

SCOTTISH LAW COMMISSION
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Discussion Paper on Breach of Trust

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Contents

	<i>Paragraph</i>	<i>Page</i>
ABBREVIATIONS		vi
PART 1 INTRODUCTION		
Background to the project	1.1	1
Scope of the project	1.4	1
General principles for reform	1.7	2
Our reform programme	1.11	3
Breach of trust and the plan of the discussion paper	1.13	4
Advisory Group	1.20	5
Trust Law Review Seminar	1.21	5
Legislative competence	1.22	6
PART 2 <i>ULTRA VIRES</i> BREACH		
Introduction	2.1	7
The existing law	2.2	7
Proposals for reform	2.12	10
Immunity clauses	2.17	12
PART 3 <i>INTRA VIRES</i> DELICTUAL BREACH		
Introduction	3.1	13
(1) Standard of care		
The existing law	3.2	13
Proposals for reform	3.4	14
(2) Immunity clauses restricting trustees' liability		
Introduction	3.12	17
The position in Scotland	3.13	17
Proposals for reform		
(a) The main options	3.18	20
(b) Is gross negligence a workable concept?	3.23	21
(c) Restricting the effect of immunity clauses: professional and lay trustees	3.31	24
(d) Conclusion	3.41	26
Other aspects of immunity clauses	3.49	28
(3) Other terms restricting trustees' liability		
Introduction	3.51	29
Lowering the standard of care	3.52	29
Enlarging trustees' powers	3.53	30
Abridging the trustees' duties	3.54	30
Indemnity clauses	3.61	32

PART 4 BREACH OF FIDUCIARY DUTY

Introduction	4.1	33
(1) General		
The current law in Scotland	4.2	33
Are the rules on breach of fiduciary duty too strict?	4.7	35
Options for reform	4.10	36
(2) Trustees' remuneration		
The present law in Scotland	4.18	38
Options for reform	4.21	40
Policing trustees' remuneration	4.30	43
Courts' powers in relation to remuneration	4.35	44

PART 5 INDEMNITY INSURANCE AT TRUST ESTATE'S EXPENSE

Introduction	5.1	46
The current law in Scotland	5.5	47
Options for reform	5.13	49
Statutory default power	5.16	50
Application to the court	5.17	50

PART 6 JUDICIAL RELIEF FROM LIABILITY FOR BREACH OF TRUST

Introduction	6.1	52
Power to make beneficiary indemnify for breach of trust	6.2	52
Power to relieve trustee from personal liability	6.3	53
Proposals for reform	6.7	54

PART 7 MISCELLANEOUS

Introduction	7.1	56
(1) Liability for co trustees		
The present position	7.2	56
Proposals for reform	7.5	57
(2) Applicable law and immunity clauses	7.8	58
(3) Transitional provisions	7.12	59

PART 8 LIST OF PROPOSALS AND QUESTIONS

APPENDIX A Comparative Law		64
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APPENDIX B Members of the Advisory Group on Trust Law		77
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Abbreviations

Barr *et al*, *Drafting Wills*

A R Barr, J M H Biggar, A M C Dalgleish & H J Stevens, *Drafting Wills in Scotland* (Edinburgh, 1994)

Birks and Pretto, *Breach of Trust*

P Birks and A Pretto (eds), *Breach of Trust* (Oxford, 2002)

BCLI, *Exculpation Clauses*

British Columbia Law Institute, *Report on Exculpation Clauses in Trust Instruments* (BCLI Report No 17) (2002)

BCLI, *Remuneration of Trustees*

British Columbia Law Institute, *Report on Statutory Remuneration of Trustees and Trustees' Accounts* (Report No 6) (1999)

Chalmers, *Cases and Materials*

J Chalmers, *Trusts: Cases and Materials* (Edinburgh, 2002)

Erskine

J Erskine, *An Institute of the Law of Scotland* (Edinburgh, 1773)

Honoré, *Trusts*

Honoré's South African Law of Trusts (5th edn by E Cameron, M de Waal, B Wunsch, P Solomon and E Kahn)

LC, *Trustees' Powers and Duties*

Law Commission/Scottish Law Commission, *Report on Trustees' Powers and Duties* (Law Com No 260) (Scot Law Com No 172) (1997)

LC, *Trustee Exemption Clauses*

Law Commission, *Consultation Paper on Trustee Exemption Clauses* (Consultation Paper No 171) (2003)

Lewin, *Trusts*

T Lewin, *Trusts* (17th edn, J Mowbray, L Tucker, N Le Poidevin & E Simpson) (London, 2000)

Mackenzie Stuart, *Trusts*

A Mackenzie Stuart, *The Law of Trusts* (Edinburgh, 1932)

Menzies, *Trustees*

A J P Menzies, *The Law of Scotland Affecting Trustees* (Edinburgh, 1913)

Norrie and Scobbie, *Trusts*

K McK Norrie and E M Scobbie, *Trusts* (Edinburgh, 1991)

NZLC, *Problems in the Law of Trusts*

New Zealand Law Commission, Report on *Some Problems in the Law of Trusts*
(Report 79) (2002)

OLRC, *Trusts*

Ontario Law Reform Commission, Report on *The Law of Trusts* (2 Vols) (1984)

Stair Memorial Encyclopaedia

The Laws of Scotland – Stair Memorial Encyclopaedia (25 Vols) (Edinburgh, 1986 – 1995)

TLC, *Trustee Exemption Clauses*

Trust Law Committee, Consultation Paper on *Trustee Exemption Clauses* (1999)

Wilson and Duncan, *Trusts, Trustees and Executors*

W A Wilson and A G M Duncan, *Trusts, Trustees and Executors* (Edinburgh, 1995)

Part 1 Introduction

Background to the project

1.1 Trust law has been one of the Commission's programme subjects for some time. In our *Fifth Programme of Law Reform*, published in 1997, we indicated that trust law was a long-term project meaning that work would be undertaken only as and when resources permitted. During the currency of that programme (1997-2000) we looked at trustees' powers of investment and the Trustee Investments Act 1961. We made recommendations on those areas in a joint report with the Law Commission, *Trustees' Powers and Duties*.¹ The Scottish recommendations were confined to the investment powers of trustees and their ability to purchase land whether for investment or otherwise. The remainder of the project contained recommendations by the Law Commission alone in relation to the powers and duties of trustees in England and Wales. The Trustee Act 2000 implemented the report's recommendations as far as England and Wales were concerned, but there has as yet been no legislation to implement our recommendations.

1.2 Trust law was promoted to a medium-term project in our *Sixth Programme of Law Reform* published in 2000.² It was envisaged that a substantial amount of work would be done on the project during this programme which is due to end in December 2004. We have drawn up a list of topics for inclusion in the project with assistance from the Law Society of Scotland, members of the Society of Trust and Estate Practitioners, individual practitioners and academics. We also received further suggestions from our Advisory Group³ and the speakers and participants at our Trust Law Review Seminar.⁴

1.3 The Trust Law Committee⁵ and the Law Commission⁶ have published several papers in the area of trust law. We have derived much benefit from reading them and refer to some of them in this discussion paper. We have also been in close contact with the Commissioners and staff of the Law Commission and have had useful and constructive discussions with them.

Scope of the project

1.4 Our trust law project is mainly confined to express voluntary trusts, both public and private. Implied, resulting and constructive trusts are dealt with only in so far as they

¹ Scot Law Com No 172, Law Com No 260 (1999).

² Scot Law Com No 176 (2000).

³ See para 1.20 below.

⁴ See para 1.21 below.

⁵ Consultation Paper on *Rights of Creditors Against Trustees and Trust Funds* (1997); Consultation Paper on *Equitable Interests in Pools of Investments* (1998); Consultation Paper on *Capital and Income of Trusts* (1999); Consultation Paper on *Draft Schedule A Powers for Trustees* (1999); Consultation Paper on *Trustee Exemption Clauses* (1999); Consultation Paper on *Proper Protection of Trustees by Liens, Indemnities etc* (2000); Report on *Rights of Creditors against Trustees and Trust Funds* (2000).

⁶ Consultation Paper on *Trustees' Powers and Duties* (No 146, 1997); Report on *The Rules against Perpetuities and Excessive Accumulations* (Law Com No 251, 1998); Report on *Trustees' Powers and Duties* (Scot Law Com No 172, Law Com No 260, 1999); Consultation Paper on *Trustee Exemption Clauses* (No 171, 2003).

impinge on express trusts. We do not intend to examine pension trusts or unit trusts except in so far as the powers, duties and liabilities of trustees are concerned.

1.5 The definitions of "trust" and "trustee" in the Trusts (Scotland) Acts 1921 and 1961 include judicial factories and judicial factors.⁷ A judicial factor is a person appointed by the court to administer and manage property where the existing machinery breaks down. For example, a judicial factor may be appointed to manage the property of a person who has disappeared and cannot be traced. A substantial majority of the judicial factors used to be curators bonis who were appointed as managers of the estates of incapable individuals. Curators have been replaced by guardians whose powers and duties are now laid down in the Adults with Incapacity (Scotland) Act 2000 and who are no longer subject to the Trusts Acts. As a result, the number of judicial factors now subject to the Trusts Acts is fairly small. Even then, much of the trust legislation is either not applicable to judicial factors or there are alternative provisions in the judicial factors legislation.⁸

1.6 Judicial factors are mentioned as a long-term project in our *Sixth Programme of Law Reform*,⁹ and some initial research has already been carried out. This is an area in need of a radical overhaul and it is very likely that the end result will be new legislation dealing comprehensively with judicial factors and removing them from the ambit of the Trusts Acts into which they were spatchcocked in 1921.

General principles for reform

1.7 In our view Scottish trust law is not in need of comprehensive and radical reform, and production of a trust code along the lines of the Uniform Trust Code in the United States of America is unnecessary. Most trust law rests on the common law. However, much, if not all, of the existing legislation would be repealed if our proposals in this and our other planned discussion papers were to be enacted. The main Scottish trust legislation consists of the Trusts (Scotland) Acts of 1921 and 1961 together with the Trustee Investments Act 1961. We have already recommended the repeal of most of the Trustee Investments Act 1961 in our joint report with Law Commission.¹⁰ The Trusts (Scotland) Act 1921 was largely a consolidation of mid to late 19th century trust legislation. Although the 1921 Act has been amended from time to time its underlying structure and outlook reflects the customs and practice of Victorian times.

1.8 We have adopted in this discussion paper the modern "dual patrimony" theory which emphasises the separation of the trust property and the personal property held by the trustee.¹¹ A trustee is regarded as having a trust patrimony consisting of the trust assets and a private patrimony consisting of his or her own personal property. Liabilities are likewise separate. A private creditor may claim only against the trustee's private patrimony. This protects trust property from the claims of the trustee's personal creditors on bankruptcy and

⁷ 1921 Act, s 2 and 1961 Act, s 6(1).

⁸ The Judicial Factors Act 1849, the Judicial Factors (Scotland) Act 1880 and the Judicial Factors (Scotland) Act 1889.

⁹ Scot Law Com No 176 (2000), paras 2.9–2.10.

¹⁰ LC, *Trustees' Powers and Duties*.

¹¹ K G C Reid, "Patrimony not Equity: The Trust in Scotland" (2000) 8 ERPL 427 and "National Report for Scotland" in D J Hayton *et al* (eds), *Principles of European Trust Law* (1999); G L Gretton, "Trust Without Equity" (2000) 49 ICLQ 599 and "Trust and Patrimony" in H L MacQueen (ed), *Scots Law into the 21st Century: Essays in Honour of W A Wilson* (1996); J W G Blackie, "Trusts in the Law of Scotland" in M Cantin-Cumyn (ed), *La Fiducie Face au Trust dans les Rapports des Affaires/ Trust vs Fiducie in a Business Context*.

from claims by the spouse or children of the trustee on the trustee's death or divorce. Similarly, trust creditors can claim only against the trust patrimony, but to this general rule there are exceptions. Under the present law there are situations where trust creditors may claim against the trustee's private patrimony. As a result, trustees may be putting their personal wealth at risk in the course of administering the trust.

1.9 One of the principles underlying our proposals in this discussion paper is that trustees should be personally liable, ie liable in their own private patrimonies, only if they were personally at fault. Put another way, we have taken the view that liability in one's private patrimony should not be an incident of trusteeship. Our proposals in this discussion paper on breach of trust give effect to this. We have also sought to strengthen the corollary of this principle – that trustees should be personally liable if they were at fault. In Part 3, below, we set out our preliminary view that clauses in trust deeds which seek to exempt trustees from personal liability where they are negligent should be ineffective, at least in so far as professional trustees are concerned.

1.10 Trusts come in many different shapes and sizes. They range from a modest family trust to large commercial trusts, and from trusts for limited purposes where the trustees need few powers to trusts with complicated purposes for which wide powers are required. We have therefore adopted a flexible approach for the most part. Rather than lay down rules that may not be suitable for all the many types of trust, we propose that there should be conferred on trustees and the courts discretionary powers that would be available to be exercised in appropriate circumstances.

Our reform programme

1.11 We have decided to tackle this review of trust law in two phases. The first, Phase 1, concentrates on trustees and their powers and duties, with the exception of powers of investment on which we have already made recommendations.¹² This discussion paper on breach of trust is published as part of the first phase. Two other discussion papers will make up the remainder of Phase 1. The first will look at the allocation and apportionment of receipts and outgoings between various classes of beneficiaries, especially those interested in the income or the capital. The second deals with the assumption, resignation and removal of trustees, their powers to administer the trust estate and the role of the courts.

1.12 The second phase, Phase 2, is to deal with trusts, their constitution and termination, and the restraints on accumulation of income and long-term private trusts. It will also look at the liability of trustees to third parties and the ways in which beneficiaries may enforce their rights against the trustees and the property subject to the trust. However, before beginning this second phase we intend to issue a discussion paper on whether a trust should have legal personality. Giving a trust legal personality would mean that the trust estate was owned by the trust with the trustees being its administrators or managers, rather than being the owners of the trust property as under the present law. Such a change would affect radically most of the topics in Phase 2 and therefore should be consulted on in advance.

¹² See para 1.1, above.

Breach of trust and the plan of the discussion paper

1.13 Breach of trust is an extremely wide concept and covers many types of conduct. As Lord Kyllachy said in *The Town and County Bank Ltd v Walker*:¹³

"A breach of trust may consist of embezzlement, or it may arise simply from failure to account, or it may consist, as alleged here, of some act or default which amounts only to some irregularity or error of judgment for which, nevertheless, there may be personal liability."

We divide breach of trust into three categories:

- (a) *ultra vires* breach,¹⁴
- (b) *intra vires* delictual breach;
- (c) breach of fiduciary duty or acting as *auctor in rem suam*.

The current law imposes different standards of care on trustees and different liabilities in relation to each of the categories.

1.14 Part 2 is concerned with *ultra vires* breaches of trust. An *ultra vires* breach occurs when trustees perform some act which is not authorised by the trust deed or the rules of trust law. An example of such a breach is making over trust property (income or capital) to a person who is not entitled to it in terms of the trust, ie paying the wrong "beneficiary".¹⁵ Investing in types of property outwith their powers of investment is another way in which trustees may commit an *ultra vires* breach.¹⁶ We propose some relaxation of the present almost absolute liability of trustees for this kind of breach.

1.15 Trustees may commit an *intra vires* delictual breach when they carry out an authorised action carelessly, or fail to take appropriate steps which they have power to take, and thereby cause loss to the beneficiaries. They may, for example, have invested trust funds in a rash speculation without proper consideration of the risks,¹⁷ or failed to dispose of a poorly performing investment left by the truster,¹⁸ or failed to supervise an agent or co-trustee appointed to manage some part of the trust business.¹⁹ Part 3 deals with the standard of care appropriate to professional and lay trustees and the effect of various clauses in trust deeds that seek to prevent trustees being made liable for the beneficiaries' losses.

1.16 Trustees, as fiduciaries, are bound to exercise their powers under the trust deed so as to best further the interests of the beneficiaries and must not use their position as trustees to further their own interests. This is often expressed by saying that a trustee must not be *auctor in rem suam*. This phrase is derived from Roman law in which tutors and curators could not create obligations in their own favour against their pupils or minors. It subsequently became part of Scots law.²⁰ Its meaning has widened since then and it is now

¹³ (1904) 12 SLT 411 at 412.

¹⁴ "Preface" to Birks and Pretto, *Breach of Trust* at (ix).

¹⁵ See, for example, *Armour v Glasgow Royal Infirmary* 1909 SC 916; *Grant v Grant's Exrs* 1994 SLT 163.

¹⁶ *Ritchie v Ritchie's Trs* (1888) 15 R 1086, putting money into a partnership was not an "investment".

¹⁷ *Raes v Meek* (1887) 16 R (HL) 31.

¹⁸ *Clarke v Clarke's Trs* 1925 SC 693.

¹⁹ *Seton v Dawson* (1841) 4 D 310.

²⁰ Erskine, i. vii, 19.

used interchangeably with breach of fiduciary duties.²¹ Examples of acting as *auctor in rem suam* are: buying trust assets or doing business with the trust, trustees contracting in conflict with trust interests and setting up a business in competition with that of the trust. Part 4 examines the issues in this area, in particular the rule that a trustee cannot receive remuneration for services rendered to the trust unless authorised by the trust deed or the beneficiaries.

1.17 In Part 5 we consider to what extent trustees should be entitled to charge to the trust estate the cost of insurance in relation to claims made by third parties against them. Insuring lay trustees in private trusts against claims by beneficiaries is also considered.

1.18 Part 6 explores the role of the courts in providing relief under sections 31 and 32 of the Trusts (Scotland) Act 1921 for trustees who are guilty of breaches of trust. Section 32 contains the more general power, but because it is exercisable only in favour of trustees who have acted honestly and reasonably, it cannot be used where trustees have been negligent. Consequently, its use is limited to *ultra vires* breaches of trust and violations of the *auctor in rem suam* rule. The proposed relaxation of the present rules of liability for *ultra vires* acts and breaches of fiduciary duty may leave section 32 with little or no role to play.

1.19 This paper concludes with Part 7 which contains some miscellaneous issues. Among these is the liability of trustees for acts or omissions of their co-trustees. Part 8 contains a list of our proposals and questions on which we invite views. Appendix A sets out the relevant law in some other jurisdictions we have studied while Appendix B lists the members of the Advisory Group.

Advisory Group

1.20 In 2002 we set up an Advisory Group to assist us in this project. The group contains both practitioners and academics and its members have a good spread of interests. So far it has met once to consider preliminary drafts of the three Phase 1 discussion papers and members have subsequently commented on revised drafts. We have received a great many helpful comments and much information about how the law works in current practice. We are very grateful to the group for this input. We wish, however, to make it clear that the members of the Advisory Group do not bear any responsibility for the proposals in this discussion paper or for any errors in it.

Trust Law Review Seminar

1.21 In November 2002 we held a seminar on trust law with an invited audience of practitioners, academics and officials from the Scottish Executive. One of our Commissioners, Professor Joseph Thomson, presented a paper on the remedies of beneficiaries where a breach of trust has occurred. Mr Simon Mackintosh of Turcan Connell, Solicitors, spoke about the problems currently faced by practitioners. Professor David Hayton outlined the recommendations made by the Trust Law Committee in England and Wales, of which he is the deputy chairman, in its various consultative papers²² and commented on the provisions of the Trustee Act 2000. We found the papers

²¹ Mackenzie Stuart, *Trusts*, 167-183; *Dale v IRC* [1954] AC 11, Lord Normand at 26-27; Wilson and Duncan, *Trusts, Trustees and Executors*, ch 26.

²² See above, note 5.

and the discussion following them very helpful and are most grateful to the speakers and all the participants.

Legislative competence

1.22 The proposals in this discussion paper relate to the powers, duties and liabilities of trustees which are not in general reserved matters in terms of the Scotland Act 1998. However, our proposals would affect the powers, duties and liabilities of trustees of unit and investment trusts²³ and also the obligations of trustees of occupational and personal pension trusts,²⁴ which are matters reserved to the UK Parliament. Our provisional view is that the Scottish Parliament would nevertheless have legislative competence to implement our proposals in these areas in terms of section 29(4). This provides:

"A provision which –

- (a) would otherwise not relate to reserved matters, but
- (b) makes modifications of Scots private law, or Scots criminal law, as it applies to reserved matters,

is to be treated as relating to reserved matters unless the purpose of the provision is to make the law in question apply consistently to reserved matters and otherwise."

Scots private law includes the law of trusts²⁵ and the purpose of our proposals is to make the law in question apply consistently to trusts that deal with reserved matters and those that do not.

1.23 A further aspect of the legislative competence of the Scottish Parliament is that an Act of the Parliament must be compatible with the rights set out in the European Convention on Human Rights.²⁶ In our view enactment of the proposals made in this discussion paper would not breach Convention rights.

²³ Scotland Act 1998, Sch 5, s A3.

²⁴ Scotland Act 1998, Sch 5, s F3. Arguably the powers and immunities of such trustees are not reserved.

²⁵ Scotland Act 1998, s 126(4).

²⁶ Scotland Act 1998, s 29(2)(d); Human Rights Act 1998, s 1(1).

Part 2 *Ultra Vires* Breach

Introduction

2.1 In this Part we look at the personal liability of trustees for *ultra vires* breaches of trust. A breach of trust is *ultra vires* if the act of the trustees is outwith their authority as determined by the trust deed, any statutory provisions, or any other rule of law.

The existing law

2.2 Trustees who commit an *ultra vires* breach incur almost strict liability for any loss thereby suffered by the beneficiaries. Where, for example, trustees have made a payment to a non-beneficiary, it does not matter that the trustees honestly and reasonably believed that that person was a person entitled to the payment under the trust deed. Likewise, trustees may not escape liability for making an unauthorised investment because they reasonably and in good faith believed the investment was authorised and in the best interests of the trust.¹

2.3 Trustees must account to the beneficiaries for the administration of the trust.² A beneficiary is entitled to obtain an account of the intromissions of the trustee in an action for count, reckoning and payment. Where an intromission constitutes an *ultra vires* breach of trust the trustees cannot take credit for it in their accounts. Thus, for example, where the trustees invested trust funds in local authority stock where it was outwith their powers to do so, they were personally liable to replace the purchase price of the stock in the trust estate.³ The trustees will also have to credit the trust funds with the income that the assets would have generated if the mis-disposition had not taken place. On the other hand, if an *ultra vires* investment shows a profit the trustees must account to the beneficiaries for the profit by adding it to the capital of the trust estate.⁴ The trustees are entitled to deduct their expenses in acquiring and realising the investment so that the trust estate is credited only with the net profit.⁵ The beneficiaries have the option of adopting the *ultra vires* investment. Where the *ultra vires* breach consists of the transfer of trust property to a person who was not a beneficiary, the true beneficiaries may be able to recover the property, or if the property cannot be recovered, require the trustees to restore its value to the trust estate⁶ or claim damages.⁷ We will be examining the remedies of beneficiaries in a later discussion paper.

¹ *Ritchie v Ritchie's Trs* (1888) 15 R 1086; *Polloxfen v Stewart* (1841) 3 D 1215.

² *Somerfield's Trs v Wemess* (1854) 17 D 151; *McKenzie's Ex v Thomson's Trs* 1965 SLT 410.

³ *Beveridge's Trs v Beveridge* 1908 SC 791.

⁴ *Grant v Baillie* (1869) 8 M 77.

⁵ *Currie and Ors (Lamb's Trs)* (1901) 9 SLT 170. See also *Laird v Laird* (1858) 20 D 972; *Sao Paulo Alpargatas SA v Standard Chartered Bank, Ltd* 1985 SLT 433 and *Southern Cross Commodities Property, Ltd v Martin* 1991 SLT 83.

⁶ *Hobday v Kirkpatrick's Trs* 1985 SLT 197.

⁷ *Hood v Macdonald's Tr* 1949 SC 24; *Ross v Davy* 1996 SCLR 369.

2.4 The duty of trustees to pay the correct beneficiaries is high. The approach the courts take to liability of the trustees in these circumstances is summed up in this passage from Lord Kinloch's judgment in *Lamond's Trustees v Croom*.⁸

"I consider it to be a settled principle of our law that trustees, in distributing the trust-estate, are bound to pay it away to the party in right to receive it, and are liable to that party if they pay it away to any other. There is no hardship to trustees in so holding, for if the matter is one of difficulty, they can always have recourse to judicial authority, and refrain from paying without the warrant of a court. The case of distribution herein differs essentially from that of realisation. I do not hold it of any moment what the precise blunder is. The payment may be to the wrong beneficiary, or may be to the beneficiary and not to the creditors, or it may be, as here, to the secondary creditors and not the primary. In all such cases it is the rule of law that the wrong paying trustee is responsible."

Accordingly, trustees should insist that the beneficiaries establish their lawful title and if any doubt lingers they may apply to the court for directions.⁹ In *Corbridge v Fraser*¹⁰ a beneficiary's right to the income from a trust estate depended upon her divorce. The trustees knew that an action for reduction of the divorce had been raised, and it was held that the trustees ought to have stopped paying her any benefit as soon as that action was raised. This doubt meant that the rightful beneficiary could not be ascertained and the trustees should have withheld payment until the doubt was resolved.

