eg any other omission or irregularity of procedure). In our opinion protection for onerous grantees should apply irrespective of the manner in which the deed was executed and should therefore be expressed more generally.

2.51 At present only third party grantees in good faith are protected. This requirement is inconsistent with section 2 of the Trusts (Scotland) Act 1961 which renders certain types of transaction unchallengeable on the ground that it is outwith the powers of the trustees, whether or not the third party is in good faith. We think that good faith should either be required in both provisions or in neither. In Proposal 2(2) we asked for views on the need for good faith and therefore repeat this request here.

2.52 Section 7 of the 1921 Act follows section 2 of the 1961 Act in not extending protection to grantees who are co-trustees or beneficiaries. Co-trustees ought to be aware of procedural irregularities and would be failing in their duty as trustees if they did not keep themselves informed of the actings of the other trustees. We think that the exclusion of co-trustees from the statutory protection is justified. The case for excluding beneficiaries who have entered into an onerous transaction with the trustees seems weaker. They may have little information as regards the scope of the powers of the trustees or the internal administration of the trust and should not be expected to undertake detailed investigations.

2.53 In order to elicit views from those with practical experience of the issues we put forward the following proposals and questions:

6. (1) **Section 7 of the Trusts (Scotland) Act 1921 should be replaced by a new statutory provision whereby a deed in favour of an onerous grantee validly executed by or on behalf of trustees is not to be void or challengeable on the ground that there was any omission or irregularity of procedure on the part of the trustees or any of them in relation to the transaction implemented by the deed.**
- (2) **Should good faith on the part of the grantee be required? If so, how should good faith be defined?**
- (3) **The protection in paragraph 1 above should continue to be unavailable to a grantee who is a co-trustee, but should it be available to a grantee who is a beneficiary of the trust?**

Part 3 Liability for delict and other wrongs

Introduction

3.1 In this part we look at the delictual liability of trustees to third parties and their liability to third parties in relation to their ownership of assets or receipt of property. We are not concerned with the liability as such but rather with its allocation between the trustees' trust patrimony and their private patrimonies.

A: LIABILITY IN DELICT

The present law

3.2 One of the main areas where trustees might become liable to third parties is delict. For example, liability might arise where an employee of a family electrical contracting business run by trustees caused a house fire due to mis-wiring or where a customer in a charity shop breaks a leg by tripping on an uneven floor. There is a dearth of reported Scottish cases. Most of these involve statutory road, docks and similar public works trusts and date from the 19th century.

3.3 There is only one reported¹ private trust delict case, viz *Mulholland v MacFarlane's Trustees*.² The trustees ran a bus company and a bus driven by one of their employees ran down and injured Mr Mulholland. He sued the trustees and was awarded £250. Decree was granted against the trustees as trustees but expenses were awarded against them as individuals. Lord Moncrieff held that since the action had been brought against the trustees "as trustees", decree had to be granted in that form. But he went on to say:³

"...had it not been for the form of the crave of the initial writ I should have felt that there was great force in the pursuer's contention [for decree to be granted against trustees as individuals]. The sum sued for is claimed as due in respect of the action of the trustees themselves in the conduct of the truster's business as carried on by them after the truster's death. To make payment of such a claim trustees are *prima facie* liable as individuals."

Where the trust estate is sufficient to meet an award of damages then the form of the decree does not matter since the trustees are entitled to meet their obligations out of their trust patrimony. As Mackenzie Stuart observes:⁴

"Where the trustees, in administering the trust, have been found liable in damages to third parties, either through their own actings in good faith and for the intended benefit of the trust, or through the fault of persons employed by them, the damages

¹ The other case, *Johnston v Waddell* 1928 S.N. 81, involved an injured bus passenger who sued for breach of contract rather than on delictual grounds.

² 1928 SLT 251.

³ *Ibid*, at 252.

⁴ Mackenzie Stuart, p 335.

which the trustees have paid, or for which they have become liable, are chargeable against the trust estate."

However, should the trust estate be insufficient, the form of the decree becomes important. A pursuer with a decree against the trustees "as trustees" is limited to their trust patrimony. A pursuer with a decree against the trustees as individuals is not so limited and may recover any balance from the trustees' private patrimonies. And had the trustees themselves been negligent it would be possible for damages to be awarded against them personally without any right of relief or indemnity against their trust patrimony.

3.4 In the 18th and 19th centuries many services now provided by local authorities, such as roads, bridges, docks and police, were provided by trusts or commissions set up by a local Act of Parliament. There were many cases where such trusts were sued for injuries caused by negligence of the trustees' employees, such as leaving unguarded holes or obstacles in the road. Prior to the case of *Duncan v Findlater*,⁵ the practice in Scotland was to sue the officer (clerk or treasurer) appointed in terms of the trust statute to represent the trustees and for any damages to be payable out of the trust funds. The trustees as individuals were not sued nor were the negligent employees.⁶ In *Duncan v Findlater* however the House of Lords held (following contemporary English practice) that the statutory trust fund was immune from delictual claims. Any claims had to be against the negligent employees or the trustees personally where they had in some way been personally liable.⁷ This was followed in *Heriot's Hospital v Ross*⁸ where a boy sued for being wrongfully refused admission to a school and the loss of a superior education.

3.5 These two cases created what became known as the "trust fund theory" of charitable or public trust immunity. The trust funds were immune against delictual claims because the funds were to be used *solely* for the charitable or public purposes. This immunity was short-lived. In 1866 the House of Lords in the English case of *Mersey Docks and Harbour Trustees v Gibbs*⁹ held that non-profit statutory public trusts were subject to the same liabilities as private persons unless the statute in question provided immunity. The *Mersey Docks* case was followed in Scotland in *Virtue v Commissioners of Police of Alloa*¹⁰ where damages were awarded against the clerk representing the Commissioners which would have been payable out of the Commissioners' trust patrimony.

Proposals for reform

3.6 Trustees must be liable for delicts committed by them, their agents or employees. It would be unjust for third parties' injuries to go uncompensated simply because the person ultimately responsible was a body of trustees. The question is to what extent damages should be payable by the trustees personally out of their private patrimonies or by the trustees out of their trust patrimony alone.

3.7 If, as seems to be the case, trustees may be sued personally in all situations then we think that the law should be changed. It is wrong that the trustees' private patrimonies

⁵ (1839) 1 McL and Rob 911.

⁶ *Virtue v Alloa Police Commissioners* (1873) 1R 285, Lord President Inglis at 292.

⁷ (1839) 1 McL and Rob 911, Cottenham L C at 930. The trustees were also not personally vicariously liable.

⁸ (1846) 5 Bell's App 37.

⁹ [1866] 11 ER 1500; [1866] XI HLC 685.

¹⁰ (1873) 1R 285.

should always be at risk from their employee's or agent's negligence. We understand that people are becoming increasingly reluctant to act as trustees because of the financial risks involved. Insurance against personal liability is often impossible to obtain and even when it is available the cover provided is limited. We are attracted to the approach of the American Uniform Trust Code in terms of which trustees are personally liable only if they themselves have been at fault. Section 1010(b) provides that:

"A trustee is personally liable for torts committed in the course of administering a trust, or for obligations arising from ownership or control of trust property, including liability for violation of environmental law, only if the trustee is personally at fault."

The concept of fault would however include knowingly employing an incompetent employee or a dishonest agent. On the other hand, when a third party has suffered loss without any trustee being personally at fault, the trustees should be sued in their representative capacities so that any damages awarded would be payable only out of their trust patrimony. It might be objected that a small trust would be unable to pay much in the way of damages and to that extent a victim's injuries would go uncompensated. This is likely to be very uncommon as trustees who engage in activities (such as running a business or a shop) which could give rise to delictual claims should be insured.¹¹ Moreover, the victim could sue the negligent employee or agent directly.

3.8 But not all situations will be as clear cut as in the previous paragraph. For example, take a person in the street who was injured by a lorry belonging to the trustees. The main cause of the accident was that it had been driven negligently by their employee. But the accident was aggravated due the poor state of the brakes. One of the trustees is responsible for the lorry's maintenance. Due to his negligence he fails to have the brakes repaired. In this situation the injured person would be able to sue the trustee at fault personally and the trustees collectively. The court should be able to apportion the damages due to the injured person between the trust patrimony and the personal patrimony of the trustee at fault. We are not in favour of allowing a trustee who is at fault and therefore personally liable to seek relief or indemnity from the trust estate. It is difficult to see how trustees who were at fault can be said to have behaved reasonably and within their powers. Relief or indemnity is appropriate only in a system, such as that in England and Wales, where trustees are in the first instance personally liable irrespective of fault.

