

RIGHTS OF CREDITORS AGAINST TRUSTEES AND TRUST FUNDS

TRUST LAW COMMITTEE REPORT

1.0 INTRODUCTION

1.1 This report makes recommendations for reform of the law relating to rights of creditors against trustees and trust funds. In April 1997, we published a Consultation Paper (*via* Tolley Publishing Co Ltd and with the assistance of the Society of Trust and Estate Practitioners) in which we set out in detail the unsatisfactory and, in some places, uncertain state of the law and then made a range of proposals for reform. We set out a summary of questions for responses and invited the submission of answers, observations and suggestions from interested individuals and organisations. We received many valuable comments for which we are most grateful. A list of the commentators is contained in Appendix A. We also had the benefit of a half day Conference organised by the Society of Trust and Estate Practitioners on the afternoon of 8 July 1997 (attended by 62 persons) and the benefit of a Discussion Forum hosted by Freshfields on 29 January 1998 (attended by 40 persons).

2.0 THE PRESENT STATE OF THE LAW AS TO CONTRACTUAL

DEALINGS

2.1 No commentator took issue with our exposition of the law affecting creditors' rights against trustees and trust funds, so that we will only summarise the law to the extent needed to explain our suggested reforms, referring readers to our Consultation Paper for further background detail.

2.2 Where creditors contract with a trustee, it may be that they both think that the trustee (especially if he contracts "as trustee") is acting as agent of the trust so as to make the trust liable to be sued or able to sue. This trap has caught out many a trustee, as happened in two cases¹ decided since we prepared our Consultation Paper. Because a trust is not a legal entity like a company, it cannot be a principal and so cannot have an agent. Moreover, since it is not an artificial person like a company, no *ultra vires* rules can apply to it nor can rules analogous to company law rules enabling third parties to assume that internal procedures have been complied with² or that particular persons have ostensible or apparent authority³.

2.3 Instead, the individual or company that is trustee is personally liable to the full extent of his, her or its private wealth unless in the contract with the creditor there is a provision limiting liability e.g. to the extent that there are trust assets out of which the trustee can be indemnified. The contract cannot be *ultra vires* an individual who is trustee because individuals have the full capacity of natural persons to enter into contracts⁴. Where a company is trustee, its actions will nowadays normally not be affected by lack of capacity under its memorandum of association due to the

¹ Perring v Draper July 2, 1997, Mantell J [1997] EGCS 109; Marston Thompson & Evershed PLC v Bend September 19, 1997, Chadwick J (1997) Law Soc Gazette 94/39, 15 Oct 1997

² Royal British Bank v Turquand (1856) 6 E & B 327, Companies Act 1985 ss. 35A, 35B

³ E.g. Freeman & Lockyer v Buckhurst Park Properties Ltd [1964] 2 QB 480

⁴ De Vigier v IRC [1964] 1 WLR 1073, 1083

protection accorded to third parties dealing in good faith with an English company⁵. Hence, individual or corporate trustees will have their contractual obligations as trustee enforceable against them personally in accordance with normal contract principles.

2.4 However, where the contractual liability was properly incurred in the performance of T's duties and powers as trustee, T has a right of indemnity out of the trust fund, entitling him to pay the relevant amounts directly out of the trust fund or to reimburse himself if he paid the amount out of his own pocket. Unfortunately, for a creditor, C, who seeks to take advantage of T's right of indemnity, risks arise because T's liability to C may have been improperly incurred due to any of the following three reasons:

- (i) Lack of capacity: T may not have been empowered by the trust instrument or by law to enter into the contract.
- (ii) Lack of due authorisation: T's power to contract with C may not have been exercised in accordance with an internal procedure requisite to its exercise e.g. only two of three trustees agreed when unanimity was required, they agreed unanimously but failed to obtain the consent of X or failed to have a meeting before circulating an agreement that they signed.
- (iii) Breach of equitable duties: T's power may have been exercised in breach of T's duty to diversify investments, to supervise agents, to invest with the care of a prudent businessman mindful that he is dealing with others' property, to take account of relevant considerations and to ignore irrelevant considerations.