2.5 A distinction was drawn by Mackenzie Stuart between liability for errors of law and errors of fact. Error of law includes an error in construing the trust deed.¹¹ As regards errors of law, Mackenzie Stuart expressed the view¹² that the trustees' liability was unqualified, citing the Privy Council case of *National Trustees Company of Australia, Limited v General Finance Company of Australia, Limited*¹³ where trustees were held liable for having distributed the estate following erroneous advice from their law agents as to the applicability of a statute. A less strict rule may apply in public trusts where no private beneficiary has suffered from the misapplication.¹⁴ Later, however, he states that Scottish courts have exonerated trustees from liability for acting on a mistaken interpretation of the trust deed where they were following legal advice.¹⁵ Moreover, in *Warren's Judicial Factor v Warren's Executrix*¹⁶ the court declined to hold a trustee personally liable for loss on a possibly *ultra vires* investment because the powers of investment in the trust deed had not been clearly drawn and the deceased trustee might have believed in good faith that the investment was within his powers.¹⁷

2.6 As regards errors of fact, Mackenzie Stuart thought that it was not quite clear whether the trustees' liability depended on them having used the care of a reasonably

⁸ (1871) 9 M 662 at 671.

⁹ The application is made to the Inner House by petition – Court of Session Act 1988, s 6(vi); RCS 63.4-6.

¹⁰ (1915) 1 SLT 67.

¹¹ *Grant v Grant's Exs* 1994 SLT 163.

¹² Mackenzie Stuart, *Trusts*, 222.

¹³ [1905] AC 373.

¹⁴ *Free Church of Scotland v MacKnight's Trs* (1915) 2 SLT 237.

¹⁵ Mackenzie Stuart, *Trusts*, 223.

¹⁶ (1903) 5 F 890.

¹⁷ See also *Douglas v Douglas's Trs* (1867) 5 M 827 where a trustee had in good faith misinterpreted his powers to alter the deceased's settlements.

prudent business man.¹⁸ Liability is not absolute, as Lord Kinloch noted in *Lamond's Trustees v Croom*:¹⁹

"Cases may undoubtedly occur in which the facts necessary to be known, in order to point out the true person entitled, may be beyond the knowledge, and fairly possible discovery of the trustees; and in such cases responsibility may be modified."

There are several circumstances in which it has been said that liability may be modified. The first is where the true beneficiaries had misled the trustees. As Lord Kinneir observed in *Buttercase and Geddie's Trustee v Geddie*:²⁰

"I think there might be circumstances in which a trustee might well be in a position to claim as against persons interested in the trust that payment of a claim in error was justifiable on the ground either of some concession made by them or of some failure or neglect on their part to bring before him the true nature of the objection to the claim erroneously paid."

2.7 Secondly, trustees will not be liable if they are unable to pay beneficiaries because the trust estate has diminished due to factors outwith their control, such as theft or embezzlement by a properly appointed agent.²¹ Thirdly, executors have some protection against the late emergence of creditors of the deceased. After six months from the date of the deceased's death, the executors may pay creditors whose claims are known provided that they are reasonably satisfied that the estate is solvent, and may also distribute the estate to beneficiaries if reasonably satisfied that there are no further debts to be paid.²²

2.8 Mackenzie Stuart²³ and Norrie and Scobbie²⁴ both state that trustees may escape liability for a wrongful distribution of trust property due to a mistake as to foreign law. The basis for their view is that foreign law is a question of fact. This exception and the reason stated for it have been doubted by Chalmers.²⁵ There is no Scottish case law authority on this point.

2.9 Another exception mentioned by both Mackenzie Stuart²⁶ and Norrie and Scobbie²⁷ is where the beneficiary has assigned his or her interest to another person, but the trustees in ignorance of the assignation pay the beneficiary instead of the cedent. However, as Chalmers points out,²⁸ this is not an exception at all. Until the assignation is intimated to the trustees, it is not effective in relation to them and they remain entitled to pay the beneficiary.²⁹

2.10 Finally, there are also various statutory provisions which protect trustees where it would be difficult for them to ascertain the full facts. Section 24(2) of the Succession (Scotland) Act 1964 protects trustees and executors who distribute property to a person

¹⁸ Mackenzie Stuart, *Trusts*, 223.

¹⁹ (1871) 9 M 662 at 671.

²⁰ (1897) 24 R 1128 at 1134.

²¹ Mackenzie Stuart, *Trusts*, 226.

²² *Stewart's Trs v Evans* (1871) 9 M 810; *Beith v Mackenzie* (1875) 3 R 185.

²³ Mackenzie Stuart, *Trusts*, 224-245.

²⁴ Norrie and Scobbie, *Trusts*, 198.

²⁵ Chalmers, *Cases and Materials*, para 6.27.

²⁶ Mackenzie Stuart, *Trusts*, 225.

²⁷ Norrie and Scobbie, *Trusts*, 198.

²⁸ Chalmers, *Cases and Materials*, para 6.27.

²⁹ See K G C Reid, "Unintimated Assignations" 1989 SLT (News) 267.

without having ascertained that no adoption order has been made by virtue of which any person is or may be entitled to any interest in the estate. They are not liable to any person whose claim they were not aware of at the time of distribution, but this is without prejudice to any right to recover the property from the recipient. However, as Wilson and Duncan note,³⁰ there is no protection in relation to an adoption order by virtue of which a person ceases to be entitled to trust property. Section 7 of the Law Reform (Miscellaneous Provisions) (Scotland) Act 1968 provides similar protection in relation to persons born to unmarried parents. It authorises trustees or executors to distribute property without having ascertained the existence of beneficiaries born outwith marriage or the existence of a paternal relative of a person born outwith marriage who has an interest in the property. It prevents trustees from being personally liable if they did not know of such a beneficiary's or relative's existence at the time of distribution. Section 33 of the Trusts (Scotland) Act 1921 expressly provides that trustees are not liable for breach of trust by reason only that they continue to hold an investment which has ceased to be an authorised investment either in terms of the trust deed or the Act.

2.11 Section 32 of the Trusts (Scotland) Act 1921 gives the court power to grant relief from personal liability to trustees who have acted honestly and reasonably. Relief may be partial or full. The existence of this judicial remedy serves to mitigate the severity of the common law. We examine the workings of this section later in Part 6.

Proposals for reform

2.12 As can be seen from paragraphs 2.2 to 2.10, above, the present law is not clear. That in itself is a reason for reform. But even taking a generous view of the various exemptions from personal liability, we think that the present near absolute liability of trustees for an *ultra vires* breach of trust is too heavy a burden on them. For example, it seems harsh that trustees should be personally liable for a prudent investment which turned out disastrously if they reasonably but mistakenly thought it was one that was within their powers to make, yet would escape liability if the same investment was authorised by the trust deed. It is true that the trustees can protect themselves by seeking directions or clarification of their powers or duties from the court.³¹ Of course, situations will arise where the only prudent course of action is for the trustees to apply for clarification prior to acting, but legal proceedings with their attendant delay and expense seem a disproportionate solution. The same criticism can be levelled at judicial relief under section 32 of the Trusts (Scotland) Act 1921. Moreover, because an application for relief can only be made retrospectively, the trustees run the risk that the court will refuse relief and hold them liable for the breach of trust.

2.13 Our provisional preference is for a less strict rule of personal liability. It seems to us that in principle trustees should be personally liable for an *ultra vires* breach of trust only if they acted in bad faith or without due care. Thus, provided the trustees took all reasonable steps, both as to their power to act and the prudence of their action, such as seeking advice from a person believed to be an expert in the field, and made full enquiries, they ought to escape personal liability without having to apply to the courts for advance authorisation or retrospective relief. We do not think that strict liability is necessary to ensure that trustees keep to the powers conferred on them by the trust deed or statute. In our project on succession we examined the statutory protections involving persons born outwith marriage

³⁰ Wilson and Duncan, *Trusts, Trustees and Executors*, para 27-23.

³¹ Except where the narrow statutory protections apply.

and adopted persons outlined in paragraph 2.10, above, and considered that these provisions should be expressed in a more general fashion. Our proposal³² that a trustee or executor should not be personally liable for any error based on ignorance of the existence or non-existence of any person if he or she had acted in good faith and made such enquiries as a reasonable and prudent trustee would have made in such circumstances was approved by all those who commented on it. Our Report on *Succession* therefore made a recommendation to that effect.³³ Our proposal in this discussion paper would apply this recommendation more generally.

2.14 We do not think that the distinction that may be present in the current law between trustees' liability for *ultra vires* acts arising out of errors of law and their liability for errors of fact serves any useful purpose. Our proposal does not contain any such distinction, which has been abandoned in other areas of the law. It used to be the rule that payments made under error of fact might be recovered by means of a claim based on unjustified enrichment, while payments made under error of law were irrecoverable. Now, as a result of the case of *Morgan Guaranty Trust Co of New York v Lothian Regional Council*,³⁴ both types of payment may be recovered. Further, a father now has parental responsibilities and rights in relation to his child where the purported marriage to the mother was void but believed by the parties to be valid, whether the error was one of fact or of law.³⁵

2.15 The release of trustees from strict liability would not necessarily be at the expense of the beneficiaries. In cases of wrongful distribution, the trustees would be entitled to recover trust property distributed in error (whether of fact or law) from a wrongful recipient. Even if the trustees decline to take action themselves, they must lend their names to an action by the correct beneficiary on being indemnified for the expenses of the action. Exceptionally, the beneficiary may have a direct claim against the wrongful recipient of trust property.³⁶ In short, the beneficiary's right of recovery does not require strict liability as between beneficiary and trustee. However, our proposed new rule of personal liability for an *ultra vires* breach would prejudice beneficiaries in the case of an unauthorised investment. We do not see this as a substantial disadvantage. Most trust deeds nowadays confer extremely wide powers of investment. The concept of an unauthorised investment would virtually disappear if our recommendation that trustees should be able to make any kind of investment of the trust estate were implemented as one could only have *ultra vires* investment in the uncommon situation where the trust deed restricted the trustees' investment powers.

³² Consultative Memorandum No 71 (1986), *Some Miscellaneous Topics in the Law of Succession*, Proposal 24 at para 5.9.

³³ Scot Law Com No 155 (1990), paras 8.15-8.18 and Recommendation 42 at para 8.18.

³⁴ 1995 SLT 299.

³⁵ Children (Scotland) Act 1995, s 3(2)(b). Previously only error of fact had this effect, *Purves's Trs v Purves* (1895) 22 R 513.

³⁶ *Armour v Glasgow Royal Infirmary* 1909 SC 916.

2.16 We therefore propose that:

1. **Trustees should not be personally liable for any losses arising out of an action amounting to an *ultra vires* breach of trust provided they acted in good faith and after taking all reasonable steps and making all reasonable enquiries believed that such action was within their powers. This should not prejudice any right of recovery by the beneficiaries from persons other than the trustees or the trustees' right of recovery of wrongfully distributed property.**

Immunity clauses

2.17 The effect of an immunity clause in a trust deed relieving trustees of personal liability in relation to *ultra vires* acts is not altogether clear. It appears that it does not protect trustees who deliberately commit a breach of trust, even if done in the belief that their action was in the best interests of the beneficiaries. As Lord Watson said in *Knox v Mackinnon*:³⁷

"I think it is equally clear that the clause will afford no protection to trustees who, from motives however laudable in themselves, act in plain violation of the duty which they owe to the individuals beneficially interested in the funds which they administer."

We do not think that trustees who commit an *ultra vires* breach of trust should be entitled to shelter behind a wide-ranging immunity clause. That would enable them to disregard the terms of the trust and to go beyond their statutory and common law powers.

2.18 An immunity clause protecting trustees who reasonably believed they were acting within their powers seems unobjectionable. Indeed, it would be in line with the proposed change to trustees' personal liability for *ultra vires* acts contained in Proposal 1, above. It seems to us wrong for an immunity clause to confer wider protection for trustees. If that proposal were accepted, then we think that the rule should be that any clause providing immunity in respect of *ultra vires* acts is ineffective. On the other hand, if the present almost absolute liability is to be retained then we think that an immunity clause should be allowed its present limited effect. Even in that situation, new provisions might be thought useful to put the present position beyond doubt. In order to obtain views on whether a clarifying provision is required we ask:

2. **If Proposal 1 is not accepted, should there be new clarifying legislation providing that an immunity clause relating to trustees' personal liability for *ultra vires* acts may protect them where they reasonably believed they were acting within their powers, but should be ineffective to any greater extent?**

³⁷ (1888) 15 R (HL) 83 at 86.

Part 3 *Intra Vires* Delictual Breach

Introduction

3.1 In this Part we look at the liability of trustees who commit an *intra vires* breach of trust. Here liability is not strict, rather it depends on fault. The trustees are liable for loss arising out of an act authorised by the terms of the trust deed or by trust law only if they failed to carry it out to the appropriate standard of care. Similarly, the trustees are liable for their omission to do some act which they were authorised to carry out, only if their failure to act was negligent. We deal first with the standard of care required of trustees and then look at the effect of various clauses that may be inserted into trust deeds to limit or avoid trustees' liability for failure to meet that standard.

(1) Standard of care

The existing law

3.2 There is no statutory regulation in Scotland of a trustee's duty or standard of care. The position is set out in late 19th century House of Lords cases. In *Raes v Meek*¹ Lord Herschell stated:

"[t]he law ... requires of a trustee the same degree of diligence that a man of ordinary prudence would exercise in the management of his own affairs."

This objective test was applied in the more recent case of *Tibbert v McColl*.² The suggestion that trustees should be held to a subjective standard of care was roundly rejected by Lord Watson in *Knox v Mackinnon*³ thus:

"It was seriously argued that, according to the law of Scotland, the responsibility of a gratuitous trustee must (apart from any special dispensation from the truster) be tested by reference, not to an average standard, but to the degree of care and prudence which he uses in the management of his own private affairs. The rule, which is quite new to me, would be highly inconvenient in practice. In every case where neglect of duty is imputed to a body of trustees it would necessitate an exhaustive inquiry into the private transactions of each individual member, the interest of the trustee being to shew that he was a stupid fellow, careless in money matters, and that of his opponents to prove that he was a man of superior intelligence and exceptional shrewdness."

¹ (1889) 16 R (HL) 31 at 33. See also, *Learoyd v Whitely* (1887) 12 AC 727.

² 1994 SLT 1227.

³ (1888) 15 R (HL) 83 at 87.

In deciding whether the trustees failed to reach the standard of care, the facts of each case must be judged objectively and not on the basis of hindsight.⁴ Trustees should take professional advice where a person of reasonable prudence would do so.⁵

3.3 There is some uncertainty as to whether trustees who act as such in the course of their business or have relevant special skills are expected to show a higher standard of diligence and knowledge than the basic objective standard of an ordinary prudent person. There is no reported Scottish authority on this point. Wilson and Duncan state that a higher standard applies, citing the English case of *Re Waterman's Will Trusts*⁶ as authority.⁷ Professor Blackie agrees with this view because the approach taken in England does not seem to depend on any feature of English trust law that is different from Scots trust law.⁸ However, Norrie and Scobbie argue that there is no authority for the proposition that there is a higher standard of care required of a professional or remunerated trustee in Scotland.⁹ Those authors consider that the standard of care required is designed to protect the beneficiaries and therefore it is wholly fortuitous whether or not the trustee is corporate or non-corporate, professional or non-professional.

Proposals for reform

3.4 For the reasons set out in paragraphs 3.7 to 3.9, below, we consider that a higher standard of care should be required of "professional" trustees. In our opinion it will require legislation to achieve this as it is uncertain whether this is already the position in Scotland. We do not think that it is a sensible option to wait for the Scottish courts to resolve the issue. It might take many years before a suitable case arose in which the court could prescribe a higher standard, if indeed it thought that appropriate. If legislation is required then we think it would be better to have a statutory formulation of the standard of care for both classes of trustee rather than a provision merely introducing a higher standard for professional trustees.

3.5 We think there has to be a minimum standard applicable to all trustees. A basic minimum standard of care is necessary in order to secure the proper administration of trusts. In the absence of a minimum standard, the trust estate and the beneficiaries would be at the mercy of lazy, ignorant or incompetent trustees. The minimum standard must be objective. Requiring trustees to act merely as they would in relation to their own private affairs is subjective and potentially too low a standard. While such a standard would be easy for trustees to use it would, as Lord Watson pointed out in *Knox v Mackinnon*,¹⁰ pose great difficulties for deciding whether a breach of trust has occurred. Evidence would have to be led as to the way in which that particular trustee conducted his or her own affairs. Moreover, it exposes the beneficiaries to risk if incompetent trustees are appointed.

3.6 We think the choice for a minimum standard lies between the current Scottish standard – trustee to use the same care and diligence as an ordinary prudent person would

⁴ *Gillespie & Sons v Gardner* 1909 SC 1053, Lord President Dunedin at 1061.

⁵ *Wilson's Tr v Wilson's Creditors* (1863) 2 M 9; *Leith and East Coast Steam Shipping Co Ltd in Liquidation* (1909) 1 SLT 53.

⁶ [1952] 2 All ER 1054.

⁷ Wilson and Duncan, *Trusts, Trustees and Executors*, para 28-17.

⁸ J W G Blackie, "Trusts in the Law of Scotland" in M Cantin-Cumyn (ed), *La Fiducie Face au Trust dans les Rapports des Affaires/Trusts vs Fiducie in a Business Context*, 141.

⁹ Norrie and Scobbie, *Trusts*, 141.

¹⁰ (1888) 15 R (HL) 83 at 87.

use in relation to his or her own affairs; the pre-Trustee Act 2000 English common law – trustee to use the same care and diligence as an ordinary prudent business person would use in the same circumstances;¹¹ or the South African formula – trustee to use the same care and diligence as an ordinary prudent person would use in managing the affairs of others.¹² We are attracted by the South African formula as it emphasises the fact of trusteeship. Trustees are administering the trust estate for the beneficiaries not for themselves. People are generally more careful and diligent in relation to the affairs of others than they are in relation to their own. While they might be prepared to take risks with their own money or decide not to take some action because it involves too much effort, they would adopt a more cautious and careful approach with other people's money. The proposed new standard would also be workable. Trustees and the courts could readily envisage what an ordinary prudent person managing another's affairs would have done in the circumstances. We also favour an express reference to an ordinary prudent person as this focuses trustees' minds on what is required of them and gives them a role model to follow. Expressing the standard of care in terms of what is reasonable in all the circumstances, as is done in section 1(1) of the Trustee Act 2000 for England and Wales (set out in paragraph 3.8, below) seems to us to be too imprecise and unlikely to give sufficient guidance to trustees.¹³ Although having to act as an ordinary prudent person would in the affairs of others is perhaps a slightly higher standard than the current position in Scotland, we do not think it would be too severe for ordinary lay trustees who have no special skills. On the other hand, comparison with a prudent business person may set too high a basic standard. It imputes the skills and knowledge of those who are in business and it prevents a clear distinction being drawn between professional and lay trustees.

3.7 Trustees vary greatly in their skills and expertise, ranging from ordinary people with no training in trusteeship to trust corporations who have many highly knowledgeable and trained staff with longstanding expertise in all aspects of trust administration. We do not think that just the basic minimum standard should apply to each and every kind of trustee. We agree with the approach adopted in many other jurisdictions that a higher standard should be required of "professional" trustees. Solicitors, accountants and banks put themselves forward for trusteeship on the footing that they offer a superior standard of service to that of untrained amateurs. It is therefore not unreasonable for the law to hold them to a higher standard. We would draw a parallel with liability in delict in other areas of professional practice. There, in addition to the minimum standard of a reasonable person of ordinary intelligence and experience,¹⁴ the law requires that a person who professes to have particular skills must display the same standard of care as other members of that profession whether or not he or she actually possesses those skills. Moreover, a professional person will be negligent only if he or she follows a course of action that no ordinary competent member of that profession would have adopted if acting with ordinary care.¹⁵

¹¹ See Appendix A, paras 5 and 6.

¹² See Appendix A, para 7. The Ontario Law Reform Commission also made a similar recommendation, see Appendix A, paras 9 and 10.

¹³ An alternative formula for the standard of care based on a reasonably prudent business person was rejected by the Law Commission on the ground that more should be expected of professional trustees and trustees with qualifications and experience – LC, *Trustees' Powers and Duties*, para 3.24.

¹⁴ *Muir v Glasgow Corporation* 1943 SC (HL) 3.

¹⁵ *Hunter v Hanley* 1955 SC 200. This standard can be criticised for giving too much weight to current professional practice. Liability will be avoided if a not inconsiderable minority of the profession would have adopted the same course of action.

3.8 The other jurisdictions that we have studied which have a higher standard of care for certain classes of trustees adopt different ways of formulating it. Section 1(1) of the Trustee Act 2000 provides for England and Wales that the trustee:

"... must exercise such care and skill as is reasonable in the circumstances, having regard in particular –

- (a) to any special knowledge or experience that he has or holds himself out as having, and
- (b) if he acts as trustee in the course of a business or profession, to any special knowledge or experience that it is reasonable to expect of a person acting in the course of that kind of business or profession.

The Model Trustee Code for the Australian States and Territories 1989¹⁶ contains a requirement that the trustee should:

"act with care, skill, prudence and diligence having regard to –

- (a) the nature composition and purposes of the trust; and
- (b) the skills which the trustee possesses or ought, by reason of his business or calling, to possess.¹⁷

Section 4(2) of the draft Ontario Trustee Act appended to the Ontario Law Reform Commission's Report on the *Law of Trusts* provides that:

"... trustees who in fact possess, or because of their profession, business or calling ought to possess, a particular level of knowledge or skill which in all the circumstances is relevant to the administration of the trust, shall employ that particular level of knowledge or skill in the administration of the trust."

3.9 We would reject the Ontario formula. It requires trustees to exercise the skills the trustee has or can be assumed to have, whether or not they are paid or are acting in the course of business. For example, a son who acts in an unpaid capacity as a trustee in his late father's testamentary trust should not be held to a higher standard simply because he happens to be a solicitor or an accountant. He should not be expected to put his professional expertise at the disposal of the trust. Professionals who act other than in the course of business will be acting gratuitously and are unlikely to be covered by their professional indemnity insurance. Thus, for example, the Law Society of Scotland's Master Policy covers liabilities "incurred in connection with the Practice carried on by or on behalf of the Insured...", but excluding liability for any "dishonest fraudulent criminal or malicious act or omission".¹⁸ In our view, the higher standard by reference to a trustee's skills and knowledge should only apply where that trustee acts in the course of business as section 1(1)(b) of the Trustee Act 2000 provides.¹⁹ We are not in favour of using the criterion of payment for the imposition of a higher standard of care. If a professional person acts in the course of his or her business a professional standard of care and expertise would be expected, even if no

¹⁶ Drafted by a number of distinguished Australian judges, practitioners and academics and published by the University of Queensland.

¹⁷ S 11.1.

¹⁸ A partner of a firm who acted as a gratuitous trustee of a public trust with the knowledge and approval of the firm might be covered, even though the firm did no legal work for the trust.

¹⁹ See para 3.8, above.

remuneration was charged. Moreover, many lay trustees are left modest legacies or gifts as a token of appreciation for the services they will render as trustees. Such a gift should not result in the recipient who happens to have extra skills and knowledge being liable on the higher standard.

3.10 Part of the trustee's duty of care is the selection, appointment and supervision of agents. Section 34(2) of the Pensions Act 1995 authorises the trustees of an occupational pension scheme established under a trust to delegate investment decisions to a fund manager. The trustees are not liable for loss caused by any act or default of the fund manager provided they have taken all reasonable steps to satisfy themselves that the manager has appropriate knowledge and experience and is carrying out the delegated work competently.²⁰ Our proposed formula for the standard of care expected of trustees is not intended to replace the above provisions.

3.11 Summing up we propose that:

3. Unless otherwise provided by statute, in carrying out their trust duties –

(a) Every trustee should have to use the same care and diligence that a person of ordinary prudence would use in managing the affairs of others.

(b) A trustee who acts as such in the course of his or her business or profession should in addition have to use any special knowledge or expertise that it is reasonable to expect of a member of that business or profession.

(2) Immunity clauses restricting trustees' liability

Introduction

3.12 We turn now to consider the effects of immunity clauses which purport to relieve the trustees of their personal liability for delictual breaches of trust. Other types of clause, such as an indemnity clause which allows liable trustees to indemnify themselves out of the trust estate, are considered afterwards.²¹ The Law Commission has recently published a Consultation Paper on *Trustee Exemption Clauses*²² to which we refer at appropriate places.

The position in Scotland

3.13 It is common practice for trust deeds to contain an immunity clause in favour of the trustees. An example of a typical immunity clause to be included in a testamentary trust is:

"My trustees shall not be liable for depreciation in value of the property in my estate, nor for omissions or errors in judgment, nor for neglect in management, nor for

²⁰ S 34(4). Occupational pension scheme trustees have to be registered under the Financial Services and Markets Act 2000 unless they delegate all day to day and routine investment decisions to an authorised or exempt person, Financial Services and Markets Act 2000 (Carrying on Regulated Activities by Way of Business) Order 2001, SI 2001/1177.

