

Exemption clauses – different clauses and different results

By John Brown, Barrister, New Zealand

Two recent decisions with seemingly quite different results concerning exemption clauses, causes us to focus our attention on the actions of the trustees and the specific clauses concerned. In *Spread Trustee Co Ltd v Hutcheson*¹ a majority of the Privy Council found the particular exemption clause effective, notwithstanding that the trustee may have been grossly negligent. (The beneficiaries alleged the trustee had failed to investigate breaches of trust on the part of previous trustees and had failed in the matter of investment policy). In contrast, in *Spencer v Spencer*² the trustees allowed their friendship with the settlor/discretionary beneficiary and their views as to his entitlement to the trust property, to override their obligations to the other beneficiaries. The New Zealand High Court in *Spencer* went on to hold that an exemption clause in the trust deed was not available to the trustees to relieve them of personal liability and also denied them possible statutory relief.³

Ian Millard QC in *New Zealand Master Trusts Guide* and his chapter on “Trustees Duties” summarises the position with regard to exemption clauses;

“An exemption clause contained in the trust deed may limit the liability of a trustee to the beneficiaries but cannot protect a trustee from liability when dealing with third parties. Even when sued by a beneficiary, trustees bear the onus of establishing that they are protected by the exemption clause with any exemption clause being construed narrowly against the trustees”.⁴

An exemption clause may limit liability

Generally a limitation or exemption clause in a trust deed is valid. Whether it does in fact exempt or limit the trustee’s liability in a particular situation depends on the wording of the clause and the manner in which the trustee has or has not executed the trust.

Both *Spread Trustee Co Ltd* and *Spencer* referred to the well known statement of Lord Millett in *Armitage v Nurse*,⁵ that there is;

“an irreducible core of obligations owed by a trustee to a beneficiary which is fundamental to the concept of a trust and which cannot be excluded, namely the duty of the trustee to perform the trust honestly and in good faith for the benefit of the beneficiaries.”

In *Spread Trustee Co Ltd*, the exemption clause contained in the trust deed relieved the trustee of liability, “except wilful and individual fraud and wrongdoing on the part of the trustee...” A majority of the Privy Council held that the exemption excused the

¹ *Spread Trustees Co Ltd v Hutcheson* [2011] UKPC 13 [*Spread Trustees Co Ltd*].

² *Spencer v Spencer* (2011) 3 NZTR 21-023 (HC) [*Spencer*].

³ Trustee Act 1956, s 73 (NZ). The High Court may relieve the trustee of liability for a breach the trustee has committed where the trustee has acted honestly and reasonably, and ought fairly to be excused.

⁴ *New Zealand Master Trusts Guide*, 3rd Ed, Chapter 5 p 118 “Trustees Duties”, published by CCH (NZ) Ltd, Dec 2011.

⁵ *Armitage v Nurse* [1998] Ch 241 (CA).

trustees in that case under then Guernsey Law⁶, even in the event of gross negligence.⁷

It cannot protect a trustee from liability when dealing with third parties

However, an exemption clause only operates to protect the trustee from a claim brought by a beneficiary of the trust and does not protect the trustee from liability incurred to a third party, even though that party had notice of the trust deed and the exemption clause.⁸

In contrast to an exemption clause, where the trustee is contracting with a third party if the trustee wishes to limit personal liability to the contracting third party, then it is up to the trustee to see that the words used do that are sufficient to make that clear.⁹ An express statement that the trustee's liability is limited is required to avoid exposure to personal risk. It is not sufficient to merely sign the contract as "trustee".

Trustees bear the onus of establishing that they are protected by the exemption clause which will be construed narrowly against the trustees

The exemption clause will be narrowly construed against the trustees seeking to rely on it and the trustees bear the onus of establishing that they are protected by the exemption clause.¹⁰ Construed against the trustees, the exemption provided to the trustees in *Spencer* although commonly used in trust deeds in New Zealand, offered the trustees considerably less protection than the clause in *Spread Trustees Co Ltd*. In *Spencer* the exemption clause protected the trustee, "except for any loss attributable to the trustee's dishonesty or wilful commission or omission of an act known to be a breach of trust".