3.9 We propose that:

7. (1) **Where a person suffers loss as a result of some act or omission of the trustees (or anyone for whom they are responsible) in the course of administering the trust, damages should generally be payable from the trustees' trust patrimony. Damages should be payable from a trustee's private patrimony only if, and to the extent that, he or she was personally at fault.**

¹¹ Insurance will not be available for criminal conduct such as child abuse: see *E (S M) v Christian Brothers of Ireland in Canada* [1995] 136 Nfld & P E I R 52 where the charitable trust became insolvent due to massive claims.

(2) It should be competent for the court to award damages partly from the trustees' trust patrimony and partly from the private patrimony of a trustee who was at fault.

B: OWNERSHIP AND OCCUPATION OF PROPERTY

Environmental liability

3.10 A major potential liability for trustees owning land relates to contamination and pollution. The trustees may incur civil liability in respect of contaminated land¹² in two ways: first as actual polluters and secondly as owners or occupiers of contaminated land. Trustees could be actual polluters by carrying on activities in the course of their business which caused contamination to affect the land or discharged pollutants into controlled waters.¹³ An owner is defined as a person for the time being entitled to receive, or who if the land were let would be entitled to receive, rents of the land.¹⁴ Trustees, judicial factors, guardians and trustees of public lands are expressly included as owners. Trustees could also be liable as current owners to pay for remediation of any contaminated land, whether or not they were responsible for its contamination.¹⁵ The legislation is silent as to the capacity in which the trustees are liable. It has been suggested in relation to trustees' liability as owners that liability is not personal.¹⁶

3.11 Criminal liability may arise if the trustees carried on a business which involved controlled waste¹⁷ or caused pollution to enter controlled waters.¹⁸ If the Scottish Environment Protection Agency carries out operations to remedy or forestall pollution it may recover the costs from the persons responsible. Trustees could therefore also incur civil liability for pollution. Trustees could also incur liability under other environmental legislation, such as the Oil Pollution Act 1971, section 62 of the Control of Pollution Act 1974 (noise pollution), the Food and Environment Protection Act 1985,¹⁹ the Radioactive Substances Act 1993, and the Clean Air Act 1993.

3.12 Section 1010(b) of the American Uniform Trust Code provides that:

"A trustee is personally liable for torts committed in the course of administering a trust, or for obligations arising from ownership or control of trust property, including liability for violation of environmental law, only if the trustee is personally at fault."

The official comment states that protection from personal liability for environmental law violations had been specifically included as that was of particular concern to trustees. One of the specific powers conferred on trustees by the Code is the power to abate or remedy any violation of environmental law and to charge the trust estate with the costs.²⁰

¹² Defined in s 78A of the Environmental Protection Act 1990, as amended by the Environment Act 1995, s 57.

¹³ *Ibid*, s 78F(2).

¹⁴ *Ibid*, s 78A(9).

¹⁵ *Ibid*, s 78E.

¹⁶ Brown, para 15.31.

¹⁷ Environmental Protection Act 1990, s 33 and Pollution Prevention and Control (Scotland) Regulations 2000.

¹⁸ Control of Pollution Act 1974, s 30F.

¹⁹ Part II, dumping at sea.

²⁰ S 816(13).

Owner's and occupier's liability

3.13 The Occupiers Liability (Scotland) Act 1960 imposes a duty of care on those occupying or controlling premises towards persons entering the premises. The occupier or person in control has to show reasonable care in the circumstances to prevent injury or damage.²¹ Landlords who are responsible for the maintenance and repair of premises owe a similar duty of care to persons lawfully entering them.²² The Act does not specifically deal with trustees and it is not clear whether they would be personally liable or liable only in their representative capacity.

Proposals for reform

3.14 We think it would be useful to clarify the liability of trustees in these areas. We agree with the approach in the American Uniform Trust Code that personal liability should require some element of personal fault. Ownership or occupation of property should be insufficient by itself. This would be consistent with our proposals for delictual liability²³ and the present rules of criminal procedure.²⁴ We therefore propose that:

8. (1) **Where liability arises out of the trustees' ownership or control of trust property or under environmental legislation only the trustees' trust patrimony should generally be liable. A trustee's private patrimony should be liable only if, and to the extent that, he or she was personally at fault.**
- (2) **It should be competent for the court to award damages partly from the trustees' trust patrimony and partly from the private patrimony of a trustee who was at fault.**

C: MISCELLANEOUS

Taxation

3.15 Section 151(2) of the Finance Act 1989 charges income tax on the trustee in whose name trust income arises and on any subsequent trustee of the trust. The situation is different as regards capital gains tax. There the trustees are treated as a single and continuous body of persons distinct from the persons who may from time to time be trustees.²⁵ For inheritance tax purposes trustees are only liable for tax up to the value of the property that they have received, disposed or become liable to account for to the beneficiaries and of any other property which is their hands for the payment of tax (or would have been but for their own neglect or default).²⁶ We make no proposals for amendment of these provisions.

²¹ See for example *Titchener v British Railways Board* 1984 SC(HL) 34.

²² S 3.

²³ See para 3.9 above.

²⁴ See para 3.16 below.

²⁵ Taxation of Chargeable Gains Act 1992, s 69(1) and (4).

²⁶ Inheritance Tax Act 1984, s 204(2).

Criminal liability

3.16 In the course of their management of the trust estate the trustees may commit an offence and be prosecuted. Section 143(1) of the Criminal Procedure (Scotland) Act 1995 provides that, without prejudice to other statutes, the provisions of section 143 apply to the prosecution by summary procedure of, among other entities, a "body of trustees". Subsection (2) states that proceedings may be taken against the "body of trustees in their corporate capacity" and any penalty imposed is to be recoverable by civil diligence. In the case of *Aitkenhead v Fraser*²⁷ the trustees of an agricultural estate were charged under the Health and Safety at Work etc Act 1974 for failing to ensure the welfare of an employee. They were charged as individuals and as the trustees of the estate. On appeal the High Court held that the phrase "in their corporate capacity" meant that the trustees, while being named, must be prosecuted as a body and not as individuals. Any conviction was likewise of the trustees as a body so that the individual trustees would not have a criminal conviction against their names. Trustees as a body could not be imprisoned and any fine imposed would be payable out of the trust estate. The beneficiaries could subsequently seek to recover from the trustees' private patrimonies any fine paid out of the trust patrimony. The High Court also indicated that a similar approach should be adopted in relation to solemn proceedings, but expressly limited its opinion to summary proceedings.

3.17 Where the circumstances are such that a trustee committed an offence in the course of his or her duties, that trustee could be prosecuted as an individual, whether alone or in conjunction with the trustees as a body. We think the present law is satisfactory and make no proposals for reform.

²⁷ 2006 SLT 711; it appears in the Scottish court opinions website as *Aitkenhead and Strang Steel v PF Selkirk* [2006] HCJAC 51.

Part 4 Liability for litigation expenses

Introduction

4.1 At one time the courts awarded expenses against unsuccessful litigants only if they had acted unreasonably, improperly or in bad faith. Around the beginning of the 19th century the modern practice developed of expenses following success so that an unsuccessful litigant was generally found liable for the successful opponent's expenses. However, where trustees were concerned, the old rule tended to persist for some time thereafter.¹ Although there are no fixed rules about expenses, as awards are always at the discretion of the court, the general practice of making an award in favour of the successful party is generally followed. A court is not bound by the representative capacity in which the trustees were cited as defenders.²

4.2 There are three main types of award of expenses against persons such as trustees who litigate in a representative capacity. The first is where the interlocutor awards expenses against the trustees "as trustees", the second is where the interlocutor awards expenses against the named trustees personally, and the third awards expenses against the named trustees without any further qualification. We turn now to examine the effect of each of these interlocutors and the circumstances in which a particular form of award is appropriate.

Liable as trustee

4.3 Where the award of expenses is against the named trustees "as trustees" then the trustees are liable in their representative capacity only and are to pay the expenses out of their trust patrimony. Should that patrimony be insufficient the balance cannot be recovered out of their private patrimonies.³ Section 34 of the Trusts (Scotland) Act 1921 gives legislative effect to this practice. It provides that in relation to any application under the Act, the court may direct that any of the expenses shall be payable out of the trust estate where it considers that to be reasonable. Section 34 may also be used to award out of the trust estate the expenses of all parties to the action. This is often used where the meaning of the trust deed is unclear and resort has been made to litigation in order to obtain a ruling.⁴ Such an award prejudices the beneficiaries who may not be parties to the action.⁵ It authorises trustees to pay the expenses from their trust patrimony without the beneficiaries having an opportunity to challenge this.