²¹ Paras 3.51 to 3.61, below.

²² Consultation Paper No 171 (2003).

insolvency of debtors, nor for the acts, omissions, neglects or defaults of each other or of any agent employed by them."²³

However, the protection provided by such seemingly wide clauses is limited. In *Seton v Dawson*²⁴ the immunity clause provided that the trustees "shall not be liable for omissions, neglect of diligence, of any kind, nor singuli in solidum, but each only for his own actual intrusions ...". It was held that the trustees were liable for having allowed one of their number to hold trust property for several years without enquiring what he was doing with it. They were guilty of *culpa lata* (gross negligence) and had committed a positive breach of their duty to monitor the actions of a co-trustee who subsequently became bankrupt. As five of the judges put it in their combined opinion:²⁵

"... the general principle of our law is, that neither the protecting clause which occurs in this particular deed, nor any of the usual clauses framed for the same object, can be held to liberate trustees from the consequences of such gross negligence as amounts to *culpa lata*."

Such a clause did not, therefore, give immunity against positive breaches of duty or *culpa lata*. The immunity clause in *Knox v Mackinnon*²⁶ was in almost identical terms. Lord Watson²⁷ said:

"I see no reason to doubt that a clause conceived in these or similar terms will afford a considerable measure of protection to trustees who have *bona fide* abstained from closely superintending the administration of the trust, or who have committed mere errors of judgment whilst acting with a single eye to the benefit of the trust and of the persons whom it concerns; but it is settled in the law of Scotland that such a clause is ineffectual to protect a trustee against the consequences of *culpa lata*, or of gross negligence on his part, or of any conduct which is inconsistent with *bona fides*. I think it is equally clear that the clause will afford no protection to trustees who, from motives however laudable in themselves, act in plain violation of the duty which they owe to the individuals beneficially interested in the funds which they administer."

This statement was approved in the later House of Lords case of *Raes v Meek*.²⁸ In *Clarke v Clarke's Trustees*²⁹ the trustees left money on deposit receipt instead of investing it and had retained one of the testator's investments until it became worthless. The immunity clause purported to exclude liability in respect of the sufficiency of investments with express mention of those held at death by the testator. Nevertheless, the trustees were held liable on the basis of their gross negligence. Lord President Clyde³⁰ commented that:

"It is difficult to imagine that any clause of indemnity in a trust settlement could be capable of being construed to mean that the trustees might with impunity neglect to execute their duty as trustees, in other words, that they were licensed to perform their duty carelessly. There is at any rate no such clause in this settlement."

²³ Barr *et al*, *Drafting Wills*, style 9.9.

²⁴ (1841) 4 D 310.

²⁵ (1841) 4 D 310, Lord Cockburn, Lords Justice-General (Boyle), Mackenzie, Fullerton and Cunninghame at 316-317.

²⁶ (1888) 15 R (HL) 83.

²⁷ At 86.

²⁸ (1889) 16 R (HL) 31, Lord Herschell at 35. See also *Ferguson v Paterson* (1900) 2 F (HL) 37, trustees liable as they were guilty of a positive breach of trust and gross negligence.

²⁹ 1925 SC 693.

³⁰ At 707.

3.14 The scope of immunity clauses also featured in *Inglis and Others, Petitioners*.³¹ The trustees sought a variation of the terms of the trust deed so as to add wide investment powers and a provision that "the trustees shall not be responsible for nor shall liability attach to them in any way whatsoever for any loss or depreciation ... in consequence of any investments made ...". The variation was refused. Lord President Clyde, in following the earlier cases mentioned above, commented that the inclusion of immunity clauses "only creates a false sense of security in the minds of the trustees."³²

3.15 Finally, in the most recent Scottish case, *Lutea Trustees Ltd v Orbis Trustees Guernsey Ltd*,³³ Lord McCluskey³⁴ stated:

"I can, however, find nothing in the terms of the trust deed that would exclude the defenders from incurring liability to the trust in respect of the loss resulting from grossly negligent intromission with the trust estate. Indeed, counsel for the defenders and reclaimers expressly accepted that neither the terms of the trust deed nor the common law would enable the trustees to avoid liability for the consequences to the trust estate of *culpa lata*."

3.16 Comments made in the English case of *Armitage v Nurse*³⁵ may have cast doubts on whether the position outlined in the above paragraphs remains accurate. There the Court of Appeal considered that there was no prohibition in Scotland on clauses which exempted trustees from being liable for negligence or gross negligence. Millet L J, as he then was, considered that each one of the Scottish cases on this matter was merely a decision on the proper construction of the particular clauses under consideration which were at the time in common form. In particular, he thought that the comments made by Lord President Clyde in *Clarke v Clarke's Trustees*³⁶ emphasised the need for an immunity clause excluding liability for negligence to be in clear and unambiguous words did not purport to exclude the efficacy of such a clause on the grounds of public policy. In our view, however, the Scottish law on immunity clauses remains as stated in the 19th century cases.³⁷ Gross negligence or gross breach of duty is regarded as tantamount to dole or fraud and cannot be excused: *culpa lata dolo aequiparatur*.³⁸

3.17 There are also a number of UK statutory provisions in connection with immunity clauses in certain types of trust. Thus, for example, in relation to debenture trust deeds section 192(1) of the Companies Act 1985 renders void any provision:

"... exempting a trustee of the deed from, or indemnifying him against, liability for breach of trust where he fails to show the degree of care and diligence required of him as trustee, having regard to the provisions of the trust deed conferring on him any powers, authorities or discretions."

³¹ 1965 SLT 326.

³² At 327.

³³ 1998 SLT 471.

³⁴ At 478I-J.

³⁵ [1998] Ch 241.

³⁶ See para 3.13 above.

³⁷ Gloag and Henderson, *An Introduction to the Law of Scotland* (11th edn, 2001), Lewin, *Trusts*, para 39.82, footnote 93 and the Trust Law Committee in its Consultation Paper on *Trustee Exemption Clauses* (1999) are of the same opinion.

³⁸ *Seton v Dawson* (1841) 4 D 310, Lord Moncrieff at 331; *Lutea Trs Ltd v Orbis Trs Guernsey Ltd* 1998 SLT 471, Lord McCluskey at 478G.

Similar provisions can be found in section 253 of the Financial Services and Markets Act 2000³⁹ dealing with unit trusts,

"Any provision of the trust deed of an authorised unit trust scheme is void in so far as it would have the effect of exempting the manager or trustee from liability for any failure to exercise due care and diligence in the discharge of his functions in respect of the scheme."

and in section 33(1) of the Pensions Act 1995 in relation to pension funds:

"Liability for breach of an obligation under any rule of law to take care or exercise skill in the performance of any investment functions, where the function is exercisable –

- (a) by a trustee of a trust scheme, or
- (b) by a person to whom the function has been delegated under section 34,

cannot be excluded or restricted by any instrument or agreement."

Proposals for reform

(a) The main options

3.18 We turn now to consider to what extent an immunity clause in a trust deed should be effective, and whether different classes of trustees should be treated differently. Our tentative view is that new statutory provisions are necessary even if the law is not to be changed. The case of *Armitage v Nurse*⁴⁰ has cast enough doubt on the hitherto settled understanding in Scotland to make it desirable to set down the position in legislation. We discuss immunity clauses in relation to professional or remunerated trustees first and then consider whether lay trustees should be treated in the same way.

3.19 An immunity clause which purports to exclude liability for fraud should, we think, be ineffective as a matter of public policy. Fraud in this context means a deliberate disregard for the interests of the beneficiaries or reckless indifference to their interests and contains an element of dishonesty.⁴¹ Fraudulent conduct may also be criminal, as for example where a trustee embezzles trust funds, but criminality is not a necessary component of fraud. None of the jurisdictions we have examined permits trustees to act dishonestly without incurring liability.

3.20 The Law Commission has invited views on a proposal that the courts be empowered to strike down unreasonable immunity clauses in much the same way as is done for exemption clauses under the Unfair Contract Terms Act 1977.⁴² A professional trustee would therefore be permitted to rely on an exemption of liability clause in a trust deed in so far as the clause was fair and reasonable. Immunity clauses would be permitted to continue to have their current wide-ranging effect where lay trustees were involved. The British Columbia Law Institute recommended a similar solution in its Report on *Exculpation Clauses*

³⁹ Replacing an almost identical provision contained in s 84 of the Financial Services Act 1986.

⁴⁰ [1998] Ch 241.

⁴¹ *Boyd & Forrest v Glasgow and South Western Railway Co* 1912 SC (HL) 93, *Armitage v Nurse* [1998] Ch 241.

⁴² LC, *Trustee Exemption Clauses*, para 4.52.

in Trust Instruments.⁴³ This would be a flexible solution in that the clause would be considered in the context of the other terms of the trust deed, the availability of liability insurance, the options offered to the truster and the value and nature of the trust fund. The Commission remarked that such legislation would have a deterrent effect on excessively wide immunity clauses. However, it would take some time for a body of case law to build up.⁴⁴ Another drawback is that trusts may last for many years. If the legislation followed the principles in the 1977 Act, the reasonableness of a clause would depend on an evaluation of the factors as they stood at the inception of the trust. Any increase in the trust estate or the assumption of new trustees of a different calibre would not be taken into account. In these circumstances the Commission concluded that there were better ways of tackling immunity clauses. We share that view. Scotland has at present a fixed rule which gives the benefit of certainty. The slow build up of cases would be a serious problem for a small jurisdiction like Scotland, even though English decisions would be of persuasive authority if the legislative provisions were sufficiently similar. Our preference is for any replacement to be a fixed rule rather than conferring a discretionary power to strike down such clauses on the courts. Jersey considered but rejected such an approach when amending its trust law in 1989. It opted instead for a rule prohibiting the trust deed from excluding liability for gross negligence.⁴⁵

3.21 The American Uniform Trust Code allows clauses excluding liability for breaches of trust arising from any conduct short of bad faith or reckless indifference to the interests of beneficiaries or the purposes of the trust. If such a clause is drafted by the trustee then it is invalid unless the trustee shows it was fair under the circumstances and its existence and contents were adequately communicated to the truster.⁴⁶ We do not regard this as providing adequate protection for the beneficiaries.

3.22 From our study of other jurisdictions there appear to be three main options for a fixed rule on immunity clauses. First, an immunity clause could be declared ineffective in so far as it purports to exclude liability for negligence, gross negligence or fraud. This is tantamount to outlawing immunity clauses. Second, an immunity clause could be effective to exclude liability for negligence but not for gross negligence or fraud. This is the current position in Scotland. Finally, an immunity clause could be effective to exclude liability for negligence and gross negligence, but not for fraud.

(b) Is gross negligence a workable concept?

3.23 The second option requires that the court can draw a distinction between negligence and gross negligence. The Scottish cases where trustees have been held to be grossly negligent (or guilty of *culpa lata*) furnish illustrations of gross negligence but do not contain much discussion of the concept.⁴⁷ Lord Herschell in *Raes v Meek*⁴⁸ simply referred to "that high degree of negligence which is termed *culpa lata*", whereas Lord President Inglis in

⁴³ BCLI, *Exculpation Clauses*. See paras 3.28 and 3.39 below and Appendix A for further details.

⁴⁴ Cf the development of case law under the Unfair Contract Terms Act 1977.

⁴⁵ See Appendix A, para 17.

⁴⁶ S 1008(b).

⁴⁷ *Knox v Mackinnon* (1888) 15 R (HL) 83, sale of trust property to one of the beneficiaries with a large part of the price secured only by personal bond; *Raes v Meek* (1889) 16 R (HL) 31, loan on speculative building project; *Ferguson v Paterson* (1900) 2 F (HL) 37, trust funds left in hands of law agent who became bankrupt; *Carruthers v Carruthers* (1896) 23 R (HL) 55, failure to audit factor's accounts annually as directed in trust deed; *Carruthers v Cairns* (1890) 17 R 769, failure by trustees to enforce a debt owed to the trust estate.

⁴⁸ (1889) 16 R (HL) 31 at 35.

*Carruthers v Cairns*⁴⁹ equated gross negligence with a gross neglect of duty and wilful default.⁵⁰ Some guidance can be found from professional negligence cases. In the 19th century, law agents were not liable to their clients unless they had been grossly or crassly negligent or ignorant. In *Purves v Landell*⁵¹ crass negligence was considered to be "considerable mismanagement, considerable ignorance and the absence of attentive conduct in general."⁵² Two later cases of *Cooke v Falconer's Representatives*⁵³ and *Hamilton v Emslie*⁵⁴ explained it as a substantial deviation from normal professional standards. In the 20th century, professional liability became based on absence of reasonable care in the circumstances or negligence, rather than gross negligence. Lord President Clyde in *Hunter v Hanley*,⁵⁵ a medical negligence case, remarked that gross negligence indicated "so marked a departure from the normal standard of conduct of a professional man as to infer a lack of that ordinary care which a man of ordinary skill would display." He went on to say that these words aptly described the criterion of liability although they might give the impression that there are degrees of negligence. Lords Russell and Sorn both thought that in civil claims based on negligence there was now only one standard – failure to take reasonable care.

3.24 In England and Wales the distinction between gross negligence and negligence was of importance in the liability of bailees.⁵⁶ A gratuitous bailee (a person who looked after another's goods without remuneration) was liable for loss only if grossly negligent, while a bailee for reward was liable if the loss arose through negligence. Hence Collins J in *Martin v London County Council*⁵⁷ said of gross negligence that:

"I do not know whether that degree of negligence can be accurately defined, but it must be some sort of carelessness which would appear to the plain man of common sense as being gross."

The current law is that a bailor must take reasonable care of the goods,⁵⁸ the standard of care depending on the circumstances of each particular case,⁵⁹ so that no distinction now falls to be made between negligence and gross negligence in the field of bailment.

3.25 The case of the *Hellespont Ardent*⁶⁰ involved shipping agreements which excluded claims except where they resulted from a party's bad faith, gross negligence or wilful misconduct. The agreements were made under New York law which disallows on public policy grounds clauses conferring immunity where gross negligence is concerned. Mance J considered that the concept of gross negligence both under New York law and the ordinary meaning of the phrase "appears to ... embrace serious negligence amounting to reckless disregard, without any necessary implication of consciousness of the high degree of risk or

⁴⁹ (1890) 17 R 769.

⁵⁰ It was held in *Wilson v Guthrie Smith* (1894) 2 SLT 338 that wilful default itself cannot be distinguished from "wilful and intentional misdoing" despite the fact that there may have been no sinister motive for the conduct in question.

⁵¹ (1845) 4 Bell's App 46.

⁵² Lord Brougham at 59.

⁵³ (1850) 13 D 157.

⁵⁴ (1868) 7 M 173.

⁵⁵ 1955 SC 200 at 206.

⁵⁶ *Coggs v Barnard* (1703) 2 Ld Raym 909. See also J Getzler, "Duty of Care" in Birks and Pretto, *Breach of Trust*.

⁵⁷ [1947] KB 628 at 631.

⁵⁸ *Morris v C W Martin and Sons Ltd* [1966] 1 QB 716.

⁵⁹ *Houghland v R R Low (Luxury Coaches) Ltd* [1962] 1 QB 694; *Toor v Bassi* [2000] ECGS 9.

⁶⁰ [1997] 2 Lloyds Reps 547.

the likely consequences of the conduct ...".⁶¹ He went on to remark that if purely English principles of construction were to be used then, "Gross' negligence is clearly intended to represent something more fundamental than failure to exercise proper skill and/or care constituting negligence. But, as a matter of ordinary language and general impression, the concept of gross negligence seems to me capable of embracing not only conduct undertaken with actual appreciation of the risks involved, but also serious disregard of or indifference to an obvious risk."⁶²

3.26 Jersey and Guernsey both amended their Trust Laws to deny validity to immunity clauses where the trustees had been grossly negligent. This was done in order to ensure that there was no slippage in standards in what is an important part of Jersey's financial services business.⁶³ In *Midland Bank Trustee (Jersey) Limited v Federated Pension Schemes*⁶⁴ gross negligence was held to mean no more than a serious or flagrant degree of negligence.

3.27 On the other hand, Rolfe, B (later Lord Chancellor Cranworth) "could see no difference between negligence and gross negligence, that it was the same thing, with the addition of a vituperative epithet".⁶⁵ In *Armitage v Nurse* Millet L J said⁶⁶ that English lawyers have always had a healthy disregard for the distinction between gross negligence and negligence, considering it to be a difference of degree rather than of kind. The Law Commission in its Consultation Paper on *Trustees Exemption Clauses* considered that the concept of gross negligence was not sufficiently clear and distinctive to form a basis for regulating immunity clauses.⁶⁷

3.28 The British Columbia Law Reform Institute in its Report on *Exculpation Clauses in Trust Instruments*⁶⁸ rejected any formulation that required courts to distinguish between gross negligence and negligence as they considered that the Canadian courts had displayed hostility to this in construing "guest passenger" legislation. Many provinces of Canada had a statutory bar on claims by non-paying passengers in motor vehicles against the driver who was responsible for their injuries unless the driver had been grossly negligent. For example, section 182 of the Highway Traffic Act of Alberta⁶⁹ provided that a gratuitous passenger could not sue for damages unless "the accident was caused by the gross negligent or wilful or wanton conduct of the owner or operator of the motor vehicle ...". In one of the leading cases gross negligence was taken to imply "conduct in which, if there is not conscious wrong doing, there is a very marked departure from the standards by which responsible and competent people in charge of motor cars habitually govern themselves".⁷⁰

⁶¹ *Ibid* at 586.

⁶² *Ibid*.

⁶³ Trusts (Guernsey) Law 1989, s 34(7), amended in 1990; Trusts (Jersey) Law, art 26(9), amended in 1989. See Appendix A, para 17.

⁶⁴ [1996] PLR 179.

⁶⁵ *Wilson v Brett* (1843) 11 M & W 113 at 116. Tony Weir vituperatively disagrees: "It is nothing of the sort: it is no more difficult to say whether a person fell far below the acceptable standard than whether he fell below it at all. There is no real difficulty in saying whether conduct is more or less negligent ...": *Tort Law* (2002), 65.

⁶⁶ [1998] Ch 241 at 254.

⁶⁷ Para 4.78.

⁶⁸ BCLI Report No 17 (2002).

⁶⁹ RSA 1980, c H-7, repealed by the Highway Traffic Act RSA 2000, c H-8, which contains no reference to gross negligence.

⁷⁰ *McCulloch v Murray* [1942] SCR 141, Duff C J at 145.

3.29 However, in the later case of *Engler v Rossingol*⁷¹ the Ontario Court of Appeal commented⁷² on the lack of a clear demarcation between gross negligence and negligence and said that it was getting more difficult to distinguish between them in particular cases. However, this was due in part to a growing perception that the legislative policy was wrong in that injured passengers ought to be compensated if the driver had been merely negligent. Many provinces have since abolished the special statutory restrictions on claims by guest passengers.

3.30 We think that gross negligence is a workable concept. The courts in Scotland have been using gross negligence in the field of trust law for well over a century without it having caused difficulties. The switch in the field of professional liability from gross negligence to negligence was due to changes in public attitudes rather than the unworkability of gross negligence as a legal concept. It has to be acknowledged that it is impossible to draw a hard and fast line between negligence and gross negligence,⁷³ but difficulties in establishing boundaries occur throughout the law, for example whether or not an agreement was fair and reasonable in all the circumstances.

(c) Restricting the effect of immunity clauses: professional and lay trustees

3.31 We first consider the arguments for and against restricting the effect of immunity clauses in general. We go on to see how these apply in relation to professional trustees and to lay trustees, as the considerations are not the same for each of the two categories.

3.32 As stated earlier, we think that there should be no protection in respect of fraud, while there will be no delictual liability unless the trustees have been at least negligent. The arguments against allowing an immunity clause to exclude liability arising out of trustees' negligence or gross negligence are as follows.

3.33 Trustees are appointed to carry out the purposes of the trust and act in the interests of all the beneficiaries. There is a public interest in the proper administration of trusts. The law lays down the standard of care with which trustees must comply. If they do not, they are at least negligent. It may be argued that the duty of care to the legal standard should not be subverted by contrary provisions in the trust deed. As Lord President Clyde said in *Clarke v Clarke's Trustees*⁷⁴ an immunity clause means that trustees are being licensed to perform their duties carelessly.⁷⁵ This suggests that immunity clauses which purport to relieve trustees from negligence, let alone gross negligence, should not be effective.

3.34 An effective immunity clause puts the interests of the beneficiaries at risk from acts or defaults of the trustees. Should loss thereby occur the beneficiaries will not be able to sue the trustees and will have no redress. The beneficiaries could cover the risk of the trustees' negligence by means of insurance, but even adult vested beneficiaries may find it difficult to obtain this. Insurance for contingent beneficiaries and young children would present additional problems, while it would be impossible for unascertained future beneficiaries to

⁷¹ (1976) 64 DLR (3rd) 429.

⁷² Evans J A at 435, McKinnon J A at 440.

⁷³ Lord Herschell in *Raes v Meek* (1889) 16R(HL) 31 at 35 said "It is impossible to draw any hard and fast line between the want of that care which a man of ordinary prudence would display in the management of his own affairs and that high degree of negligence which is termed *culpa lata*".

⁷⁴ 1925 SC 693 at 707.

⁷⁵ G Hill in "Law Commission Consultation Paper 171: a response", (2003) 47 *Amicus Curiae*, May/June, 25 remarks that the purpose of diplomatic immunity is not to allow diplomats to get away with crime.

insure themselves. This suggests that the risk should not be shifted by immunity clauses from the trustees to the beneficiaries. Both the Ontario Law Reform Commission and the New Zealand Law Commissions gave this as one of the reasons for recommending a restrictive effect for immunity clauses.⁷⁶

3.35 In paragraph 3.17, above, we set out the statutory provisions which deny effect to immunity clauses in debenture trusts, unit trusts and pension funds and hold the trustees liable for their negligence. Such trusts could be seen as special cases in that they normally have a large number of beneficiaries who rely on them for their savings or security for loans. We prefer to see such provisions as a model for trusts in general. Beneficiaries of other trusts, such as a widow liferenting her deceased husband's estate or the creditors in a trust deed for creditors, are equally relying, and should be entitled to rely, on the competence of the trustees.

3.36 On the other hand, the following arguments can be advanced for allowing immunity clauses to have effect except in relation to fraud. First, trusters should be entitled to set out in the trust deed the powers and liabilities of the trustees. This has been called the principle of settlor autonomy or freedom of settlement. However, the trust is being set up for the beneficiaries who will bear the risk of losses due to breaches of trust by the trustees under a generous immunity clause. Moreover, it has to be doubted whether trusters consciously apply their minds to immunity clauses or their terms. Institutional trustees may use a style of trust deed containing standard administration clauses, including an immunity clause, that are non-negotiable. Such a style will be presented on a "take it or leave it" basis to trusters.⁷⁷ In these circumstances the "autonomy" or "freedom" is that of the trustee, not the truster.

3.37 Secondly, in trusts in the commercial field, immunity clauses can be seen simply as a way of allocating the risk of negligence between the business entities involved. Such clauses are arguably no more objectionable than other risk-shifting mechanisms, such as contracting out of liability for latent defects in goods. In particular, institutional trustees managing very large trust estates may find it impossible to obtain insurance at a reasonable cost so that immunity clauses are seen as providing the necessary protection.

3.38 Thirdly, the beneficiaries are generally the recipients of the truster's bounty. They obtain their interests as a gift and ought, so the argument goes, to accept them subject to any immunity clauses and other conditions imposed by the truster. However, there would seem to be a difference between conditions which lay down when the beneficiaries become entitled to their interests (such as on marriage or survivance of a liferenter) and conditions which allow the beneficiaries to be deprived of their interests due to the negligence of third parties, the trustees, who were appointed to safeguard them. Immunity clauses may also be seen as a way of protecting trustees from being harassed by unfounded accusations of negligence made by quarrelsome beneficiaries.⁷⁸

3.39 Fourthly, denying effect to generous immunity clauses might result in professional trustees becoming unwilling to act. This has been called "trustee chill".⁷⁹ It was one of the possible consequences which induced the British Columbia Law Institute to change its

⁷⁶ OLRC, *The Law of Trusts*, Vol 1, 40; NZLC, *Problems in the Law of Trusts*, para 14.

⁷⁷ Lewin, *Trusts*, para 39-88 states that to obtain the services of one of the better trust corporations trusters have to agree to a wide special indemnity clause.

⁷⁸ G Hill, "Law Commission Consultation Paper 171: a response", (2003) 47 *Amicus Curiae*, May/June, 25.

