TRUSTEE EXEMPTION CLAUSES: REDUNDANT OR REQUIRED?

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1. Introduction

Many testamentary instruments include clauses which are intended to relieve trustees from liability in the execution of their duties. Such exemption clauses, as they will be referred to in this paper, take a variety of forms but are generally quite broad so as to relieve the trustee from consequences stemming from negligence so long as the conduct does not amount to fraud or intentional wrongdoing. As noted by the Ontario Law Reform Commission ("OLRC") in its *Report on the Law of Trusts*, "trust instruments drawn in this Province, whether testamentary or *inter vivos*, very often exonerate the trustee from liability for any loss arising from the administration of the trust, if the trustee has acted in good faith".[1]

While the common law has not dealt with this issue to a great extent in Canada, other jurisdictions have dealt with the issue of exemption clauses to a much greater degree. This paper will examine these approaches in an attempt to discern what the future approach of the Canadian courts may be. This paper will also examine the impact of the provisions in the *Trustee Act*[2] which also address the issue of trustee liability. While clauses which purport to relive trustees of liability have become commonplace in the creation of testamentary and trust instruments, such clauses may have little utility in light of the detailed and comprehensive statutory provisions and the approach likely to be taken by the courts.

2. Types of Exemption Clauses

The typical exemption clause, found in a trust instrument, is one

* Of Goodman and Carr LLP. The author gratefully acknowledges the assistance of Martha Simmons, student-at-Law for her assistance in the preparation of this paper. This paper is submitted in honour and memory of the late Wolfe D. Goodman Q.C., LSM, SJD, a founding partner of the firm, a great mentor, and one of Canada's leading estate planning and tax lawyers.

1. Ontario Law Reform Commission, *Report on the Law of Trusts*, 1984, at p. 39.
2. R.S.O. 1990, c. T.23.

which excludes the liability of the trustee for having committed an unintentional breach of trust. The reasoning upon which these clauses are based is that a duty exists, that duty has been breached, and, were it not for the clause, liability would be alleged by the beneficiaries. The exemption clause, however, operates to remove, mitigate, or reduce such liability. An example of a boilerplate exemption clause used in Ontario is the following:

> I declare that my Trustees shall not be liable for any loss that may happen to my estate or be suffered by any beneficiary of my estate resulting from the exercise by my Trustees of any discretion given to them in this Will which is exercised honestly and in good faith.

In addition to the exemption clause which alters the liability of the trustee, some exclusion clauses may also operate to remove or reduce the duty owed by the trustee to the beneficiaries.[3] This paper will be primarily concerned with the first type of exemption clause, although many of the factors are equally applicable to both.

The terms of exemption clauses, of either type, often specify the level of culpability required before a trustee will be held liable for a breach of trust. These levels range from fraud and recklessness to gross negligence and general negligence. Clauses may specify which type of behaviour is acceptable in the face of a breach of trust.

3. Validity of Exemption Clauses

(1) Canada

Canadian courts have not, at an appellate level, laid out a position regarding the effectiveness of exemption clauses in relieving trustees from liability for losses caused by their negligence. The Alberta case of *Poche v. Poche Estate*[4] is the only case to substantively address this issue. In that case, a clause in a will purported to relieve the executrix and trustee for those losses not attributable to her own dishonesty or to acts which she knew to be a breach of trust. The specific exemption clause examined in that case stated:

> 8. I declare that the Trustee of this my Will shall not be liable for any loss not attributable:

3. An example of this type of clause can be found in the English Privy Counsel decision of *Hayim v. Citibank*, [1987] AC 730, in which the testator appointed an executor on the terms that the executor "shall have no responsibility or duty with respect to" his house in Hong Kong until the death of both of the testator's siblings.
4. (1983), 6 D.L.R. (4th) 40, 16 E.T.R. 68, 50 A.R. 264 (Alta. Surr. Ct.).

