

Redressing the Balance: The Case for the Reform of Trustee Liability in Transactions with Third Parties

In October 1878, the City of Glasgow Bank collapsed. The House of Lords found that Muir and others, who had accepted transfer ‘as trust disponees’ of certain shares in the City of Glasgow Bank, were personally liable to the creditors for all calls made on those same shares.¹ Lord Penzance clarified that a trustee ‘could not avoid liability on ... debts by merely shewing that they arose out of matters in which he acted in the capacity of trustee or executor only, even though he should be able to shew, in addition, that the creditors of the concern knew all along the capacity in which he acted’².

Reporting on the handing down of the judgement, a writer for the Spectator described an atmosphere of regret in the House of Lords upon a decision ‘most cruel’: ‘seven of the strongest lawyers in the Kingdom, pronounced, sometimes with deep emotion, always with deep regret, and with an avowed consciousness that their judgment involved “a national calamity,” for the unlimited liability of Trustees’³.

During the financial crisis of 2008, a series of investments made by the corporate trustees of Investec Trust (Guernsey) collapsed, leaving the trust with significant liabilities to creditors. In discussing the relevant liabilities of the trustees, Lord Hodge JSC returned the findings made by Lord Penzance in *Muir and Others* [1879]⁴. In doing so, Lord Hodge reiterated to the Privy Council that ‘although a trustee has duties specific to his status as such,

¹ *Muir and Others v City of Glasgow Bank* (1879) 4 App Cas 337

² *Ibid*, 368

³ The Spectator, 12 April 1879 <http://archive.spectator.co.uk/article/12th-april-1879/8/the-law-lords-on-the-liability-of-trustees-a-nothe>

⁴ *Investec Trust (Guernsey) Ltd v Glenalla Properties Ltd* [2019] A.C. 271

when it comes to the consequences English law does not distinguish between his personal and his fiduciary capacity⁵.

The personal liability incurred by trustees in the course of trust administration enjoys a long precedent. However, since the early misgivings expressed by witnesses to the handing down of the 1878 decision in *Muir and Others*, concerns as to the appropriateness of placing trustees' personal liabilities at the basis of third party contracts has grown in legal scholarship and reform papers⁶.

This essay proposes that the interests of creditors, trustees, settlors and beneficiaries would be advanced by a reconsideration of trustee liability. First, the existing law is set out, followed by an overview of the problems raised. Second, reforms in foreign jurisdictions are examined. Finally the proposed reform is set out as desirable, practical and useful.

The Law on Trustee Liability in Transactions with Third Parties

As both the Privy Council⁷ and the Court of Appeal⁸ have affirmed in 2018, it is trite law that a trust has no legal personality. Consequently, when a trustee enters a contract on a behalf of a trust, he must be bound personally⁹ and bears liability against the extent of his own estate to satisfy the full contractual liability if the trust funds prove insufficient. The opportunity remains open for trustees to limit their personal liability with third parties in contract¹⁰.

⁵ *Investec Trust (Guernsey) Ltd v Glenalla Properties Ltd* [2019] A.C. 271, 59 iii

⁶ See, for example: Trust Law Committee Consultation: Rights of Creditors against Trustees and Trust Funds (April 1997); Trust Law Committee Report: Rights of Creditors against Trustees and Trust Funds (April 1999); In Scots Law: Discussion Paper on Liability of Trustees to Third Parties, April 2008.

⁷ *Investec Trust (Guernsey) Ltd v Glenalla Properties Ltd* [2019] A.C. 271

⁸ *First Tower Trustees v. CDS (Superstores International) Ltd* [2019] 1 W.L.R. 637

⁹ *Muir and Others v City of Glasgow Bank* [1879] 4 App Cas 337

¹⁰ *First Tower Trustees v. CDS (Superstores International) Ltd* [2019] 1 W.L.R. 637, as per Lord Justice Lewison at para 82.