⁷⁹ NZLC, *Problems in the Law of Trusts*, para 8, footnote 9.

views. The Institute's consultation paper had proposed that immunity clauses should be ineffective and that trustees should have to seek relief from the courts. The report, however, recommended that immunity clauses should be effective (except in relation to fraud), but that the court could, on application by a beneficiary, ignore the clause and hold the trustees liable if their conduct was so unreasonable or incompetent that in fairness to the beneficiary the immunity clause should be ignored. The Law Commission's Consultation Paper on *Trustee Exemption Clauses* contains details of independent socio-economic research on exemption clauses and the implications of regulating them. It found that such clauses are widely used in England and Wales and that professional trustees have come to rely on them as affording a means of protection from liability for breach of trust. Some professional trustees took the view that those who charge for their services should be properly accountable. Others argued that such clauses were a necessary component of modern trust practice and thought that regulation might lead to a reluctance to act or to trusts being set up in a less regulated jurisdiction. We do not find these arguments convincing. We are not aware of any evidence from the other jurisdictions which restrict the effect of immunity clauses that it is difficult to obtain the services of trustees there.⁸⁰ Scotland allows immunity clauses only a limited effect, yet trustees seem not to be deterred from acting. "Trustee chill" seems unlikely because trustees, especially professional trustees, can obtain insurance and charge that cost against the trust estate or increase their fees to cover it. Professional trustees are unlikely to be deterred from acting by the absence of an immunity clause. By statute, any immunity clause is ineffective to exclude the liability of trustees of debenture trusts and authorised unit trusts for negligence,⁸¹ yet we are not aware of there being any difficulty in obtaining trustees.

3.40 Fifthly, narrowing the effectiveness of immunity clauses could increase the cost of trust administration via increased charges. This argument would have force in Scotland only if immunity clauses were to be treated as ineffective as regards negligence instead of (as at present) gross negligence. On the other hand the beneficiaries may regard some slight increase in fees as a price worth paying to guard against the possibility of a large loss of the trust estate through the trustees' negligence.

(d) Conclusion

3.41 Our view is that, on grounds of public policy, immunity clauses should receive only a limited effect. We tend to favour professional trustees being liable for breaches of their duty of care, whatever the terms of the immunity clause. Professional trustees are appointed on the basis that they can provide a better standard of service than ordinary untrained people. They hold themselves out as specialists in the areas in question. Solicitors, accountants, bankers and such like do not generally act for their clients in other areas of work on the basis that they are to be immune from claims for negligence. It may be asked why the position in trust work should be any different. If a loss to the trust estate arises from a breach of trust the loss has to be borne either by the trustees or the beneficiaries. Professional trustees can readily obtain insurance against negligence claims. Indeed solicitors and accountants are obliged, as a condition of their licence to practice, to be insured against negligence claims arising out of their professional activities which includes acting as a trustee. Our approach is in line with the Law Commission's provisional proposal

⁸⁰ Lewin, *Trusts*, para 39-88 where the authors opine that any change in the effect of immunity clauses is unlikely to result in professional trustees abandoning trust business.

⁸¹ See para 3.17 above.

that professional trustees should not be able to exclude personal liability for breaches of trust arising from their negligence.⁸²

3.42 The position of lay trustees, ie those who undertake trusteeship duties otherwise than in course of their business, is perhaps different. At present a standard style of immunity clause protects trustees (lay and professional) against negligence but not gross negligence. Arguably this is the correct position for lay trustees. Liability for negligence might be regarded as too heavy a burden for untrained people, so that it should be competent for the trust deed to alleviate this by means of an effective immunity clause. This would draw a justifiable distinction between lay trustees and professional trustees where our provisional view is that the latter should be held to account for their negligence whatever the terms of the immunity clause. The counter-arguments are that the standard of care required of lay trustees is not unduly high and that specialist help is available to them. Lay trustees are liable for breaches of trust if they fail to act as a prudent person would have done. They can, and invariably do, obtain help and advice from a wide variety of sources including any professional co-trustee. It would be unusual for a trust to be run entirely by lay trustees without any outside assistance. Indeed, it would be negligent for them to fail to seek professional help and advice in circumstances where a prudent person would take that step. If, having employed professional advisers, lay trustees are then sued for breach of trust they are likely to convene their professional advisers as third parties in the hope that the claim would be met by professional indemnity insurance.

3.43 Allowing lay trustees immunity for gross negligence seems to us to be going too far in that they would then be liable only if they had been fraudulent or dishonest. It would permit them knowingly to take decisions that carried considerable risks for the beneficiaries or to disregard obvious risks. The Law Commission has provisionally proposed that lay trustees should have immunity from gross negligence, but that is against the background of the decision in *Armitage v Nurse*⁸³ where it was held that a wide immunity clause⁸⁴ was effective in relation to all breaches of trust except fraud. Its proposal is for no change in the present law. Also the Law Commission rejected the use of gross negligence in this context because it considered the term imprecise and likely to lead to uncertainty. But England and Wales, unlike Scotland, does not use gross negligence in the field of civil law.

3.44 Another argument that has been advanced in favour of more effective immunity for lay trustees is that they may not find it easy to obtain personal liability insurance on an affordable basis. Professional trustees have no such problem. Indeed, they are generally required to be insured against losses arising out of their professional negligence. They will pass on the cost of insurance to their various clients.

3.45 The Ontario Law Reform Commission recommended against immunity clauses indemnifying lay trustees from liability for negligence. They thought that trusteeship was a voluntary office and that those who were unsure of their competence should not accept. We think this is only partly true. Many lay trustees have a close connection with the truster or the beneficiaries. They consider it their duty to accept in order to make their personal knowledge available. Public trusts benefit from having at least some lay trustees who live in

⁸² LC, *Trustee Exemption Clauses*, para 4.85.

⁸³ [1998] Ch 241.

⁸⁴ Set out in Appendix A, para 18.

the area served by the trust or who have experience of the problems faced by potential beneficiaries. But putting personal assets at risk is a disincentive to acting as trustee.

3.46 Summing up, we seek views on the following proposals:

4. **A clause in a trust deed purporting to relieve trustees acting in the course of their business or profession from liability should be regarded as ineffective in so far as the liability arises from the trustees' failure to exercise the degree of care, diligence and skill required by law.**
5. **There should be no change in the present law regarding the effectiveness of immunity clauses in trust deeds in relation to lay trustees. Accordingly, an immunity clause should continue to be effective in excluding liability for negligence but not for gross negligence.**

3.47 We do not think that an immunity clause having a differential effect on professional trustees and lay trustees would cause problems in trusts where there were both types of trustee. The situation could arise whereby the professional trustees were negligent and could be sued despite an immunity clause, but the equally negligent lay trustees would be able to shelter behind the clause. We do not find such a result inappropriate. It is one that might arise at present if, as seems likely, the standard of care is different for each type of trustee. It might be thought that the professional trustees would be able to recover a rateable share of the damages from the lay trustees because where loss to the trust estate arises out of a breach of trust all the trustees involved are jointly and severally liable. This would effectively negate the lay trustee's protection under the immunity clause. We think that this fear is unfounded.

3.48 It is true that any one of the trustees liable for a breach of trust may be sued leaving the defender to seek relief subsequently from the others.⁸⁵ The defender may also bring the others into the original action by means of third party procedure.⁸⁶ However, the starting point is that the lay trustees are not liable because as far as they are concerned the immunity clause is effective. They therefore cannot be sued initially nor can they be brought in later via third party procedure. Joint and several liability arises only where the wrongdoers concerned are all liable to some extent. Section 3(2) of the Law Reform (Miscellaneous Provisions) (Scotland) Act 1940 deals with the situation where one wrongdoer has been sued and seeks to recover part of the amount he or she has paid to the pursuer from others liable. The paying wrongdoer is "entitled to recover from any other person who, if sued, might also have been held liable in respect of the loss or damage on which the action was founded, such contribution, if any, as the court may deem just". This would not assist the professional trustees either as the lay trustees could not have been held liable.

Other aspects of immunity clauses

3.49 Section 33 of the Pensions Act 1995 renders ineffective the exclusion or restriction of liability by trustees for breach of their obligation to take care and exercise skill in relation to investment matters. Excluding or restricting liability is given an extended meaning as it

⁸⁵ *Croskery v Gilmour's Trs* (1890) 17R 697, following *Liquidators of the Western Bank v Douglas* (1860) 22D 447; *Allen v McCombie's Trs* 1909 SC 710.

⁸⁶ *Anderson v Anderson* 1981 SLT 271.

includes making the liability or its enforcement subject to restrictive or onerous conditions, excluding or restricting any right or remedy in respect of the liability, subjecting any person to any prejudice in respect of pursuing any such right or remedy, or excluding or restricting rules of evidence or procedure.⁸⁷ This wording comes from section 13 of the Unfair Contract Terms Act 1977. The equivalent provisions for debenture trusts and unit trusts, contained in section 192 of the Companies Act 1985 and section 253 of the Financial Services and Markets Act 2000 respectively, does not contain these extra provisions.

3.50 Both the Ontario Law Reform Commission and the British Columbia Law Institute in their respective reports included an almost identical extended definition of an immunity or exemption clause. On the other hand there is nothing similar in the legislation in Guernsey, Jersey, South Africa or the Turks and Caicos Islands. We are not at present persuaded of the need for such extra complexities, but in order to elicit views ask the following question:

6. **Should any new statutory provision rendering ineffective terms in a trust deed relieving trustees from liability in respect of negligence or gross negligence also render ineffective any terms making the exercise or enforcement of beneficiaries' rights in this area more difficult?**

(3) Other terms restricting trustees' liability

Introduction

3.51 Besides an immunity clause declaring that trustees are not to be liable for losses caused by their negligence or gross negligence,⁸⁸ the trust deed may contain other clauses restricting liability. These include clauses lowering the standard of care, enlarging the powers of trustees, abridging the trustees' duties or authorising trustees to indemnify themselves out of the trust estate.

Lowering the standard of care

3.52 The Trustee Act 2000 provides a standard of care for trustees but permits this to be disapplied by an appropriate clause in the trust deed.⁸⁹ Concerns were raised during the passage of the legislation through Parliament⁹⁰ as a result of which the Lord Chancellor referred the issue of immunity clauses and other matters to the Law Commission.⁹¹ In the context of its recommendation that an immunity clause should be ineffective as regards professional trustees, the New Zealand Law Commission commented that an obvious device to circumvent this would be to draft the clause in terms of limiting the duty of care incumbent on the trustees. They therefore recommended that a provision in a trust deed limiting the degree of care, diligence and skill required from a trustee acting for reward should be ineffective.⁹² We agree with this and would extend it to lay trustees. We propose that:

⁸⁷ Another type of clause restricting challenges which is met with very occasionally brings about the forfeiture of a beneficiary's entitlement should he or she challenge certain acts or decisions of the trustees.

⁸⁸ See style in para 3.13 above.

⁸⁹ Sch 1, para 7.

⁹⁰ Lord Goodhart, Hansard (HL) 14 April 2000, vol 612, col 383–384.

⁹¹ See LC, *Trustee Exemption Clauses*.

⁹² NZLC, *Problems in the Law of Trusts*, para 15.

7. **Without prejudice to the effectiveness of any immunity clause, a term in a trust deed purporting to lower the standard of care that would otherwise be expected from a trustee should be ineffective.**

Enlarging trustees' powers

3.53 Another aspect of trustees' immunity is the effect of a clause conferring extended powers on the trustees, such as a power to retain the truster's investments or to lend on personal credit. However, it is settled that such a clause does not exonerate trustees from liability if they exercise such a power negligently. In *Knox v Mackinnon*⁹³ the trustees lent a very substantial sum of money for many years to one of the beneficiaries on personal credit. The beneficiary became bankrupt so that the loan was irrecoverable. The trustees were held to have been grossly negligent and remained liable despite the power in the trust deed to lend on personal credit. A similar situation occurred in *Clarke v Clarke's Trustees*⁹⁴ where the will empowered the trustees to retain the truster's investments. They retained a doubtful investment, never obtained proper advice about it and neglected to keep it under review for many years until eventually it became worthless. A clause absolving the trustees from liability in respect of retained investments was held ineffective in the circumstances. We think that the law in this area is satisfactory.

Abridging the trustees' duties

3.54 Yet another way of limiting the potential liability of trustees is by excluding certain duties. Trustees cannot commit a breach of trust in failing to carry out a particular duty if this duty has been expressly excluded by the trust deed. There do not appear to be any reported Scottish decisions on this aspect of trustees' liability. In England and Wales such abridgement clauses may provide a defence to trustees for losses arising out of their conduct. A 19th century example is *Wilkins v Hogg*⁹⁵ where the trust deed provided:

"any trustee who shall pay over to his co-trustee, or shall do or concur in any act enabling his co-trustee to receive any monies ... shall not be obliged to see to the application thereof, nor shall such trustee be subsequently rendered responsible by an express notice or intimation of the actual misapplication of the same monies."

Two trustees enabled a third to receive money which he then misapplied and concealed his fraud for two years. The two trustees were held not liable in view of the above provision limiting their duties.

3.55 A more recent example is the Privy Council case of *Hayim v Citibank*.⁹⁶ Mr Hayim, a Hong Kong resident, appointed Citibank as executor of his American will and provided that it "should have no responsibility or duty" with respect to the house in Hong Kong until his elderly brother and sister who were living there died. By a Hong Kong will he appointed another executor to hold the house in trust for Citibank as executor of the American will. This scheme was devised by Mr Hayim as a way of ensuring that his siblings could stay on in the house rent free without making them beneficiaries. Citibank declined to take any

⁹³ (1888) 15 R(HL) 83.

⁹⁴ 1925 SC 693.

⁹⁵ (1861) 31 L J Ch 41 at 41.

⁹⁶ [1987] AC 730, an appeal from Hong Kong decided on English law as no evidence was led as to Hong Kong or American law.

steps to have the Hong Kong house sold until the surviving sibling died despite urgings by the American beneficiaries. The delay resulted in a substantial loss. The Privy Council held that Citibank was protected by the abridgement of duty clause which was understandable in the circumstances.

3.56 Another common example of abridgement of duties is where the trustees are major shareholders in a family company. The trust deed may provide that the trustees are to have no duty to oversee or interfere with the management of the company unless they become aware that the directors are acting dishonestly.⁹⁷ There is a natural limit to the effectiveness of abridgement provisions. Removal of too many duties that would otherwise fall on the trustees may have the effect that no trust is created.⁹⁸

3.57 The Trust Law Committee looked at introducing a statutory restriction of abridgement clauses. A possible formula they considered was:

"a provision in a trust purporting, whether wholly or partly, to negative a positive duty that in the absence of such provision would otherwise lie on the trustee is void to the extent that such trustee could not rely on an exemption clause purporting to relieve from liability for breach of such duty."⁹⁹

The Committee concentrated on positive duties since an abridgement of a negative duty would not alter the trustees' liability. For example, a provision in the trust deed that the trustees were not to sell or consider selling their shares in the family company is an abridgement of a positive duty, breach of which would normally result in liability. However, a provision that authorises trustees to buy land in France is a restriction of the trustees' negative duty not to buy land. The trustees would remain liable if they failed to exercise due care in such a purchase. The Committee considered that framing statutory provisions in terms of positive and negative duties could give rise to practical difficulties since it was possible to regard many rules of trust law as having both positive and negative aspects. Two solutions were proposed: listing the positive duties that could be validly abridged or disapplying the provision against abridgement clauses quoted above if "negating a positive duty affords the trustee power to take particular action".

3.58 However, the Trust Law Committee doubted the utility of such complex provisions as in the circumstances of a specified trust a particular abridgement clause might be justifiable. We agree with this view. There is not the same public policy objection to limiting the trustees' duties as there is to licensing them to carry out their duties carelessly. It is worth noting that the statutory provisions rendering immunity clauses ineffective in the field of debenture, unit and pension fund trusts¹⁰⁰ do not contain any anti-abridgement provisions.

3.59 If, contrary to our provisional view, legislation was thought necessary to counter abridgement clauses we think that the best way would be to empower the courts to declare a clause in the trust deed in question to be ineffective. In contrast to immunity clauses it would be almost impossible to devise fixed rules in this area. A Scottish court could be

⁹⁷ Lewin, *Trusts*, para 39-79. A similar example was given by the Trust Law Committee where the trustees are expressly relieved of their duty to consider diversifying investments in order to protect the family's long-term interest in the company – TLC, *Trustee Exemption Clauses*, para 7.15.

⁹⁸ Lewin, *Trusts*, para 39-80.

⁹⁹ TLC, *Trustee Exemption Clauses*, para 7.11.

¹⁰⁰ See para 3.17 above.

given power to set aside an abridgement clause which was not fair and reasonable in all the circumstances. This flexible test is used and works well in other areas of law.¹⁰¹ The Law Commission's Consultation Paper on *Trustee Exemption Clauses* has put forward a similar proposal.¹⁰² An abridgement of duty clause (which it terms a duty exclusion clause) and an extended powers clause could be disappplied by the court when deciding whether trustees have been negligent if the clause was unreasonable in the circumstances and inconsistent with the overall purposes of the trust.¹⁰³ The British Columbia Law Institute recommended a similar approach in its report. An immunity (or exemption) clause was to be subject to judicial control on application by a beneficiary and was defined to include a provision "which purports to negative a duty that, in the absence of such a provision, would otherwise lie on the trustee".¹⁰⁴

3.60 We ask the following questions:

8. **Should new statutory provisions be introduced in order to render ineffective terms in a trust deed which negative or abridge any duty that, in the absence of such a term, would be incumbent on the trustees? If so, should the court have power to disregard any such term that was not reasonable in the circumstances or consistent with the trust purposes?**

Indemnity clauses

3.61 An indemnity clause provides that trustees who incur personal liability for negligence in connection with the trust are entitled to be reimbursed from the trust estate. It effectively recycles the liability back to the beneficiaries. We understand that indemnity clauses are used in commercial trusts. However, we agree with the Law Commission that if immunity clauses purporting to exclude liability for negligence are to be regulated then the same approach has to be taken with indemnity clauses.¹⁰⁵ We therefore propose that:

9. **Indemnity clauses in trust deeds should be ineffective to the same extent as immunity clauses.**

¹⁰¹ For example setting aside an agreement between spouses as to financial provision on their divorce, Family Law (Scotland) Act 1985, s 16.

¹⁰² LC, *Trustee Exemption Clauses*, para 4.97.

¹⁰³ *Ibid*, paras 4.95-4.96.

¹⁰⁴ BCLI, *Exculpation Clauses*, 16 (Recommended new s 96(4)(c)).

¹⁰⁵ LC, *Trustee Exemption Clauses*, para 4.88.

Part 4 Breach of Fiduciary Duty

Introduction

4.1 In this section we look at breaches of trust arising from transactions carried out by the trustees in violation of the duties they owe as fiduciaries to the beneficiaries. We look first at transactions in general and deal later with the particular aspect of entitlement of trustees to remuneration out of the trust estate for their services to the trust.

(1) General

The current law in Scotland

4.2 Trustees have fiduciary duties towards beneficiaries which arise by virtue of the trust relationship. Trustees must not place themselves in a situation where their personal interests conflict, or may possibly conflict, with their duties to the beneficiaries in terms of the trust deed. As Lord Young said in *Huntington Copper and Sulphur Co Ltd v Henderson*:¹

"It is the simple and familiar rule of trust law that a trustee (using the term in its largest sense), shall not without the knowledge and consent of his constituent make profit of his office, or take any personal benefit from his execution of it. It is not a different rule, but merely a development and instance of the same rule, that a trustee shall not be permitted to do anything which involves or may involve a conflict between his personal interest and his trust duty. The rule is not confined to particular cases which are capable of being enumerated, but is commensurate with a large and important principle on which it rests. That principle is that a person who is charged with the duty of attending to the interest of another shall not bring his own interest into competition with his duty."

4.3 The following types of transaction are regarded as being in breach of fiduciary duty:

- (a) A purchase of trust property by the trustee.²
- (b) A sale by a trustee of property to the trust,³ a loan to or by a trustee⁴ and other similar contracts where there is an actual or potential conflict of interest.⁵
- (c) A trustee renewing a lease in his or her own name⁶ or a trustee transferring a lease to him or herself in (partial) satisfaction of succession rights.⁷

¹ (1877) 4 R 294 at 299.

² *Magistrates of Aberdeen v University of Aberdeen* (1877) 4 R (HL) 48; *Johnston v MacFarlane* 1987 SLT 593.

³ *Cherry's Trs v Patrick* (1911) 2 SLT 313.

⁴ *Perston v Perston's Trs* (1863) 1 M 245 (loan from trust); *Wilson v Smith's Trs* 1939 SLT 120 (loan to trust).

⁵ Using the trust estate for their own business, *Cochrane v Black* (1855) 17 D 321.

⁶ *Wilson v Wilson* (1789) Mor 16376.

⁷ *Inglis v Inglis* 1983 SC 8.

- (d) A trustee diverting contracts that would otherwise come to the trust to himself or herself or setting up in competition to a trust business.⁸
- (e) A trustee taking remuneration or commission.⁹
- (f) A trustee using for personal advantage information obtained by virtue of being a trustee or disclosing such information.

4.4 A trustee who enters into conflicting or potentially conflicting transactions is said to be acting as *auctor in rem suam*. As Lord Neaves said in *Aitkin v Hunter*¹⁰:

"It appears to me that from first to last the rule of the law of Scotland has been that any one holding a fiduciary character, whether that of guardian or trustee, cannot lawfully become *auctor in rem suam*."

The *auctor in rem suam* rule stems from the Roman law doctrine applying to tutors and curators. Such officeholders were prohibited from creating an obligation in their own favour against their pupils or minors. The doctrine was received in Scotland¹¹ and applied to trustees. At least as far as trustees are concerned, the concepts of breach of fiduciary duty and *auctor in rem suam* seem to have become virtually synonymous.¹²

4.5 A trustee who obtains any property or advantage in breach of fiduciary duty is deemed to hold it on behalf of the beneficiaries. They may recover the property by reducing the transaction or making the trustee account to them for any profit.¹³ These remedies are available whether or not the transaction was fair,¹⁴ the trustee acted reasonably, or the trust estate had not in fact suffered any loss.¹⁵ The beneficiaries may also raise an action of damages against the trustee for loss suffered by the trust estate¹⁶, irrespective of whether the transaction was fair or the trustee acted reasonably. However, some conflict of interest situations will not be regarded as a breach of fiduciary duty if the transaction as a whole is fair and reasonable. These include purchase of trust property by a person closely connected with the trustee¹⁷ or a purchase by a trustee of a beneficiary's interest.¹⁸ A transaction that would be a breach of fiduciary duty by a trustee may be allowed to be carried out by an ex-trustee, but the court would view it with suspicion. Factors that weigh against the ex-trustee are that negotiations about the transaction took place prior to resignation and that the ex-trustee resigned for the purpose of carrying out the transaction afterwards.¹⁹

⁸ Stair Memorial Encyclopaedia, Vol 24, paras 181 and 182.

⁹ See paras 4.18-4.36 below.

¹⁰ (1871) 9 M 756 at 762.

¹¹ Erskine, i. vii,19.

¹² Wilson and Duncan, *Trusts, Trustees and Executors*, ch 26 dealing with breaches of fiduciary duty headed "Auctor In Rem Suam"; Gloag and Henderson, *Introduction to the Law of Scotland* (11th edn, 2001) para 47.13 dealing with breaches of fiduciary duty headed "Auctor In Rem Suam"; Stair Memorial Encyclopaedia, Vol 24, 116, s (6), both breach of fiduciary duty and *auctor in rem suam* used in the heading.

¹³ *Inglis v Inglis* 1983 SC 8; *Morrison v Morrison's Exrx* 1994 GWD 29-1776.

¹⁴ *Aberdeen Railway Co v Blaikie Brothers* (1853) 1 Macq 461; *Laird v Laird* (1855) 17 D 984; *Cherry's Trs v Patrick* (1911) 2 SLT 313; *Inglis v Inglis* 1983 SC 8, Lord Hunter at 16.

¹⁵ *Aberdeen Railway Co v Blaikie Brothers* (1853) 1 Macq 461, Lord Cranworth at 471; *Hamilton v Wright* (1842) 1 Bell's App 574; *Gillies v Maclachlan's Repts* (1846) 8 D 487.

¹⁶ Stair Memorial Encyclopedia, Vol 24, para 186.

¹⁷ *Burrell v Burrell's Trs* 1915 SC 333.

¹⁸ *Dougan v Macpherson* (1902) 4 F (HL) 7; *Buckner v Jopp's Trs* (1887) 14 R 1006; *Davis v Davis* (1908) 16 SLT 380.

¹⁹ *Chalmers, Cases and Materials*, para 8.32; Stair Memorial Encyclopaedia, Vol 24, para 177.

4.6 A trustee may carry out a transaction in breach of fiduciary duty if it is authorised in the trust deed or agreed by the beneficiaries. Some trust deeds authorise a wide variety of transactions.²⁰ Following the case of *In re Drexel Burnham Lambert Pension Plan*²¹ we understand that clauses are inserted allowing trustees who are also beneficiaries to exercise powers in favour of a class that includes them. Normally the authorisation in the trust deed must be express so that a power to sell to any beneficiary was held not to authorise a sale to a beneficiary who was also a trustee.²² However, authorisation may be implied from the situation in which the truster has placed the trustee. Thus in *Sarris v Clark*²³ a farmer left a will making his wife and his three children by a previous marriage equal beneficiaries and appointed his wife and others as executors. In another document he granted his wife leases of his four farms. In order to realise the estate, the executors negotiated a renunciation by the widow of the leases. The Lord Ordinary allowed the widow a proof before answer on her averments that her late husband must have foreseen the conflict of interest and impliedly authorised it. The Inner House refused the children's reclaiming motion.²⁴ The beneficiaries may consent to a transaction by a trustee in breach of fiduciary duty but the onus is on the trustees to show that they were fully informed and aware that the transaction would otherwise be a breach of trust.²⁵ The Court of Session has no power under its *nobile officium* to authorise a transaction in breach of the *auctor in rem suam* rule.²⁶ Section 32 of the Trusts (Scotland) Act 1921 does empower the court to grant relief to trustees from personal liability for a breach of trust if satisfied that they have acted honestly and reasonably and ought fairly to be excused.²⁷

Are the rules on breach of fiduciary duty too strict?