4.4 In *Craig v Hogg*⁶ Lord M'Laren gave examples of cases where expenses ought to be payable only out of the trust estate. Apart from ambiguous trust deeds (mentioned in paragraph 4.3 above), he mentioned trustees defending the interests of children or insane or absent persons. The justification was that the trustees were unable to consult with them as

¹ MacLaren, p 172.

² *Mulholland v Macfarlane's Trs* 1928 SLT 251 in which decree of expenses against the trustee as individuals was awarded although they were sued in their representative capacities.

³ *Craig v Hogg* (1896) 24R 6; *Dyer v Craig Law Developments Limited* 1999 SLT 1228.

⁴ *Wright's Trs Petrs* (1870) 8M 708, Lord Cowan at 713.

⁵ MacLaren, p 103.

⁶ (1896) 24R 6 at 20.

to the appropriateness of litigation and had to make the decision themselves.⁷ Expenses were awarded against trustees as trustees in *Independent Pension Trustees Limited v LAW Construction Co Ltd*⁸ the Lord Ordinary (Hamilton) said that the trustees' actions were *bona fide* and were reasonably taken in the light of legal advice obtained in respect of an area of novelty and difficulty.

Liabie personally

4.5 The interlocutor relating to expenses may award them against the named trustees personally. The effect of this is that the trustees must pay the expenses out of their private patrimonies without any right of reimbursement or relief from their trust patrimony.⁹ Sometimes the interlocutor expressly states that relief from the trust estate or patrimony is not permitted.¹⁰ Cases where trustees have had expenses awarded against them personally include:

- (a) where they engaged in unnecessary litigation, either as pursuers or defenders;¹¹
- (b) where the trustees unsuccessfully opposed their removal or replacement by a judicial factor;¹²
- (c) where the litigation has arisen due to the trustees' neglect of duty;¹³
- (d) where a minority of the trustees unsuccessfully pursued an action in the name of the trustees without consulting their co-trustees.¹⁴ Where a minority defends, relief is allowed against the trust estate only if the trust has benefited from the intervention;¹⁵
- (e) where the trustees have unsuccessfully opposed the reduction of the trust deed,¹⁶ but relief may be allowed where the character of the trustees has been impugned¹⁷ or where they defended the deed in good faith, particularly if they acted on the advice of counsel.¹⁸

Liabie simpliciter

4.6 The normal form of an award of expenses against trustees is for the interlocutor to be against the named trustees without any further qualification. This has the effect of making the trustees personally liable to pay the expenses to the successful opponent but preserves the trustees' right of relief against the trust estate.¹⁹ The general rule is that trustees are

⁷ MacLaren, p 183.

⁸ 17 December 1996, unreported.

⁹ *Kilmarnock Theatre Co Ltd v Buchanan* 1911 SC 607.

¹⁰ *Buckle v Kirk* (1908) 15 SLT 1002.

¹¹ *Smith v Telford* (1838) 16S 1223; *Law v Humphrey* (1876) 3R 1192.

¹² *Brown v Burt* (1848) 11D 338; *Stewart v Morrison* (1892) 19R 1009.

¹³ *Jassal's Tr v Jassal* 1987 SLT 371.

¹⁴ *Morison v Gowans* (1873) 1R 116.

¹⁵ *Stewart v Dobie's Trs* (1899) 1F 1183.

¹⁶ *Graham v Marshall* (1860) 23D 41.

¹⁷ *Ross v Ross' Trs* (1898) 25R 897.

¹⁸ *Watson v Watson's Trs* (1875) 2R 344; *Sinclair v Royal Bank of Scotland* 1983 SLT 256.

¹⁹ *Craig v Hogg* (1896) 24R 6, Lord M'Laren at 20. The beneficiaries may of course challenge later the trustees' inclusion of the expenses in the trust accounts.

entitled to be indemnified for all expenses necessarily, properly and reasonably incurred in the discharge of their duty. As Lord M'Laren said in *Gibson v Caddall's Trustees*.²⁰

"It is always understood that where trustees, acting in the discharge of their duty, litigate in the name of the trust estate and for the protection of the interests of the trust, they are entitled to charge the trust with the account for expenses, upon the principle that representative persons are entitled to the costs necessarily incurred in the interests of their constituents. It would, I think, be unfair that their right should depend upon the circumstances of their being successful in the litigation, and if such a rule were established, I imagine that it would be difficult to find persons willing to become trustees."

Following the advice of counsel in deciding to litigate will normally entitle the trustees to reimbursement from the trust estate.²¹ Trustees who have a right of relief against the trust estate in relation to the expenses of an unsuccessful litigation are entitled to charge what they paid their own legal advisers as well as the expenses they have to pay to their successful opponent.²² Where trustees unsuccessfully litigate with a beneficiary the expenses may not be taken out of his or her share of the trust estate.²³

4.7 A cohabitant may apply to the court for an award out of his or her deceased partner's intestate estate under section 29 of the Family Law (Scotland) Act 2006. The contradictor will be the executor-dative acting on behalf of the intestate heirs. In the case of *Cameron v Gibson (No 2)*²⁴ it was held that an executor-dative who had unsuccessfully defended an action of reduction of an adoption order was personally liable for his own and the pursuer's expenses. The executor-dative was not defending the deceased's testamentary settlement and the litigation was truly between those who were entitled to the estate if the adoption order was reduced and those who were entitled to the estate if the adoption order was not reduced. This case has led to concerns by executors-dative that they may be personally liable for all the expenses of a successful cohabitant's application, particularly as the award is a discretionary one and there is as yet no guidance from decided cases as to what would be a reasonable award. The executor-dative can avoid having to meet the expenses personally by obtaining an indemnity from the intestate heirs.

Proposals for reform

4.8 The main advantage of the general rule that an award of expenses is made against the trustees without further qualification is that it leaves open the question of the trustees' right of relief against the trust estate. The matter can then be resolved between the trustees and the beneficiaries at a later date, with further proceedings if necessary. It also discourages trustees from indulging in rash litigation for they are personally responsible in the first instance and may have to pay out of their own pockets should the trust estate prove insufficient. The present rules also benefit successful litigants who raise or defend proceedings against trustees. Unless the form of the award of expenses precludes recourse against the trust patrimony or the trustees' private patrimonies the litigant has the benefit of

²⁰ (1895) 22R 889 at 893.

²¹ *Buckle v Kirk* (1908) 15 SLT 1002, Lord President Dunedin at 1004.

²² *Lord Lovat v Fraser* (1866) 4M (HL) 32, Lord Kingsdown at 39.

²³ *Anderson v Anderson's Trs* (1901) 4F 96.

²⁴ 2006 CSIH 53.

recourse against both patrimonies. Should either patrimony prove insufficient, the balance can be recovered from the other.

4.9 It could be argued that the present system is too discretionary and potentially onerous for trustees. Trustees normally litigate responsibly and do not raise or defend actions needlessly. As we argued earlier in the context of contractual, delictual and other liabilities, trustees should not have to put their private patrimonies at risk when they are simply performing their duties properly. Setting out new expenses rules in legislation would lessen this risk and create a more certain climate. The basic rule should be that trustees who litigate as trustees should not be personally liable in expenses. The expenses would be awarded against the trustees as trustees and be paid by them out of their trust patrimony. Should that patrimony prove insufficient the balance would not be payable by the trustees out of their private patrimonies. The legislation would then list situations where the trustees would be personally liable without recourse to their trust patrimony. This list would be modelled on the current list (set out in paragraph 4.5 above) where trustees are likely to be found personally liable. A final provision would give the court discretion to depart from the rules in exceptional circumstances. The beneficiaries and the trustees would be entitled to make representations that the normal rules should be departed from. The form of the decree for expenses would settle which patrimony was liable for them and prevent the issue being raised in separate proceedings between the trustees and the beneficiaries later.

4.10 In order to obtain views, especially from those with practical experience of trust litigation, we ask the following questions:

9. (a) **Should trustees' liability for litigation expenses be set out in new legislation along the lines of the scheme outlined in paragraph 4.9?**
- (b) **If not, what other changes, if any, to current practice should be made?**

Prior authority to litigate without incurring personal liability

4.11 Prudent trustees will seek the agreement of the beneficiaries before pursuing or defending civil proceedings relating to the trust and obtain an indemnity from the beneficiaries should they be found liable in expenses. However, it may not be possible to obtain the agreement of all the beneficiaries, where for example the trust is a discretionary one for an extended family or is a public trust. If the trustees are seeking directions from the court in relation to proposed trust litigation then the question of liability for expenses could be dealt with at the same time. But this remedy is of limited general application.

