



Scottish Law Commission

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TRUST LAW REVIEW: BREACH OF TRUST AND APPORTIONMENT

The Scottish Law Commission today publishes two discussion papers as part of its Trust Law Review. They are Discussion Paper No 123 on Breach of Trust and Discussion Paper No 124 on Apportionment of Trust Receipts and Outgoings.

Background

Trust law is one of the topics in the Commission's current programme of law reform. The law is widely regarded as being in need of modernisation. The bulk of the decided cases stem from the 19th and early 20th centuries while the latest legislation affecting trustees generally is the Trusts (Scotland) Act 1961. The two discussion papers published today are the first in a series that the Commission intends to issue over the next year or so.

Breach of Trust

Breaches of trust arise in many different situations. One type of breach occurs when trustees do something that is not authorised either by the terms of the trust deed or by the general law. For example, trustees may make over trust property to someone other than the true beneficiary. At present trustees are, with some minor exceptions, liable for this type of breach even though they acted honestly and in good faith. Arguably, this rule is unduly harsh. The Commission asks for views on whether trustees should cease to be liable for this kind of breach of trust if they acted in good faith and after taking all reasonable steps and making all reasonable enquiries believed that what they did was authorised.

Another type of breach of trust occurs when trustees carry out authorised acts carelessly. Thus, where the trust estate is substantially diminished through rash investment the trustees would be liable. Trustees are expected to use the same degree of care that a prudent person would use in looking after his or her own affairs. It is not clear whether any higher standard is expected of professional trustees (such as solicitors, accountants and banks) who act as trustees in the course of business. The Commission proposes (1) a slightly higher standard for lay trustees who would be expected to use the same degree of care that a prudent person would use in looking after another person's affairs, and (2) a higher standard for professional trustees in that such trustees should have to use the special knowledge and experience that they can be reasonably expected to have.

Trust deeds often contain immunity clauses which seek to protect the trustees against claims for losses caused by breach of trust. At present, such clauses are effective unless the trustees have been fraudulent or **grossly** negligent. The Commission proposes that professional trustees should not be able to avoid liability by means of immunity clauses, even if they have only been simply negligent, but that the law should remain unchanged for lay trustees. An allied issue on which the Commission invites views is whether trustees should be able to protect themselves against personal liability by obtaining insurance at the trust estate's expense.

Trustees are under a duty not to put themselves in a situation where their personal interests conflict with their duties as trustees, and any breach of this fiduciary duty is a breach of trust. For example, trustees may not buy in their personal capacity trust property or be paid for work they carry out in connection with the trust, unless the trust deed sanctions this or all the beneficiaries agree. The Commission suggests that a transaction by a trustee in breach of his or her fiduciary duty should not be challengeable provided it was of benefit to the trust estate and the beneficiaries as a whole and was on terms at least as favourable as an arms-length transaction. With regard to remuneration, the Commission does not suggest that all trustees should be paid. Instead, it proposes that the trustees as a body should be entitled to appoint one or more of their own number to carry out specified aspects of the trust business at a reasonable rate of remuneration. Views are sought on possible mechanisms to prevent overcharging.

Apportionment

Where a trust has different classes of beneficiaries the trustees have to apportion payments made to or by the trust estate between the various classes. The rules on apportionment are complex and sometimes fail to achieve a fair balance between the various classes of beneficiaries. For example, in company mergers or demergers very large payments may be made that are regarded as income in the hands of the trustees who hold shares in the company. The beneficiaries interested in the income of the trust estate therefore receive a disproportionate benefit at the expense of the capital beneficiaries. Another example of the current rules not working well is where a man creates a trust giving his widow the income of his estate for life with the children as capital beneficiaries getting the estate on her death. A yearly dividend on trust shares payable shortly after the man's death is apportioned mainly to the children as capital beneficiaries. The widow does not become entitled to the whole of a dividend until it is payable in respect of a period wholly after the deceased's death. The result is that she is short of income when she needs it most.

To deal with the many anomalies that the existing apportionment rules create, the Commission proposes that the trustees should have a discretionary power to apportion any receipts or outgoings of the trust estate so as to maintain a fair balance between the various classes of beneficiary.

The next steps

The consultation period on these two discussion papers lasts until 31st December 2003. The Commission looks forward to receiving comments from a wide variety of organisations and individuals with an interest in this area of the law. Subsequently, the Commission will review the issues in the light of the responses received and will make its final recommendations for reform in a report to the Scottish Ministers.

NOTES TO EDITORS

1. The Scottish Law Commission was set up in 1965 to promote the reform of the law of Scotland. The Chairman is the Honourable Lord Eassie. The other Commissioners are currently Professor Gerard Maher, Professor Kenneth G C Reid and Professor Joseph M Thomson.
2. Further information can be obtained by contacting Dr David Nichols, Scottish Law Commission, 140 Causewayside, Edinburgh EH9 1PR (Tel: 0131 668 2131, Fax: 0131 662 4900, e-mail: info@scotlawcom.gov.uk.)
3. The paper may be viewed on our website at www.scotlawcom.gov.uk or purchased from TSO Scotland Bookshops.