Re: Trust Law (Amendment) Bill 2013

Position Paper of
the Hong Kong Bar Association

A. Introduction

1. After two rounds of public consultation (initiated in June 2009 and March 2012 respectively), the Administration put forward the Trust Law (Amendment) Bill 2013 (**"the Bill"**) for consideration by the Legislature.

2. This paper sets out the position of the Hong Kong Bar Association (**"HKBA"**) on the Bill.

3. Where necessary, reference will be made to the HKBA's previous position paper that was sent to the Administration in May 2012 (**"2012 Position Paper"**).

B. Proposals based on English legislation and reform

4. The Bill includes various provisions intended to introduce proposals modelled on the English legislation. These include provisions relating to:

   (1) Statutory duty of care;
   (2) Trustee's power to insure;
   (3) Beneficiaries' right to replace trustees;
   (4) Appointment of agents, nominees and custodians; and
   (5) Trustee's remuneration and expenses.

5. In the 2012 Position Paper (at §7), the HKBA's general position was that the above categories of proposals modelled on the English legislation could be followed in Hong Kong.

6. Upon consideration of the Bill, the HKBA sees no reason to depart from that position.

7. Further, given that the wording of the Bill substantially follows the equivalent English legislation, the HKBA generally has no comment on that wording.

8. However, there are a number of subsidiary drafting points which the HKBA wishes to bring to the Legislature's attention.

B1. Trustee's power to insure

Section 21[1]

9. This is modelled on the English legislation (section 19 of the Trustee Act 1925 as substituted by s. 34 Trustee Act 2000).

10. As pointed out in **Lewin on Trusts**, 18th edn., §34-58, it is unclear whether, for the purposes of this section, "bare trust" includes a trust in which the trustee has a lien on the trust property for some outstanding liability incurred by him in connection with the trust. The editors explain:

> *"[The English section] makes special provision for bare trusts, permitting the beneficiaries to give directions forbidding or restricting the exercise of the power. A trustee may, of course, have a personal interest in insuring the trust property, if he has a lien on it for some outstanding liability incurred by him in connection with the trust. It is not clear whether such a trust should be treated as a*

[1] Section numbers refer to those that would appear in the amended Trustee Ordinance (rather than section numbers in the amending legislation).

bare trust within the section (if it would otherwise qualify), so that the beneficiaries are entitled to forbid insurance. If it should, the provision appears in part to have reversed the rule [stated in X v A [2000] 1 All ER 490] that a trustee's powers to insure, being administrative powers, continue despite the fact that the trust property is otherwise held for one or more persons absolutely. If it should not, the provision has very little operation, since trustees holding lands or chattels will nearly always have some outstanding liability."

11. In light of the above, the Legislature may wish to consider whether to make this clear in the section (or alternatively in the Explanatory Memorandum).

B2. Appointment of agents

Section 41B

12. This is modelled on the English legislation (s. 11(1) Trustee Act 2000)

13. The draft section provides that *"The trustees of a trust may authorize a person..."*. This differs slightly from the English legislation (*"the trustees of a trust may authorise any person..."*).

14. We suggest replicating the wording of the English legislation to avoid any doubt that trustee may appoint any person as agent subject to the qualifications set out in s.41C.[2]

Section 41O(1)(b) and (2)(b)

15. This is modelled on the English legislation (s.23(1)(b) and (2)(b) Trustee Act 2000).

[2] Although s.41C is headed "Persons who may act as agents", it does not set out a general rule that any person may act as agent, but rather contains a number of qualifications.

16. As pointed out in **Pearce, Stevens & Barr: Law of Trusts and Equitable Obligations**, 5th edn., p.797, a literal reading of the section leaves it ambiguous whether a trustee who fails to conduct a review at all (as opposed to carrying out a review badly) would be liable. Although the courts would most likely adopt a purposive interpretation and regard trustees as liable for both unreasonable omissions and careless commissions, the Legislature may wish to make this clear in the drafting of the section (or alternatively in the Explanatory Memorandum).

B3. Trustee's remuneration

Sections 41S(3) and 41T(3)

17. This is modelled on the English legislation (ss. 28(3) and 29(3) Trustee Act 2000). As pointed out in **Lewin** (supra) at §§20-159 and 20-165, the wording of the section leaves it unclear (in the case of a professional trustee who is not a corporation):

    (1) Whether the payment/remuneration can be received by the trustee's firm (although the editors opine that this is implicit in the section); and

    (2) Whether the payment/remuneration covers fees for services rendered by the trustee *through the firm*.

18. The Legislature may wish to consider whether these two points should be made clear in the drafting of the section (or alternatively in the Explanatory Memorandum).