⁵ Companies Act 1985 ss. 3A, 4, 35, 35A, 35B, subject to Charities Act, s.65

2.5 Even if C overcomes these hurdles, there is a fourth hurdle to overcome:

(iv) Unconnected indebtedness of T to the trust: T may be indebted to the trust by reason of some conduct totally unconnected with the proper transaction with C, such as some breach of trust occurring before or after the contract with C. Thus, if there is a properly incurred debt of £900 for goods supplied by C but T becomes insolvent owing £400 to the trust, T cannot deny that he has £400 of trust money available to pay C, so C has to look to T for this £400 and can only claim the balance of £500 from the successor trustee, T₂, who can pay this out of the trust fund⁶.

2.6 The problem with the above four situations is that C steps into T's shoes by way of subrogation and can have no higher rights than T to whom C gave credit: T cannot claim any money from the trust before making good any deficiency on the taking of accounts between T and the trust. However, a fifth hurdle may arise where T is replaced by T₂.

(v) Where T is replaced by T₂, then, just as C's only route to the trust fund is *via* T when T is trustee thereof so, when the trust fund is vested in T₂, C's route against T with whom C contracted will have to be extended against T₂ *via* T's right to an indemnity against T₂, which possibly may be ineffective to the extent T₂ is indebted to the trust for any reason. Thus, it is possible that a fifth hurdle may arise where T is replaced by T₂.

⁶ Re British Power Traction & Lighting Co Ltd [1910] 2 Ch 470 but where there are co-trustees C can take advantage of the right of indemnity of a co-trustee who is not indebted to the trust: Re Frith [1902] 1 Ch 342

2.7 Can C do anything to overcome these five hurdles in the absence of the settlor having made some special express provision in the trust instrument to protect creditors dealing in good faith with trustees of the trust?

3.0 PROPOSALS FOR TACKLING THE PRECEDING PROBLEMS

Hurdles 4 and 5

3.1 The unconnected indebtedness of T or T₂ (giving rise to the fourth and fifth hurdles just discussed) is immaterial if, to secure the debt to C, T created a fixed charge over particular trust assets or made C a beneficiary in the fluctuating trust fund (so as to have an equitable fluctuating or floating charge), but with preferential claims over the settlor's beneficiaries and over the trustee's right to an indemnity for paying unsecured creditors and, perhaps, for paying its own trusteeship fees. Power to create such a floating charge is unusual but is permitted by law if expressly provided for in the trust instrument. The vast majority of responses to our Consultation Paper favoured statute prospectively conferring upon all trustees (subject to any contrary intention in the trust instrument and subject to section 38 of the Charities Act 1993) power to create a fixed charge over trust assets or a floating charge over the fluctuating trust fund, and leaving it to the good sense of the trustees in complying with their equitable duties whether or not to exercise such power. **We recommend the enactment of such a default power**, protection of such charges and priority thereof being subject to the currently applicable law, on which see Consultation Paper paras 2.38-2.42, 3.9-3.10.⁷

⁷ Chief Commissioner of Stamp Duties v Buckle (1998) ALJR 242 reinforces our view that while many trust creditors *ex abundante cautela* register under s. 395 Companies Act their charges over property owned by a Company as trustee (rather than privately for its own benefit) this is not necessary, the trustee, T, not having any beneficial interest or

3.2 Instead of circumventing the unconnected indebtedness problem by making C a secured creditor, can T, in the absence of an express power in the trust instrument, circumvent the problem by an express term in the contract with C which gives C a direct indemnity by way of an unsecured right of recourse to the trust fund (and not against T personally at all, or only if the trust fund proves inadequate) independent of any indebtedness of T to the trust? T can do this if the power conferred by the settlor for T to enter into the contract is construed as implicitly extending to agreeing such an express term in C's favour if negotiated as part of the "price" of the contract.

3.3 It may be that the English courts, like American courts, will favour such an implicit construction. The vast majority of responses to our Consultation Paper favoured the promotion of certainty by way of a new statutory provision prospectively presuming, in the absence of contrary provision in the trust instrument, that a trustee's power to enter into a contract extends to authorising an express term of the contract affording the other party a direct indemnity by way of an unsecured right of recourse to the trust fund, independent of the state of accounts between the trustee and the trust fund.