4.7 We think that in general there is a clear need for trustees to be subject to rules against self-dealing and conflicts of interest. Nevertheless, it is arguable that the current rules are too strict and inflexible. Transactions which represent good value for the trust are struck at as well as those which are disadvantageous. Also, where a trustee has to make over to the trust all the profits gained in the transaction, inadequate account may be taken of the trustee's own work and efforts in producing that profit. Thus in *Cherry's Trustees v Patrick*²⁸ one of the trustees, Mr Patrick, was a licensed wholesaler and carried on supplying the retail outlets owned by the deceased, Mr Cherry, (which business was carried on after his death by the trustees) on the same terms. Mr Patrick gave a discount on beer that was equivalent to the highest discount that any other wholesaler would have given and supplied whisky at prices equal to or less than the trustees would otherwise have had to pay. Nevertheless he was held bound to pay to the trust all the profits he had made over several years from these transactions.

²⁰ Barr *et al*, *Drafting Wills*, style 7.10(14) trustees to have power "to enter into any transaction or do any act otherwise authorised by law or by this deed notwithstanding that any trustee is or might be acting as auctor in rem suam or with a conflict of interest between such trustee and himself as an individual or as trustee of any other trust or any partnership of which the trustee is a partner or any company of which the trustee is a shareholder or director or in relation to any combination of these capacities provided that the trustee or trustees with whom there is or may be any such conflict is or are not the sole trustee or trustees."

²¹ [1995] 1 WLR 32, see Appendix A, para 21.

²² *Johnston v Macfarlane* 1987 SLT 593.

²³ 1995 SLT 44.

²⁴ See also *Goodsir v Carruthers* (1858) 20 D 1141; *Cameron's Trs v Cameron* (1864) 3 M 200.

²⁵ *Buckner v Jopp's Trs* (1887) 14R 1006; *Taylor v Hillhouse's Trs* (1901) 9 SLT 31.

²⁶ *Hall's Trs v McArthur* 1918 SC 646; distinguishing *Coates' Trs* 1914 SC 723.

²⁷ See para 4.8 (c) and Part 6 below.

²⁸ (1911) 2 SLT 313.

4.8 The arguments against the rule in its present form are:

(a) It is a penal rule and unnecessarily strict in its effect. Even though the trustee has been honest, endeavoured to do the best for the trust, and transacted on terms that were favourable to the trust, the transaction may nevertheless be reduced or all profits forfeited as the case of *Cherry's Trustees* in the previous paragraph shows.

(b) It might be said that a trustee can avoid the rule by resigning, but this is not always the case.²⁹ Moreover, resignation may not be in the best interests of the trust or the trustee may not be able to resign, for example if an executor-dative.

(c) The court has no power (as it does in some other jurisdictions)³⁰ to sanction in advance a transaction by a trustee in breach of the *auctor in rem suam* rule. Although section 32 of the Trusts (Scotland) Act 1921 empowers the court to grant relief for breaches of trust, we are not aware of any cases where it has been used to relieve a trustee who was *auctor in rem suam* or in breach of fiduciary duty. The provision requires the trustee to have acted honestly and reasonably. These criteria would be almost impossible for such a trustee to fulfil, given the current attitude of the courts. Moreover it only provides relief after the transaction has taken place.

4.9 The arguments for retaining the rules in their current strict form are:

(a) It is difficult for the court to discover the background and facts of the transaction and much time would have to be spent by the court in investigating this and deciding whether any particular transaction was fair.³¹

(b) It removes the temptation from trustees to abuse their position since they know that any advantage gained will have to be made over to the trust and they will be liable for any losses suffered by the trust.

(c) There is a need to maintain public confidence in trusteeship where loyalty to the trust is properly expected.³² The rules do this by imposing exacting standards of conduct.

(d) There will always be a suspicion that the trustee has got a good bargain by virtue of inside information.³³ The fact that a trustee is a potential purchaser may put others off.

In summary, the current rules are clear and simple to apply.

Options for reform

4.10 A general statutory relaxation sanctioning transactions by trustees in breach of their fiduciary duty would go too far. It would encourage trustees to misuse their office for personal advantage. On the other hand it would be very difficult to specify in legislation

²⁹ See para 4.5 above.

³⁰ See Appendix A, paras 21 and 22.

³¹ *Aberdeen Railway Co v Blaikie Brothers* (1853) 1 Macq 461, Lord Cranworth at 472; *Hamilton v Wright* (1842) 1 Bell's App 574, Lord Brougham at 591.

³² *Hughes Aircraft Systems International v Airservices Australia* (1997) 146 ALR 1, Finn J at 81.

³³ *Elias v Black* (1856) 18 D 1225, Lord President M'Neill at 1230.

those cases where some relaxation was appropriate.³⁴ We consider that the types of transaction are too varied to adopt a rule-based approach. If there is to be any relaxation of the rules then it should be done by the courts on a case-by-case basis.

4.11 Section 16 of the Succession (Scotland) Act 1964 empowers the executor to transfer the deceased's interest as tenant under a lease to a person with an interest in the estate. In *Inglis v Inglis*³⁵ it was held that an executor-dative who transferred the lease to himself as an individual had acted as *auctor in rem suam* and hence held the lease and the sum received for its renunciation for behoof of the beneficiaries of the estate. In our *Report on Succession*³⁶ we pointed out that conflicts of interest are very likely in such a situation. Executors, particularly executors-dative, are often close relatives of the deceased tenant and may have helped the tenant in the business. The executor may therefore be the only person who is interested in taking over the business and who is acceptable to the landlord. We therefore recommended a limited exception to the *auctor in rem suam* rule in that the transfer would be unchallengeable provided it was done at a value agreed by all interested parties or fixed by the court.³⁷ In executries or family trusts it may be difficult or impossible to avoid transactions in breach of fiduciary duty. Resignation of the trustee or executor in question may be damaging to the functioning of the trust, especially as it may have to be for an extended period of uncertain length.

4.12 We were aware of similar problems with guardians and others appointed to manage the finances or personal welfare of incapable adults. We recommended in our *Report on Incapable Adults*³⁸ that appointees should not be liable for acting in breach of fiduciary duty provided they acted reasonably, in good faith and in accordance with the general principles applicable to all dealings involving incapable adults. Section 82 of the Adults with Incapacity (Scotland) Act 2000 implemented this recommendation. However, such a solution would not be appropriate for trustees and executors as there is no statutory list of general principles which they have to follow in dealing with beneficiaries.

4.13 The courts could be given a discretionary power to authorise a proposed transaction that would be in breach of the trustees' fiduciary duties and to approve retrospectively a completed transaction. But it seems doubtful whether the facility of prospective approval would be used to any great extent. The proposed transaction would have to be substantial to justify the time and expense of an application to the court which would be necessary in the absence of consent by all the beneficiaries. Also, in practice, the issue of breach of fiduciary duty often comes to mind only well after the transaction has occurred. For these reasons we tend to think that the courts' new powers should be confined to upholding certain completed transactions.

4.14 The terms on which the transaction in breach of fiduciary duty had been carried out would be critical. One justification for the present rules is that they prevent trustees getting a good bargain for themselves at the expense of the trust estate. We think that the court should uphold a transaction only if satisfied that the terms were at least as favourable to the trust estate and the beneficiaries as those of an arms-length transaction with an unconnected

³⁴ But we suggest such a solution in the special case of remuneration, see para 4.29 below.

³⁵ 1983 SC 8.

³⁶ Scot Law Com No 124 (1990).

³⁷ Recommendation 50, para 8.46. The court would be the Scottish Land Court for agricultural leases and the Lands Tribunal for Scotland for other leases.

³⁸ Scot Law Com No 151 (1995), Recommendation 15, para 2.79.

third party. The onus of satisfying the court by means of documentary and other evidence would lie on the trustee. Should the trustee also have to show that he or she acted in good faith or honestly? This requirement seems more problematic as it would exclude a transaction that had conferred benefits on the trust estate (that might not otherwise have been achievable) where the trustee had carried out the transaction in the full knowledge that it was a breach of fiduciary duty.

4.15 It would be possible to amend section 32 of the Trusts (Scotland) Act 1921 by including a provision along the above lines. Our tentative preference, however, is to have a new provision focused on breaches of fiduciary duty.

4.16 Summing up we propose that:

10. (1) Where the court is satisfied that a transaction by a trustee in breach of fiduciary duty:

- (a) had been of benefit to the trust estate and the beneficiaries as a whole, and**
- (b) the terms of the transaction were at least as favourable to the trust estate as those likely to be contained in a comparable arms-length transaction,**

it should have the power to make an order wholly or partly relieving the trustee of the consequences of the transaction having been in breach of fiduciary duty.

(2) Should it also be a requirement for the exercise of the above power that the trustee had acted reasonably and in good faith?

4.17 Given the availability of retrospective sanctioning of transactions in breach of fiduciary duty by the court, we think that trustees should not get further protection via wide-ranging immunity or indemnity clauses. The fiduciary relationship lies at the heart of trusts. Trustees cannot be permitted to disregard it and all of its associated duties without destroying the very nature of the trust. We therefore propose that:

11. Without prejudice to clauses in trust deeds authorising transactions by the trustees that would otherwise be in breach of their fiduciary duty, an immunity or an indemnity clause in a trust deed should be ineffective in relation to any trustee's liability arising out of a breach of fiduciary duty.

(2) Trustees' remuneration

The present law in Scotland

4.18 Acting gratuitously is seen as an aspect of the *auctor in rem suam* rule or fiduciary duty which prohibits trustees from profiting personally from their position.³⁹ Trustees are however entitled to reimbursement of their out of pocket expenses. Before 1841, Scots law

³⁹ *Fegan v Thomson* (1855) 17 D 1146; *Aitken v Hunter* (1871) 9 M 756; Wilson and Duncan, *Trusts, Trustees and Executors*, para 26-34.

allowed trustees to appoint one or more of their own number to act as factors or agents at the usual rate of remuneration.⁴⁰ However, in *Home v Pringle*⁴¹ the House of Lords imposed the stricter English rules on Scottish trustees. Since then work undertaken by trustees in the management of a trust must be undertaken gratuitously, unless payment is authorised by an express provision in the trust deed or by consent of the beneficiaries. The prohibition against remuneration applies to commissions or agency payments earned by a trustee in dealing with trust funds⁴² and trustees who are partners of firms may not employ their firms as agents of the trust.⁴³ Commissions and other payments received by trustees by virtue of their position have to be accounted for to the beneficiaries. The position regarding fees earned by trustees as directors of a company in which the trust holds shares depends on the circumstances. Trustees who are appointed as directors because of their personal skills and qualities may be entitled to retain their fees and need not account for them to the beneficiaries.⁴⁴ However, they may be obliged to account if they used the trust shareholding to vote themselves onto the board.⁴⁵

4.19 Professionally prepared wills and trust deeds almost always contain a clause allowing for remuneration of the trustees, commonly termed a "charging clause". Thus one recent style of will creating a liferent for the surviving spouse authorises the trustees "to appoint one or more of their number to act as solicitor or agent in any other capacity and to allow him or them the same remuneration to which he or they would have been entitled if not a trustee or trustees".⁴⁶ A very similarly worded power appears in another style.⁴⁷ We understand that trust deeds currently prepared for public or charitable trusts normally have charging clauses too, and that the trustees often appoint one or more of their number as paid agents. Authorisation in the trust deed is usually express, but it can be implied. It has been held, for example, that a power to appoint one or more of the trustees as law agents or factors to the trust showed an intention that the appointed trustee be remunerated.⁴⁸

4.20 The beneficiaries may authorise the payment of remuneration to trustees if the trust deed does not authorise payment.⁴⁹ All the beneficiaries must consent and be aware that they are authorising a payment which would not otherwise be legally due.⁵⁰ Remuneration cannot be authorised in this way if any of the beneficiaries are under age, mentally incapable or not yet in existence. It seems that the Court of Session has no power under the *nobile officium* to authorise payment of remuneration where this is not authorised by the trust deed. The Court may consent on behalf of unborn or underage beneficiaries to a variation of the trust deed under section 1 of the Trusts (Scotland) Act 1961 "enlarging the powers of the trustees in managing or administering the trust estate". A remuneration clause could be added by this method, but it would be worth doing only as part of an application for other powers to vary the trust or overhaul the trust machinery.

⁴⁰ *Montgomery v Wauchope* June 4 1822 FC; *Miller's Trs v Miller* (1848) 10 D 765.

⁴¹ (1841) 2 Rob App 384.

⁴² *Cherry's Trs v Patrick* (1911) 2 SLT 313.

⁴³ *Lord Gray and Others, Petrs* (1856) 19 D 1.

⁴⁴ *Elliot v Mackie and Son Ltd* 1935 SC 81.

⁴⁵ *Norrie and Scobbie Trusts* 133.

⁴⁶ *Barr et al, Drafting Wills*, style 5.12(17).

⁴⁷ *Journal of Law Society of Scotland, Workshop*, p lxxv, produced by the Law Society's Styles Committee in 1979.

⁴⁸ *Lewis's Trs v Pirie* 1912 SC 574.

⁴⁹ *Henderson v Watson* 1939 SC 711.

⁵⁰ *Ommanney v Smith* (1854) 16 D 721; *Lauder v Millars* (1859) 21 D 1353.

Options for reform

4.21 The complexity of many trusts means that the trustees will require to have certain functions carried out for them. Such trusts can no longer be run and administered by lay trustees on an unpaid basis. Trustees can obtain and pay for help by virtue of their statutory power to appoint law agents and factors.⁵¹ The issue is whether the trustees should be able to provide such services themselves on a remunerated basis in the absence of a charging clause or without obtaining the consent of the beneficiaries.

4.22 One option would be for all trustees to be statutorily entitled to remuneration, as is the position in South Africa and most provinces in Canada.⁵² This would turn trusteeship into a paid office, something we do not favour. There is in Scotland a tradition of gratuitous trusteeship, especially in relation to family and public trusts. In our view, a better way would be to have a new statutory provision authorising the trustees to appoint one or more of their number as their agents on a remunerated basis. This statutory charging clause would apply unless the trust deed provided otherwise. The almost universal use of charging clauses in trust deeds, even in public trusts, shows that they meet the needs of those involved. It will usually be cheaper and easier for trustees who have the necessary skills to carry out the work themselves than for them to instruct and monitor outside agents and the beneficiaries would benefit from the reduced administrative costs. Another consideration for private trusts is confidentiality. Employing outside agents makes the existence of a trust and its terms known to those beyond the circle of truster, trustees and beneficiaries.

4.23 We are not aware of any dissatisfaction with the current styles of charging clause (see paragraph 4.19, above), under which Scottish trustee/agents may charge for work that could be done by non-professionals. In the absence of any difficulties we see no need for legislation along the lines of section 28 of the Trustee Act 2000 which make it clear that professional trustees are entitled to charge for work that could be done by a lay trustee.⁵³ In our view the choice lies between leaving things as they are or introducing a statutory charging clause which would apply unless the trust deed provided otherwise.

4.24 The arguments in favour of a new statutory provision allowing trustees to charge for their services as agents are:

- (a) It would bring the law into line with current practice.⁵⁴ Charging clauses are almost invariably added to professionally prepared trust deeds because of the perceived deficiencies of the existing common law.
- (b) A statutory charging clause would shorten trust deeds as it would meet the needs and expectations of the parties in the vast majority of cases.
- (c) A statutory charging clause would assist in those cases where there was no charging clause, either due to an oversight or because the trust had arisen by

⁵¹ Trusts (Scotland) Act 1921, s 4(1)(f).

⁵² See Appendix A, paras 28-30.

⁵³ See Appendix A, paras 23 and 24.

⁵⁴ Indeed it would re-instate the pre-1841 Scots common law, see para 4.18 above.

operation of law. The last point has less force in Scotland than in those jurisdictions where an intestacy may give rise to a statutory life interest trust.⁵⁵

4.25 The justifications for the existing common law prohibiting trustees from receiving remuneration for their services unless in pursuance of a charging clause or with the consent of the beneficiaries are:

(a) Trustees may become more concerned with providing services and generating fees for themselves than giving unbiased consideration to the trust affairs. A trustee being a paid provider of services to the trust could lead to a conflict of interest in that the trustees are under a duty to supervise and monitor the actions of their paid agents.

(b) Trustees could abuse their entitlement to remuneration and enrich themselves at the expense of the beneficiaries by creating remunerative work or charging excessive fees. As Lord Justice Clerk Hope said in *Fegan v Thomson*⁵⁶ "a man is not to be the judge of what is proper remuneration for himself".

(c) Trustees should have to consider the issue of trustees' remuneration. A statutory implied charging clause might lead to trustees being unaware that they were appointing trustees who could charge for their work since there would be nothing in the trust deed to bring the matter to their attention.

We do not find these points persuasive. We have been informed that overcharging does occur very occasionally, but we are not aware of any evidence that trustees are abusing their position under current charging clauses to any substantial extent by creating work or charging excessive fees. In paragraphs 4.30 to 4.36 below we ask whether there should be more independent scrutiny of trustees' fees. Similarly, trustees often appoint one or more of their number as paid agents and we are not aware of any difficulty in supervision. Lawyers preparing trust deeds are under a duty to explain the import of the deed to their clients and that would include the background law of remuneration against which the deed was drafted. The current style of charging clause does not contain any express mention that the trustees' remuneration has to be reasonable, although this is implied.⁵⁷ We think that if there were to be legislation the statutory formulation could usefully include a reference to reasonable charges. The principal argument against statutory intervention is that the present position is not giving rise to any problems, and that it is therefore unnecessary to change it. On the other hand, it is unsatisfactory for the law to be so out of line with current expectations and practice that almost everyone makes alternative arrangements.

4.26 If there were to be a statutory charging clause what form should it take? Provisionally we favour a statutory provision along the lines of the current style of charging clause quoted in paragraph 4.19, above, but with an express limitation to reasonable charges. The current style achieves the desired outcome, is succinct and seems not to give rise to any difficulties. Trustees are required to consider, by virtue of their duty of care, whether it is necessary or prudent to appoint an agent to carry out trust business and if so whether one of

⁵⁵ Executories are trusts but for realisation and distribution of the estate and the executors' duties are usually short term in nature.

⁵⁶ (1855) 17 D 1146 at 1148.

⁵⁷ Menzies, *Trustees*, para 1175.

their number has the appropriate skills and experience. We understand that the appointment of agents is generally formally minuted. In terms of the style, trustees are paid for the work they properly do as agents. This is not restricted to professional tasks as it may cover work that ordinary people could do, but which would be unduly onerous for them. For example, trustees could appoint a secretary to deal with voluminous correspondence or a cashier to ingather and distribute income. Trustees appointed as legal advisers or secretaries may charge for attending trust meetings and discussing trust business. If the trustees do not exercise the power given by the statutory charging clause to appoint one or more of their number as paid agents, the existing common law would apply and the trustees would have to act gratuitously. The new statutory provision could be displaced by contrary provisions in the trust deed, and this might be done in commercial trusts which operated as a security arrangement.

4.27 The proposed new statutory charging provision should not apply to sole trustees as it would involve merging the identities of principal and agent. A sole trustee could not appoint himself or herself as a paid agent of the trust.⁵⁸ This objection would not arise where the sole trustee's firm was appointed as agent, although effective supervision and control might still be a problem. Institutional trustees who are often sole trustees have their own styles of trust deed which will allow them to charge for their services as trustees without being appointed agents. We see no need to have special statutory provisions dealing with such trustees.

4.28 Sometimes a trustee is given a modest legacy or gift as an honorarium for taking on the duties. Should the trustee have to choose between this and remuneration under any statutory charging clause? Should the same apply to a trustee who is a substantial beneficiary? If not, where is the line to be drawn between a modest and a substantial gift? We tend to think that these issues should be left to the discretion of the trustees when appointing one of their number as a paid agent. What would be reasonable remuneration would depend on what other arrangements had been made. Statutory provisions to cater for all the various cases would be too complex.

4.29 In order to elicit views on this issue we ask the following questions:

12. (1) **Should there be a new statutory provision (which would apply in the absence of any contrary intention expressed in the trust deed) authorising the trustees to appoint one of them as their agent and to allow the appointee reasonable remuneration for the services provided as agent?**
- (2) **Should this new statutory provision apply to public trusts?**
- (3) **If there is to be a new statutory charging provision, in fixing the reasonable remuneration of a trustee appointed as agent the trustees should take into account any other benefit the trustee is to receive in terms of the trust deed.**

⁵⁸ There is no objection however to A, B and C agreeing that A be their agent. The House of Lords in the case of *Clydesdale Bank v Davidson* 1998 SC (HL) 51 held that A, B and C as co-owners of property could not grant A a lease, but could agree that A should have a personal right of exclusive occupation.

Policing trustees' remuneration

4.30 We have been made aware of occasional instances of overcharging by trustees in their capacity as agents, although we understand that this is not a widespread problem. There is also a potential danger of overcharging where an institutional trustee charges for acting as trustee. Overcharging might become more of a problem if appointment as a remunerated agent became the statutory default position. What measures, if any, are necessary to ensure that abuses do not occur?

4.31 At present the first level of control lies with the other trustees.⁵⁹ They are under a duty to supervise their agents and to satisfy themselves that any remuneration claimed is properly charged and reasonable in amount. They would be failing in their duty of care if they allowed excessive charges to be debited against the trust fund. The second level of control involves the beneficiaries. The trustees are under a duty to account to them and they may challenge any remuneration or outlays that they consider excessive or unnecessary. There is a third level of control for charities due perhaps to the absence of individual beneficiaries. A recognised body in terms of section 1 of the Law Reform (Miscellaneous Provisions) (Scotland) Act 1990 – effectively a Scottish charity – must prepare annual accounts. The Lord Advocate may ask for the accounts to be produced to him free of charge for inspection and audit, and any member of the public can ask for a copy of the accounts on payment of copying charges and postage.⁶⁰ If it appears that there has been mismanagement, the Lord Advocate may suspend any person concerned with the management of the charity or apply to the court for a wider range of orders.⁶¹

4.32 In the event of a dispute over remuneration due to a trustee/legal agent the accounts may be submitted for taxation to the Auditor of the Court of Session or the auditor of the local sheriff court. Many other professional bodies have schemes for resolving disputes over fees involving their members.⁶² Finally, the trustee/agent or any person with an interest in the trust fund may apply to the court to have a dispute about remuneration determined.

4.33 The current position seems satisfactory if the co-trustees or the beneficiaries are sufficiently motivated to challenge a trustee's charges, if necessary by court action. But perhaps there should be some machinery for making an independent check in the absence of any formal challenge. In the 19th and early 20th centuries a trustee who acted as law agent to the trust had to have any business account taxed by the Auditor of the Court of Session before it could be charged against the trust fund.⁶³ This was abandoned as a general practice many years ago but a Practice Guideline recently issued by the Law Society of Scotland recommends that a solicitor who acts either as an administrator of a client's funds under a power of attorney or in a sole representative capacity – eg a sole executor or trustee – should have the fees assessed independently by an auditor of court.⁶⁴ If the guideline is not followed, the solicitor would have to justify that course of action in the event of a complaint being made. The old general practice could be reinstated and extended to other professional or business charges made by trustees/agents. The Auditor of the Court of Session at present

⁵⁹ This is absent where a sole trustee charges for acting as such.

⁶⁰ 1990 Act, s 5(6),(7).

⁶¹ 1990 Act, ss 6 and 7.

⁶² For example the Institute of Chartered Accountants for Scotland has an arbitration service. The parties pay a fee and are bound by the arbiter's award.

⁶³ Menzies, *Trustees*, para 1175.

⁶⁴ (2003) 48(3) JLSS, 9.

taxes business accounts other than those of lawyers, for example the remuneration of a receiver where the deed of appointment fails to provide for it.⁶⁵ Such a scheme would entail a very considerable amount of extra work for the Auditor even if it was shared with sheriff court auditors. The fees for taxing the trustees' claim for remuneration and outlays would be met by the trust fund, and would be a heavy burden on modest trusts. We are not aware that mis-charging occurs to such an extent as to warrant the compulsory taxation of all charges by trustees/agents. We are likewise not in favour of certification by the relevant professional body that every trustee's remuneration was reasonable.