B4. Trustee's expenses

Section 41U(1)

19. This is modelled on the English legislation (s.31(1) Trustee Act 2000).

20. In general terms, a trustee's charge or lien (which secures his right of indemnity) extends over the whole trust fund so that a liability in respect of a part of the trust fund may be discharged out of any other part of the trust fund. As explained in **Lewin** (supra) at §21-34, this general rule was, as the law stood before the Trustee Act 2000, subject to two interrelated limitations:

(1) Where a trustee was authorised to apply part only of a trust fund in a particular manner, costs or expenses incurred by him in exercising his authority in that manner could be met only from that part of the trust fund.

(2) Where there were distinct funds held on separate trusts, a trustee was (except in certain circumstances) not entitled to indemnify himself against liabilities incurred in respect of one fund from another fund held on separate trusts.

The editors of **Lewin** (loc. cit.) point out that the literal wording of the section raises a doubt as to whether it intended to abolish the two above limitations. Although the editors believe that the courts are *unlikely* to perceive such an intention, the Legislature may wish to consider whether to make this clear in the section (or alternatively in the Explanatory Memorandum).

21. More controversial is whether the section is intended to reverse the traditional rules regulating which expenses should be borne out of income

and capital respectively[3], and instead confer a general discretion on trustees to allocate expenses between income and capital as they see fit:

(1) **Lewin** (supra) at §25-67 expresses the view that the section was *not* intended to alter the traditional rules:

> *"At any rate we find it hard to believe that, in enacting section 31(1), Parliament intended to give trustees a discretion to determine the ultimate incidence of expenses generally as they saw fit. It would enable them to throw income tax, or the cost of collecting rents, onto capital, and to throw inheritance tax, or the expenses of selling a family house, onto income...It seems to us to follow that the 2000 Act does not, in using the same words, confer any discretion on trustees to allocate between capital and income simply as they see fit either the remuneration of agents, the remuneration of nominees and custodians, or insurance premiums. We consider that the principles stated in the preceding paragraphs continue to apply."*

(2) **Thomas & Hudson: Law of Trusts**, 2nd edn, at §10.07 adopts a more guarded stance but is also doubtful that the section was intended to confer an unrestrained discretion to allocate the incidence of expenses:

> *"The general wording of section 31 would now seem to confer on trustees a very broad discretion as to the incidence of outgoings. However, how broad it is and for what purpose is not at all clear. One view is that section 31 merely authorizes trustees to resort to capital or income to meet proper expenses in the first instance, but that the ultimate incidence of such expenses would still need to be allocated or adjusted subsequently, in accordance with the general rules outlined above. Another view is that section 31 ought to be read literally. It is improbable that the legislation was intended to confer an uncontrolled discretion on the trustees,*

[3] For an explanation of those rules, see **Lewin** (supra) at §25-52 *et seq.* For instance, as stated in §25-52 (citing ***Carver v Duncan*** [1985] AC 1082 at 1120): *"The general rule is that income must bear all ordinary outgoings of a recurrent nature, such as rates and taxes, and interest on charges and incumbrances. Capital must bear all costs, charges, and expenses incurred for the benefit of the whole estate."*

so that, if they wished, they could, for example, throw on income all expenses normally falling on capital. Thus, even if section 31 has widened trustees' discretion in this area, it would seem that some constraints on that discretion are required, such as a requirement that they act fairly as between the income and capital beneficiaries. If this is the case, it would seem likely that the general principles outlined earlier in this section could furnish the appropriate constraints, and it is unlikely, therefore, that section 31 has simply made them redundant."

(3) By contrast, **Underhill & Hayton: Law of Trusts and Trustees**, 17th edn., §§51.1-51.4 takes the position that the section was intended to confer on trustees a general discretion to allocate expenses between income and capital as they deemed fit. This is recanted in the current (18th) edition at §§47.1-47.4 in reliance on ***Revenue & Customs Comrs v Trustees of the Peter Clay Discretionary Trust*** [2009] Ch 296, in which the Court of Appeal restated the traditional rules. However, it is notable that the Court of Appeal made no mention at all of the changes introduced by the Trustee Act 2000.

Again, the Legislature may wish to consider whether this is something that needs to be further investigated and clarified in the Ordinance.

C. Statutory Control on Trustees' Exemption Clauses

C1. Introduction

22. It is unnecessary to repeat the views set out in the 2012 Position Paper at §§8-17, in which the HKBA expressed reservations as to whether Hong Kong should follow the Jersey and Guernsey model for controlling trustees' exemption clauses.

23. It appears from the Bill that the Administration maintains the view that the Jersey and Guernsey model should be imported into Hong Kong.

