



Banking & Financial Services Law Association

BFSLA Conference 2014

Trustee Limitation of Liability Clauses

Chair: Paul Rogerson, Head of Legal, NRMA

Dr Nuncio D'Angelo, Partner, Norton Rose Fulbright

Diccon Loxton, Partner, Allens

Rachel Paris, Partner, Bell Gully

From the Trustee's perspective

- 1 All trust debts are personal to the trustee – legally, a “trust” cannot have debts (cf accounting treatment and commercial understanding)
- 2 Trustee can indemnify itself out of trust assets for trust liabilities (even if indemnity is not documented)
- 3 That indemnity is conditional:
 - the liability is incurred within power;
 - the liability is incurred “properly”; and
 - the trust accounts are “clear” as between trustee and beneficiaries (“clear accounts rule”).
- 4 “Properly” means in compliance with:
 - the trust instrument;
 - any statute relating to trustee conduct; and
 - the general law of trusts (to the extent not modified by trust instrument or statute).
- 5 “Clear accounts rule”: if the trustee causes loss to the trust estate via breach (eg neglect or misapplication of assets) it cannot take any money out the estate until it makes good the loss – a form of “set-off” applies
- 6 The indemnity can be totally lost or impaired (ie unavailable) in relation to a given debt (“related breach”) – a liability-by-liability test
- 7 The indemnity can be partially lost or impaired, under the clear accounts rule (“unrelated breaches”) - whole-of-trust test

From the Creditor's perspective

- 1 No statutory protection for indoor management matters as for companies:
 - see ss125-129 Corporations Act (Aus) and ss15-19 Companies Act (NZ)
- 2 Secured creditor can be affected by “related” breaches of trust depending on level of knowledge or indifference:
 - bona fide purchaser rule: actual and constructive (“put on enquiry”) knowledge
 - accessory liability under *Barnes v Addy*: actual knowledge and culpable indifference (but not constructive “put on enquiry” knowledge)
- 3 Unsecured creditors have no right of execution against trust assets. Their only access to trust assets on enforcement or insolvency is subrogation to the trustee’s indemnity:
 - their claim is only as good as the trustee’s claim
 - if the indemnity is impaired or lost for trustee’s breach then unsecured creditors’ access to trust assets is correspondingly impaired or lost
- 4 Risk is controllable for “related breaches” via:
 - due diligence (necessary because no statutory indoor management protections);
 - documentation (only partially effective); and
 - legal advice.
- 5 Risk is *uncontrollable* (or only partially controllable) for “unrelated breaches” because due diligence cannot find them – thus, unsecured creditors can lose out even if innocent and ignorant of breach
- 6 No statutory regime for insolvency of trusts (and they are invisible to the statutory insolvency regimes for companies)

For Managed Investment Schemes (Australia)

- 1 A trust will be a MIS if it satisfies the definition in the CA (essentially, “public unit trusts”):
 - partial regulatory regime in Ch 5C of the CA
 - trustee is called “responsible entity”
 - trust instrument called “constitution”
- 2 Ch 5C of the CA only partially regulates them – gap-filling is left to general trust law
- 3 Section s601GA(2): RE’s right to indemnify is conditional:
 - it must be set out in the constitution; and
 - it must only be in relation to the “proper performance of duties”
- 4 “Proper performance of duties” is as per Rule 4 for Trustees but includes the statutory duties imposed on REs in s601FC of the CA (but not clear if includes breach by the RE’s directors of duties at general law and/or under s601FD)
- 5 Otherwise, creditors’ position is the same as for trusts generally:
 - no additional protections given them under Ch 5C (which is about investor protection not really creditor protection)
 - no statutory assumptions as per ss125-129
 - no insolvency regime for MIS despite being regulated – insolvency is left to the general law of trusts

| Issue | Unsecured trust creditor | Secured trust creditor ¹ |
|--|--|--|
| Nature of claim to trust assets | Derivative proprietary claim via its ability to subrogate to the trustee's indemnity. (Also an additional personal claim against the beneficiaries unless excluded). | Direct, proprietary access to trust assets based on its security interest. |
| Is the breadth of the trustee's indemnity right relevant? | Yes | No. |
| Creditor risks | <ul style="list-style-type: none"> • Unenforceable or overly restrictive trustee indemnity right limiting ability to subrogate. • Breach of trust/improper administration of the trust (including lack of capacity, authority or breach of duty in entering into a liability). • Beneficiary cross-claim/ no "clear accounts". • Insolvent/illiquid trust assets (in which case relying on trustee's obligation to personally fund liability and then reimburse itself under its indemnity). | <ul style="list-style-type: none"> • Deficient security interest – e.g. attachment, perfection, priority issues. • Trustee lacks power/authority to grant security. • Secured creditor has a relevant type of notice of breach of trust: <ul style="list-style-type: none"> – if a legal security, not a bona fide purchaser – in any case, accessory liability (knowing receipt). |
| What should creditor do to mitigate/minimise risks? | <ul style="list-style-type: none"> • Focus on due diligence and representations to address issues of capacity and authority (checking trust powers, etc) and ensure no previous trust breaches; trustee certificates. • Ensure no unnecessary fetters on documentary trustee indemnity right. | <ul style="list-style-type: none"> • Ensure trustee is able to grant security (requires express power in trust deed) and has satisfied any preconditions/limitations. • Make the enquiries that a reasonable and honest person would make to ensure the granting of the security is not in breach of the trust. |
| Is it relevant whether the trustee is committing a breach of a trustee duty under this transaction? | Yes | Yes |
| Is it relevant whether the trustee is in breach of any <i>other</i> duty (i.e. outside this transaction?) | Yes. | No. |

