TRUST ADMINISTRATION: A GUIDE TO THE NEW ENVIRONMENT[1]

Charles Gothard[2]

Private client lawyers increasingly spend much of their time defusing disputes of a semi-contentious nature between trustees and beneficiaries, where tensions are bubbling under the surface but, fortunately, have not yet 'blown up' or resulted in court proceedings. Almost all trustees have woken up to the increasingly litigious environment, and this article highlights some of the practical risks and common pitfalls they face – and ways of mitigating them.

THE RISKS/PITFALLS

Regulatory breaches

Although English trustees do not, yet, have to obtain regulatory authorisation, many offshore trustees do. For example, in Jersey and Guernsey licences have to be obtained from the respective Financial Services Commission. Licences can be withdrawn (or not renewed) for regulatory breaches, and restrictions can be placed on individual trust company directors. In addition, a few jurisdictions, such as Guernsey, even have a 'code of conduct' for trustees requiring, for instance, that any complaint to the trustee that remains unresolved after 3 months must be reported to the regulator.

Money laundering

This can result in criminal penalties against trustees and irrecoverable reputational damage. While modern 'know your customer' requirements usually ensure that trustees have reasonable knowledge of who and what they are dealing with, it is not unusual for trustees of older trusts not to know who the 'real' settlor of the trust is, or the activities of an underlying company.

---

[1] A similar article was first published in the Trusts & Estates Special Report 2005

[2] Speechly Bircham

Challenges to the validity of the trust

For a trust to be properly constituted there must be certainty of intention, subject matter and beneficial class. The trust must also comply with relevant formal requirements in relation to its creation and the transfer of assets to it. Otherwise, the trust can be void *ab initio*. This would also be the case if the trust was a sham from the outset, requiring a common intention by the settlor and trustees for the trust documents not to create the legal trust relationship that they give the appearance of creating (for further analysis see Alison Meek et al, *Contentious Trusts & Estates* (Tolley, 2002)). Other scenarios may result in the trust being voidable if:

- undue influence was exerted on the settlor; or
- the trust was set aside as a result of the settlor's subsequent bankruptcy (see ss 339–341 and s 423 of the Insolvency Act 1986).

Mis-management of the trust assets

Increasingly, claims are made against trustees for investment losses, even if the investment management has been delegated to investment professionals.

Questions are raised about whether the trustees:

- selected appropriate managers;
- set appropriate investment parameters;
- ensured the manager complied with the parameters;
- monitored the investment performance; and/or
- switched managers if appropriate.

Section 15 of the Trustee Act 2000

Section 15 of the Trustee Act 2000 requires trustees of English law trusts (wherever administered) and foreign law trusts administered in England to put an investment policy statement in place and regularly review its appropriateness and compliance with it. A surprising number of trustees still have a dangerously cavalier attitude in this area and leave themselves exposed to criticism for failure to obtain professional advice.

Disclosure of information

Most trustees are wary of requests for information from some beneficiaries and following *Schmidt v Rosewood Trust Ltd*[3] it is arguably less clear what should or

[3] [2003] 2 WLR 1442.

should not be disclosed. What is clear, however, is that the court has reasserted its inherent supervisory jurisdiction over trustees, and if trustees fail to disclose requested information, they may be exposed to personal costs (irrecoverable from the trust fund), unless they had proper justification for their non-disclosure. It is worth noting that in appropriate circumstances disclosure can be limited to professional advisers only.

Advice and communication

Quite often trustees shy away from consulting lawyers before dealing with a particular issue and the lawyer only finds out about it afterwards. Ideally, the trustees should use their judgement and have a sufficiently close relationship with their (or the family's) lawyers so that in a situation where they are not absolutely sure about the appropriate course of action, they will instinctively pick up the phone or drop a line to the lawyer, confident that preliminary advice can be obtained for little or no cost. Increasingly, trustees are realising that this sort of user-friendly lawyer relationship can add value to the trustees' business and help with risk management.

Making a mistake

The trustees might act *ultra vires* by incorrectly assuming they had the power to take the action in question or by not realising the limits of the power. Alternatively, the trustees might distribute assets to a beneficiary that weren't trust assets at all – for example, if the trust was void from the start, or pay funds to the wrong beneficiary or overpay the beneficiary. It is interesting to note that since 1999 the trustees' equitable remedy for recovery of money paid by mistake can be deployed to recover assets distributed to a beneficiary by mistake of fact or law (see *Kleinwort Benson v Lincoln City Council*)[4].

Failure to exercise a power correctly

Often this results from a poorly drafted trust deed that, for instance, stated the power could be exercised by 'written instrument' rather than 'Written Instrument' - the lack of capital letters thereby not prompting the reader to check the defined terms and the specific requirements for the instrument in question. The classic example is trustees failing to obtain protector consent, the requirement for which is only apparent from a schedule at the end of the trust deed.

---

[4] [1999] 2 AC 349.

Excessive fees

Trustees sometimes get caught out by charging more than is permitted under a prior fee agreement (some old trust deeds only permit charges in accordance with a historic fee scale). Notwithstanding any fee agreement, beneficiaries and the courts are increasingly seeking a correlation between the fees and service received and the value of the trust funds.

In *Parujan v Atlantic Western Trustees Ltd*[5] the Jersey court described the trust company as having 'lost control of the situation', allowing 'transactions to proceed without knowing what was going on'. The court ordered an independent assessment and subsequent reduction of the trustee's fees.