4.12 In England and Wales trustees can obtain authority to litigate at the beneficiaries' expense by means of an application for a *Beddoe* order.²⁵ The effect of an order being granted is that if the trustees are unsuccessful in the subsequent litigation and have costs awarded against them, they are not personally liable. The costs are payable only out of the trust estate. The advantage of this procedure is that it protects trustees from having to pay the costs out of their own pockets. On the other hand, the existence of such a procedure means that trustees and beneficiaries feel obliged to use it for all except the more minor litigation and are reluctant to rely on the advice of experienced litigation practitioners or

²⁵ See Appendix A, para 37.

advocates. Introducing *Beddoe* orders into Scots trust law would add to the costs of trust litigation and create an extra hurdle for trustees to surmount before they could commence proceedings. The need to introduce a pre-litigation authorisation procedure would be much lessened if the liability of trustees for expenses was less discretionary and the situations where personally liability arose were confined to certain clearly set out situations as we proposed in paragraph 4.9 above.

4.13 We have considered whether trustees might be able to escape personal liability for expenses if an experienced litigation practitioner or advocate had certified that it would be reasonable for the trustees to pursue or defend the civil proceedings in question. We have rejected this as being too bureaucratic. It would require some organisation such as the Law Society of Scotland or the Faculty of Advocates to set up and maintain a register of experienced litigation practitioners and advocates. This would involve fixing the criteria for inclusion on the register, deciding who qualified and removing those who ceased to qualify by retirement or otherwise.

4.14 We invite views on the following negative proposal:

10. There is no need to introduce new procedures whereby trustees would not be personally liable for any expenses arising out of their participation in existing or proposed civil proceedings if:

(a) a court, on application by the trustees, had authorised them to pursue or defend such proceedings, or

(b) an experienced litigation practitioner or advocate had certified that the trustees' participation would be reasonable.

Part 5 List of Proposals and Questions

1. Where trustees enter into a contract with a third party which is within their powers in the course of administering the trust and either:

- (a) the fact that the trustees are acting in a representative capacity on behalf of a specified trust is disclosed at that time to the third party; or

- (b) the third party was otherwise aware that the trustees were so acting,

then the third party's rights under the contract should be enforceable only against the trustees' trust patrimony, unless the contract provides otherwise.

(Paragraph 2.20)

2. Where the trustees' private patrimonies are liable under a contract with a third party but the trustees have a right of relief in respect of that liability against their trust patrimony:

- (a) should the third party have a direct right of recovery from the trust patrimony; and

- (b) if so, what is the best way of achieving this?

(Paragraph 2.24)

3. (1) Section 2(1) of the Trusts (Scotland) Act 1961 should be amended so that all onerous transactions relating to the trust estate between the trustees and a third party are unchallengeable on the ground that the transaction was at variance with the terms and purposes of the trust.

- (2) Should good faith on the part of the third party be made a requirement for the protection in section 2(1)? If so, how should good faith be defined?

- (3) The protection in section 2(1) should continue to be unavailable to a third party who is one of the trustees, but should it be available to a third party who is a beneficiary?

(Paragraph 2.34)

4. A third party who acted in good faith in an onerous contract with the trustees which was outwith the powers of the trustees should continue to be restricted to claiming against the trustees' private patrimonies and should not be entitled to claim against the trustees' trust patrimony.

(Paragraph 2.38)

5. A deed bearing to be granted by all the acting trustees should be formally valid if it is executed by a quorum of them as defined by law or in the trust deed.

(Paragraph 2.48)

6. (1) Section 7 of the Trusts (Scotland) Act 1921 should be replaced by a new statutory provision whereby a deed in favour of an onerous grantee validly executed by or on behalf of trustees is not to be void or challengeable on the ground that there was any omission or irregularity of procedure on the part of the trustees or any of them in relation to the transaction implemented by the deed.

(2) Should good faith on the part of the grantee be required? If so, how should good faith be defined?

(3) The protection in paragraph 1 above should continue to be unavailable to a grantee who is a co-trustee, but should it be available to a grantee who is a beneficiary of the trust?

(Paragraph 2.53)

7. (1) Where a person suffers loss as a result of some act or omission of the trustees (or anyone for whom they are responsible) in the course of administering the trust, damages should generally be payable from the trustees' trust patrimony. Damages should be payable from a trustee's private patrimony only if, and to the extent that, he or she was personally at fault.

(2) It should be competent for the court to award damages partly from the trustees' trust patrimony and partly from the private patrimony of a trustee who was at fault.

(Paragraph 3.9)

8. (1) Where liability arises out of the trustees' ownership or control of trust property or under environmental legislation only the trustees' trust patrimony should generally be liable. A trustee's private patrimony should be liable only if, and to the extent that, he or she was personally at fault.

(2) It should be competent for the court to award damages partly from the trustees' trust patrimony and partly from the private patrimony of a trustee who was at fault.

(Paragraph 3.14)

9. (a) Should trustees' liability for litigation expenses be set out in new legislation along the lines of the scheme outlined in paragraph 4.9?

(b) If not, what other changes, if any, to current practice should be made?

(Paragraph 4.10)

10. There is no need to introduce new procedures whereby trustees would not be personally liable for any expenses arising out of their participation in existing or proposed civil proceedings if:
 - (a) a court, on application by the trustees, had authorised them to pursue or defend such proceedings, or
 - (b) an experienced litigation practitioner or advocate had certified that the trustees' participation would be reasonable.

(Paragraph 4.14)

Appendix A Comparative Law

A. CONTRACTUAL LIABILITY

England and Wales

1. Lewin states that:

"A trustee who enters into a contract will generally be personally liable under the contract, like other contracting parties. Subject to any contractual limitations on a trustee's liability, his personal liability to the other contracting party will be unlimited. However, it is open to the trustee, if the contract is of a character which admits of limited liability, to limit his liability to a specified amount, or to the extent of the trust assets available for the purpose of meeting a claim... Moreover, a trustee may, at any rate if so authorised by the trust instrument...contract that he will not be liable to make payment personally, but be liable only to make payment out of the trust fund."¹

In attempting to limit liability it is not enough for the trustee merely to describe himself as a trustee; something more is required. Thus a statement to the effect that the trustee is contracting "as trustee but not otherwise" or "as trustee only" might be sufficient to limit liability.² Lewin considers it to be not altogether clear what effect a contract providing for payment out of the trust fund will have:

"Plainly the other contracting party may sue the trustee and require him to meet the liability out of the trust fund. And if the trustee fails to do so, it is thought that, at least, the other contracting party would be subrogated to the trustee's right to meet the payment from the trust fund, to the extent that the trustee enjoyed such a right. Arguably, the other contracting party might acquire a direct equitable charge over the trust fund which would be independent of the trustee's right of subrogation, but it is thought that such a direct equitable charge would not arise by reason only that the trustee had contracted to meet the liability from the trust fund."³

Trustees will be entitled to discharge their personal liability out of the trust funds provided the contract was made by them in the proper course of administration of the trust.⁴ Thus section 31(1) of the Trustee Act 2000 provides that:

"A trustee
a) is entitled to be reimbursed from the trust funds, or
b) may pay out of the trust funds,
expenses properly incurred by him when acting on behalf of the trust."

This indemnity has been described as a first charge or lien upon the trust fund which confers an equitable interest in the trust fund and comprises rights of reimbursement, exoneration, retention and realisation.⁵ Thus the trustee may elect whether to discharge the liability from his own resources and then seek repayment, or may discharge liability directly from the trust

¹ Lewin, para 21-11.

² *Ibid.*

³ *Ibid.*, para 21-12.

⁴ *Ibid.*, para 21-13.

⁵ *Ibid.*, para 21-33.

fund and so exonerate himself from liability.⁶ The latter scenario is the more common. The trustee also has the right to retain trust assets until he has been indemnified and may realise trust assets for the purpose of meeting his costs. The right to indemnity is a crucially important facet of trusteeship due to the unlimited personal liability trustees face at common law, and it has been said to be "inseparable from the office of the trustee".⁷ Trustees cannot avoid personal liability by claiming that the contract was *ultra vires* and thus void, as they contract as individuals and so *prima facie* "have no restriction on their capacity as individuals."⁸

2. Indemnity is of such paramount importance that it is given precedence over all beneficial interests. Where the trust fund is insufficient, trustees are entitled to have all their costs and liabilities paid in priority to the beneficiary's claim.⁹ If the trustees are in some way indebted to the trust, perhaps for losses or damages caused by breach of trust, they will not be entitled to indemnity until the debt is cleared.¹⁰ Thus if they incur liability under a contract whilst so indebted, they must discharge the liability from their private patrimony.