Acting "dishonestly" has been judicially interpreted as "not acting as an honest person would in the circumstances".¹¹ However it should be pointed out that the standard of dishonesty embracing conduct such that no reasonable person could have believed it honest, was a point not argued before the Privy Council in *Spread Trustees Co Ltd*.¹² If it had been, results may have been quite different. In *Spencer* this issue of whether the trustees had acted "dishonestly" was to be decisive.

In *Spencer*, the trustees were Mr Spencer, his accountant and a business associate. The latter two "allowed their friendship with Mr Spencer to over-ride their legal obligations to [the other beneficiaries]".¹³ The trust had arisen as a result of a marriage breakup, Family Court proceedings and a consent order which provided for the establishment of the trust and that one of the children (who was mentally disabled)

⁶ The Trusts (Guernsey) Law 1989, s 34(7) provided that nothing in the terms of a trust shall relieve a trustee of liability for breach of trust arising from his own fraud or wilful misconduct. By an amendment effective from 19 February 1991 the subsection was extended to include gross negligence. The alleged acts took place before the amendment came into effect.

⁷ *Spread Trustees Co Ltd* at [36], [52], [63]. There were however two strong dissenting judgments.

⁸ *Niak v Davidson* (1999) 1 NZTR 9-009; *Re Jaques & UDC Finance Ltd* (2009) 2 NZTR 19-012 at [15] & [17].

⁹ *Muir v City of Glasgow Bank* (1879) 4 App Cas 337 (HL) at 389.

¹⁰ *Spread Trustees Co Ltd* at [106]; *Wong v Burt* (2004) 1 NZTR 14-012 (CA) at [51]; [2005] 1NZLR 91.

¹¹ *Royal Brunei Airlines Sdn Bhn v Tan* [1995] 3 All ER 97 (PC) at p 105; *Wong v Burt* (2004) 1 NZTR 14-012 (CA) at [53]; [2005] 1NZLR 91.

¹² *Spread Trustees Co Ltd* at [107], [112] referring to *Walker v Stones* [2000] 4 All ER 412.

¹³ *Spencer* at [197].

was to receive a fixed amount per week from the trust net income. A few weeks after the establishment of the trust these payments ceased, the accountant-trustee asserting to the beneficiary's mother that the trustees did not have the resources to make the fixed payments. The trust did not have the income because in breach of trust a significant part of its income was applied in payment of excessive building management expenses to a company controlled by Mr Spencer and a number of other steps taken, which had the effect of not just favouring Mr Spencer (a discretionary beneficiary) and treating the trust assets as his property,¹⁴ but of stripping the trust of income so that the trust was unable to meet its Court order obligations. In essence there was a fundamental failure by the trustees to perform the trust honestly and in good faith in terms of the Court order under which the trust was established.

The general tone of the trustees' evidence was found to be one of "righteous self-indignation" and they "expressed a strong sense of outrage at being sued".¹⁵ However the Court found that the trustees simply did not act as an honest person would in the circumstances and that a person can act dishonestly for the purposes of the exemption clause even although he or she genuinely believes their actions are morally justified.

The trustees were found personally liable and they were also denied relief under s 73 because they had not acted reasonably or honestly.

Could the exemption clause compromise the execution of the trust?

Behind the issue of exemption clauses is a practical point that goes to the foundation of the trust itself. Should the trustee be drafting his own wide exemption clause? A wide exemption clause may not only release the trustee from liability but it may also compromise the proper and competent execution of the trust. If the trustee insists on a wide exemption clause the settlor needs to consider, how appropriate is this trustee?

Conclusion

An exemption clause in the trust deed may limit trustees' liability to beneficiaries, but that clause will be narrowly construed against the trustees who will bear the onus of establishing that they are protected by that clause. The settlor should ensure that the exemption clause will not hinder the trust from being competently executed.

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¹⁴ *Spencer* at [192].

¹⁵ *Spencer* at [190] – [191]