Protection strategies

In *Parujan*, the court noted that 'a trustee should be in the saddle and firmly holding the reins; he should not be running after the horse desperately trying to mount it!' Below are some practical suggestions to keep trustees in the saddle, even if they cannot always keep a firm hold of the reins.

A clearly drafted trust deed

This will reduce the possibility of trustees failing to act in accordance with its terms by exercising the wrong power or failing to obtain requisite consents.

Trustee protection clauses

No matter how careful the trustee, residual risks will remain and the most effective way for trustees to protect themselves against these risks is through carefully drafted protection clauses. There are four main types.

(1) Trustee exemption clauses

These exempt trustees from liability for specified risks (eg loss to the trust fund resulting from the trustees' negligence). English law is still remarkably lenient in this area and permits very wide exemption clauses. The leading case is *Armitage v Nurse* in which,[6] despite serious reservations, the Court of Appeal held that an exemption clause was effective 'no matter how indolent, unprudent, lacking in diligence, negligent or wilful [the trustee] may have been, so long as he has not acted dishonestly'.

---

[5] [2003] JRC 045

[6] [1998] Ch 241.

However, during the passage of the Trustee Bill, the Lord Chancellor undertook to refer the question of trustee exemption clauses to the Law Commission, which issued a consultation paper in December 2002. It recommended that professional trustees should in future not be able to rely on a clause exempting them from liability for their own negligence. The Commission's rationale was that 'the current law is too deferential to trustees, in particular professional trustees' as it is not in beneficiaries' interests for trustees to have the benefit of insurance and sweeping exemption clauses. Many other jurisdictions already have statutory restrictions on the scope of permissible exemption clauses – for example, since 1989/1990, Jersey and Guernsey's trust legislation has prohibited exoneration for fraud, wilful misconduct or gross negligence, and in the Turks and Caicos this extends to any negligence (s 29(10) of the Trusts Ordinance 1990).

At the time of writing, the Commission has not yet published its final proposals, but it seems that the benign state of this aspect of English law is unlikely to continue.

(2) Duty exclusion or limitation clauses

These exclude or limit specific statutory or common law duties that would otherwise be imposed on trustees. A typical example is the exclusion/ limitation of the statutory duty of care (s 1 and s 7 of Sch 1 to the Trustee Act 2000) or so-called 'anti-*Bartlett*' clauses.

(3) Enlargement of powers clauses

These confer extended powers on trustees, reducing the possibility of acting *ultra vires*, although the trustees must still act in good faith and in the best interests of the beneficiaries, which are irreducible core duties.

The Law Commission also considered duty exclusion/limitation and enlargement of powers clauses and recommended that they should be subject to a reasonableness criterion to prevent trustees from obtaining protection equivalent to the protection lost through the proposed restriction on exemption clauses.

For the time being, it is important that trustees of any English law trust or foreign law trust administered in England or Wales are at least aware of the possibility that they might not in future be able to rely on these types of protection clauses to the same extent. This could pose a significant problem for trustees with vexatious beneficiaries, who only agreed to take on the trust because of the existence of the exemption clause.

(4) Release and indemnity clauses

These can take a variety of forms, but the most effective ones automatically release an outgoing trustee for specified liabilities and indemnify the trustee out of the trust

fund in respect of liabilities incurred. The usefulness of the indemnity depends on the trust assets, and frequently an outgoing trustee will also seek a separate indemnity from the new trustees and one or more beneficiaries.

Independent advice for settlors

The Law Commission noted that settlors are often not advised of the existence (let alone the scope) of trustee protection clauses. This is dangerous as well as bad practice, as it risks the clauses being rendered ineffective. The Commission was not inclined to make independent advice a statutory requirement, but in many cases it is clearly a good idea, notwithstanding the additional cost. It is also likely to reduce any possibility of the trust being set aside for the reasons mentioned above.

Internal processes

By putting appropriate processes in place, such as requiring the exercise of various powers to be documented in a particular way or certain types of decision to need the approval of two directors, mistakes can often be avoided and the paper trail will exist that may help to rebut criticism. It is imperative that trustees take great care with all trust-related communications, particularly in view of the growth in discovery orders against them. This is especially important in matrimonial proceedings, where it could be fatal in the case of a beneficiary for e-mail correspondence or file notes to be disclosed referring to the beneficiary as 'the client' and indicating (even if it is not the case) that the trustees automatically implement every request from the beneficiary without considering the merits of doing so.

Insurance

The scope of the trustees' insurance policy should be kept under review and directors of corporate trustees should ensure that they are covered for personal liabilities that might be incurred as a result of common law claims or statutory liability. In relation to the scope of directors' liabilities, see *HR v JAPT*,[7] art 52 of the Trusts (Jersey) Law 1984 and s 70 of the Trusts (Guernsey) Law 1989. Individual professionals should be wary of taking on unpaid, personal trusteeships in respect of which they may not be covered by their firm's PI insurance, and for which separate insurance may be difficult and costly to obtain.

Many of the risks and pitfalls highlighted above may appear obvious to more savvy readers, but everyone makes mistakes and in the present litigious climate the need for trustees to become more 'streetwise' by embracing the risk-management

[7] [1997] *Pensions Law Reports* 99.

techniques mentioned above is becoming increasingly apparent – both to trustees and their advisers.

Charles Gothard is an international tax and trusts partner at Speechly Bircham
Charles Gothard, Partner
Speechly Bircham
6 St Andrew Street
London
EC4A 3LX

Direct dial: 0207 427 6460
Fax: 0207 427 6600
Email: charles.gothard@speechlys.com