Contracting with Trusts – Avoiding the Pitfalls

Questions & Answers

QUESTION: inaudible

PROF JOHN CARTER: I think that is two or three questions masquerading under one. I know I've had a concern - and I'd be interested in Michael's reaction. I had a concern that a trustee who gives an unlimited indemnity to a contracting party may not be acting in the interests of the trust at all. As I've said, there is no reason why people entering into contracts should give indemnities. There is a whole body of law governing liability that is really fair and just, so I have had concerns about the trustee who gives an unlimited indemnity acting in the interests of the beneficiaries, and querying whether there may not be a potential exposure for the trustee in that respect, and the loss of the right of indemnity, but I mean, in a sense it would be a bit silly for the contracting party to say, "I want an unlimited indemnity, but I'm happy to have it limited by your right of indemnity," because it depends then on two different indemnities matching up.

MICHAEL KINGSTON: I think I agree with John that the trustee would want to think very carefully before he granted some extreme form of indemnity. I suspect it turns a bit on the context and the trust instrument, and what the trust venture is trying to do, but if you look at those comments earlier about the need for prudence, for example; well, it may not be a prudent thing to do, and if there wasn't a reason by reference to the context of the trust, or the trust instrument to say that prudence overlay is not relevant to this trust, there would be a question, - just as, - I think the courts look hard at call options granted by trustees over trust property, and even more, put options written by them, saying, well, you may technically have had power, but was that a very sensible thing to go about doing, in terms of managing the trust estate. And I think, you know, similar questions could be raised about an extreme form of unlimited indemnity granted by the trustee when acting as trustee.

CHAIR: Any other questions from the audience? I just have one, for John. Often times, with exclusion clauses, and limitation of liability clauses, there are references to officers, agents, employees of the trustee, given they are not a party to the contract, are those officers agents or employees - able to rely upon the limitation or exclusion?

PROF JOHN CARTER: This is Alan getting at me because he suggested that I amend my paper by including a discussion of privity of contract. From the trustee's perspective, privity issues don't readily spring to mind, but then that may be because I don't have a good understanding of the way in which trustees do their business, but certainly from the other contracting party's perspective, privity is a difficult area. This is a trap. We were actually present in state today - where there is a third party benefit statute, that is, the provisions in the Property Law Act, which enables third parties to get the

benefit of contractual provisions, but, elsewhere, other than Western Australia and the Northern Territory, we're generally in the common law, and the common law is you can only enforce a contract provision if you are a party to the contract, so the drafting - which I'm sure you've all seen – "neither the trustee nor any of the trustee's employees, agents, - directors, etcetera, shall be liable for" - is, for most part, worthless. You might as well save paper and not bother to include them.

I mean, it can be done, and there are three ways to protect the employees, agents, and so on: one is to obtain a covenant not sue. You get the other party to say that if an employee is negligent, that the other party to the contract won't sue the employee, because the employee has a liability in tort, may have duty of care, and therefore, may be sued in tort. Well, you get the other party to say it won't bring an action in tort, or whatever. And I think, in many ways, that is an easy quick fix which doesn't create any other problems. The second device is to create a trust. We are seeing quite a lot these days, the idea of - maybe it is the fact that academics are doing more consulting, I don't know. This provision is entered into by the trustee on its own behalf, and for the benefit of its employees, agents, etcetera, etcetera, and that will be good, because if it is an exclusion of liability, the trustee holds the benefit of it on trust for the other individuals, and therefore, they will be protected.

You have got to watch out, because if you - say, you are trustee receiving an income of 10 million dollars under this contract, or the trustee having a liability of 10 million dollars under this contract, if you make the benefit of the contract subject to the trust, you may end up with a situation where you have an enormous stamp duties liability, because you have declared a trust in relation to a 10 million dollar benefit, so you need to watch you are not going too wide with the indemnity with the trust itself.

And the final demise is simply to make them a party to the contract, and I mention that last, because, in most cases, it is just an absurd idea that the trustee should make a promise on behalf of itself and its employees in consideration of the third party agreeing to exclude the employees' liability. It is not feasible, in most cases, and I always had a bit of a concern with provisions in the contract. You know, it starts off with the contracting party, the trustee, and then when you come to the definitions in the contract, you see trustee defined:

Trustee includes the trustee's employees, agents, etcetera.

What are we to make of that? Does that mean that all those people have the liability to pay for the services? Are they really parties to the contract? I think not, is the answer, so that yet another simple way of achieving all this fails miserably. So, at the end of the day, it is quick fix: covenant not to sue; sophisticated approach: a trust of the benefit of the exclusion.