> (a) To her own dishonesty, or
> (b) To a wilful commission by her of any act known by her to be a breach of trust.[5]

The court held that, although the trustee's conduct was not dishonest or wilful, it amounted to gross negligence and thus she could not be relieved of liability. In drawing from a line of Scottish cases, the court stated that "a trustee must be held responsible for any loss resulting from his gross negligence, regardless of any provision in the trust instrument relieving him from such liability".[6]

It is important that the exclusion clause be narrow enough to be properly interpreted by the court as valid and binding. As stated by Waters, the more general an exemption clause is, the more likely the courts will conclude that the settlor did not intend to relieve the trustee from liability.[7] Thus, the general boilerplate exemption provisions may be of little utility to trustees as terms such as "good faith", which are often used in such clauses, are quite uncertain and can be interpreted in various ways. Notwithstanding Professor Waters' comments, the English Court of Appeal has held that an executor or trustee who drafts the trust of a settlor can properly benefit from a very broad exemption clause as long as the clause and its effect are properly brought to the attention of the settlor.[8] Presumably, the Canadian courts would be more comfortable with this if the settlor is sent for independent legal advice on this point.

(2) Great Britain

Courts in England and Scotland have dealt with the issue of exemption clauses in trust instruments for many years. The House of Lords, in *Knox v. Mackinnon,*[9] accepted that such clauses will afford considerable protection to trustees who have failed to closely monitor the administration of a trust or who have committed errors of judgment. However, Lord Watson went on to state that

> . . . it is settled in the law of Scotland that such a clause is ineffectual; to protect a trustee against the consequences of culpa lata, or gross negligence on his part, or of any conduct which is inconsistent with bona fides.[10]

5. *Ibid.*
6. *Ibid.*, at para. 70.
7. Donovan W.M. Waters, Mark R. Gillen, Lionel D. Smith, *Waters' Law of Trusts in Canada*, 3rd ed. (Toronto: Carswell, 2005), at p. 928.
8. *Bogg v. Raper*, [1998] Times 22 April.
9. (1888), 13 App. Cas. 753 (H.L.).
10. *Ibid.*

Various other cases of the House of Lords have adopted the same position. Early on, in *Wyman v. Patterson,*[11] Lord Shand stated that this position is equally applicable in both England and Scotland.

More recently, there appears to be one fundamental difference between the laws of Scotland and England. Specifically, English law has not distinguished between negligence and gross negligence in the absence of statutory or contractual terms requiring such a distinction. The Scottish civil system, however, equates gross negligence with fraud.

The English Court of Appeal, in *Armitage v. Nurse,*[12] considered the application of exemption clauses. The court stated that no legal or public policy reason exists which suggests that exemption clauses should generally be unenforceable. The court held that, where a provision is unambiguous at relieving a trustee from liability, such relief should be granted. The clause at hand in that case stated: "no trustee shall be liable for any loss or damage . . . at any time or from any cause whatsoever unless . . . caused by his own actual fraud".[13] This clause was found by the court to be clear and unambiguous, holding that such a clause would relieve the trustee from liability regardless of how "indolent, imprudent, lacking in diligence, negligent or wilful he may have been, so long as he has not acted dishonestly".[14]

The Island of Jersey has taken another approach, opting to enact statutory provisions to address this issue. The relevant statute, *Trust (Jersey) Law 1984*, was amended in 1989 to include a new Article 26(9) (now Article 30(10)) which states:

> Nothing in the terms of a trust shall relieve, release or exonerate a trustee from liability for breach of trust arising from his own fraud, wilful misconduct or gross negligence.[15]

The Court of Appeal of Jersey considered this provision in *Midland Bank (Jersey) Ltd. v. Federated Pension Services Ltd.*[16] That case dealt with a trustee who delayed making an investment of funds at a time of rising stock markets, resulting in a loss estimated at £800,000. The trustee attempted to rely on an exemption clause which excluded liability unless there had been "a breach of trust knowingly