3. Where the trustee has a right of indemnity the other contracting party may also have a right, by way of subrogation, to stand in the place of the trustee and enforce his claim directly against the trust property.¹¹ He may only enforce this claim to the extent that the trustee was himself entitled to indemnity. In order to enforce his right of subrogation the creditor must establish that the trustee was in fact entitled to indemnity.¹² However it has been stated that it does not follow that the right of subrogation may be enforced against the trust fund in the same manner as the right of indemnity may be enforced by the trustee:

"In a case where the right of subrogation was expressed in broad terms, [it] was justified as avoiding the need for a double process of the creditor...suing the trustee, recovering the damages from him and leaving the trustee to recoup himself out of the trust fund. But the right of subrogation goes further than this, and enables a creditor to enforce an unsecured claim against the trust property in cases where it would not be possible for the claim to be enforced against the trustee personally, as where the trustee has absconded, or has died and his personal representatives are able to defend the claim by a plea of *plene administravit*, or most importantly where the trustee is insolvent. The right of subrogation prevents the beneficiaries from avoiding liabilities which properly fall on the trust fund by having a trustee who is a man of straw. In an ordinary case, a trustee, though personally liable, is entitled to meet the liability directly from the trust property, and there appears to be no practical problem such as justifies the creditor...in bringing proceedings against the beneficiaries so as to enforce the claim against the trust property. It may therefore be the case that the court will make an order in favour of a creditor...who claims to be subrogated to the trustee's right of indemnity only where the trust is being administered by the court, or where there is good reason...to bring the claim against the beneficiaries, as where

⁶ *Ibid.*

⁷ Underhill and Hayton, p 1001, citing as authority two old English cases: *Worrall v Harford* [1802] 8 Ves 4; *Re Exhall Coal Co Ltd* [1866] 35 Beav 449.

⁸ *Ibid.*, p 1002.

⁹ *Ibid.*, p 1008.

¹⁰ *Ibid.*, p 1015.

¹¹ Lewin, para 21-13.

¹² *Ibid.*, para 21-40.

the creditor...is unable to enforce the personal liability of the trustee, or the trustee's right of indemnity is disputed by the beneficiaries..."¹³

4. Whilst the right to indemnity is in general enforceable against the trust fund only, there are certain circumstances in which it can be enforced against the beneficiary personally. This may be permitted where the beneficiary was the creator of the trust, or where the beneficiary personally requested the trustee to assume office or where the trustee was nominated to hold shares.¹⁴ This last situation occurred in the case of *Hardoon v Bellios*¹⁵ in which shares were placed in the plaintiff's name by his employers. He had no beneficial interest in the shares and was essentially bare trustee for his employers.¹⁶ Upon a call being made on him which he was obliged to pay he sued the defendant, who was the successor in title of the trustee's employers and thus was beneficially entitled to the shares. It was held that such a beneficiary who was *sui juris* was obliged to indemnify the trustee out of his personal estate. Lord Lindley stated that:

"The plainest principles of justice require that the cestui que trust who gets all the benefit of the property should bear its burdens unless he can show some good reason why his trustee should bear them himself...Although the defendant did not create the trust, he accepted a transfer of the beneficial ownership in the shares...with full knowledge of the fact that they were registered in the plaintiff's name as trustee for their original purchaser and their assigns..."¹⁷

5. In exceptional circumstances, it may be possible for trustees to have a right of indemnity even where they were not acting in the proper course of trust business. The best example is where they were not authorised to act in the way they did, yet did so in good faith and in so doing conferred some benefit on the trust property.¹⁸ In such a case they may be entitled to indemnity up to the value of the benefit.

Some Commonwealth jurisdictions

6. Some jurisdictions have tended to use the English model of trustee liability as their template.¹⁹ Trustees are thus personally liable for the full amount of the debt at common law, but may be relieved by the right of indemnity. As in England and Wales the right to indemnity tends to be statutory. Much of the legislation in these jurisdictions is essentially a mirror image of the English Trustee Act 1925, for example the New Zealand Trustee Act 1956. The wording of the statutory provisions varies as between the different States and Provinces of Australia and Canada but the fundamental principle is always preserved.²⁰

7. The Queensland Trusts Act 1973 departs from the consensus by frustrating any attempt in the trust deed to oust the right to indemnity. The 1973 Act states that such a right "shall apply whether or not a contrary intention is expressed in the instrument creating the trust."²¹ This was applied in the case of *Kemtron*²² where it was observed that "the right of

¹³ *Ibid*, para 21-41.

¹⁴ Parker and Mellows, p 618.

¹⁵ [1901] AC 118.

¹⁶ Underhill and Hayton, p 1012.

¹⁷ [1901] AC 118, at 123-124.

¹⁸ Underhill and Hayton, p 999.

¹⁹ In particular Australia, Canada and New Zealand.

²⁰ See, for example, the New South Wales Trustee Act 1925 s 59, the Queensland Trusts Act 1973 s 71, the Nova Scotia Trustee Act (RSNS) 1989 s29 and the British Columbia Trustee Act (RSBC 1996) s 95.

²¹ Queensland Trusts Act 1973, s 65.

the trustee to indemnity from the assets is an incident of the office of the trustee and is inseparable from it... For that reason it is probably incapable of being excluded." This decision was affirmed by the Supreme Court of New South Wales despite the fact that exclusion of indemnity is permitted by the legislation of that State.²³

Quebec

8. The Quebec Civil Code does not follow the English position and thus deserves separate mention. It is provided that:

"1319. Where an administrator binds himself, within the limits of his powers, in the name of the beneficiary or the trust patrimony, he is not personally liable towards third parties with whom he contracts.

He is liable towards them if he binds himself in his own name, subject to any rights they have against the beneficiary or the trust patrimony."

Thus Quebec prefers an approach based on the concept of disclosure, rather than *prima facie* liability of the trustee personally.

Guernsey

9. Section 37 of the Trusts (Guernsey) Law 1989, as amended by the Trusts (Amendment) (Guernsey) Law 1990, deals with trust transactions between trustees and third parties. It provides that a trustee who informs a third party in a transaction affecting the trust that he or she is acting as trustee does not incur personal liability and the third party's claim extends only to the trust property.²⁴ However, the trustee may remain personally liable for a transaction in breach of trust or a breach of warranty of authority.²⁵ A trustee who fails to inform the third party of the fact that he or she is acting as trustee generally incurs personal liability, but with a right of indemnity from the trust property except for breaches of trust.²⁶ But this personal liability is negated if the third party was nevertheless aware that the trustee was acting as such. This awareness could come from a communication on trust letter paper.²⁷

Jersey

10. The original provision of the Trusts (Jersey) Law 1984 dealing with liability of trustees to third parties stated that where a trustee informed a third party that they were acting as trustee, any claim would extend only to the trust property.²⁸ Where trustees failed to so inform, they would be personally liable on the transaction with a right of indemnity against the trust property.²⁹

11. The Trusts (Amendment No. 4) (Jersey) Law 2006 modified the Jersey position. Article 32 of the modified law states that:

²² *Kemtron Industries Pty Ltd v Commissioner of Stamp Duties* [1984] 1 QLD R 576, at 584-5.

²³ *J A Pty Ltd v Jonco Holdings Pty Ltd* [2000] 33 ACSR 691.

²⁴ Ss (1).

²⁵ Ss (3).

²⁶ Ss (2).

²⁷ Ashton, p 112.

²⁸ Article 28 (1).

²⁹ Article 28 (3).

"32 (1) Where a trustee is a party to any transaction or matter affecting the trust,

- a) if the other party knows that the trustee is acting as trustee, any claim by the other party shall be against the trustee as trustee and shall extend only to the trust property;
- b) if the other party does not know that the trustee is acting as trustee, any claim by the other party may be made against the trustee personally (though, without prejudice to his or her personal liability, the trustee shall have a right of recourse to the trust property by way of indemnity)."

12. Jersey will therefore impose personal liability only where the third party is unaware of the trustee's status as trustee, and in this case provides a right of relief against the trust estate. The Amendment revises many areas of Jersey trust law "with a view to clarifying matters which are uncertain, simplifying areas which had previously required delicate drafting and removing barriers to work coming to the island."³⁰ The amendments were adopted following extensive consultation and discussion with leading trusts practitioners and representatives from the financial sector.

United States

13. The Uniform Trust Code was created in 2000 and has so far been adopted by 19 States.³¹ The Code tends to be adopted with modifications which vary between jurisdictions; some such as Ohio making more extensive changes than others.³² Section 1010 of the Code deals with the personal liability of trustees. Subsection (a) dealing with liability under contracts provides:

"Except as otherwise provided in the contract, a trustee is not personally liable on a contract properly entered into in the trustee's fiduciary capacity in the course of administering the trust if the trustee in the contract disclosed the fiduciary capacity."