Trustees further have a right of indemnity¹¹ and associated equitable lien over trust assets for liabilities incurred in the course of trust administration¹², though they remain absolutely personally liable for any breach of trust. When contracting with the trustee in the course of their fiduciary duties, creditors and other third parties are entitled to a subrogation of trustee's right to indemnification by the trust fund. Since third parties hold a derivative right to indemnity, subrogated from the trustee's right, they are subject to the same limitations as bind the trustee themselves. Consequently, if the trustee is indebted to the trust due to breach of trust, a creditor may lose any subrogated right to indemnification by the trust fund¹³.

The established position in the caselaw thus assumes a personal liability indemnifiable to the trust fund on the part of trustees carrying out their fiduciary duties, unless expressly contracted otherwise. Third parties are limited in their rights of recourse to the trust fund by the conditions of the subrogation of the trustee's personal liability.

Issues Raised by the Current Position on Trustee Liability to Third Parties

The established case law on trustee liability in transactions with third parties raises several issues for the competitive and equitable management of trusts in the United Kingdom.

In the first instance, as was reported in *Muir and Others*, trustees face extensive personal loss should trust funds prove insufficient to meet creditor's obligations incurred in the course of fiduciary duty. As the Law Commission has reported in the last Trust Law Committee Report, individuals contracting as 'trustee' or 'executor' can be expected to act

¹¹ *Re Blundell* [1888] 40 ChD 370

¹² *Jennings v Mather* [1901] 1 KB 108

¹³ *Re Pumfrey* [1882] 22 ChD 225

without recourse to legal advice, and rarely expect to be subjects to personal liability¹⁴. The current case law thus risks ‘creating a trap’ for the ‘expectations of ordinary mortals’¹⁵.

Compounding these trustee difficulties is the evidence of barriers to obtaining valid trustee insurance for those trustees who are aware of the possibility of personal liability recorded by the Scottish Law Commission in their report on trustee liability¹⁶.

Though detrimental to trustee interests, these problems are not limited to trustees in their impact. Incurring personal liability to third parties for administration acts as a deterrent to potential trustees¹⁷ a problem for settlors in their choice of the UK law when establishing a trust. Such difficulties for trustees and settlors in initiating and transacting with trusts ultimately injure the competitiveness of UK trust services, a concern the Law Commission has placed at the forefront of their programme of UK Trust Reform in the future¹⁸.

The current position in the case law also creates problems for creditors. An expected recourse to trustee personal liability, when in place, requires an scrutiny of the personal affairs of trustees and their relationship to the trust. First, it is necessary for creditors to both assess the trust’s assets and the trustee’s personal estate and take a judgement as to their likelihood of return on investment. Second, trustees must also do their utmost to ensure that the trustee is not in debt to the trust or breach of their obligations in order to protect their right to the subrogation of the trustee’s indemnity to the trust fund. As several commentators have pointed out, this is a difficult task which risks placing a third party in a conflicted position: if a third party believes they have got ‘the better end of the bargain’, they may fail

¹⁴ See Trust Law Committee Report: Rights of Creditors against Trustees and Trust Funds, April 1999, pp. 2, 10, 11, citing *Perring v Draper* [1997] EGCS 109, *Marston Thompson & Evershed PLC v Bend* 1997 Law Soc Gaz 94/39.

¹⁵ *Ibid*, pp. 11

¹⁶ Scottish Law Commission, Discussion Paper on Liability of Trustees to Third Parties, April 2008: ‘Insurance is difficult to obtain and even when it is available the cover is often limited’ – pp. 10.

¹⁷ Scottish Law Commission, Report on Trusts Law, 2014, p. 151-161.

¹⁸ Law Commission, Modernising Trust Law for a Global Britain. Accessed 10/09/2019 <https://www.lawcom.gov.uk/project/modernising-trust-law-for-a-global-britain/>

to collect any indemnity against trust funds because the trustee failed to exercise sufficient care in the transaction¹⁹. The wider consequences of such difficulties for the overall trusts market been noted by English in his analysis of a similar model in place in certain states of the United States (US) before they implemented versions of the Uniform Trust Code ‘the overall effect was the chilling of transactions’²⁰.