4.34 Another option might be modelled on the powers of sheriffs principal in relation to officers of court or of the Public Guardian, Mental Welfare Commission for Scotland and local authority in relation to incapable adults. Section 78(1) of the Debtors (Scotland) Act 1987 provides that a sheriff principal may order an investigation of an officer's work and fees charged and this may be done even in the absence of any complaint. Similarly, section 6 of the Adults with Incapacity (Scotland) Act 2000 empowers the Public Guardian "to investigate any circumstances made known to him in which the property or financial affairs of an adult seem to be at risk". Sections 9 and 10 confer the same power on the Mental Welfare Commission for Scotland and Local Authorities in relation to an adult's personal welfare. A scheme modelled on that for incapable adults would be far less bureaucratic and expensive than compulsory comprehensive taxation or certification of every trustee's business account, in that it would be triggered only if an auditor of court or some other public official became or was made aware of suspicious circumstances, and would be likely to be invoked only occasionally. Nevertheless, the existence of such a scheme and the possibility of its being used would be a deterrent against over-charging by trustees. In order to elicit views from those with practical experience of the problems we ask the following questions:

13. Should:

- (a) an account of remuneration and outlays claimed by a trustee who is appointed as an agent be subject in every case to taxation by an auditor of court or certification by the professional body of which the trustee is a member before being chargeable against the trust fund, or**
- (b) an auditor of court who becomes aware of circumstances suggestive of over-charging have power to require the trustees to submit the account for taxation, or**
- (c) the law be left as it is?**

Courts' powers in relation to remuneration

4.35 As outlined in paragraph 4.32, above, the courts will determine any dispute between the beneficiaries and the trustees in relation to the remuneration of the latter. But the Scottish courts do not have an inherent power to award remuneration if the trust deed fails to provide for this or to vary the level of remuneration provided for in the trust deed. In other jurisdictions the courts have a more pro-active role and can award reasonable remuneration or can vary the level of remuneration from that provided for in the trust

⁶⁵ Rules of the Court of Session Annotated, Greens Parliament House Book, C 44, r 3.7.

deed.⁶⁶ We are not in favour of Scottish courts having to fix the remuneration of all trustees. We think that the courts should confine themselves to determining disputes about a trustee's remuneration that cannot be resolved by other means. On the other hand, the power to vary the level of remuneration fixed by the trust deed could be useful, especially where the deed provided for such an inadequate level that the trustees would not accept office or were unwilling to carry on. It might also be useful to have power to decrease the remuneration from that provided in the trust deed where in the circumstances the trustees' work was less than anticipated.

4.36 We propose that:

14. **The courts should have the power, on application by any trustee or beneficiary, to increase or decrease the level of remuneration provided for trustees by the trust deed.**

⁶⁶ See Appendix A, paras 23-32.

Part 5 Indemnity Insurance at Trust Estate's Expense

Introduction

5.1 This Part looks at the issue of trustees obtaining insurance against personal liability incurred in the course of their acting as trustees and charging the premiums against the trust estate. This type of insurance is different from the insurance of trust property against fire, theft and other risks in that it is taken out to protect the trustees rather than the trust estate and the beneficiaries interested in that estate. Trustees have a common law power to insure trust property.¹ A duty of care applies to such insurance so that trustees would be liable for failure to insure if a reasonably prudent person would have taken out insurance in the same circumstances. We exclude from our consideration insurance which trustees are required by statute to have when carrying out certain activities, such as employer's liability insurance against claims for personal injuries by employees.² The premiums for compulsory insurance would be a proper charge on the trust estate. Although this discussion paper is, as a whole, concerned with breach of trust, indemnity insurance generally covers both the trustees' personal liability to third parties and their personal liability to the beneficiaries arising from a breach of trust. We therefore look at both aspects in this Part.

5.2 Immunity and indemnity clauses which we dealt with in Part 3 and personal liability indemnity insurance are similar in the sense that they both seek to relieve the trustees of personal liability. Nonetheless, there are substantial differences between them which justify a separate examination and a different approach. As far as the trustees' liability to the beneficiaries is concerned, an immunity clause negates liability and prevents the beneficiaries from making any claim. The beneficiaries will therefore suffer financially if the trustees commit a breach of trust which adversely affects the trust estate. An indemnity clause would also prevent any effective claim by the beneficiaries in respect of any personal liability since, in terms of such clause, the trustees are entitled to reimburse themselves from the trust estate. By contrast, indemnity insurance benefits the beneficiaries as well as protecting the trustees. If a loss occurs within the scope of the policy, the insurers will pay.

5.3 Turning to the trustees' liability to third parties, an immunity clause in the trust deed would be ineffective to bar a claim by a third party against the trustees. Depending on the circumstances the trustees can be personally liable in the first instance but able to claim relief from the trust estate. Contracts where the trustees do not expressly contract as trustees or *qua* trustees fall into this category³ as probably do delictual claims based on vicarious liability or ownership of property.⁴ They would then incur personal liability only if the

¹ *Glover's Trs v Glover* 1913 SC 115.

² Employers Liability (Compulsory Insurance) Act 1969, s 1, as amended by the Financial Services and Markets Act 2000 (Consequential Amendments and Repeals) Order 2001 (SI 2001/3649), art 280.

³ *Cunningham v Montgomerie* (1879) 6 R 1333.

⁴ *Mulholland v MacFarlane's Trs* 1928 SLT 251.

claim exceeded the value of the trust estate.⁵ Sometimes the trustees have no right of relief and are then personally liable to the full extent of the third party's claim. Examples of full personal liability are the expenses of unnecessary and unsuccessful litigation⁶ and *ultra vires* contracts.⁷ Indemnity insurance thus has an important role to play where the trust is such that the trustees enter into contracts with third parties or carry out activities which could possibly result in third parties being injured. Such insurance protects the trustees from potentially ruinous claims and it also protects the trust estate in those cases where the trustees have a right of relief against the trust estate.

5.4 Indemnity insurance does not cover liability arising out of dishonest, fraudulent or criminal conduct on the part of the trustees. Immunity clauses are also ineffective in these situations.

The current law in Scotland

5.5 Trustees can always pay for personal liability insurance out of their own pockets. Professional trustees will recoup this cost from the fees they charge for their services. There is no common law power to charge the cost of personal liability insurance against the trust estate, nor is it amongst the powers of trustees listed in section 4(1) of the Trusts (Scotland) Act 1921 and deemed to be included in any trust deed unless the contrary is expressed. Therefore, before trustees can charge the premiums against the trust estate, power to do so must be given expressly in the trust deed, or authority must be granted by the court or all the beneficiaries must consent.

5.6 Trust deeds commonly contain a provision granting trustees power "to effect, maintain and acquire policies of whatever description; and to insure any property on whatever terms they think fit including on a first loss basis".⁸ This power is not intended to authorise personal liability insurance. Clauses authorising personal liability insurance are now sometimes included in public trust deeds.⁹

5.7 The Court of Session may grant powers additional to those in the trust deed by virtue of its extraordinary equitable jurisdiction, the *nobile officium*.¹⁰ The court is reluctant to grant powers in excess of those in the trust deed and will do so only in cases of necessity or strong expediency.¹¹ It is doubtful whether personal liability insurance for trustees would fall into this category. Another court-based route is a petition for variation of the trust under section 1 of the Trusts (Scotland) Act 1961. The Court of Session has power to approve on behalf of unascertained, incapax or under-age beneficiaries an arrangement "... enlarging the powers of the trustees of managing or administering the trust estate ...". All the adult capax beneficiaries must consent to the arrangement. Again it is doubtful whether a petition to authorise the trustees to obtain personal liability insurance at the trust's expense would be competent as this action is not an aspect of "managing or administering the trust estate".

⁵ An indemnity clause would ensure that the trustees always had a right of relief.

⁶ *Law v Humphrey* (1876) 3 R 1192.

⁷ *City of Glasgow Bank v Parkhurst* (1880) 7 R 749.

⁸ Barr *et al*, *Drafting Wills*, 354 and style 5(3).

⁹ The following style has been brought to our attention: "The trustees may effect trustee or director indemnity insurance in their own names in respect of their actings in relation to this trust or in relation to any company in which this trust may be interested, and meet the premiums of such insurance from the trust fund, provided always that the extent of such insurance does not prejudice the charitable status of this trust."

¹⁰ Wilson and Duncan, *Trusts, Trustees and Executors*, para 24-10.

¹¹ *Gibson's Trs* 1933 SC 190.

Moreover, both applications to the Court of Session involve a petition to the Inner House, so making this route not an economically viable option for modest trusts.¹² Some statutes contain express provisions for judicial approval or amendment of trust deeds. Thus section 105(4A) of the Education (Scotland) Act 1980 empowers the Court of Session in connection with a local authority reorganisation of educational endowments to "give effect to draft schemes for the future government and management of the endowment".

5.8 The question of whether trustees can obtain power to insure themselves at the expense of the trust estate where there is no express provision in the trust deed was considered for the first time in *Governors of Dollar Academy Trust, Petitioners*.¹³ The case involved a variation of an educational endowment under section 105(4A) of the Education (Scotland) Act 1980. The trustees (governors) of Dollar Academy Trust came from a variety of backgrounds, were unremunerated and could, because of the scale of the activities for which they were responsible in the running of the school, become personally liable for substantial sums. They petitioned the court to amend the trust deed to allow them to purchase insurance against personal liability in the following terms:¹⁴

"... for any governor insurance against (i) any liability which by virtue of any rule of law may attach to him in respect of any negligence, default, breach of duty or breach of trust of which he may be guilty in his capacity as governor; (ii) all costs, charges and expenses which may be incurred by him in contesting any such liability or alleged liability but always excluding liability arising from any act or omission which the governor knew to be a breach of trust or breach of duty or which was committed by the governor in reckless disregard of whether it was a breach of trust or breach of duty or not."

5.9 The Lord Advocate argued, among other things, that to allow the trustees to purchase insurance out of trust funds would breach the principle of *auctor in rem suam*. This principle states that trustees may not place themselves in a position where their personal interests and their duty may possibly conflict.¹⁵ Since trustees would benefit from the provision of indemnity insurance, to allow them to buy such insurance from funds held in trust for a beneficiary would conflict with their duty to act in the interests of the beneficiary. He also argued that section 32 of the Trusts (Scotland) Act 1921 provided sufficient protection for the trustees. This empowers the court to grant relief to trustees who are personally liable for a breach of trust if they had acted honestly and reasonably and ought fairly to be excused.

5.10 Nevertheless, the court allowed the amendment. The basis for this was that a majority of the trustees were lay persons and none received payment for their position. It was seen as desirable that the governing body should be comprised of individuals with varied backgrounds and experience. There was concern that, if the trust was not permitted to purchase insurance for the governors, it would have problems attracting and retaining the appropriate range of governors. Lord President Hope also expressed the view that, given the nature of the activities for which the trustees were responsible, the discretion to relieve trustees of personal liability under section 32 of the 1921 Act did not provide adequate protection.

¹² We intend to examine the allocation of trust applications within the Scottish court system in a later discussion paper, but even a sheriff court application involves not inconsiderable delay and expense.

¹³ 1995 SLT 596.

¹⁴ At 598.

¹⁵ See paras 4.2-4.6 above.

5.11 With regard to the availability and cost of such insurance the position seems to depend on the nature of the trust. Insurance is available for charity trustees, often on a package basis incorporating other forms of insurance.¹⁶ There are also insurance policies available for pensions trustees. In relation to private or family trusts, insurance is available, but may be expensive and contain numerous exclusions. Given the varied nature of private trusts it is difficult to provide examples of premiums payable.

5.12 In the absence of any power in the trust deed or authority granted by the court, insurance premiums for personal liability insurance could be charged against the trust estate if all the beneficiaries consented. The beneficiaries would have to be given full information and be aware that they were agreeing to payments that would otherwise not be chargeable against the trust estate.¹⁷

Options for reform

5.13 We agree with Lord President Hope's view in *Governors of Dollar Academy Trust v Lord Advocate*¹⁸ that the power of the court to relieve trustees of personal liability under section 32 of the Trusts (Scotland) Act 1921¹⁹ is not an adequate substitute for insurance. The courts have been reluctant to grant relief and have imposed high standards for honesty and reasonableness. Moreover, the section applies only to liability for breach of trust and not to liability in contract or delict. However, it has to be realised that insurance would not offer complete protection either. First, it would be most unlikely to cover claims based on a knowing breach of trust or duty or reckless disregard for whether the act was a breach of trust or duty.²⁰ Second, insurance companies typically only meet a claim if insurance is in place at the time when the claim was made. This means that insurance ought to be kept up for former trustees until prescription extinguishes any possible claim, but this could be too great a burden for a modest trust estate. Moreover, indemnity policies may contain clauses which entitle the company in certain circumstances to refuse payment of an otherwise valid claim.²¹

5.14 One option would be to leave the law as it is. The problem is confined to lay trustees since professional trustees will simply include the cost of any indemnity insurance in the fees which they charge the trust estate. For most trusts the risk to the personal patrimonies of lay trustees is fairly remote at present. We intend to examine the liability of trustees to third parties in a later discussion paper and may make proposals which would greatly restrict trustees' personal liability where they were not personally at fault. In the field of charitable trusts, moves are afoot to introduce a new simple form of charitable organisation which would have limited liability and a legal personality separate from the trustees and members. This proposal arises from concern about the personal liability of trustees of charities.²² Moreover, many trusts with lay trustees will also have professional trustees who will be insured. Any claims against lay trustees are likely to be defended on the basis that they relied on the advice of the professional trustees. Another consideration is that liability insurance can be charged against the trust estate with the consent of the beneficiaries. The situations where such consent would be unavailable or difficult to obtain are public trusts

¹⁶ For example, a charity running a care home paid £2,000 per year for cover of up to £1m.

¹⁷ See para 4.20, above, for a similar rule in relation to trustees' remuneration.

¹⁸ 1995 SLT 596.

¹⁹ See paras 6.3-6.6, below.

²⁰ *Governors of Dollar Academy Trust* 1995 SLT 596.

²¹ LC, *Trustee Exemption Clauses*, para 3.89.

²² Cabinet Office Performance and Innovation Unit, *Charitable Incorporated Organisation* (December 2001).

and private trusts with a large number of beneficiaries or with minor beneficiaries. However, we understand that it is now standard practice to include in public trust deeds a "Dollar Academy" clause²³ authorising trustees to obtain personal liability insurance at the trust estate's expense. Finally, it might be argued that beneficiaries should not have to pay for the trustees insuring themselves for breach of trust. If our proposals in Parts 2 to 4 were enacted, trustees would be liable only if they had acted unreasonably or negligently. There is also a danger that widespread insurance will reduce the financial incentive on trustees to carry out their duties to the requisite standard.

5.15 If the law is thought to be in need of reform then the choice seems to us to lie between authorising personal liability indemnity insurance at the trust estate's expense via a statutory default power which would apply to all trusts or via a simple and cheap judicial procedure.

5.16 **Statutory default power.** Under this option the general powers of trustees set out in section 4(1) of the Trusts (Scotland) Act 1921 would be amended so as to authorise trustees to insure themselves against personal liability and to charge the premiums to the trust estate. This would apply unless the trust deed provided otherwise. We do not think that trustees should be obliged to be insured, as compulsory insurance would be a heavy burden for modest trust estates in much the same way as bonds of caution already are for executors-dative in intestate estates. Merely authorising trustees to obtain insurance leaves the choice to them. This is the provisional proposal put forward in relation to insurance for breach of trust by the Law Commission in its recent Consultation Paper on *Trustee Exemption Clauses*.²⁴ The disadvantage of a statutory default power is that it would apply to all trusts, even though the problems of personal liability are, by and large, confined to certain situations. Its existence might encourage trustees to take out insurance, even where the nature of the trust meant that the risks of personal liability were minute.

5.17 **Application to the court.** Here trustees who otherwise lack power to insure themselves at the trust's expense would have to apply to the court for authority to do so. The court would have to be satisfied that this was not prohibited by the trust deed and was an appropriate use of trust funds. Because it would be available on a case-by-case basis, the judicial route would prevent trustees imposing a heavy insurance burden on modest estates and also reduce the pressure on them to take out insurance. However, application to the court would be expensive and time-consuming with the expenses of the application being a burden on the trust estate over and above the insurance premiums. This burden could be lessened by making the application procedure as simple and cheap as possible.

5.18 Public trusts are probably the main type of trusts where the problems of paying for insurance to cover the personal liability of trustees may cause difficulties in obtaining or retaining the services of lay trustees. The Scottish Executive have announced that a body is to be set up to supervise charitable trusts along the lines of the Charity Commission in England and Wales.²⁵ The Charity Commission has power on application to authorise trustees to obtain liability insurance at the charity's expense.²⁶ Application to the Scottish

²³ Quoted at para 5.8 above.

²⁴ Para 4.32.

²⁵ *Charity Regulation in Scotland: The Scottish Executive's response to the report of the Scottish Charity Law Review Commission* (December, 2002).

²⁶ Charities Act 1993, s 26.

Charity Commission when established might be a cheaper and simpler alternative to judicial proceedings.

5.19 We seek views on the following questions:

15. (1) **Should the law be changed so that trustees would have a power to insure themselves at the expense of the trust estate against any personal liability arising out of their position as trustees in the absence of consent by the beneficiaries or any express power in the trust deed?**

- (2) **If so, should such a power be conferred on all trustees by statute which would be available unless the trust deed prohibited it, or should there be a simple procedure whereby the court could, on application by the trustees, authorise the trustees to obtain insurance?**

Part 6 Judicial Relief from Liability for Breach of Trust

Introduction

6.1 Trustees can escape liability for a breach of trust by seeking relief from the courts. There are at present two statutory mechanisms for relief. These are to be found in sections 31 and 32 of the Trusts (Scotland) Act 1921. Section 31 is a re-enactment of section 6 of the Trusts (Amendment) (Scotland) Act 1891.¹ The equivalent for England and Wales is section 61(2) of the Trustee Act 1925 which stems from section 6 of the Trustee Act 1888. Section 32 stems from section 3 of the Judicial Trustees Act 1896, a UK measure. Section 3 was re-enacted for England and Wales in section 61(1) of the Trustee Act 1925. English case law is therefore cited along with Scottish when discussing sections 31 and 32. Breach of trust in these statutory provisions includes not only negligent performance by the trustees of their functions under the trust deed but also *ultra vires* acts.

Power to make beneficiary indemnify for breach of trust

6.2 At common law a beneficiary who agrees to a breach of trust is personally barred from taking action against the trustees for any loss incurred.² This remains useful where the beneficiary assented to the breach but did not do so in writing. However, the common law does not entitle the trustee to apply the interest of that beneficiary in the trust property to satisfy claims arising from the breach brought by other beneficiaries. Statute now enables trustees to be granted this relief. Section 31 of the Trusts (Scotland) Act 1921 provides:

"Where a trustee shall have committed a breach of trust at the instigation or request or with the consent in writing of a beneficiary, the court may, if it shall think fit, make such order as to the court shall seem just for applying all or any part of the interest of the beneficiary in the trust estate by way of indemnity to the trustee or person claiming through him."

A consent must be in writing, but an instigation or a request need not be.³ This provision does not confer on the trustees a right of personal action against the beneficiary, but rather empowers the court to authorise the trustees not to pay the beneficiary in full. In order for the court to consider granting relief under section 31, the beneficiary must have known the facts that made the trustee's action a breach of trust.⁴ In *Henderson v Henderson's Trustees* Lord President Balfour⁵ stated:

¹ With the provisions about married women deleted.

² Mackenzie Stuart, *Trusts*, 383; *City of Glasgow Bank v Parkhurst* (1880) 7 R 749; *Raes v Meek* (1889) 16 R (HL) 31; *Cathcart's Trs v Cathcart* (1907) 15 SLT 646.

³ *Griffiths v Hughes* [1892] 3 Ch 105.

⁴ *Re Somerset* [1894] 1 Ch 231.

⁵ (1900) 2 F 1295 at 1311.

"The concurrence of a beneficiary in a breach of trust must be clear and direct to raise a claim of indemnity in favour of the trustees by whom the breach was committed ..."

Section 31 is also not appropriate if the beneficiary relied on the trustees' advice that the investment was *intra vires* and prudent. The case of *Henderson* also emphasises that section 31 does not give an absolute right to indemnity, but confers a judicial discretion to grant it. Furthermore, the trustees' action must be in itself a breach of trust and not merely be something which became a breach because of their carelessness.⁶

Power to relieve trustee from personal liability

6.3 Section 32(1) of the Trusts (Scotland) Act 1921 provides:

"If it appears to the court that a trustee is or may be personally liable for any breach of trust, whether the transaction alleged to be a breach of trust occurred before or after the passing of this Act, but has acted honestly and reasonably, and ought fairly to be excused for the breach of trust, then the court may relieve the trustee either wholly or partly from personal liability for the same."

It is not necessary for the court, in order to grant relief, to decide that the trustee is under a personal liability. It is sufficient that in the opinion of the court the trustee may be liable. This provision does not operate to authorise a future liability.⁷

6.4 "Dishonesty" has never been defined in any reported Scottish trust case, although the opinion has been expressed that it means acting for reasons other than a *bona fide* consideration of what is in the best interests of the trust.⁸ Having acted honestly is not enough to be granted relief, for the trustees must also have acted reasonably and the onus of proof lies on them.⁹ If the trustees' actions amounted to negligence then that will always be considered unreasonable. In *Clarke v Clarke's Trustees*¹⁰ a trustee had let a large sum of money remain on deposit receipt for two years instead of investing part of it to provide an annuity. The court held that while the trustee had acted honestly, he had been grossly negligent and accordingly was not entitled to be excused. It was held in *Re Grindey*¹¹ that "reasonably" must mean reasonably as trustees. Furthermore, when determining the reasonableness of the trustees' actions or omissions, the court looks only at their conduct in regard to the specific matter which has caused the alleged breach of trust, and not at their conduct of the trust administration as a whole.¹²

6.5 The terms of the trust deed may be an important factor in determining whether the trustees' conduct can be considered reasonable. Relief may be granted where a breach of trust has been induced by a construction of the terms which, although ultimately decided to be inaccurate by the court, was not unreasonable.¹³ Trustees may not rely on their own

⁶ *Cathcart's Trs v Cathcart* (1907) 15 SLT 646, Lord Mackenzie at 648.

⁷ *Underhill and Hayton on Trusts and Trustees* (16th edn, 2003, by DJ Hayton), 914.

⁸ Norrie and Scobbie, *Trusts*, 150.

⁹ *Wynne v Tempest* (1897) 1 Ch 110.

¹⁰ 1925 SC 693.

¹¹ [1898] 2 Ch 593, Chitty LJ at 601.

¹² *Palmer v Emerson* [1911] 1 Ch 758.

¹³ *Re Grindey* [1898] 2 Ch 593; *Re Mackay* [1911] 1 Ch 300.

interpretation of doubtful terms. In order to have acted reasonably they must have sought appropriate advice,¹⁴ having given the advisor proper instructions and sufficient time.¹⁵

6.6 There has been some debate on whether it is sufficient that the trustees have acted reasonably and honestly. Norrie and Scobbie consider that it is not clear that the additional phrase "ought fairly to be excused" is simply meant to indicate that the court has an ultimate discretion to grant relief.¹⁶ Mackenzie Stuart¹⁷ and Wilson & Duncan¹⁸ seem to regard fairness as a more substantive third condition. In a recent case partial relief was granted where the trustee had acted honestly and reasonably. She was one of two residuary beneficiaries and had wrongly assumed that the other beneficiary was dead. The "missing beneficiary" policy paid the capital amount due but was insufficient to meet the many years interest in full. The court limited her liability to the proceeds of sale of the deceased's house which was the only unrealised trust asset.¹⁹ The courts look more favourably on applications by gratuitous trustees than on those by paid trustees.²⁰ Relief was refused where a bank acted as paid trustee and placed itself in a position where its duty to the trust conflicted with its interest as a bank.²¹ Relieving the trustees means that the loss falls elsewhere so that fairness to all parties concerned should be considered.²²

Proposals for reform

6.7 Section 31 of the Trusts (Scotland) Act 1921 serves a useful purpose and has not given rise to difficulties in the few cases in which it has been used. We therefore make no proposals for its amendment.

6.8 The courts have not adopted a generous approach to section 32. As the Law Commission states in its Consultation Paper on *Trustee Exemption Clauses*:²³

"It is well known, however, that courts have been reluctant to relieve trustees under section 61 [the equivalent of section 32], adopting a narrow construction of their jurisdiction and applying a high standard to the test of reasonableness ... Relief under the section appears to be limited to cases of honest mistake made notwithstanding every reasonable care."

6.9 Trustees are liable for *intra vires* acts or omissions only if they have been negligent and failed to carry out their duties to the appropriate standard of care. The courts have refused relief under section 32 to negligent trustees on the basis that the trustees cannot be said to have acted reasonably. We agree with that approach. Granting relief to negligent trustees would encourage a careless attitude to trust administration. A more lenient attitude has traditionally been taken towards lay trustees in deciding whether they had been negligent. Our proposed higher standard of care for professional trustees would encourage

¹⁴ *Clarke v Clarke's Trs* 1925 SC 693. See also in another context *Board of Management of Dundee General Hospitals v Bell's Trs* 1952 SC (HL) 78.

¹⁵ *Baden v Soci te G n rale* [1992] 4 All ER 161, Peter Gibson J at 272.