The official comment states that trustees may disclose their fiduciary capacity by signature as trustee or by simply referring to the trust, and that "properly entered into" means that the trustee is exercising an available power and is not violating any duty. All of the States that have so far adopted the code have enacted this section.

14. States that have not yet adopted the Code continue to rely on the common law and their own legislation. Where there is no statutory provision stating otherwise, the trustee will be personally liable on all contracts unless such liability is expressly excluded in the contract; merely signing the contract "trustee" will not necessarily be sufficient to do so.³³ This is so even if it seemed apparent to the third party that he was dealing with a trust:

"The trustee is personally liable whether or not the existence of the trust and the names of the beneficiaries are known to the other party to the contract, and whether

³⁰ www.gov.je - Ministerial decisions in 2006.

³¹ The 19 States that have so far enacted the UTC are: Alabama, Arkansas, District of Columbia, Florida, Kansas, Maine, Missouri, Nebraska, New Hampshire, New Mexico, North Carolina, Ohio, Oregon, Pennsylvania, South Carolina, Tennessee, Utah, Virginia and Wyoming. Several other States are currently considering adopting the Code.

³² Ohio Revised Code, Chapter 5801: Ohio Trust Code.

³³ Restatement (Second) of Trusts, § 262 and 263. See also Mezzullo, L A and Ramsey, K E, "Creditors' Rights Against Trustees and Trust Funds in the United States", in Atherton, R (ed), Papers of the International Academy of Estate and Trust Law (2001), p 219.

or not it appears in the contract that the trustee is making it in the course of the administration of the trust, unless it is agreed that he shall not be personally liable."³⁴

It has been observed that this stance, which is essentially the same as the English position, has led to the "chilling of transactions" and "an approach of caution when dealing with a trustee."³⁵ The *prima facie* personal liability of the trustee is offset by the right to indemnity against the trust estate. The right of indemnity is allowed where expenses have been properly incurred in the course of administering the trust estate. It is also allowed where the expenses are not properly incurred, but where there has been a benefit to the trust estate. Indemnity is given to the extent of the benefit.³⁶ On the nature of the right to indemnity it has been said that "when the law gives the trustee a right to use trust funds, or to reimbursement, the funds do not in law belong to the beneficiaries."³⁷

15. Louisiana is unique in the USA in having a decidedly civilian legal tradition and thus deserves separate mention. Trust law in Louisiana is codified in the Louisiana Trust Code.³⁸ § 2125 of the Code states that:

"A. If a trustee makes a contract that is within his powers as trustee, or if a predecessor trustee has made such a contract, and if a cause of action arises thereon, the party in whose favor the cause of action has accrued may sue the trustee in his representative capacity. A judgment rendered in the action in favor of the plaintiff shall affect or be satisfied out of the trust property.

B. A beneficiary may intervene in such an action for the purpose of contesting the right of the plaintiff to recover.

C. The plaintiff may also hold a trustee who makes a contract personally liable on the contract, if the contract does not exclude personal liability. The addition of the word "trustee" or the words "as trustee" together with language identifying the trust, after the signature of a trustee to a contract, shall be deemed *prima facie* evidence of an intent to exclude a trustee from personal liability."

16. Paragraph C creates a presumption which excludes personal liability by holding that the use of the word "trustee" after the signature is *prima facie* evidence of an intent to exclude personal liability. This does not go as far as the Uniform Trust Code which states that disclosure of trustee status shall be sufficient to exclude such liability.

South Africa

17. Trust creditors must sue the trustees in their capacity as trustees and any such decree is enforceable against the trust property only. Personal liability may arise if the trustees agree to undertake such liability or if the transaction is in breach of trust.³⁹ The trustee cannot be compelled to pay a debt of the trust estate from personal funds in the first instance. Trust funds may be used immediately, but if personal funds are used the trustee

³⁴ Restatement (Second) of Trusts § 262.

³⁵ English, D M, "The Uniform Trust Code (2000): Significant Provisions and Policy Issues" (2002) 67 Missouri Law Review 143, p 209.

³⁶ Restatement (Third) of Trusts, § 88.

³⁷ *Wells Fargo v Superior Court* 22 Cal.4th 201, January 13th 2000.

³⁸ Ancillary to the Louisiana Civil Code, Revised Statutes, Title 9:1721 et seq., as Revised and Amended through the 2003 Regular Session of the Legislature.

³⁹ Honoré, p 29.

has a right of indemnity from the trust fund.⁴⁰ The liability of the trust estate, being separate from that of the trustees' personal estates, means that a trust is a debtor for the purposes of insolvency and can be sequestrated.⁴¹

B. DELICTUAL LIABILITY

England and Wales

18. Trustees are *prima facie* personally liable in tort in respect of acts or omissions of themselves or their employees and agents in connection with the administration of the trust property.⁴² This personal liability is not dependent on whether they were acting properly in the course of trust business and is not limited to the trust assets available for the purpose of meeting the claim.⁴³

19. As with liability under contract, trustees enjoy a broad right of indemnity against the trust assets in tort cases. In *Benett v Wyndham*⁴⁴ the trustee was vicariously liable for an injury caused by an employee to a passer-by by a bough from the tree the employee had been hired to fell. The passer-by was entitled to recover damages from the trustee. The court held that the trustee was entitled to charge these damages to the trust estate as he had meant well, acted with due diligence and had acted properly in employing an agent to do an act which was within the sphere of his duty as trustee. The employee had merely made a mistake, the cost of which it was proper to take from the trust fund. Similarly in *Re Raybould*⁴⁵ although the trustee himself had committed the tort he was still entitled to indemnity as he satisfied the test of reasonableness and due diligence. This principle was followed in *Flower v Prechtel*.⁴⁶

20. It has been maintained that even where there is a finding of personal fault the trustee will not necessarily be denied indemnity.⁴⁷ The example given is that it would be harsh to deny a trustee relief from liability where damage was caused by a building which the trustee properly retained in the trust estate yet had no funds to maintain it.

21. Where a right of indemnity exists, the creditor may have a right by subrogation⁴⁸ to stand in the place of the trustee and enforce the claim against the trust estate, in addition to a claim against the trustee personally.

Some Commonwealth jurisdictions

22. Australia, New Zealand and Canada tend to follow the English approach in relation to liability in tort. Thus Ford and Lee⁴⁹ state that "the liability falls on the trustee personally since the trust assets are not an entity which in law can be regarded as a person liable." As a point of equitable principle Australian law will not debar the trustee from indemnification by

⁴⁰ Honoré, p 347.

⁴¹ Honoré, p 70.

⁴² *Flower v Prechtel* [1934] 150 LT 491 CA.

⁴³ Lewin, para 21-14.

⁴⁴ [1857] 4 De GF & J 259.

⁴⁵ [1900] 1 Ch 199.

⁴⁶ [1934] 150 LT 491 CA.

⁴⁷ Lewin, para 21-14.

⁴⁸ See para 3 above.

⁴⁹ Ford and Lee, p 14-53.

the fact that the liability rose from a tort, although the tort must occur in the proper performance of trust duties.⁵⁰ On the question of fault on the part of the trustee, the New South Wales Court of Appeal held in *Gatsios Holdings Pty Ltd v Nick Kritharas Holdings Pty Ltd*⁵¹ that personal negligence on the part of a trustee towards a third party is not of itself sufficient to deprive him of the right of indemnity. In all three countries the right to indemnity tends to be statutory.⁵²

23. It is interesting to note the decision of the Canadian courts in *Re Winding-up of the Christian Brothers of Ireland in Canada*.⁵³ The Christian Brothers organisation was found vicariously liable for sexual abuse committed by individual members in orphanages run by the Brothers. It was held that all of the property owned by the organisation, including that held in special charitable purpose trusts unconnected with the abuse, was liable to meet the damages. The case turned on the nature of the concept of a special purpose trust but the trust was held liable despite the fact that these were wrongs committed by individuals personally and could not be said to have been in the course of their duties. It is likely that this is a decision of policy as much as law and whether it would be followed in a case where the tort in question is of a less controversial nature is unclear. The case has engendered concern in the Canadian legal community; a report by the British Columbia Law Institute stated that "this decision constitutes a serious distortion of the law of trusts".⁵⁴ The Institute considers that it is incorrect to hold that "merely because a trustee has chosen to administer two trusts the assets of each trust are available to compensate wronged third parties that relate only to one of the trusts".⁵⁵ The concern is that the case might jeopardise the financial stability of the charitable sector by making charitable assets more vulnerable to tort claims and rendering potential donors wary of making gifts for special purposes as there is no guarantee that they will be immune from the trustee's creditors.⁵⁶

United States

24. Generally a trustee is personally liable for all torts committed in the administration of the trust regardless of fault, including liability for acts of agents or employees for whom the trustee is responsible.⁵⁷ The position of the trustee in relation to torts is "just as though no trust existed".⁵⁸ Trustees are entitled to avail themselves of the right to indemnity if without personal fault.⁵⁹ The imposition of personal liability on trustees is justified primarily on the basis that the estate is not a legal entity and the principle that fiduciaries ought not to be able to impair the position of the estate and the interests of the beneficiaries through their own

⁵⁰ *Ibid*, p 14-3059.