11. [1900] A.C. 271 (H.L.).
12. [1998] Ch. 241 (C.A.) [hereinafter *Armitage*].
13. *Ibid.*, at para. 14.
14. *Ibid.*, at para. 24.
15. Article 26(9) is now found in Article 30(10) after the most recent amendments to the *Trust (Jersey) Law* 1984 which came into force on the 27th of October, 2006.
16. [1996] PLR 179.

and wilfully committed". Sir Godfrey Le Quesney provided the judgment and stated that such clauses are enforceable but should be narrowly and restrictively construed. He also held that Article 26(9) was retrospective and overrode the exemption clause in a case of gross negligence. Since the trustee was found to have been grossly negligent, Article 26(9) disentitled him to the relief provided by the exemption clause.

Thus, while Jersey has statutory guidelines that do not exist in other British jurisdictions, the common law throughout Great Britain is clear in stating that no exemption clause will be effectual in removing liability from a trustee who has acted in bad faith but the degree of the effectiveness of such clauses varies where gross negligence is found.

(3) United States

American courts have taken a different approach to that adopted in Great Britain. In general, courts in the United States have found that relieving trustees of liability for gross negligence contravenes public policy.[17] While there is considerable consensus among the States, particular States have also taken discrete positions. For instance, New York has enacted a statute which renders exclusion clauses unenforceable.

American commentators have criticised exemption clauses because they are often dictated by trustees, particularly corporate trustees, who convey to the settlor that they have the requisite skills and will act in the best interests of the settlor.[18] In this way, exemption clauses are seen to have been inserted as an abuse of a confidential or fiduciary relationship between the settlor and the trustee and thus should not be accepted.

Public policy concerns have also led to the invalidation of exemption clauses. Scott describes the categories under which clauses will likely to be held to be void as against public policy. These include: breaches committed in bad faith, intentional breaches, and breaches through which the trustee benefits.[19]

Gross negligence is another category under which American courts have been reluctant to excuse trustees. As stated in *Browning v. Fidelity Trust Co.*, "a trustee cannot contract for immunity for liability for acts of gross negligence".[20] Even provisions relieving

17. A.W. Scott, *The Law of Trusts*, 4th ed., Volume III (Little Brown, 1987), at paras. 222 and 222.3 [hereinafter Scott].
18. G.T. Bogert, *Trusts*, 6th ed. (West Hornbook Series, 1987).
19. Scott, *op. cit.*, footnote 17.

trustees from ordinary negligence have been held to be against public policy in the United States since particular standards of conduct have been held to be required of trustees.[21]

4. Statutory Influence on Exemption Clauses in Ontario

Like other jurisdictions examined above, Ontario has relevant statutory provisions which must be examined in order to examine the utility of exemption clauses in trust instruments. The standard to be applied in seeking relief from liability differs, depending on whether or not the loss to the trust arose from the investment of trust property.

(1) Losses not Arising from Investment

There are a variety of examples of cases in which losses have occurred which have not been attributable to the investment of property—for instance, where a trustee applies funds in a manner not authorized by the trust instrument; where a trustee fails to act impartially between beneficiaries; or where the trustee delays paying interest-bearing debts. These are but a few examples and many more situations arise in which trustees may seek to be relieved of liability for breach of trust.

Section 35 of the *Trustee Act* (the "*Act*") provides for the relief of Trustees committing a breach of trust. Specifically, the Act states:

> 35. (1) If in any proceeding affecting a trustee or trust property it appears to the Court that a trustee, or that any other person who may be held to be fiduciarily responsible as a trustee, is or may be personally liable for any breach of trust whenever the transaction alleged or found to be a breach of trust occurred, but has acted honestly and reasonably, and ought fairly to be excused for the breach of trust, and for omitting to obtain the directions of the Court in the matter in which the trustee committed the breach, the Court may relieve the trustee wholly or partly from personal liability for the same.
>
> (2) Subsection (1) does not apply to liability for a loss to the trust arising from the investment of trust property.[22]

Thus, the court has discretion to relieve trustees who have committed a breach of trust where the trustee has acted honestly and reasonably and to determine when such relief is warranted.