3.4 We would recommend such a power if we did not think that reform should go further. It seems to us most unjust that unconnected indebtedness of a trustee to the trust, which is most unlikely to be owned up to by the trustee if existing at the time of a contract with a creditor and which is completely undiscoverable by such creditor, if arising after the contract, should ever prejudice the rights of the creditor in any way and fortuitously benefit the beneficiaries. The position is stronger than that arising where the trustee was in breach of his equitable duties in agreeing to the contract

charge in respect of the property. Only when an account is taken at a particular time (balancing what is due to T against T's indebtedness e.g. for breaches of trust) is it known that a specific sum is due to T, so that, as a necessary incident of

and dealt with below (paragraphs 3.9 - 3.11). **Thus, we recommend that the indebtedness of a trustee that is not connected with the contract with the creditor should not prevent such creditor having a right to be indemnified out of the trust fund** (although preventing the trustee from having such a right of indemnity).

Hurdles 1 and 2

3.5 In respect of the first hurdle of lack of capacity, one can legitimately expect that if C is not prepared to rely on the personal liability of T due to the relative impecuniosity of T, then C should investigate whether the projected contract is *intra vires* the trust instrument, taking account of any statutory default powers applicable to the trust. After all, C will want wherever possible to be a *bona fide* purchaser without notice of any breach of trust.

3.6 Such investigation should help in respect of the second hurdle of lack of authorisation by revealing any internal procedures required to be satisfied before the projected contract is duly authorised, although proof of whether or not such procedures have been satisfied may require some further investigation or may require reliance on the word of some trustee(s). However, it will be relatively easy to determine whether all or the requisite majority of trustees have agreed to the transaction. Where C is a purchaser of unregistered land from a trustee, he has extensive protection unless having actual notice of lack of due authorisation⁸, but where C may be regarded as a purchaser of trust money or of an obligation to pay trust money in return for goods or services supplied by C to the trust, he has no similar statutory protection.

the office of trustee, T may seek authorisation from the court to sell trust assets in order to obtain reimbursement if insufficient trust cash is available for such purpose.

⁸ Trusts of Land and Appointment of Trustees Act 1996, s.16 inapplicable to charity trustees by s. 16(6) and to registered land by s. 16(7). In the case of registered land if no restriction is entered on the register (e.g. as to the need

3.7 In company law, the courts developed the principle that creditors dealing with persons conducting the affairs of the company are not to be affected with any irregularities taking place in the internal management of the company unless having knowledge of them⁹. In the commercial trading context, it was sensibly felt appropriate to subordinate the interests of shareholders to the interests of those in the marketplace in the general interests of facilitating speedy commercial dealings, so as generally to benefit companies and their shareholders.

3.8 It seems likely that the House of Lords will not regard it as sensible similarly to subordinate the interests of beneficiaries under family trusts or pension trusts or charitable trusts (as opposed to trading trusts), so preserving a significant distinction between trusts and companies. However, in practice, in England if one wants to trade, the corporate vehicle is used rather than the trust and, indeed, trustees can use an underlying company to carry on a trade. Moreover, if a settlor sets up a well-endowed trust where many dealings with creditors are anticipated, he can insert an express clause in the trust instrument to protect creditors dealing in good faith with the trustees or their agents. We therefore make no proposal here for reform of trust law concerning hurdle 2, although there was a majority of responses to our Consultation Paper in favour of reform.

Hurdle 3

3.9 Checking whether or not T will be guilty of a breach of equitable duty if he concludes the contract with C is the most difficult and unsatisfactory third hurdle for C to surmount. Without detailed inquiries, which the trustees and the beneficiaries (wanting privacy) may well resent, how

for consents) a purchaser will take free from matters not protected by such entry: Land Registration Act 1925, ss. 20 and 23.

⁹ Royal British Bank v Turquand (1856) 6 E & B 327, Mahoney v East Holyford Mining Co 1875 LR 7 HL 869.

can C know whether T is in breach of his duty to diversify investments or to supervise the agent dealing with T or to take account of a particularly relevant consideration, or has failed to measure up to the standard of care required to be exhibited in contracting with C. It is not far short of astonishing that if C knows that T is a trustee but desires to be able to have recourse to the trust assets (in case T cannot personally satisfy a judgment obtained by C) then, if C believes he is clearly getting the better of the bargain with T, C has to disclose this to T in order that T does not become guilty of breach of trust for negligently failing to safeguard the interests of the beneficiaries. Creditors are thus effectively placed in the position of a fiduciary.