Finally, these same barriers caused by difficulties in trustee liability ultimately impinge on the interests of beneficiaries. The ‘chilling’ of transactions noted by English created by the necessarily cautious approaches of both trustees and creditors ultimately impacts on the incomes available to beneficiaries who lose out on the benefits of potential contractual relationships.

Reform in Other Jurisdictions

Developments in other jurisdictions have reconsidered the allocation of trustee liability in dealing with third parties. Two common law jurisdictions in particular serve as useful comparative case studies: the approach of the US in the Uniform Trust Code, and the Jersey Trusts Law, 1984.

Uniform Trust Code, United States

¹⁹ Trust Law Committee Consultation: Rights of Creditors against Trustees and Trust Funds (April 1997) page 6; Trust Law Committee Report: Rights of Creditors against Trustees and Trust Funds (April 1999) page 9.

²⁰ English, *The Uniform Trust Code (2000): Significant Provisions and Policy Issues*, 2002, pp. 209.

The US Uniform Trust Code (UTC) is a model law that has been enacted by 31 states and the District of Columbia, as of July 2019²¹. Section 1010 addresses the liabilities of trustees to third parties, specifying at subsection A:

‘Except as otherwise provided in the contract, a trustee is not personally liable on a contract properly entered into in the trustee’s fiduciary capacity in the course of administering the trust if the trustee in the contract disclosed the fiduciary capacity’²²

This is a significant modification from the position in English Law, which begins from the assumption that trusts have no legal personality. Under this approach, recourse to creditors is only available from the trust fund via the mechanism of a subrogation of the trustee’s right to indemnity.

In contrast, the Section 1010 a of the US UTC has the effect of enacting, as Lord Hodge describes it in *Investec*, ‘the personification of a trust’²³. The attribution of a legal personality to the trust fund enables creditors to take direct right of action against the entity of ‘the trust’, while relieving creditors of their obligation to personal liability.

The purpose of this shift, in the words of The American Law Institute, is to reflect ‘modern reality rather than traditional concepts ... the trust is treated as an entity to such an extent that it is no longer inappropriate ... to refer to and treat trusts, in law and in practice, as if they were entities in numerous other contexts’²⁴.

²¹ The American College of Trust and Estate Council, Accessed 25 July 2019

<https://actecfoundation.org/podcasts/uniform-trust-code-trust-law/>

²² United States Uniform Trust Code, Section 1010, Subsection A

²³ *Investec Trust (Guernsey) Ltd v Glenalla Properties Ltd* [2019] A.C. 271, as per Lord Hodge at p. 62

²⁴ The American Law Institute, Restatement of the Law, Trusts 3d (2011), Chapter 21, pp 94-95, as cited in *Investec Trust (Guernsey) Ltd v Glenalla Properties Ltd* [2019] A.C. 271, as per Lord Hodge at p. 31.

The current position under the Trusts (Jersey) Law 1984 also modifies the allocation of trustee liability in contract, though with less radical consequences than provided for in the US Uniform Trust Code. Article 32, subsection (a) provides as follows:

‘32 Trustee’s liability to third parties

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

(a) if the other party knows that the trustee is acting as trustee, any claim by the other party shall be against the trustee as trustee and shall extend only to the trust property;’²⁵

The interpretation of the nature of trustee liability as articulated in Article 32 subsection 1 (a) was recently clarified by the Privy Council in *Investec* [2019]²⁶. The case (discussed in a preliminary fashion in the introduction) involved a corporate trustee based in Guernsey with substantial liabilities to creditors based in the British Virgin Islands. The trustees claimed the creditors had no right of indemnity against the trust funds by subrogation since the liabilities were incurred in breach of trust.