¹ The position described for "secured creditors" applies only to the extent that the secured creditor's claim is able to be satisfied out of the proceeds of security realisation. To the extent that the secured creditor's claim cannot be satisfied out of secured property, the secured creditor is in the same position as an unsecured creditor in respect of the residual claim.

“Typical” limitation of liability clause

- (a) The Borrower enters into this agreement as trustee of the Trust and not in its personal capacity.

It will cease to have any obligation or liability under this agreement if it ceases to be trustee of the Trust.

The Custodian enters into this agreement as custodian and agent of Loxton Laundries Limited as trustee of the Trust and in no other capacity.

(b) Any obligation or liability arising under this agreement is limited to and can be enforced against the Borrower only to the extent to which it is actually indemnified from assets of the Trust for the obligation or liability.

The Borrower is not liable or subject to any obligation in its personal capacity.

- (c) The other parties may not:
- (i) sue the Borrower personally;
 - (ii) seek execution or other process against the Borrower's personal assets;
 - (iii) seek the appointment of a liquidator, administrator, receiver or similar person to the Borrower;
 - (iv) prove in any liquidation, administration or arrangement of or affecting the Borrower;
or
 - (v) exercise any right of set-off against the Borrower.

(d) This clause will not apply to any obligation or liability of the Borrower to the extent to which it is not satisfied because there is a reduction in the extent or an extinguishment of the Borrower's indemnification out of the assets of the trust as a result of its fraud, gross negligence, material breach of duty or wilful default.

[(e) No attorney, [receiver] or other person appointed under this agreement has authority to act on behalf of the Borrower in a way that exposes the Borrower to any personal liability and no act or omission of such a person will be considered fraud, gross negligence, material breach of duty or wilful default of the Borrower for the purposes of paragraph (d)

Model LOL clause

- (a) Trustee enters into and performs this agreement and the transactions it contemplates only as trustee of the Trust, except where expressly stated otherwise.

This applies also in respect of any past and future conduct (including omissions) relating to this agreement or those transactions.

- (b) Under and in connection with this agreement and those transactions and conduct:
 - (i) Trustee's liability (including for negligence) is limited to the extent it can be satisfied out of the assets of the Trust. Trustee need not pay any such liability out of other assets.

[In relation to any given liability, amounts which are not Trust assets and which have been actually received by Trustee to indemnify it against that liability will be taken to be assets of the Trust (but no other party will have any rights in respect of any such indemnity)]

- (ii) another party may only do the following (but any resulting liability remains subject to this clause):
 - (A) prove and participate in, and otherwise benefit from, the winding up of Trustee or any form of insolvency administration of Trustee but only with respect to Trust assets;
 - (B) exercise rights and remedies with respect to Trust assets, including set-off;
 - (C) enforce any security and exercise contractual rights; and
 - (D) bring any other proceedings against Trustee, seeking relief or orders that are not inconsistent with the limitations in this clause

and may not otherwise:

- (E) bring proceedings against Trustee;
- (F) take any steps to have Trustee wound up or placed into any form of insolvency administration (but this does not prevent the appointment of a receiver, or a receiver and manager, in respect of Trust assets); or
- (G) seek by any means (including set-off) to have a liability of Trustee to that party (including for negligence) satisfied out of any assets of Trustee other than Trust assets.

- (c) Paragraphs (a) and (b) apply despite any other provision in this agreement but do not apply with respect to any liability of the Trustee to another party (including for negligence):
 - (i) to the extent that Trustee has no right or power to have Trust assets applied towards satisfaction of that liability, or its right or power to do so is subject to a limitation, reduction, deduction, obligation to make good or to clear accounts, in any case because Trustee has acted beyond power or improperly in relation to the Trust; or

(ii) in connection with [[*insert reference to selected trust representations and undertakings*] or] any [other] provision which expressly binds Trustee other than as trustee of the Trust (whether or not it also binds it as trustee of the Trust).

- (d) The limitation in paragraph (b)(i) is to be disregarded for the purposes (but only for the purposes) of the rights and remedies described in paragraph (b)(ii), and interpreting this agreement and any security for it, including in determining the following:
 - (i) whether amounts are to be regarded as payable (and for this purpose damages or other amounts will be regarded as payable if they would have been owed had a suit or action barred under paragraph (b)(ii) been brought);
 - (ii) the calculation of amounts owing; or
 - (iii) whether a breach or event of default has occurred, but any resulting liability will be subject to the limitations in this clause.