⁵¹ [2002] NSWCA 29.

⁵² For example, the New South Wales Trustee Act 1925, the Queensland Trusts Act 1973, the Nova Scotia Trustee Act (RSNS) 1989, the British Columbia Trustee Act (RSBC 1996) and the New Zealand Trustee Act 1956.

⁵³ [2000] 47 OR (3d) 674.

⁵⁴ British Columbia Law Institute Committee on the Modernisation of the Trustee Act, "Creditor Access to the Assets of a Purpose Trust" (2003).

⁵⁵ *Ibid*, p 6. See also the dissenting judgement of Braidwood J.A. in *Rowland v Vancouver College Ltd* [2001] BCCA 527, at para [184].

⁵⁶ *Ibid*, p 3.

⁵⁷ Restatement (Second) of Trusts, §§ 247 and 264.

⁵⁸ Curtis, Jr, J J, "The Transmogrification of the American Trust" (1996) 31 Real Property, Probate and Trusts Journal 251, p 280.

⁵⁹ Restatement (Second) of Trusts, § 247.

tortious acts.⁶⁰ This will be the position for States that have not adopted the Uniform Trust Code or enacted their own legislation.

25. Section 1010 of the Uniform Trust Code deals with liability for torts. Subsection (b) provides that a trustee is personally liable for torts committed in the course of administering the trust only if the trustee is personally at fault. The official comment states that the fault may occur intentionally or negligently and that the new provision is intended to go against the traditional principle of *respondeat superior* whereby trustees are personally liable for the acts of their agents or employees.

26. Before the Code was promulgated the liability of trustees for torts had already been modified in several States by statute or case law.⁶¹ Ten years before the Code, Hoey observed that "the general effect of [the trend] has been to render the trust estate a 'quasi-corporation' regarding liability to third party creditors".⁶² This move towards protecting the trustee and third parties at the expense of the trust estate is not one which is favoured by all. Curtis has argued that this approach obscures the true function of the trust as a vehicle for the preservation of trust assets and maligns the character of the trustee as the guardian of the estate by tempting him to siphon off his own liability onto the trust.⁶³

27. The position of Louisiana is again different. The Louisiana Trust Code states that:

"2126. Tort liability of trust

A. If a trustee or his predecessor has incurred personal liability for a tort committed in the course of administration, the trustee in his representative capacity may be sued and collection had from the trust property, if the court determines in such an action:

(1) That the tort was a common incident of the kind of business activity in which the trustee or his predecessor was properly engaged for the trust; or

(2) That, although the tort was not a common incident of such an activity, neither a trustee nor his predecessor nor an officer or employee of the trustee or his predecessor was guilty of personal fault in incurring the liability; or

(3) That, although the tort does not fall within paragraphs (1) or (2) above, it increased the value of the trust property.

B. If the tort falls within paragraphs (1) or (2) of Sub-section A above, collection may be had of the full amount of damage proved and, if the tort falls within paragraph (3) of Sub-section A above, collection may be had only to the extent of the increase in the value of the trust property.

⁶⁰ Dubis, M F, "Fiduciary and Estate Liability in Contract and in Tort" (1972) 55 Marquette Law Review 297, p 301.

⁶¹ Hoey, W L, "Personal Liability of Trustees Under the Comprehensive Environmental Response, Compensation and Liability Act" (1990) 68 University of Detroit Mercy Law Review 73, p 78.

⁶² *Ibid*, p 79.

⁶³ Curtis, Jr, J J, "The Transmogrification of the American Trust" (1996) 31 Real Property, Probate and Trusts Journal 251, p 290 and 293.

C. A beneficiary may intervene in such an action for the purpose of contesting the right of the plaintiff to recover.

D. A trustee may also be held personally liable for any tort committed by him or his agents or employees in the course of their employment, subject to the right of exoneration or reimbursement provided in R.S. 9:2191 through 9:2196."

28. These provisions strike a balance between holding the trustee personally liable and allowing the creditor to access the trust assets. They confer a discretion on the court to make the trust property liable for a tort committed by trustees or their agents. Thus even where the trustee is at fault and the tort was not of a kind common to the nature of the business, the trustee may be sued in a representative capacity if the tort increased the value of trust property.

South Africa

29. In the same way that trustees who hold themselves out as having personal responsibility for trust dealings may become liable to trust creditors, so persons "acting or purporting to act as trustees may incur personal delictual liability for their wrongful conduct to those to whom they owe a duty of care".⁶⁴ If in the proper course of carrying out duties under the trust a trustee or a servant of the trust commits a delict, the trustees as trustees may be sued jointly; damages are paid out of the trust estate. This is so even where they did not participate in or authorise the wrong.⁶⁵

C. ENVIRONMENTAL LIABILITY

England and Wales

30. The trustee's right of indemnity provides a lien over the trust fund. This has been held to extend to liabilities incurred under the Environmental Protection Act 1990. Liability under the Act for the costs of cleaning up contaminated land has been of particular concern to trustees.⁶⁶ In *X v A*⁶⁷ the sole trustee under a will became concerned about liability that he might incur in relation to land once Part IIA of the 1990 Act came into force. He accordingly applied to the court for directions as to whether he had a lien over the trust fund which would apply to any liability incurred under the environmental legislation. It was held that a trustee's lien extended to all liabilities of the trustee as such, including future liabilities under the 1990 Act. This means that (for the purpose of discharging the environmental liability) trustees may retain and manage trust assets even after beneficiaries have become absolutely entitled to the trust property.⁶⁸

⁶⁴ Honoré, p 29.

⁶⁵ *Ibid*, p 325.

⁶⁶ Underhill and Hayton, p 1003.

⁶⁷ [2000] Env. L.R. 104.

⁶⁸ Underhill and Hayton, p 1003.

Australia

31. Section 38 of the New South Wales Contaminated Land Management Act 1997 states that:

"(1) The financial liability under this Division of a legal personal representative in respect of an estate (or of a trustee of property) that is or includes land that is within an investigation area or a remediation site is limited respectively to such value of the assets of the estate (or such value of the property) as the representative or trustee may lawfully realise to meet a liability under this Division.

(2) A person is not, in such a capacity, personally liable for any costs under this Act that relate to an investigation or remediation order that relates to the land and is not required to carry out such an order to a greater extent than may be paid for by the person's lawfully realising the assets of the estate or the property to meet those costs or that payment."

32. This goes further than the mere right to indemnity and positively excludes the possibility of any personal liability attaching to the trustee in this matter. Thus although in principle Australian law views the trustee as an individual and not merely an agent, it is recognised that liability ought not to arise merely by virtue of ownership of trust property.

Canada

33. Section 46(1) of the British Columbia Environmental Management Act 2003 exempts certain categories of people from responsibility for remediation of land including "a person who is in a class designated in the regulations as not responsible for remediation". The Contaminated Sites Regulation 1997 includes trustees in that class where they are not personally at fault.⁶⁹ Personal fault will arise where the trustee has negligently exercised control over the property and thus caused it to become contaminated. The regulation further provides that the trustee is liable as trustee for remediation of the site, up to the value of the trust fund.⁷⁰

United States

34. Environmental liability of trustees in the United States had become an increasing concern following the enactment of the Comprehensive Environmental Response, Compensation and Liability Act 1980 (CERCLA).⁷¹ CERCLA leaves trustees completely exposed as it sets the bar for personal liability at simple ownership.⁷² This approach fails to take account of the fact that trustees own property in a representative role and not personally.⁷³

35. In response to concerns raised by trustees, s 1010(b) of the USA's Uniform Trust Code (UTC) expressly provides that trustees will not be liable personally in relation to

⁶⁹ B.C. Reg. 375/96, Contaminated Sites Regulation 1997 s 27(2).

⁷⁰ *Ibid*, s 27(3).

⁷¹ CERCLA forms Chapter 103 of Title 42 (The Public Health and Welfare) of the United States Code.

⁷² CERCLA s 9607. See *United States v Burns*, No 88-094-S (D.N.H. August 9, 1990) where it was held that a trustee's lack of involvement in the contamination was irrelevant as an owner is liable without being an operator of the facility.