3.10 It is thus possible that the House of Lords or a bold Court of Appeal might refuse to follow nineteenth century cases and the full logic of C's right being a derivative right of subrogation to T's rights, and thus allow C a right of recourse to the trust fund where T was in breach of his equitable duties in his dealings with C, so long as C is in the position of a *bona fide* purchaser without notice of the breach. Outside the conveyancing context, in commercial dealings with a trustee, there should be no scope for traditional constructive notice¹⁰ allegedly based on a duty to inquire whether there are possible breaches of equitable duties: instead, a purchaser should only be bound by breaches of which he has actual knowledge so as to be dishonest in proceeding with the transaction.

3.11 However, the time it takes for an appropriate case to arise and to be appealed, the costs incurred by the losing litigant and the unreimbursed costs of the winning litigant, coupled with the uncertainties as to the precise principles to be developed by the appellate courts, surely militate strongly in favour of legislative reform to provide the appropriate fair balance between the interests of creditors and the interests of beneficiaries. The vast majority of responses to our Consultation Paper favoured the reforming certainty of a new prospective statutory provision that a trustee's

¹⁰ *Macmillan Inc v Bishopsgate Investment Trust plc* [1995] 3 all ER 747, 769, 783.

breach of his equitable duties in dealing with a creditor shall not prevent such creditor having a right to be indemnified out of the trust fund unless such creditor was dishonest in the sense established by Royal Brunei Airlines v Tan¹¹. **We recommend the enactment of such a provision** to deal with hurdle 3.

3.12 A further point arises that will give more effect to the expectations of ordinary creditors dealing with T as a trustee, and so believing that they will have rights against the trust fund as an entity if T does not pay up. Several responses to our Consultation Paper went beyond the questions therein to deal with the expectations of ordinary individuals expressly contracting “as trustee” with a creditor, these individuals then believing that, if such contract is properly entered into, they can only be liable to the extent that the trust fund is sufficient to discharge the relevant contractual liability. Such belief, based upon the false premise that T is acting as agent for the trust, is a common one amongst laymen¹², although trust lawyers may consider it obvious that a trust is not a legal entity like a company, so that the trustees must be contracting personally when they cannot be agents of the trust. A similar belief based on the same sort of false premise arises amongst many laymen who contract “as executor” or “as administrator” or “as personal representative” in the course of administering a deceased’s estate.

3.13 The responses suggested that if fundamental reforms were not to make the trust primarily liable as an entity (albeit without legal personality) at the very least, if an individual contracted “as trustee” with a creditor and the contract was properly entered into, then such individual trustee, T, should not be personally liable to the creditor beyond the value of the trust fund at the time the creditor requests payment. Exceptionally, where T knew of a liquidated amount that is due or will

¹¹ [1995] 2 AC 378.

¹² Perring v Draper [1997] EGCS 109, Marston Thompson & Evershed PLC v Bend 1997 Law Soc Gaz 94/39, 15 Oct 1997

become payable on a contingency (eg, repayment of a loan) and yet reduced the value of the trust fund by making distributions to beneficiaries or incurring further obligations that were not reasonably necessary for the preservation of trust assets, T should also be personally liable to the extent of such reduction in value. Such construction of contracting “as trustee” could, of course, be ousted by contrary intention in the contract.

3.14 While persons contracting “as receiver” can be expected to have proper legal advice available to them, it seems to us that individuals contracting “as trustee” or “as executor” or “as administrator” or “as personal representative” can properly be expected to act without having recourse to legal advice, in which case the law should give effect to expectations of ordinary mortals rather than create a trap for them. **We thus recommend the enactment of legislation that, in the absence of a contrary intention in the contract, when an individual contracts “as trustee” or “as executor” or “as administrator” or “as personal representative” with another person, the individual shall not be personally liable to such person beyond the value of the trust fund or the deceased’s estate at the time the other person requests payment; but, exceptionally, where the individual knows of a liquidated amount that is due or will become payable on a contingency and yet reduces the value of the trust fund, by making distributions to beneficiaries or by incurring further obligations that are not reasonably necessary for the preservation of the trust assets, such individual shall also be personally liable to the extent of the reduction in value.**

4.0 MORE FUNDAMENTAL REFORM?

4.1 The Chancery Bar Association “regards reform of this area of the law as highly desirable”, stating “The present law is ill-understood and uncertain, and clarification is the least required.