¹⁶ Norrie and Scobbie, *Trusts*, 151.

¹⁷ Mackenzie Stuart, *Trusts*, 380-381.

¹⁸ Wilson and Duncan, *Trusts, Trustees and Executors*, para 28-54.

¹⁹ *Re Evans (deceased)* [1999] 2 All ER 777.

²⁰ *Re Windsor Steam Coal Co (1901) Ltd* [1929] 1 Ch 151.

²¹ *National Trustees Company of Australasia v General Finance Company of Australia* [1905] AC 373; *Re Pauling's Settlement Trusts* [1963] 3 WLR 742.

²² *Re Turner* [1897] 1 Ch 536; *Re Kay* [1897] 2 Ch 518; *Re Mackay* [1911] 1 Ch 300.

²³ Para 4.63.

the continuation of that approach. In Proposal 1, above, we suggest that trustees should not be personally liable for an *ultra vires* act if, after having taken all reasonable steps, they believed the act was within their powers.²⁴ Section 32 would not give trustees any additional protection, nor should it be amended to do so. Trustees who have not taken all reasonable steps have been careless and are undeserving of judicial relief. In relation to breach of fiduciary duty we propose (Proposal 10) that the court should be empowered to sanction a transaction that was a breach provided it was as beneficial to the trust as an arms-length transaction.²⁵ As it would be a more focussed provision in relation to breaches of trust involving a breach of fiduciary duty, this new application would render an application under section 32 unnecessary. If our proposals were implemented section 32 could be repealed.

6.10 We propose that:

16. **If Proposals 1 and 10 restricting respectively trustees' liability for *ultra vires* acts and breaches of fiduciary duty are implemented, then section 32 of the Trusts (Scotland) Act 1921 (judicial relief for trustees who have acted honestly and reasonably and who ought fairly to be excused) should be repealed as unnecessary.**

²⁴ See para 2.16 above.

²⁵ See para 4.16 above.

Part 7 Miscellaneous

Introduction

7.1 In this final part we look at three miscellaneous topics. The first is the liability of trustees for breaches of trust committed by their co-trustees. The second is the applicable law and recognition of trusts, especially as regards the effect of immunity clauses. Finally, we consider what the transitional provisions should be were our proposals to be implemented.

(1) Liability for co-trustees

The present position

7.2 Section 3(d) of the Trusts (Scotland) Act 1921 provides that unless the contrary be expressed all trusts shall be held to include a provision that:

"... each trustee shall be liable only for his own acts and intromissions and shall not be liable for the acts and intromissions of co-trustees and shall not be liable for omissions ...".

This is derived from section 1 of the Trusts (Scotland) Act 1861 which was intended to restate and, where necessary, restore the common law, viz that trustees were liable for their own intromissions or negligent omissions and for any obligations of their co-trustees which they had authorised or acquiesced in.¹ The 1861 Act provision was confined to remunerated trustees but the 1921 Act extended the protection to gratuitous trustees.

7.3 On the face of it section 3(d) appears to grant immunity against liability arising out of an omission by a trustee or out of any act by the other trustees. However, an omission to carry out some act expressly laid down in the trust deed will give rise to liability, as will negligent failure to perform duties such as safeguarding the trust estate² or investing it properly.³ These are regarded as positive breaches of duty, rather than omissions, and hence are not within the scope of the statutory immunity clause.

7.4 Trustees are generally required to act as a body. This creates a duty on each trustee to monitor the actions of the other trustees. So, for example, trustees who signed a receipt for money due to the trust estate but left it in the hands of one trustee for many years without enquiring what he had done with it were held liable to make good the loss on his insolvency.⁴ As Lord President Robertson said in *Millar's Trustees v Polson*,⁵ where a trustee was found liable for not pursuing his co-trustee who had appropriated trust money instead of putting it on deposit receipt in the name of the trustees:

¹ J McLaren, *The Law of Wills and Succession* (3rd edn, 1894), Vol II, paras 2265-2267.

² *Clarke's Trs v Clarke* 1925 SC 693.

³ *Melville v Noble's Trs* (1896) 24 R 243.

⁴ *Sym v Charles* (1830) 8 S 741.

⁵ (1897) 24 R 1038 at 1043.

"It is, of course, disagreeable to take a co-trustee by the throat, but if a man undertakes to act as trustee he must face the necessity of doing disagreeable things when they become necessary in order to keep the estate intact. A trustee is not entitled to purchase a quiet life at the expense of the estate, or to act as good-natured men sometimes do in their own affairs, in letting things slide and losing money rather than create ill-feeling."

Proposals for reform

7.5 We consider that the content of the present law is satisfactory. The notion of collective responsibility is embedded in the law of trustee liability and should, we think, be expressed in any statutory reformulation of section 3(d). Trustees ought to be liable for their own acts and omissions and in some circumstances for any acts or omissions of their co-trustees. However, we think that section 3(d) is misleading for the reasons set out in paragraphs 7.3 and 7.4, above, and that it should be replaced by a new clearer provision.

7.6 Trustees bring different skills and qualities and the amount of time each is able or willing to devote to trust business will vary. It would therefore be impracticable to require each trustee to monitor constantly what the others were doing as a condition of escaping personal liability. We would therefore reject the South African approach whereby trustees are jointly and severally liable and it is no defence to a trustee that he or she did not take an active part in trust affairs. But a balance has to be struck between constant monitoring and allowing "sleeping trustees", trustees who, once appointed, take little or no further interest in the trust, to escape liability. In England and Wales and in New Zealand, a trustee is liable for a co-trustee's acts or omissions only if the loss arose through his or her own wilful default. Wilful default has been construed as meaning a conscious breach of duty or reckless performance of a duty. This would seem to suffer from the disadvantage that a trustee who simply goes along with whatever the others decide is not liable.

7.7 Section 62(6) of the Adults with Incapacity (Scotland) Act 2000 deals with the liability of joint guardians and provides that:

"... each guardian shall be liable for any loss or injury caused to the adult arising out of –

- (a) his own acts or omissions; or
- (b) his failure to take reasonable steps to ensure that a joint guardian does not breach any duty of care or fiduciary duty owed to the adult ...".

In our view a provision modelled on this formula would express the present liability of trustees in a more direct and readily understandable way than section 3(d) does. It is also a modern legislative expression of joint liability and ought to be adopted for trustees unless there are good reasons not to do so. We are not aware of any such reasons and accordingly propose that:

17. **Section 3(d) of the Trusts (Scotland) Act 1921 should be repealed and replaced by a new statutory provision to the effect that, except in so far as otherwise provided in the trust deed, each trustee should be liable for any loss caused to the beneficiaries arising out of:**
 - (a) **his or her own acts or omissions; or**

(b) his or her failure to take reasonable steps to ensure that a co-trustee does not commit a breach of trust.

(2) Applicable law and immunity clauses

7.8 The Recognition of Trusts Act 1987, which implements the Hague Convention on the Law Applicable to Trusts and on their Recognition, deals with the applicable law and recognition of express voluntary Scottish trusts. Article 6 of the Convention allows the truster to select, either expressly or impliedly, the law which is to govern the trust he or she creates. The chosen law need not have any objective connection with the trust. Where no choice is made by the truster, Article 7 of the Convention provides that the trust shall be governed by the objectively determined applicable law – ie the law which objectively has the closest connection to the trust. It provides a non-exhaustive⁶ list of factors which are particularly relevant to the determination of the "applicable law". These are: (a) the place of administration of the trust designated by the truster, (b) the situs of the trust assets, (c) the place of residence or business of the trustees and (d) the objects of the trust and the places where they are to be fulfilled.

7.9 Article 8 provides that the applicable law governs not only the validity and effects of the trust, but also its administration. The article then lists matters that the applicable law is in particular to govern. Two such matters, set out in paragraphs (g) and (j), are relevant to breach of trust. Paragraph (g) concerns "the relationships between the trustees and the beneficiaries including the personal liability of the trustees to the beneficiaries.", whilst (j) deals with "the duty of trustees to account for their administration." As Harris states,⁷ "[t]he personal, compensatory liability of a trustee to a beneficiary is a matter which will clearly be subjected to the applicable law." Also if a breach of trust has been committed then paragraph (b), "the rights and duties of the trustees among themselves" would become relevant. Article 9 permits a severable aspect of the trust, particularly matters of administration, to be governed by a different law from that applicable to other aspects.

7.10 It would be possible for the legislation implementing our proposals, in particular that regulating the effect of immunity and similar clauses, to be circumvented by the truster providing in the trust deed that the governing law should not be Scots law, but that of another jurisdiction with a more favourable system of regulation. There seems to be nothing in the Convention that prevents this course of action. Article 15 sets out mandatory rules which cannot be voluntarily be departed from. These are fundamental issues such as the protection of creditors, the transfer of title to property and the indefeasibility of fixed succession rights of spouses and issue. None of our proposals touch on matters that could be regarded as being the subject of mandatory rules. We take a similar view of Article 18. This provides that, where the applicable law of the trust in question is that of another state, the court may disregard a provision of that law if it is manifestly incompatible with the public policy of the *lex fori*.

7.11 It is not open to the Scottish Parliament to pass legislation applying the Scots law rules relating to immunity clauses to all persons carrying on trust business in Scotland where the law applicable to the trust is that of another jurisdiction. To do so would be a

⁶ Other relevant considerations are the current residence of the beneficiaries and the domicile of the truster, Norrie and Scobbie, *Trusts*, 42.

⁷ J Harris, *The Hague Trusts Convention* (2002), 245.

breach of the Convention which the United Kingdom has ratified. We doubt whether the kind of circumvention described in the previous paragraph would occur to any great extent because there are practical disadvantages in having trusts that are closely connected with Scotland governed by a foreign law. The proposals in this discussion paper would therefore apply only to trusts where the applicable law relating to the subject matter of the proposal is, in terms of the Recognition of Trusts Act 1987, that of Scotland. The same analysis applies to our proposals in our Discussion Paper on *Apportionment of Trust Receipts and Outgoings*⁸ published at the same time as this discussion paper. Accordingly any implementing legislation would apply only where the law applicable to the administration of the trust was that of Scotland.

(3) Transitional provisions

7.12 We consider that any legislative reform of trustees' powers and duties in relation to breach of trust should be prospective in effect. In other words, the new rules should apply only to acts or omissions after the date of commencement of the legislation in question. This avoids the retrospective imposition of liability on trustees. However, the new rules should apply in respect of trusts created prior to commencement as well as of trusts created after commencement. It would be undesirable to have two different sets of rules, especially as this situation could persist for a very long time. We therefore propose that:

- 18. The legislation implementing the proposals in this discussion paper should apply:**
 - (a) to trusts whether or not created before its date of commencement,**
 - (b) only in relation to any breaches of trust occurring on or after the date of commencement.**

⁸ No 124.

Part 8 List of Proposals and Questions

1. Trustees should not be personally liable for any losses arising out of an action amounting to an *ultra vires* breach of trust provided they acted in good faith and after taking all reasonable steps and making all reasonable enquiries believed that such action was within their powers. This should not prejudice any right of recovery by the beneficiaries from persons other than the trustees or the trustees' right of recovery of wrongfully distributed property.

(Paragraph 2.16)

2. If Proposal 1 is not accepted, should there be new clarifying legislation providing that an immunity clause relating to trustees' personal liability for *ultra vires* acts may protect them where they reasonably believed they were acting within their powers, but should be ineffective to any greater extent?

(Paragraph 2.18)

3. Unless otherwise provided by statute, in carrying out their trust duties –

- (a) Every trustee should have to use the same care and diligence that a person of ordinary prudence would use in managing the affairs of others.

- (b) A trustee who acts as such in the course of his or her business or profession should in addition have to use any special knowledge or expertise that it is reasonable to expect of a member of that business or profession.

(Paragraph 3.11)

4. A clause in a trust deed purporting to relieve trustees acting in the course of their business or profession from liability should be regarded as ineffective in so far as the liability arises from the trustees' failure to exercise the degree of care, diligence and skill required by law.

5. There should be no change in the present law regarding the effectiveness of immunity clauses in trust deeds in relation to lay trustees. Accordingly, an immunity clause should continue to be effective in excluding liability for negligence but not for gross negligence.

(Paragraph 3.46)

6. Should any new statutory provision rendering ineffective terms in a trust deed relieving trustees from liability in respect of negligence or gross negligence also render ineffective any terms making the exercise or enforcement of beneficiaries' rights in this area more difficult?

(Paragraph 3.50)

7. Without prejudice to the effectiveness of any immunity clause, a term in a trust deed purporting to lower the standard of care that would otherwise be expected from a trustee should be ineffective.

(Paragraph 3.52)

8. Should new statutory provisions be introduced in order to render ineffective terms in a trust deed which negative or abridge any duty that, in the absence of such a term, would be incumbent on the trustees? If so, should the court have power to disregard any such term that was not reasonable in the circumstances or consistent with the trust purposes?

(Paragraph 3.60)

9. Indemnity clauses in trust deeds should be ineffective to the same extent as immunity clauses.

(Paragraph 3.61)

10. (1) Where the court is satisfied that a transaction by a trustee in breach of fiduciary duty:

- (a) had been of benefit to the trust estate and the beneficiaries as a whole, and
- (b) the terms of the transaction were at least as favourable to the trust estate as those likely to be contained in a comparable arms-length transaction,

it should have the power to make an order wholly or partly relieving the trustee of the consequences of the transaction having been in breach of fiduciary duty.

- (2) Should it also be a requirement for the exercise of the above power that the trustee had acted reasonably and in good faith?

(Paragraph 4.16)

11. Without prejudice to clauses in trust deeds authorising transactions by the trustees that would otherwise be in breach of their fiduciary duty, an immunity or an indemnity clause in a trust deed should be ineffective in relation to any trustee's liability arising out of a breach of fiduciary duty.

(Paragraph 4.17)

12. (1) Should there be a new statutory provision (which would apply in the absence of any contrary intention expressed in the trust deed) authorising the trustees to appoint one of them as their agent and to allow the appointee reasonable remuneration for the services provided as agent?

- (2) Should this new statutory provision apply to public trusts?

(3) If there is to be a new statutory charging provision, in fixing the reasonable remuneration of a trustee appointed as agent the trustees should take into account any other benefit the trustee is to receive in terms of the trust deed.

(Paragraph 4.29)

13. Should:

(a) an account of remuneration and outlays claimed by a trustee who is appointed as an agent be subject in every case to taxation by an auditor of court or certification by the professional body of which the trustee is a member before being chargeable against the trust fund, or

(b) an auditor of court who becomes aware of circumstances suggestive of over-charging have power to require the trustees to submit the account for taxation, or

(c) the law be left as it is?

(Paragraph 4.34)

14. The courts should have the power, on application by any trustee or beneficiary, to increase or decrease the level of remuneration provided for trustees by the trust deed.

(Paragraph 4.36)

15. (1) Should the law be changed so that trustees would have a power to insure themselves at the expense of the trust estate against any personal liability arising out of their position as trustees in the absence of consent by the beneficiaries or any express power in the trust deed?

(2) If so, should such a power be conferred on all trustees by statute which would be available unless the trust deed prohibited it, or should there be a simple procedure whereby the court could, on application by the trustees, authorise the trustees to obtain insurance?

(Paragraph 5.19)

16. If Proposals 1 and 10 restricting respectively trustees' liability for *ultra vires* acts and breaches of fiduciary duty are implemented, then section 32 of the Trusts (Scotland) Act 1921 (judicial relief for trustees who have acted honestly and reasonably and who ought fairly to be excused) should be repealed as unnecessary.

(Paragraph 6.10)

17. Section 3(d) of the Trusts (Scotland) Act 1921 should be repealed and replaced by a new statutory provision to the effect that, except in so far as otherwise provided in the trust deed, each trustee should be liable for any loss caused to the beneficiaries arising out of:

(a) his or her own acts or omissions; or

(b) his or her failure to take reasonable steps to ensure that a co-trustee does not commit a breach of trust.

(Paragraph 7.7)

18. The legislation implementing the proposals in this discussion paper should apply:

(a) to trusts whether or not created before its date of commencement,

(b) only in relation to any breaches of trust occurring on or after the date of commencement.

(Paragraph 7.12)

Appendix A

Comparative Law

Ultra vires breach of trust (Part 2)

1. **England and Wales.** Trustees are personally liable for any loss that would not have occurred but for the *ultra vires* act.¹ The defences of remoteness of loss, *novus actus interveniens*, lack of foreseeability of loss, contributory negligence and failure to mitigate loss applicable to claims for damages do not apply to claims based on an *ultra vires* breach of trust.² The beneficiaries are entitled to "falsify" the trust accounts which means that the unauthorised disbursement or transfer of property is deleted from the accounts. It is treated as having been made by the trustees out of their own money for their own benefit. They are therefore required to account to the trust estate for the full cash value of the disbursement plus interest.³ This has been described as a strict and sometimes harsh remedy.⁴ Conversely, any property bought in an *ultra vires* way using trust funds does not form part of the trust estate. The trustees must account to the estate for the price. The beneficiaries may elect not to falsify the accounts. For example, if an *ultra vires* investment has increased in value they may accept it, in which case it becomes a trust asset and its price an allowable disbursement.⁵

2. An immunity clause in the trust deed may exempt the trustees from liability for *ultra vires* breaches other than ones arising from dishonesty. Trustees may therefore escape liability under a suitably wide clause if they honestly believed that the act was in the best interests of the beneficiaries, unless no reasonable trustee in the same position would have so believed.⁶

3. **South Africa.** The main civil remedy against trustees for failure to carry out their duties properly is an Aquilian action for breach of trust. The action against trustees for loss suffered as a result of breach of trust is a delictual action for pure economic loss.⁷ The damages awarded are such as to put the claimant in as good a position as if the trustees had performed their duty properly. Hence they may include sums improperly paid by the trustees.⁸

¹ If at the date of the action there is no loss, then there is no liability, *Target Holdings Ltd v Redferns* [1996] AC 421.

² *Underhill and Hayton on Trusts and Trustees* (16th edn, 2003, by D Hayton), 851.

³ *Re Duckwari* [1999] Ch 253, Nourse LJ at 262.

⁴ *Ibid* at 265.

⁵ P J Millett, "Equity's Place in the Law of Commerce" (1998) 114 LQR 214.

⁶ *Walker v Stones* [2001] QB 902.

⁷ Honoré, *Trusts*, 362.

⁸ *Ibid*, 366.

4. Trustees are liable to an Aquilian action for breach of trust if they are at fault in making a wrong distribution. If there is no fault, ie the mistake is excusable, the trustees are under a duty to recover the money or property by the *condictio indebiti*.⁹

Standard of care required of trustees (Part 3)

5. **England and Wales.** Prior to the Trustee Act 2000 the general standard, as laid down in late 19th century cases, was that which an ordinary prudent man of business would adopt in managing similar affairs of his own.¹⁰ However, later cases established a higher standard for professional and perhaps also paid trustees. In *Re Waterman's Will Trusts*¹¹ Harman J said:

"a paid trustee is expected to exercise a higher standard of diligence and knowledge than an unpaid trustee, and that a bank which advertises itself largely in the public Press as taking charge of administrations is under a special duty."

This was followed by Brightman J in *Bartlett v Barclays Bank Trust Co Ltd*¹² to the effect that a corporate trustee carrying on a specialist business of trust management which holds itself out as being skilled as a trustee will be subject to a higher standard of care and diligence than an ordinary trustee. However there is some uncertainty as to the standard to be expected of a paid but non-professional trustee. It has been argued that where Harman J in *Re Waterman's Will Trusts* referred to a paid trustee exercising a higher duty of care this should be read as referring to a professional trustee and not just a paid trustee.¹³

6. The Trustee Act 2000 sets out new statutory standards of care for trustees. Section 1(1) provides:

"(1) Whenever the duty under this subsection applies to a trustee, he must exercise such care and skill as is reasonable in the circumstances, having regard in particular–

(a) to any special knowledge or experience that he has or holds himself out as having, and

(b) if he acts as trustee in the course of a business or profession, to any special knowledge or experience that it is reasonable to expect of a person acting in the course of that kind of business or profession.

The powers of a trustee to which the duty of care is to apply are set out in Schedule 1 to the 2000 Act. They include matters such as the acquisition of land, the appointment of agents, nominees and custodians and insuring trust property. The trust deed may exclude the duty of care from applying to it or may modify the standard.¹⁴

7. **South Africa.** The duty of care has also been placed on a statutory basis in South Africa. The Trust Property Control Act 1988 provides in section 9(1) that :

⁹ *Ibid*, 387.

¹⁰ *Speight v Gaunt* (1883) 9 App Cas 1, Lord Blackburn at 19; *Leary v Whitely* (1887) 12 App Cas 727.

¹¹ [1952] 2 All ER 1054 at 1055.

¹² [1980] 1 All ER 139 at 152.

¹³ S Panesar, "The Trustee Act 2000", [2001] 12(5) ICCLR 151.

¹⁴ Trustee Act 2000, Sch 1, para 7.

"A trustee shall in the performance of his duties and the exercise of his powers act with the care, diligence and skill which can reasonably be expected of a person who manages the affairs of another."

8. **The United States of America.** Section 804 of the Uniform Trust Code states that:

"A trustee shall administer the trust as a prudent person would, by considering the purposes, terms, distributional requirements and other circumstances of the trust. In satisfying this standard, the trustee shall exercise reasonable care, skill and caution."

This duty does not depend on whether the trustee is remunerated. Although trusters are allowed to modify the standard of care specified in this section, in terms of section 1008 they cannot exclude a trustee from liability for breach of trust committed in bad faith or with reckless indifference to the purposes of the trust or to the interests of the beneficiaries.

9. **Canada: Ontario.** The position in Ontario is based on the 19th century English House of Lords cases mentioned in paragraph 5 above, to the effect that the trustee must exhibit the same diligence and care that an ordinary prudent man of business would exercise in conducting his own affairs. The Ontario Law Reform Commission said in its Report on the *Law of Trusts* that:

"As a result of these decisions, the relevant question is whether a trustee has acted with integrity in what he did, seeking to do what the task demanded; the standard of care expected of him is an objective one, external, that is, to any consideration of the skills or circumstances of the particular trustee whose conduct is impugned. The test is what would have been done by that familiar legal creature, the *reasonable man*. In the law of torts, he has traditionally been known as the man on the Clapham omnibus; in the law of trusts he is the *ordinary prudent man of business*. The particular trustee must act as this man would act in the same circumstances. If this standard is not satisfied, and loss ensues, then the trustee is in breach of trust and responsible."¹⁵

10. The Commission recommended retention of this standard for non-professional unremunerated trustees. However, the Commission also recommended that trustees who have particular knowledge or skills should employ them in the administration of the trust. They proposed the following provision:¹⁶

"(1) In the discharge of their duties and the exercise of their powers, whether the duty or power is created by law or the trust instrument, trustees shall exercise that degree of care, diligence and skill that a person of ordinary prudence would exercise in dealing with the property of another person.

(2) Without limiting the generality of subsection (1), trustees who in fact possess, or because of their profession, business or calling ought to possess, a particular level of knowledge or skill which in all the circumstances is relevant to the administration of the trust, shall employ that particular level of knowledge or skill in the administration of the trust."

Effectiveness of immunity clauses (Part 3)

11. The law of other jurisdictions shows a wide variety of approaches to the effect which is allowed to be given to immunity clauses. The following paragraphs give details of the

¹⁵ OLRC, *The Law of Trusts*, Vol 1, 25.

¹⁶ *Ibid*, Vol 2, 487 (draft Trustee Act, s 4).

main ones we have looked at. In a recent case in New Zealand, *Hansen v Young*¹⁷, the court drew a distinction between an individual's actings as solicitor and his actings as executor. The immunity clause was held ineffective to protect him against claims based on his negligence as a solicitor.

12. **Immunity clause ineffective as regards negligence and gross negligence.** The Turks and Caicos Islands Trust Ordinance 1990 provides¹⁸:

"A term of a trust shall be invalid if it purports to relieve a trustee from liability arising from his own fraud, wilful misconduct or negligence".

South Africa adopts the same strict approach.¹⁹ Section 9(2) of the Trust Property Control Act 1988 provides that:

"Any provision contained in a trust instrument shall be void in so far as it would have the effect of exempting a trustee from or indemnifying him against liability for breach of trust where he fails to show the degree of care, diligence and skill as required in subsection (1).

A similar provision has been recommended by the New Zealand Law Commission.²⁰ The present law of New Zealand is set out in paragraph 16 below.

There are also a number of UK statutory provisions to the same effect in connection with certain types of trust. Thus, for example, in relation to debenture trust deeds section 192(1) of the Companies Act 1985 renders void any provision:

"exempting a trustee of the deed from, or indemnifying him against, liability for breach of trust where he fails to show the degree of care and diligence required of him as trustee, having regard to the provisions of the trust deed conferring on him any powers, authorities or discretions".