⁷³ Viergever, B M, "Environmental Liability: Trustees *Beware*" (1992) *Detroit College of Law Review* 1101, p 1105.

violations of environmental law unless they were in some way personally at fault. Furthermore, s 701(c)(2) gives the power to persons nominated as trustees to inspect or investigate trust property for the purpose of determining any potential liability under environmental law before they accept the trusteeship. The official comment states that this is in response to particular concerns over the condition of trust property and any liability arising thereof. Section 816(13) further outlines specific powers granted to trustees to allow them to avoid incurring any environmental liability. This includes the power to pay from the trust fund any costs necessary to comply with legislation.

D. LIABILITY FOR LITIGATION EXPENSES

England and Wales

36. In general the courts have discretion in allocating the costs of litigation between parties.⁷⁴ Normally it is the unsuccessful party who will bear the burden of costs, although the courts may modify this having regard to all the circumstances.⁷⁵ The fact of trusteeship may be a factor to be considered; however trustees are afforded no special treatment. Unsuccessful trustee litigants are therefore normally personally liable for costs, but may through the right of indemnity charge these costs to the trust estate if such costs were properly incurred.⁷⁶ It is rare for a trustee to be denied the right of indemnification for litigation costs; to do so has been described as "a violent exercise of the court's discretion".⁷⁷ In practice such relief will be denied only where there is some fault on the part of the trustee, for example where the litigation was occasioned by his own negligence or where it was unnecessary.⁷⁸

37. Since the case of *Re Beddoe*⁷⁹ English law has a procedure whereby trustees can apply to the court for directions as to whether they should commence litigation on behalf of the trust. If the court approves a *Beddoe* application the trustees have immunity from personal liability for any costs of the litigation. The court will approve an application where it considers the proposed litigation to be in the interests of the trust. The availability of such protection places a strong onus on trustees to avail themselves of it and those who do not place themselves in a vulnerable position. It was observed in *Beddoe* itself that a trustee who commences litigation without court approval "does so at his own risk".⁸⁰ It is therefore common practice amongst trustees to make such an application, which must disclose all the relevant facts including both the strengths and weaknesses of the trustees' case.⁸¹

Some Commonwealth jurisdictions

38. In Australia it has been observed that, strictly speaking, an order for costs should be against trustees personally leaving them to obtain indemnity out of the trust estate.⁸² Trustees are entitled to indemnity for all legal costs arising out of their duties as trustees, although indemnity will be denied where they have acted unreasonably or for their own

⁷⁴ Civil Procedure Rules, Pt. 44.3 (1).

⁷⁵ *Ibid*, 44.3 (4).

⁷⁶ Trustee Act 2000, s 31(1).

⁷⁷ *Birks v Micklethwait* (1864) 33 Beav 409.

⁷⁸ *Re Beddoe* [1893] 1 Ch 547.

⁷⁹ [1893] 1 Ch 547.

⁸⁰ *Ibid*, at 557.

⁸¹ Lewin, para 21-125.

⁸² Ford and Lee, p 14-3061.

benefit.⁸³ The statutory indemnity provided in New Zealand and Canada echoes this principle.⁸⁴ Thus s 95 of the British Columbia Trustee Act (RSBC 1996) provides that:

"A trustee... may reimburse himself or herself, or pay or discharge out of the trust premises, all expenses incurred in or about the execution of his or her trusts or powers."

United States

39. It has been stated that at common law:

"...to make a trustee personally responsible for all reasonably incurred attorney fees for the successful defense of his actions as a fiduciary would impose an unconscionable burden on fiduciary service without justification".⁸⁵

This is consistent with the position taken in the Restatement (Third) of Trusts which states that a trustee is entitled to indemnity out of the trust estate for properly incurred expenses.⁸⁶ Thus in *Estate of Gump*⁸⁷ it was held that it was proper for the Court to allow certain ordinary attorney's fees as administrative expenses of the trust, but not extraordinary fees associated with a professional trustee's breach of fiduciary duty:

"Absent evidence of fraud or self-dealing, it seems reasonable to allow compensation for services relating to the trust assets which were properly managed, denying compensation only for those assets which were administered negligently or in breach of trust."⁸⁸

In the *Gump* case the trustees had negligently managed lease property. However the expenses they sought to recover related to other matters of the trust as well as the mis-managed lease. The Court held that not only was it proper to allow recovery of these other expenses but that:

"The trial court abused its discretion in denying entirely ordinary trustee's fees and ordinary attorney fees for services *unconnected* with administration of the lease property or the related litigation."

However, trustees must be careful in pursuing litigation as those who litigate too readily may well find themselves out of pocket. It has been stated that, in relation to litigation to determine the meaning of a will, costs will generally be paid from the trust estate if there was an "honest difference of opinion about the testator's intent".⁸⁹ However this rule was held only to apply to costs incurred in the trial court. A trustee dissatisfied with the judgment "appeals at his own risk and cost".⁹⁰

⁸³ *Ibid.*

⁸⁴ Nova Scotia Trustee Act (RSNS) 1989 s 29, British Columbia Trustee Act (RSBC 1996) s 95, and the New Zealand Trustee Act 1956 s 38. See the cases of *Bank of Nova Scotia Trust Company v Powlik* [2003] BCSC 1382, and *Hargreaves v Telford and Haining* [2006] NZHC 1476.

⁸⁵ *Rapp v Rapp* (1997) 562 N.W.2d 359, at 362.

⁸⁶ Restatement (Third) of Trusts, § 88.

⁸⁷ *Estate of Gump* (1991) 1.Cal.App.4th 582.

⁸⁸ *Ibid.*

⁸⁹ *NC Illinois Trust Co. v Madigan* (2004) 351 Ill.App.3d. 311.

⁹⁰ *Ibid.* See also *Glaser v Chicago Title and Trust Co.* (1948) 401 Ill. 387.

40. The Uniform Trust Code s 709 provides that:

"(a) A trustee is entitled to be reimbursed out of the trust property, with interest as appropriate, for:

(1) expenses that were properly incurred in the administration of the trust; and

(2) to the extent necessary to prevent unjust enrichment of the trust, expenses that were not properly incurred in the administration of the trust.

(b) An advance by the trustee of money for the protection of the trust gives rise to a lien against trust property to secure reimbursement with reasonable interest."

The official comment attached to the Code states that such reimbursement may include attorney's fees and expenses incurred by a trustee in defending an action, though not if it is determined that the trustee committed a breach of trust. In this one respect therefore the position at common law and the position of the Code are in alignment.

41. Section 1004 of the Code further states that:

"In a judicial proceeding involving the administration of a trust, the court, as justice and equity may require, may award costs and expenses, including reasonable attorney's fees, to any party, to be paid by another party or from the trust that is the subject of the controversy."

Thus it falls to be determined whether such expenses were properly incurred in assessing whether a claim for reimbursement is to be allowed; costs will only be awarded "as justice and equity may require". In order to be recoverable by the trustee, such fees and expenses must be for the benefit of the trust; if they are for the sole benefit of the trustee, he will have to bear the costs himself.⁹¹

South Africa

42. The general rule in South African law is that the right to recover expenses usually follows success with the unsuccessful party thereby being liable to the successful party for the costs the latter has incurred through litigation.⁹² It has been noted that this is a rule which should not be departed from "without the existence of good grounds for doing so".⁹³ However, the South African courts also take the view that the apportionment of expenses is at the ultimate discretion of the court and so the general rule may indeed be modified if the circumstances so dictate.⁹⁴

43. In keeping with the tendency in South African law to separate the trustee's two patrimonies, trustees are not, in practice, held personally liable for the costs of legal proceedings "to which they are properly parties in their capacities as trustees".⁹⁵ However, where such personal liability is imposed, the trustee retains a right to indemnity from the trust estate of any costs incurred in litigation "on behalf of the trust".⁹⁶ Want of success is no

⁹¹ *Heinitsh v Wachovia Bank* [2007] NCBC 18, a case heard in the North Carolina Business Court.

⁹² *Letsitele Stores v Roets* 1959 (4) SA 579 (T).

⁹³ *Ibid* at 580.

⁹⁴ *Lornadown Investments v Minister van Landbou* 1980 (2) SA 1 (A).

⁹⁵ Honoré, p 430.

⁹⁶ *Ibid*.

ground for the refusal of expenses so long as the instigation and conduct of the trustees' action was reasonable.⁹⁷ However, personal liability may be imposed where the trustee acted in a private capacity rather than as trustee (for example, where the trustee had no legal standing to litigate⁹⁸) or where the trustee was seriously at fault in the administration of the trust or in the conduct of the litigation itself.

⁹⁷ *Hoosen NO v Deedat* 1999 (4) SA 425.

⁹⁸ *Blou v Lampert & Chipkin NNO* 1973 (1) SA 1.

Appendix B Advisory Group on Trust Law

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