The Privy Council found that Article 32 of Jersey Trusts Law did not extend so far as Article 1010 of the US Uniform Trust Code, in personifying the trust to provide direct recourse to the funds by creditors. It was established by Lord Hodge that the effect of article 32 (1) (a) is instead to ‘improve the position of trustees by insulating their personal assets from liabilities to third parties expressly incurred as trustees’²⁷. However, this protection was as far as article 32 extended: liability remained with the trustee as indemnified by the trust

²⁵ TRUSTS (JERSEY) LAW 1984, Revised Edition 13.875, Showing the law as at 1 January 2019

²⁶ *Investec Trust (Guernsey) Ltd v Glenalla Properties Ltd* [2019] A.C. 271

²⁷ *Ibid.*, as per Lord Hodge, p. 63.

fund, though limited to the extent of the trust's relevant assets. Creditors might only gain recourse through the mechanism of a subrogation of this indemnity.

The pertinent development established by article 32 (1) (a), therefore, is to relieve trustees of claims to their personal assets should the trust funds prove insufficient in contracts they have contracted expressly as trustees. Significantly, article 32 subsection 2 maintains that this arrangement 'shall not affect any liability the trustee may have for breach of trust'²⁸.

Proposal for Reform

The need for the reform of trustee liability is clear. There is one clear candidate for the approach to adopt. Following article 32 (1) (a) of the Jersey Trusts Law as a model, it is proposed that:

A trustee's liability should be limited to the extent of trust assets when the other party knows the trustee is contracting in a fiduciary capacity. This reform is affect any liability the trustee may have for breach of trust.

The limitation of trustee liability stands to realise important, useful changes in trust transactions in limiting the extent of liability to the 'expectations of ordinary mortals'²⁹.

In the first instance, the reform speaks to the natural assumptions of trustees in the administration of trusts aid trustees who cannot be expected to have taken legal instruction³⁰. In doing so, it serves to afford some protection to trustees from the unexpected 'calamity'³¹

²⁸ Article 32, Subsection 2, TRUSTS (JERSEY) LAW 1984, Revised Edition 13.875, Showing the law as at 1 January 2019

²⁹ Trust Law Committee Report: Rights of Creditors against Trustees and Trust Funds, April 1999, pp. 11

³⁰ Ibid. pp. 2, 10, 11.

³¹ The Spectator, 12 April 1979 <http://archive.spectator.co.uk/article/12th-april-1879/8/the-law-lords-on-the-liability-of-trustees-a-nothe>

of the type endured by the trustees in *Muir and others*³²; as well as to allow for the difficulties in obtaining trustee insurance. Both settlors and beneficiaries stand to gain from the limitation of trustee personal liability: in the expedition of trust transactions that stands to facilitate trust revenue (beneficiaries) and in the reduction of risk that must be taken on by a future trustee (settlors).

Discussion of trustee liability reforms have tended to be phrased as of exclusive benefit or expense to trustee/creditor. Though it is important to consider the potential risks of reform to creditors, it is nonetheless useful to identify the concomitant benefit that the limitation of trustee liability brings to transactions. In restricting creditors' due diligence to the trust assets alone, the risks and obligations third parties must take on when dealing with explicitly with trustees are somewhat clarified – a reform which as English³³ points out serves to facilitate increase of transactions from both sides.

Nevertheless, it cannot be neglected from our consideration that the limitation of trustee liability to the extent of the relevant trust assets when in an explicit fiduciary capacity does raise certain challenges for creditors³⁴. As Mc Quarter and Warents³⁵ identify, the approach taken by the Privy Council in *Investec*³⁶ opens creditors up to harsh liabilities in cases of misrepresentation by trustees as to the size of the trusts' assets, with no means of recourse to their personal assets.

What is more, the application of the Jersey model of reform which maintains the mechanism of creditor subrogation of trustee rights fails to address the question

³² *Muir and Others v City of Glasgow Bank* (1879) 4 App Cas 337.

³³ English, *The Uniform Trust Code (2000): Significant Provisions and Policy Issues*, 2002, pp. 209.