More importantly, the law does not match the reasonable expectations of parties dealing with trustees or of trustees themselves and their beneficiaries, and should be modified to match those expectations.” While favouring modification and clarification of the existing law on the lines indicated in the preceding section of this Report, the CBA states “more fundamental reform” is needed along the lines canvassed in our Consultation Paper *viz.* regarding the trust fund as the primarily liable entity (albeit having no legal personality, but being treated like a separate patrimony of assets coupled with liabilities) with the trustee having a secondary personal liability unless excluded by the contract with the creditor or perhaps only if included in the contract.

4.2 A similar stance is taken by the Charity Commission, the Association of Pension Lawyers, the National Association of Pension Trusts and the Society of Trust and Estate Practitioners and the majority of individual responses.

4.3 However, the Law Society’s Land and Succession Committee came out strongly against fundamental reform, while The Association of Corporate Trustees also opposed fundamental reform, as did the minority of individual responses. At the STEP Conference on 8 July 1997, the majority opposed fundamental reform, while at Freshfields’ Discussion Forum on 29 January 1998, everyone opposed fundamental reform on the basis that the primary liability of the trust fund was most inappropriate where the trust was a commercial security device. The view was that minor reforms coupled with taking the precautions¹³ set out in the October 1997 Financial Law Panel Paper, “Financial Dealings with Trustees”, sufficed to provide a satisfactory situation.

¹³ See Appendix B

4.4 In view of such a clear division of opinion, we see little point in proceeding further to consider the fundamental reforms canvassed in our Consultation Paper. We do, however, need to consider certain insolvency matters.

5.0 INSOLVENCY OF THE TRUST FUND

5.1 No insolvency regime applicable to individuals or to companies is applicable to trusts, so that an administration order under RSC Order 85 will need to be sought where recourse is sought against the assets of an insolvent trust fund. It seems likely that the priority order that the court would lay down would be (1) creditors with fixed charges, (2) creditors with floating charges, (3) preferential creditors, (4) general creditors. It would also seem that, before rateable reduction of claims, general creditors with rights of indemnity against the trust fund conferred by virtue of the trust instrument irrespective of the trustee's indebtedness to the trust and of any failure by the trustee to act properly, should be credited with the full amount of their claims but that general creditors with derivative rights under the trustee's right of indemnity should be credited only with a rateable amount of the amount available to the trustee under his right of indemnity.

5.2 Advantage may as well be taken of legislation in the area of creditors' rights against trustees and trust funds to clarify the order of priority on the lines suggested above. **We, therefore, propose such legislative clarification.**

6.0 CONTRACTUAL NETTING AND STATUTORY SET-OFF ON INSOLVENCY

6.1 Contractual netting agreements are prevalent in the financial markets, whether for the netting of payments to be made in the course of the contractual relationship (“settlement netting”) or for the netting of liabilities in the event that the relationship is terminated (“close-out netting”). Netting, with its effect of conferring security on a creditor, only becomes crucial where insolvency of a party occurs. However, as explained in the Consultation Paper paras 2.47-2.50, upon insolvency, contractual provisions cannot oust the statutory set-off rules in section 323 Insolvency Act 1986 (dealing with bankrupt individuals) or rule 4.90 of the Insolvency Rules 1986 (dealing with insolvent companies). Such rules apply where there have been mutual credits, debits or other dealings between the defaulter and the creditor who in respect of each other are personally liable on the debt owed and beneficially entitled to the debt due.

6.2 Fortuitously, these rules cannot apply to the relationship between a trustee and a creditor because of lack of mutuality, a trustee not being beneficially entitled to the creditor’s debt. Thus, so far as the trust beneficiaries are concerned, a contractual netting agreement between a trustee and a creditor will take effect according to its terms, assuming the contract was properly entered into by the trustee without breach of any equitable duties, although the amount available for netting will be reduced to the extent that the trustee happens to be indebted to the trust where the creditor’s claim is by way of subrogation. This most unsatisfactory feature will disappear if our recommendations in paragraphs 3.4 and 3.11 are implemented, so that unconnected indebtedness of a trustee becomes irrelevant or it becomes clear that direct but unsecured recourse to the trust assets can be conferred by a contract.