Similar immunity provisions can be found in section 253 of the Financial Services and Markets Act 2000²¹ dealing with unit trusts:

"Any provision of the trust deed of an authorised unit trust scheme is void in so far as it would have the effect of exempting the manager or trustee from liability for any failure to exercise due care and diligence in the discharge of his functions in respect of the scheme."

and in section 33(1) of the Pensions Act 1995 in relation to pension funds:

"Liability for breach of an obligation under any rule of law to take care or exercise skill in the performance of any investment functions, where the function is exercisable –

- (a) by a trustee of a trust scheme, or
- (b) by a person to whom the function has been delegated under section 34,

¹⁷ [2003] 1 NZLR 83.

¹⁸ Art 29(10).

¹⁹ This has been criticised on the basis that trusters should be able to protect trustees from liability for any conduct short of dishonesty, Honoré, *Trusts*, 371.

²⁰ NZLC, *Problems in the Law of Trusts*, para 14.

²¹ Replacing an almost identical provision contained in s 84 of the Financial Services Act 1986.

cannot be excluded or restricted by any instrument or agreement."

13. **Immunity clause exempting negligence but not gross negligence.** Scots law draws the line between gross negligence and negligence. Immunity clauses are ineffective to the extent that they exempt trustees from liability arising from gross negligence or a deliberate breach of trust. Gross negligence or *culpa lata* is regarded as the equivalent of fraud (*culpa lata dolo aequiparatur*).²²

14. The position in the common law Canadian provinces is similar as they follow the authority of the late 19th century Scottish House of Lords cases.²³ However, the recent English case of *Armitage v Nurse*²⁴ has been said to cast doubt on these authorities.

15. New York outlaws immunity clauses to the extent that they purport to grant immunity for wilful misconduct or gross negligence, such clauses being deemed to be contrary to public policy.²⁵

16. In *Robertson v Howden (No 2)*²⁶ the New Zealand Court of Appeal, construing an immunity clause in a Scottish ante-nuptial marriage contract trust, applied Scots law as set down in *Raes v Meek*.²⁷ However, in the circumstances it was held that the terms of the immunity clause did not provide relief from an imprudent loan secured over New Zealand property. However, statute now accepts the possibility of valid immunity clauses. Section 13D of the Trustee Act 1956 (added in 1988) provides that the usual standard of care applies to investment decisions subject to any contrary intention in the trust deed and subject to any of its terms.

17. Jersey enacted comprehensive legislation on trusts in 1984. Article 26(9) of the Trusts (Jersey) Law 1984 provided that:

"Subject to the terms of the Trust, a trustee shall not be liable-

.....

(b) for any loss to the trust property unless such loss is due to-

(i) his wilful default, act or concurrence; or

(ii) his neglect or failure to exercise reasonable care to prevent such loss."

Doubts were subsequently expressed about the scope of the protection that a trust deed could properly provide. In 1988 the Jersey Government reviewed the provision. It rejected an amendment permitted an immunity clause to have effect except in so far as it was not fair and reasonable. Instead, it opted for prohibiting exclusion of liability where the trustees had been grossly negligent in order to ensure that there was no slippage in standards in what is an important part of Jersey's financial services business. Article 26(9), as amended by Article 5 of the Trusts (Amendment)(Jersey) Law 1984, now reads as follows:

²² *Seton v Dawson*, (1841) 4 D 310; *Lutea Trustees Ltd v Orbis Trustees Guernsey Ltd* 1998 SLT 471.

²³ *Re Poche* (1984) 6 DLR (4th) 40.

²⁴ [1998] Ch 241.

²⁵ *The Hellespont Ardent* [1997] 2 Lloyds Reps 547, Mance J at 581.

²⁶ (1892) 10 NZLR 609.

²⁷ (1889) 16 R (HL) 31.

"Nothing in the terms of a trust shall relieve, release or exonerate a trustee from liability for breach of trust arising from his own fraud, wilful misconduct or gross negligence,"

The position in Guernsey is the same as in Jersey.²⁸

18. **Immunity clause ineffective as regards fraud.** Clauses in trust deeds that exclude trustees' personal liability for breaches of trust are frequently found in practice in England and Wales. Nowadays, they generally seek to exclude liability for anything except individual fraud, dishonesty or conscious wrongdoing.²⁹ The main modern English authority is *Armitage v Nurse*³⁰ where the indemnity clause was in the following terms:

"No trustee shall be liable for any loss or damage which may happen to [the trust fund] or any part thereof or the income thereof at any time or from any cause whatsoever unless such loss or damage shall be caused by his own actual fraud ...".

Millet L J in the Court of Appeal held that actual fraud meant dishonesty. Gross negligence or a deliberate breach of trust was not enough. He accepted the formulation put forward by counsel for the trustees that "actual fraud":

"connotes at the minimum an intention on the part of the trustee to pursue a particular course of action, either knowing that it is contrary to the interests of the beneficiaries or being recklessly indifferent whether it is contrary to their interests or not."³¹

The argument that such a wide immunity clause was void as repugnant to the nature of a trust or contrary to public policy was rejected. In Lord Justice Millet's view the minimum necessary for a trust is that the trustees act honestly and in good faith for the benefit of the beneficiaries.³² The 19th century Scottish House of Lords cases mentioned above were regarded merely as decisions on the particular clauses,³³ while the comments by Lord President Clyde in *Clarke v Clarke's Trustees*³⁴ were said to be *obiter*, emphasised the need to use clear and unambiguous words to exclude liability and did not rule out immunity clauses on the grounds of public policy.³⁵ *Armitage v Nurse* has been applied in *Taylor v Midland Bank Trust Co Ltd (No 2)*³⁶ where summary judgment for the trustee was refused on the basis that a relevant case of a dishonest breach of trust had been averred. In *Walker v Stones*³⁷ it was held that the test for dishonesty in relation to solicitor-trustees had to take account of whether a genuine belief that the deliberate breach was for the benefit of the beneficiaries was so unreasonable that no solicitor-trustee could have held it. A solicitor-trustee who prepares a trust deed may properly benefit from a very broad immunity clause provided the truster was advised of its existence and effect.³⁸

²⁸ The Trusts (Guernsey) Law 1989, s 34(7) as amended by the Trust Law 1990, s 1(f).

²⁹ Lewin, *Trusts*, para 39-81.

³⁰ [1998] Ch 241.

³¹ At 251D-E.

³² At 253H-254A.

³³ At 255B-E.

³⁴ 1925 SC 693. See para 3.13 above.

³⁵ At 255H-256A.

³⁶ [2002] WTLR 95; 2000 2 ITELR 439.

³⁷ [2001] QB 902.

³⁸ *Bogg v Raper*, *The Times*, 22 April 1998.

19. The American Uniform Trust Code gives a wide effect to immunity clauses. Section 1008(a)(i) provides that a term of a trust is unenforceable to the extent that it:

"relieves the trustee of liability for breach of trust committed in bad faith or with reckless indifference to the purposes of the trust or the interests of the beneficiaries."

20. Belize also adopts a similar approach. Immunity clauses are ineffective only in relation to breaches of trust arising from the trustees' own fraud or wilful misconduct.³⁹

Breach of fiduciary duty (Part 4)

21. **England and Wales.** The law is broadly similar to that of Scotland. Trustees are not in general allowed to retain a benefit acquired or profit made by them from the use of the trust property or by virtue of their trusteeship. Also, trustees may not place themselves in a position where their personal interests conflict or may possibly conflict with their duty to the trust.⁴⁰ Nevertheless, the courts have power to sanction a transaction by a trustee. This has to be resorted to if the trust deed does not authorise the trustee's transaction or consent cannot be obtained from all the beneficiaries due to some being under age or unborn.⁴¹ A trustee may be allowed to bid for trust property at auction even if this course is objected to by an adult beneficiary. This used to be sanctioned only in exceptional cases⁴², but a more flexible attitude might be taken nowadays if the transaction would benefit the beneficiaries as a whole.⁴³ Trustees of a pension scheme have been authorised by the court to exercise their discretion under the trust deed so as to distribute the surplus on winding up the scheme to employee/beneficiaries, even though they themselves would benefit.⁴⁴

22. **Australia.** The courts in Australia have similar powers to those in England and Wales to sanction transactions by trustees. A sale of trust property to a trustee, by authorising the trustee to bid in a public auction or acquire it by private bargain, may be sanctioned, even if a beneficiary objects.⁴⁵

Trustees' remuneration (Part 4)

23. **England and Wales.** The law on trustees' remuneration is now contained in sections 28 to 33 of the Trustee Act 2000. This legislation implements (with some minor changes) the recommendations made by the Law Commission in the Report on *Trustees' Powers and Duties*.⁴⁶ The main provisions clarify a trustee's entitlement to remuneration under a charging clause in the trust deed (section 28) and authorise remuneration in the absence of any charging clause (section 29). Section 30 empowers the Secretary of State to regulate the remuneration of trustees of charitable trusts, but no regulations have been made to date.

³⁹ Trusts Act 1992, s 50(6).

⁴⁰ Lewin, *Trusts*, para 20-01.

⁴¹ *Ibid*, para 20-92.

⁴² *Ibid*, para 20-94.

⁴³ *Holder v Holder* [1968] Ch 353.

⁴⁴ *In re Drexel Burnham Lambert Pension Plan* [1995] 1 WLR 32.

⁴⁵ *Union Trustee Company of Australia Pty Ltd v Gorrie* [1962] Qd R 605, Gibbs J at 616; *Waine v King* (unreported, Supreme Court, NSW (Eq), No 5186 of 1993, 1994).

⁴⁶ Law Com No 260, Scot Law Com No 172 (1999). Although the report was a joint one with ourselves, the joint recommendations extended only to powers of investment and the purchase of land.

24. Section 28 applies to trustees acting in a professional capacity and to trust corporations. Such a trustee is to be entitled under a remuneration clause in the trust deed to receive payment in respect of services even if they are services which are capable of being provided by a lay trustee. A trustee acts in a professional capacity:

"... if he acts in the course of a profession or business which consists of or includes the provision of services in connection with –

(a) the management or administration of trusts generally or a particular kind of trust, or

(b) any particular aspect of the management or administration of trusts generally or a particular kind of trust,

and the services he provides to or on behalf of the trust fall within that description."⁴⁷

A lay trustee is one who is not a trust corporation or who does not act in a professional capacity.

25. Section 29 introduces a statutory default provision for the remuneration of certain trustees. The statutory provision applies only if the trust deed is silent as to the trustee's remuneration. A trust corporation is entitled to reasonable remuneration out of the trust funds, as is a trustee (other than a sole trustee or the trustee of a charitable trust) who acts in a professional capacity if the other trustees agree in writing to permit remuneration. The services that may be charged for include services that a lay trustee could provide.

26. The High Court also has an inherent power to award remuneration to trustees in respect of past and future services and also to award an increase over that specified in the trust deed where this is necessary to secure the good administration of the trust.⁴⁸ Solicitor trustees are also entitled to their usual fees in relation to litigation carried out on behalf of the trust.⁴⁹

27. **Australia.** The general rule is similar to that in Scotland except that the courts have an inherent power to award remuneration and will do so where the duties have been particularly onerous. Queensland and Western Australia have statutory provisions empowering the court to remunerate a trustee.⁵⁰ Any professional or business trustee may charge their usual professional or business charges for services they provide to the trust unless the deed provides otherwise and the courts may fix the rate. The Wills Acts of all states and territories allow for remuneration of executors.⁵¹

28. **South Africa.** Section 22 of the Trust Property Control Act 1988 provides that:

"A trustee shall in respect of the execution of his official duties be entitled to such remuneration as provided for in the trust instrument or, when no such provision is made, to a reasonable remuneration, which shall in the event of a dispute be fixed by the master."

⁴⁷ Trustee Act 2000, s 28(5).

⁴⁸ *Duke of Norfolk's Settlement Trusts* [1982] Ch 61; *Re Berkeley Applegate (Investment Consultants) Ltd* [1989] Ch 32, Edward Nugee QC at 51.

⁴⁹ *Cradock v Piper* (1850) 1 Mac & G 664.

⁵⁰ Trusts Act 1973, s 101 (Queensland); Trustees Act 1962, s 98 (Western Australia).

⁵¹ R P Meagher and M C Gummow, *Jacobs' Law of Trusts in Australia* (6th edn, 1997) para 1739.

For trusts not covered by the Trust Property Control Act 1988 the court probably has the power at common law to fix reasonable remuneration.⁵²

29. **Canada.**⁵³ In all the provinces and territories, trustees and executors have a statutory right to receive remuneration for their services from the trust estate, as well as out of pocket expenses. Remuneration provided for in the trust deed or will is usually considered to be in lieu of the statutory remuneration. The statutory remuneration is fixed by the court in an amount that is fair and reasonable, but in British Columbia and Newfoundland is capped by reference to a percentage of the value of the trust assets.

In British Columbia trustees can get an additional care and management fee over and above the fee based on the income collected and the capital intromitted with. In Ontario, section 61(1) of the Trustee Act 1990 allows the court to fix a reasonable allowance for the "care, pains and trouble" of the trustee in administering the estate as well as for the time expended in and about the estate. Moreover, section 61(4) of the Trustee Act 1990 allows lawyer trustees an extra allowance in respect of any necessary professional services which they have rendered to the trust. The Ontario Law Reform Commission recommended that this provision should be extended to all providers of professional services.⁵⁴ Most provinces and the Yukon territory allow an enhanced level of remuneration to solicitor trustees for legal services rendered by them to the trust.

30. The British Columbia Law Institute⁵⁵ recommended that the percentage cap on remuneration should be abolished and that there should be a procedure for obtaining remuneration without the trustees having to apply to the court provided all the adult beneficiaries agree, that trustees who provide reasonably necessary professional services within the scope of their qualifications to the trust may charge their normal fees, and that the court should have power to vary a remuneration clause in a trust deed which provides insufficient remuneration.

31. **New Zealand.** A trustee is entitled to remuneration if the trust deed so provides. The court also has power to award remuneration under its inherent jurisdiction or "commission" under the Trustee Act 1965, section 72.⁵⁶ Commission is fixed at what is just and reasonable having regard to a number of specified factors such as the amount and difficulty of the services and the value of the trust estate. The New Zealand Law Commission published a discussion paper asking for views on the remuneration of trustees⁵⁷, drawing attention to the provisions in the Trustee Act 2000 for England and Wales. The Commission in its subsequent report decided against recommending statutory default remuneration provisions along the lines of section 29 of the 2000 Act. There had been little enthusiasm on consultation and the Commission observed that in practice trust deeds almost always contain an adequate charging clause.⁵⁸

⁵² Honoré, *Trusts*, 350-353.

⁵³ Taken from BCLI, *Remuneration of Trustees*.

⁵⁴ OLRC, *Law of Trusts*, Vol 1, 257.

⁵⁵ BCLI, *Remuneration of Trustees*.

⁵⁶ As amended by subsequent legislation. There are also provisions in s 18 of the Trustee Companies Act 1967 and s 122 of the Public Trust Act 2001.

⁵⁷ Preliminary Paper No 48, *Some Problems in the Law of Trusts* (Jan 2002), paras 13-16.

⁵⁸ NZLC, *Problems in the Law of Trusts*, para 18. The Commission did recommend that remuneration under a charging clause in a testamentary trust should no longer be equated with a legacy, para 19.

32. **United States of America.** Section 708 of the Uniform Trust Code provides for compensation of trustees. If the trust deed does not contain any provisions, then the trustees are entitled to compensation that is reasonable in the circumstances. This is the present law in many states.⁵⁹ Where the trust deed specifies the compensation, in general that determines the amount, but the court may adjust the amount up or down if the amount proves inadequate or too high in relation to the duties. Trustees with special skills which they employ on behalf of the trust may be entitled to extra compensation. On the other hand trustees who delegate most of the work to outside agents will be entitled to reduced compensation.

Indemnity insurance at the trust estate's expense (Part 5)

33. **England and Wales.** Section 34 of the Trustee Act 2000 substituted a new section 19 in the Trustee Act 1925. Trustees may now insure any trust property against "risks of loss or damage due to any event".⁶⁰ This provision implemented the Law Commission's recommendation. It is thought that the phrase "due to any event" does not authorise trustees to insure against their own liability for breach of trust. The Commission were not in favour of such a statutory default power for three reasons.⁶¹ First, there was concern that such insurance would not be readily available at an economic cost. Second, trustees might feel compelled to purchase insurance in circumstances where it was unnecessary to do so. Finally, there was concern that trustees would treat insurance as a means of relieving them of their obligations to take proper care, particularly when appointing nominees and agents. In England and Wales, as in Scotland, trustees are free to purchase indemnity insurance against personal liability out of their own pockets.

34. An application for additional powers can be made to the court by trustees or by a beneficiary⁶² and the court can by order grant additional powers where it is expedient in the management or administration of the trust. In *Re Scientific Investment Pension Plan (No. 3)*⁶³ an application was made by the trustees of a pension fund for a declarator that they could purchase indemnity insurance for themselves to protect against the possibility of future claims. The court held it was not within its powers to allow the trustees to purchase such insurance since they were already amply protected by the trust deed (which contained an exoneration clause) and since purchasing such insurance would be entirely for the benefit of the trustees. It was not expedient for the trust as a whole to allow such a purchase. The *Scientific Investment* case does not rule out entirely the possibility that trustees would be allowed to purchase indemnity insurance using trust funds, provided it could be shown to be in the interest of the trust as a whole.

35. The Charity Commission has the power to alter the governing documents of charities in England and Wales.⁶⁴ It has permitted schemes which allow charity trustees to purchase personal indemnity insurance.⁶⁵ It has also established what it considers to be the

⁵⁹ BCLI, *Remuneration of Trustees*, 7.

⁶⁰ Subs (1).

⁶¹ LC, *Trustees' Powers and Duties*, para 6.4.

⁶² Trustee Act 1925, s 57.

⁶³ [1999] OPLR 1.

⁶⁴ Charities Act 1993, s 26.

⁶⁵ *Decision of the Charity Commissioners on Trustees' Indemnity Insurance* (1993), *Decisions of Charity Commissioners*, Vol 2, April 1994, referred to in *Governors of Dollar Academy Trust, Petitioners* 1995 SLT 596.

appropriate form of wording.⁶⁶ An order under section 26 of the Charities Act 1993 is expressed in the following terms:⁶⁷

"(1) Being satisfied that it is expedient in the interest of the charity that the trustees should do so, the Commissioners authorise the trustees to provide indemnity insurance for themselves out of the funds of the charity.

(2) The Commissioners direct that the insurance must not extend to

(a) any claim arising from any act or omission which:

(i) the trustees knew to be a breach of trust or breach of duty; or

(ii) was committed by the trustees in reckless disregard of whether or not it was a breach of trust or breach of duty; and

(b) the costs of an unsuccessful defence to a criminal prosecution brought against the trustees in their capacity as trustees of the charity."

36. **South Africa.** Trustees are normally required to give security for their proper administration of the trust.⁶⁸ This is akin to the bond of caution that is required for executors dative in Scotland. The cost of the security is chargeable against the estate. However, this is not the same as personal liability insurance since it is for the protection of the beneficiaries. If the insurance company has to pay out under the security, it will attempt to recover from the trustees' personal estates.

37. **United States of America.** Section 816 of the American Uniform Trust Code sets out specific powers which the trustee may exercise.⁶⁹ Included in this list of powers is the power to insure the property of the trust against damage or loss and to "insure the trustee, the trustee's agents, and beneficiaries against liability arising from the administration of the trust."⁷⁰

38. The Uniform Trust Code leaves trusters free to exclude expressly the power in the trust deed. The commentary to section 816 notes, however, that the powers included in it are powers which are commonly included in trust deeds. In fact, Scott notes⁷¹ that "[a] trustee can properly pay out of the trust estate a premium on insurance against liability, although such insurance affords protection to the trustee individually as well as to the trust estate." The inclusion of an express power in the Uniform Trust Code may therefore not make a great deal of difference in practical terms.

39. As far as the costs of purchasing insurance, trustees have the power to "pay ... expenses incurred in the administration of the trust".⁷² This would include payment of premiums incurred under the exercise of the power to purchase insurance. Where trustees

⁶⁶ The wording accepted by the Court in the *Governors of Dollar Academy Trust v Lord Advocate* 1995 SLT 596 was based, in part, on this wording.

⁶⁷ LC, *Trustee Exemption Clauses*, para 2.84.

⁶⁸ Trust Property Control Act 1988, s 6.

⁶⁹ Without prejudice to the general management power in s 815.

⁷⁰ s 816(11).

⁷¹ AW Scott, *Abridgment of the Law of Trusts* (1960), §188.1.

⁷² s 816(15).

pay insurance premiums out of their own pockets they are also entitled to be reimbursed out of the trust property (with interest) for (among other things) expenses that were properly incurred in the administration of the trust.⁷³

Judicial relief from liability for breach of trust (Part 6)

40. Many Commonwealth common law jurisdictions including Canada⁷⁴ (except the province of Prince Edward Island), Australia⁷⁵ and New Zealand⁷⁶ base their current provisions on section 3 of the Judicial Trustees Act 1896, the precursor of section 32 of the Trusts (Scotland) Act 1921 and section 61 of the Trustee Act 1925 (England and Wales). For example, section 96 of the Trustee Act in British Columbia⁷⁷ reads:

"If it appears to the court that a trustee, however appointed, is or may be personally liable for a breach of trust, whenever the transaction alleged to be a breach of trust occurred, but has acted honestly and reasonably, and ought fairly to be excused for the breach of trust and for omitting to obtain the directions of the court in the matter in which the trustee committed the breach, then the court may relieve the trustee either wholly or partly from that personal liability."

41. The Civil Code of Quebec contains no general provision whereby the court can relieve a trustee for a breach of trust. However a trustee may get relief by other means. Thus, the court can reduce the damages payable by a trustee under section 1318 which provides that:

"The court, in appreciating the extent of the liability of an administrator and fixing the resulting damages, may reduce them in view of the circumstances in which the administration is assumed or of the fact that the administrator acts gratuitously or that he is a minor or a protected person of full age."

42. In South Africa there is no general judicial power to grant relief to trustees for breach of trust and the courts do not aid trustees unless the circumstances are exceptional.⁷⁸ It is considered that the most a court can do is remove a trustee from office⁷⁹, or confirm a payment made improperly but in good faith for a trust object.⁸⁰ But this lack of relief has to be seen against the background that trustees are not personally liable for breach of trust unless they have been at fault.⁸¹

Liability for own acts and omissions and those of a co-trustee (Part 7)

43. Under section 38 of the New Zealand Trustee Act 1956 a trustee is "answerable and accountable only for his own acts, receipts, neglects or defaults" but is not liable for those of any other trustee, bank etc unless the loss has arisen "through his own wilful default". This

⁷³ s 709.

⁷⁴ For example, s 35 of the Ontario Trustee Act 1990 and s 96 of the Trustee Act 1996 in British Columbia.

⁷⁵ New South Wales – Trustee Act 1925, s 85; Victoria – Trustee Act 1958, s 67; Queensland – Trusts Act 1973, s 76; South Australia – Trustee Act 1936, s 56; Western Australia – Trustees Act 1962, s 75; Tasmania – Trustee Act 1898, s 50; Northern Territory – Trustee Act, s 49A.

⁷⁶ Trustee Act 1956 s 73.

⁷⁷ BCLI, *Exculpation Clauses*, recommends an amendment to s 96 to give the court power to set aside an immunity clause if it was unreasonable for the trustee to rely on it – see para 3.39 above.

⁷⁸ *Ex parte Hiddingh* 1935 OPD 92, 96-97.

⁷⁹ *Volkwyn No v Clark & Damant* 1946 WLD 456. The Trust Property Control Act 1988 s 20(1) states that the court must be satisfied that the removal will be in the interests of the trust and its beneficiaries.

⁸⁰ Honoré, *Trusts*, 391.

⁸¹ See para 4 above.

section echoes section 30 of the Trustee Act 1925 for England and Wales in respect of which it has been held that "wilful default" means a conscious breach of duty or reckless performance of a duty.⁸² Although section 30 of the Trustee Act 1925 has now been repealed by the Trustee Act 2000⁸³ it is considered that the law of liability of co-trustees remains much the same because the legislative provision was declaratory of the common law.⁸⁴

44. The USA Uniform Trust Code allows a majority of trustees to act. A trustee who does not join in an action of the other trustees will not generally be liable. However this does not apply to serious breaches of trust because any trustee must exercise reasonable care to prevent a co-trustee from committing a serious breach of trust.⁸⁵ Section 6 of the Uniform Trustees' Powers Act⁸⁶ also allows one co-trustee who does not join in the exercise of a power to escape liability for the acts of those other co-trustees, but a co-trustee remains liable for failure to participate in the trust administration or to prevent a breach of trust.

45. In South Africa those who are trustees at the time of the breach of trust are (unless a trust deed provides otherwise) jointly and severally liable for it. They are co-principal debtors *in solidum* and it is no defence to a trustee that he or she did not take an active part in the affairs of the trust.⁸⁷

⁸² *Re Vickery* [1931] 1 Ch 572.

⁸³ Sch 2, para 24.

⁸⁴ Lewin, *Trusts*, para 39-52.

⁸⁵ S 703(g).

⁸⁶ This has been adopted in 16 States so far.

⁸⁷ Honoré, *Trusts*, 380.

Appendix B

Advisory Group on Trust Law

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