These provisions have been applied liberally in granting relief to Trustees who have at least met the minimum standard of care and

20. *Browning v. Fidelity Trust Co.*, 250 F 321 (3rd Cir. 1918), at 325.
21. Scott, *op. cit.*, footnote 17, at para. 222.3.
22. *Trustee Act*, *supra*, footnote 2, at s. 35. As will be discussed in more detail below, investment property is dealt with in ss. 28 and 29 of the Act.

who have acted honestly, reasonably, and in good faith. As stated in *Weir v. Jackson*, the statute "ought to be very liberally applied for the purpose of relieving an executor or other trustee who has acted in good faith and reasonably".[23] Nevertheless, this does not indicate that courts have allowed for relief in all cases. The parameters were nicely laid out by the Divisional Court in *Wagner v. Van Cleef*, where it was stated:

> Ignorance of an administrator's duties does not make a defaulting trustee's actions reasonable, nor does complete reliance on others, including solicitors. The Courts have consistently declined to grant relief under s. 35 of the *Trustee Act* where there has been a complete abdication of responsibility of an administrator and trustee . . . In my view, it is unreasonable by any standard for an administrator to fail to assume any direct responsibility for the administration of an estate. Trustees are not required to be omniscient or infallible. So long as trustees exercise their discretion honestly and with ordinary prudence in light of all the information reasonably available to them at the time, a Court will not "second guess" their decisions with the benefit of hindsight.[24]

In that case, the administrator had turned over complete control of the assets of an estate to a solicitor and gave that solicitor a general power of attorney to act on his behalf in the administration of the estate. The court held that the administrator had so failed in his duty and thus could not be relieved of liability under s. 35, since acting honestly and reasonably did not excuse a trustee who did nothing, and abdicated his entire duties.

It should be noted that, in order to receive any benefit from the court's discretionary power under s. 35(1), an application must be made to the court and the trustee must meet the burden of proving that he or she has "acted honestly and reasonably *and* ought fairly to be excused for the breach of trust" [emphasis added]. This process can be both time consuming and costly. Moreover, there is little certainty that such discretionary relief will be granted.

23. *Weir v. Jackson* (1905), 5 O.W.R. 281 (Div. Ct.), at p. 282.
24. *Wagner v. Van Cleeff* (1991), 5 O.R. (3d) 477, 43 E.T.R. 115, 53 O.A.C. 161 (Div. Ct.).

(2) Losses Arising from Investment

Since s. 35(2) exempts the application of s. 35(1) to losses from the trust arising from breaches relating to the investment of property, a different standard must be examined. Changes to the Act came into effect on July 1, 1999[25] to reflect the need for flexibility regarding investment decisions on the part of trustees while continuing to protect beneficiaries. Replacing the former enumeration of authorized investments in the old ss. 26 and 27 of the Act, the "prudent investor" standard and other guiding principles now govern the investment of property. It is important to note that these provisions are retroactive and govern the investment of trust property where the trust instrument is silent on the matter, since s. 27(9) specifically condones overriding provisions in the trust instrument.

Section 27 lays out the standard of care for trustees making investments, in part, as follows:

> 27. (1) Standard of care — In investing trust property, a trustee must exercise care, skill, diligence and judgment that a prudent investor would exercise in making investments.
> (2) Authorized investments — A trustee may invest trust property in any form of property in which a prudent investor might invest . . .

The section continues, in s-s. (5) and (6), to outline criteria to be considered in planning the investment and requires the trustee to diversify when appropriate. In addition, s-s. (7) and (8) specifically permit trustees to obtain investment advice and provide that such advice may be relied upon as long as a prudent investor would rely on the advice.