6.3 In the absence of a contractual netting agreement, what happens on the insolvency of a trustee or of a trust fund? The insolvency of a trustee does not matter if the fund is solvent. It is immaterial that the creditor has to pay in if the trust fund can pay out, the contract being properly

incurred, and assuming there is no problem arising from any unconnected indebtedness of the trustee to the trust.

6.4 If the trust fund is insolvent (and recourse to the trustee is unavailable or inadequate), the statutory set-off provisions cannot apply because a trust is neither an individual nor a company. The trust will need to be wound up by the court under a creditor's administration action under RSC Order 85. It seems likely that the court will, by analogy to the automatic statutory set-off rule, allow a trust to be treated as a quasi-person for mutuality purposes so as to permit set-off to the extent that the creditor's claim is not a derivative claim reduced by any unconnected indebtedness of the trustee to the trust (although our recommendation in paragraph 3.4 would exclude any such reduction).

6.5 Virtually all those responding to our Consultation Paper on this point supported the application of a rule like the statutory set-off for insolvent individuals and corporations to insolvent trust funds. This can be provided for in the new statutory provisions already recommended for the rules of priority of creditors against insolvent trust funds. **We therefore recommend addition of such a statutory set-off rule to such new statutory provision**, such rule, like the rule for insolvent individuals and corporations, ousting contractual netting rules when insolvency arises.

6.6 Such new rule will also assist to make the law certain and clear where it is the creditor which is insolvent and not the trustee nor the trust fund, although it may well be that, despite the lack of mutuality currently required for application of the statutory set-off rule, the trustee may be able to take advantage of the doctrine of retainer to retain money due to the creditor until receipt of money due from the creditor.

7.0 TORTIOUS LIABILITY

7.1 In the absence of fundamental reform (which we do not recommend), the question does not arise whether the trust fund should be primarily liable for claims in tort as well as in contract. However, if the breach of equitable duties by a trustee and the unconnected indebtedness of the trustee to the trust are, as we recommend (following the vast majority of responses to our Consultation Paper), not to oust a creditor's rights of recourse to the trust fund by way of subrogation to the trustee's right of indemnity where the creditor's contractual right against the trustee personally is inadequate (due to the trustee's impecuniosity), then it makes sense for the position to be the same for tortious rights of creditors.

7.2 After all, where the settlor makes it possible for his trustee to commit torts in the proper or improper administration of the trust and the trustee cannot satisfy the claim of the victim of the tort, why should the loss not be borne by the trust fund rather than the victim of the tort, who can take no special precautions to protect himself against trustee tortfeasors? **We therefore recommend that, to the extent that the victim of a tort committed by a trustee in the proper or improper administration of the trust cannot recover damages in full from the trustee, he should be entitled to have recourse to the trust fund, irrespective of any unconnected indebtedness of the trustee to the trust fund or of any breach of the trustee's duties.**

8.0 LIMITATION OF LIABILITY ARISING FROM HOLDING TITLE TO THE TRUST PROPERTY

8.1 Virtually all responses to our Consultation Paper favoured the general principle that the liability incurred by a trustee as title holder of trust property should be limited to the extent of such property where the trustee is without fault for the liability and for the insufficiency of the trust fund to satisfy the liability. This principle seems necessary to accord with a fundamental sense of natural justice and so as not to deter persons from acting as trustees.

8.2 Such principle, if enacted, has significant implications for tortious liability and statutory liabilities relating to taxation and to the environment. Lack of detailed responses on this issue leads us to consider that further research and further consultation is required before any recommendations can be made.

9.0 NO DISCRIMINATION BETWEEN TYPES OF TRUSTS

9.1 While one can try to distinguish between different types of trusts (e.g. family trusts, commercial trusts, charitable trusts, pension trusts), the vast majority of responses to our Consultation Paper considered the canvassed issues to relate to trust law generally. **We therefore recommend that the new statutory provisions apply to all trusts** (subject to some statutory limitations affecting charitable trusts e.g. sections 38 and 65 Charities Act 1993).