³⁴ Lowe, *Insolvency and trusts, Trusts and Trustees*, Vol. 22, No. 9, November 2016, pp. 948-955

³⁵ McQuater and Warents, *Betting the house: trustee liability to third party creditors in the Privy Council*, *Journal of International Banking and Finance Law*, 2018 8 494;

³⁶ *Investec Trust (Guernsey) Ltd v Glenalla Properties Ltd* [2019] A.C. 271

of creditor's conflict of interest in dealing with trustees discussed at the outset. When a creditor is limited to the subrogation of the trustee's right of indemnity, they risk losing this right if the trustee is found to be in breach. This possibility places creditors in the difficult position of needing to point out if the trustee has offered them to sympathetic a proposal, and might have breached their fiduciary duty through a failure exercise sufficient care in the transaction³⁷. Both of these challenges reach a degree of resolution in the US Uniform Trust Code approach of 'personification'³⁸.

However, the case for preserving the mechanism of subrogation of indemnity established in the Jersey model remains convincing, since to find recourse in the 'personification' of the trust meets with a fundamental practical barrier: to personify the trust fund would run contrary to basic maxims of English Common Law and principles of equity.

First, the constitution of trust funds as a legal person would require the imposition of a new form of legal personality as yet unknown in English Law. This point was raised by Lord Hodge in reaching the *Investec* decision³⁹, referencing the judgement of Purchas LJ in *Bumper Development Corpn Ltd v Comr of Police of the Metropolis*⁴⁰. Purchas LJ highlighted that legal personalities were required to have some 'animate content', which is as lacking in trust as in the stone temple he decided on.

³⁷ Trust Law Committee Consultation: Rights of Creditors against Trustees and Trust Funds (April 1997) page 6; Trust Law Committee Report: Rights of Creditors against Trustees and Trust Funds (April 1999) page 9.

³⁸ *Investec Trust (Guernsey) Ltd v Glenalla Properties Ltd* [2019] A.C. 271, as per Lord Hodge at p. 62.

³⁹ *Ibid* at p. 59

⁴⁰ [1991] 1 WLR 1362, 1371

The second practical problem with trust personification is that implement such a procedure runs counter to the principles of equity itself. It is anticipated that if a new form of legal personality were to be developed. It is anticipated that this would create a range of unforeseen consequences in the wider administration of trusts, altering the provisions for insolvency, engendering potential conflicts of interest for trustees between ‘the trust’ and the beneficiaries⁴¹ and require extensive investigation by third parties wishing to deal with the trust as to the nature of the relationship⁴².

Though the loss of recourse to personal liability for third parties and creditors is recognised in cases where creditors are aware they are dealing with the trustee, it is proposed that the most practical course of action is to look to creditors rights to gain security over trust assets directly in contract. Unlike trustees, it is reasonable to expect creditors to have legal representation. In this case, creditors will either be in a clearer position as to what their potential liabilities are and be able to secure the appropriate security (now trustees are restricted to the fund alone); or, they if they are unaware they are dealing with trustees they will be afforded no less protection than before the proposed reform.

Conclusion

The reform I propose – limiting a trustee’s liability to the extent of trust assets when the other party knows the trustee is contracting in a fiduciary capacity, without affecting liability for a breach of trust – stands to make a desirable, practical and useful contribution to the operation of trusts in the UK. The reform is useful, insofar as it gives trustees protection and simplifies transactions with creditors and third parties. It is desirable, insofar as these changes promote

⁴¹ Scottish Law Commission, Discussion Paper on Liability of Trustees to Third Parties, April 2008

⁴² *Investec Trust (Guernsey) Ltd v Glenalla Properties Ltd* [2019] A.C. 271, as per Lord Mance

UK trust law to settlors, trustees and streamline the process of due diligence for creditors. Finally, it is practical, insofar as it runs in keeping with the core tenants common law and equity principles.

The Law Commission is due to begin a review of Trusts Law, and it may be that an overhaul of the basis of trusts to create new personified structures may be called for. Short of a radical reconsideration of the principles of equity in English Law, the reform proposed stands to bring trusts in line with ‘the expectations of ordinary morals’ and is therefore central to the competitiveness of UK trusts in the global market.

2901 Words.