Section 28 deals specifically with the protection of trustees from liability. It states that a trustee is not liable for a loss to the trust arising from the investment of property where the trustee's conduct "conformed to a plan or strategy for the investment of the trust property comprising reasonable assessment of risk and return, that a prudent investor could adopt under comparable circumstances". It is likely, in determining whether a satisfactory plan or strategy was applied, that a court will seek evidence regarding the seven criteria enumerated in s. 27(5). Thus, trustees should be diligent in documenting these steps.

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25. *Red Tape Reduction Act, 1998*, S.O. 1998, c. 18.

5. The Future of the Exemption Clause in Ontario

As described in the preceding section, statutory provisions exist which describe the standards under which trustees will be relieved from a breach of trust. Regardless of whether an exemption clause is included in a trust instrument, the provisions apply. Thus, presumably, if a testator wished to hold trustees to the same standard as outlined in the statute, an exemption clause would be redundant. That said, it may remove the need to defer to judicial discretion. If, on the other hand, a different standard than is provided by the Act is desired, an exemption clause may be in order.

Although Canadian courts have not considered the issue in any depth, it seems as though, while some standards may be approved, a complete exoneration in a trust instrument is not enforceable.

> Should the settlor go further and attempt to exonerate his trustee from liability for loss or damage howsoever occurring, this must surely be held invalidthe fact remains that a total exoneration of liability, including the exercise of good faith, must be contrary to public policy. Not only is a trustee a fiduciarybut the essence of a trust is a beneficiary's right of recourse against the trustee for improper administration, and if the beneficiary is altogether denied that recourse it is highly questionable whether the settlor has created a trust at all.[26]

The OLRC has taken the same approach, stating:

> We therefore recommend that no term in a trust instrumentshould be valid to the extent that it purports to exonerate trustees from liability for failure to exercise the degree of care, diligence, and skill that a person of ordinary prudence would exercise in dealing with the property of another person.[27]

This position seems to go even one step further than Waters (who casts doubt as to the validity of a clause which purports to provide the trustee with a total exoneration of liability), indicating that no clause may purport to relieve trustees from liability under a lower standard than enunciated in the Act.

As previously stated, *Poche* is the only judicial indication of the Canadian position on the enforceability of exemption clauses in trust instruments. That case held that the estate trustee could not be relieved of liability by virtue of the exclusion clause for loss caused by her grossly negligent conduct. It remains to be decided whether general negligence would be treated the same way.

It has been stated that the following principles would likely be

26. Waters, *op. cit.*, footnote 7, at p. 927 [*Waters' Law of Trusts*].
27. OLRC, *op. cit.*, footnote 1, at pp. 41-42.

adopted if the courts were, once again, asked to consider the enforceability of exclusion clauses in trust instruments:

1. an exculpatory clause cannot excuse liability for acts of gross negligence;
2. an exculpatory clause cannot excuse liability for wilful defaults or intentional wrongdoing;
3. an exculpatory clause cannot excuse liability for acts of fraud or dishonesty; and
4. an appropriately drafted exculpatory clause will be effective to relieve a trustee from liability for breaches of trust of lesser culpability than acts of gross negligence, intentional wrongdoing or bad faith.[28]

The English court of Appeal, in *Armitage*, correctly stated that, if exemption clauses "are to be denied effect, then in my opinion this should be done by Parliament which will have the advantage of wide consultation with interested bodies".[29]

One concern with abolishing exemption clauses is that arguably trustees would be reluctant to take on the post without them. However, if the relevant legislation protects trustees to a sufficient extent, this would no longer be of concern. It remains to be seen whether the statutory exemptions in the Act will amount to adequate protection to trustees, or whether further amendments will become desirable.

28. Donovan W.M. Waters, *Law of Trusts in Canada*, 2nd ed. (Toronto: Carswell, 1984), at pp. 756-7.
29. *Armitage*, *supra*, footnote 12, at p. 256.