10.0 SUMMARY OF RECOMMENDATIONS

Statutory Reforms

10.1 Subject to any contrary intention in the trust instrument and for any purpose considered by the trustees to further the interests of the beneficiaries or objects of the trust, trustees have power to create for valuable consideration a fixed legal or equitable first or subsequent charge over particular trust assets or a floating charge over the trust fund, so covering whatever assets from time to time happen to comprise the trust fund. (See paragraph 3.1 above and Consultation Paper paragraphs 2.37-2.42. 4.15-4.17).

[Such power should be available to all trusts as opposed only to trusts created after the legislation comes into force. Trustees should not exercise this extra facility if such would break their equitable duties e.g. of care]

10.2 The indebtedness of a trustee to the trust at the time a contractual creditor or a victim of a tort seeks an indemnity out of the trust fund shall not be a reason for refusing such an indemnity.

[Such provision should apply to contracts concluded, or torts committed, after the legislation comes into force]

10.3 (a) Subject to any contrary intention in the trust instrument, where a trustee's entry into a contract with a creditor was in breach of his equitable duties this shall not prevent such creditor having a right of indemnity out of the trust fund unless he was dishonest.

(b) Where a trustee's conduct as trustee makes him a tortfeasor and such conduct amounted to a breach of his equitable duties this shall not prevent the victim of the tortious conduct from having a right of indemnity out of the trust fund.

[Such provisions should apply to contracts concluded, or torts committed, after the legislation comes into force]

10.4 Where an individual, who is a trustee or an executor or an administrator or a personal representative, contracts with a person "as trustee" or "as executor" or "as administrator" or "as personal representative", he shall be rebuttably presumed not to contract otherwise than in such capacity and be liable personally no further than the value of the trust fund or the deceased's estate at the time the other person requests payment; provided that, if such representative individual knew of a liquidated sum that is due or will become payable at a future date but reduced the value of the trust fund, by making distributions to beneficiaries or by incurring further obligations that were not reasonably necessary for the preservation of trust assets, he shall also be personally liable to the extent of such reduction in value.

[Such provision should apply to contracts concluded after the legislation comes into force.]

10.5 (a) Where a creditor seeks an administration order under RSC Order 85 in respect of a trust fund that is insolvent the rights of the following creditors shall rank in the following order:

- (i) creditors with fixed charges;
- (ii) creditors with floating charges;
- (iii) preferential creditors;
- (iv) general creditors.

(b) In making a rateable distribution among general creditors those with derivative rights by way of subrogation to a trustee's right of indemnity shall be credited only with a rateable amount of the sum that the trustee can claim under his right of indemnity, while those with rights of indemnity conferred by virtue of the trust instrument irrespective of the trustee's indebtedness to the trust or of any failure by the trustee to act properly shall be credited with the full amounts of debts found due to them.

(c) (i) Where before the institution of proceedings under RSC Order 85 in respect of an insolvent trust fund there have been mutual credits, mutual debts or other mutual dealings between the trustee of such trust fund and any creditor of such trustee, an account shall be taken of what is due from each party to the other in respect of the mutual dealings and the sums due from the other; only the balance (if any) of such account is provable as a debt in the insolvency of the trust fund or, as the case may be, is to be paid over as part of the assets of such trust fund.

(ii) For the purpose of ascertaining the said mutual credits, mutual debts or other mutual dealings, a trustee shall be regarded as beneficially entitled to sums due from a creditor and as personally liable in respect of sums due to a creditor.

[Such provisions should apply to RSC Order 85 proceedings instituted after the legislation comes into force]

Interim practical considerations

10.6 We endorse the practical precautions recommended by the Financial Law Panel and set out in Appendix B hereto.

10.7 We also encourage a person dealing with a trustee to consider whether to insert in the contract a clause expressly stating that it is entered into on the basis that the creditor shall not be prevented from having a right of indemnity against the trust fund by reason of any unconnected indebtedness of the trustee to the trust fund at the time payment is sought from the trustee out of the trust fund, the authority for the trustees to enter into the contract extending to such term being part of the price of the contract (see Consultation Paper paras 2.35 and 4.1)

10.8 Finally, to strike a fair balance between the interests of beneficiaries and the interests of third parties dealing with the trustees and to encourage and facilitate

commercial dealings (particularly those needing to be concluded in a very short period of time), those drafting trusts should consider whether it is appropriate to have the flexible facility of an express clause along the lines of the clause in Appendix C, which could apply always or only when decided upon by the trustees.

APPENDIX A

Allen & Overy (Norris)
Allen & Overy (Turnor)
Anon
Association of British Insurers
Association of Pension Lawyers
Judge Paul Baker, QC
Barclays Bank plc, London
Baxendale Walker, Solicitors, London
Philippa Blake-Roberts, London
Chancery Bar Association
Charity Commission, James Dutton
Charles Russell, Solicitors, London
Chartered Institute of Taxation
Lenora Cohen, London
Credit Lyonnais
Cummins, CA, Blackpool
Dixon Wilson, CA, London
Master Dyson, Chancery Chambers
Federation of Private Resident Associations
Martin Goodwin, Solicitor, London
Charles Harpum, (personally)
Andrew Hine, Solicitor, London
Law Society: Land Law & Succession Committee
Letter from Switzerland
Lloyds Bank plc
Lloyds TSB Group plc (Legal Dept)
Mercury Asset Management
Dr Charles Mitchell, King's College London
Nat West
National Association of Pension Funds Ltd
National Council of Voluntary Organisations
Osborne Clark, Solicitors, Bristol
Payne Hicks Beach (Jarman)
Rooks Rider, Solicitors, London
Russell-Cooke, etc, Solicitors, London
Schroders, London
Sheltons, Solicitors, Nottingham
STEP, Simon Jennings
TACT, Private Trusts Committee
Taylor Joynson Garrett, Solicitors, London
Professor A Tettenborn, Exeter University
Theodore Goddard, Solicitors, London
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APPENDIX B

FINANCIAL LAW PANEL

CHECKLIST FOR DEALING WITH TRUSTEES

Counterparty

- Who are the trustees?
- Have the trustees been properly appointed?
- Have the trustees appointed an agent?
- What are the delegation powers of the trustees?
- Is the appointment of the agent within the delegated powers of the trustees?
- What restrictions apply to the trustees' ability to delegate investment decisions to the agent?
- Have those restrictions been complied with?

Capacity

- What are the investment powers of the trustees?
- Does the proposed transaction fall within the investment powers of the trustees?
- What is the investment mandate of the agent?
- Does the proposed transaction fall within the investment power of the agent?

Authority/Powers

- What restrictions apply to the trustees' ability to enter into the proposed transaction?
- Have those restrictions been complied with?
- What restrictions apply to the agent's ability to enter into the proposed transaction?

- Have those restrictions been complied with?
- Are the trustees affected by any binding undertakings given by them or their predecessors?

Proper exercise of trust powers by pension fund trustees

- Does the transaction fall within the statement of investment principles prepared by the pension fund trustees in accordance with the Pensions Act 1995?

Rights of recourse

- What are the express rights of recourse enjoyed by the trustees?
- Do the trustees have an indemnity from an outside party (e.g. the employer)?
- To what does the indemnity extend?
- What is the financial standing of the trust fund?

Security

- What are the powers of the trustees to give security?
- What assets are available over which security can be taken?
- What prior rights exist in those assets?
- How does the security need to be perfected?

APPENDIX C

“(a) A person (“the creditor”) who knowingly deals with the Trustee in circumstances where the Trustee reasonably appears to have power to deal with him shall not be prevented from being indemnified out of the Trust Fund (whether owned by the dealing Trustee or by any successor Trustee at the time the right is sought to be exercised against such Trustee-owner) in respect of any liability of the Trustee arising out of such dealing, despite the Trustee’s actual lack of power to enter into such dealing, despite such dealing being in breach of the Trustee’s equitable duties and despite the existence of any money due to the trust from the dealing Trustee or any successor Trustee [where the dealing arises out of a written contract which refers to the creditor having the benefit of this clause].

(b) For the purpose of determining whether or not the Trustee reasonably appears to have power to deal with a person by virtue of any provision in the Trust Deed, a person shall be entitled to rely upon the Trustee producing a photocopy of trust powers certified by the Trustee as being the relevant powers conferred by the Trust Deed: a person dealing with the Trustee has no right to examine the Trust Deed unless so authorised by statute.”