24. The Bill proposes to introduce the following provision:

> *"**41W. Trustee is not exempted from liability for breach of trust***
> ...
>
> *(3) The terms of a trust must not —*
>
> *(a) relieve, release or exonerate a trustee from liability for a breach of trust arising from the trustee's own fraud, wilful misconduct or gross negligence...*
>
> *(4) A term of a trust is invalid to the extent to which it purports to—*
>
> *(a) relieve, release or exonerate a trustee from liability for a breach of trust arising from the trustee's own fraud, wilful misconduct or gross negligence..."*
>
> [emphasis added]

25. The HKBA notes that this is different from the version proposed in Annex H of the Administration's Consultation Paper issued in March 2012, which used "reckless act" instead of "gross negligence".

C2. Unsatisfactory nature of "gross negligence" concept

26. However, the HKBA has serious reservations about the use of the term "gross negligence" in the proposed s.41W.

27. The HKBA's reservations arise from the fact that the concept of gross negligence is vague and problematic. This has already been mentioned at §16(2) of the 2012 Position Paper but it may be useful to provide some elaboration.

28. The courts have, on numerous occasions, doubted whether there is any real distinction between negligence and "gross" negligence. see e.g. ***Tradigrain SA v Intertek Testing Services*** [2007] 1 CLC 188, §23 (Moore-Bick LJ); ***Marex Financial Ltd v Fluxo-Cane Overseas Ltd*** [2010] EWHC 2690,

§93 (David Steel J); ***Sucden v Fluxo-Cane Overseas Ltd*** [2010] 2 CLC 216, §54 (Blair J).

29. In a well-known passage, Millett LJ stated in ***Armitage v Nurse*** [1998] Ch 241, 254C-D:

> *"But while we regard the difference between fraud on the one hand and mere negligence, however gross, on the other as a difference in kind, we regard the difference between negligence and gross negligence as merely one of degree. English lawyers have always had a healthy disrespect for the latter distinction. In Hinton v. Dibbin (1842) p 2 Q.B. 646 Lord Denman C.J. doubted whether any intelligible distinction exists; while in Grill v. General Iron Screw Collier Co.(1866) L.R. 1 C.P. 600, 612 Willes J. famously observed that gross negligence is ordinary negligence with a vituperative epithet."*

30. In 2002, the English Law Commission published a consultation paper on *Trustee Exemption Clauses* (C.P. No 171), in which the Commission considered whether statutory controls on trustee exemption clauses should be introduced. Among other formulae, the Commission considered preventing trustees from excluding liability for "gross negligence". However, the Commission opined that the concept was too ill-defined to form the basis of regulating trustee exemption clauses. The Commission stated at §4.77:

> *"We believe that any legislative provision denying professional trustees resort to exemption clauses where they have been guilty of gross negligence would have to reflect the fact that the definition is at best imprecise, and that the courts would inevitably be afforded an element of latitude in determining when trustee misconduct is sufficiently severe as to be termed gross negligence. This would lead once more to uncertainty as to the circumstances in which a professional trustee would be able to rely upon an exemption clause."*

For that reason, the Commission concluded:

> *"We do not consider that the concept of gross negligence is sufficiently clear or distinctive as to form the basis of regulation of trustee exemption clauses. We do not therefore propose that those who wish to claim for breach of trust should be obliged to establish that the trustees were guilty of gross negligence in order to deny them resort to any exemption clause in the trust instrument."*

31. The Commission noted (at §§4.72-4.73, 4.76) that the authorities contain a variety of (often inconsistent) definitions of "gross negligence", including:

- "some sort of carelessness which would appear to the plain man of common sense as being gross" (***Martin v London CC*** [1947] KB 628, 631)

- a "vituperative epithet" tacked onto negligence (***Grill v General Iron Screw Collier Co*** (1866) LR 1 600, 612)

- "nothing more than a great and aggravated degree of negligence, as distinguished from negligence of a lower degree" (***Doorman v Jenkins*** (1834) 2 Ad & E 256, 262)

- "a high degree of careless conduct, such as where a defendant did not intend a particular consequence to happen but nevertheless must have been able to foresee its occurrence" (**Charlesworth & Percy on Negligence** (10th ed 2001) para 1- 11).

- "a serious or flagrant degree of negligence (***Midland Bank Trustee (Jersey) Ltd v Federated Pension Services*** [1996] Pens LR 179, 206 – discussed further below)

- "something more fundamental than failure to exercise proper skill and/or care constituting negligence...capable of embracing not only conduct undertaken with actual appreciation of the risks involved, but also serious disregard of or indifference to an obvious risk." (***Red Sea Tankers v***

Papachristidis (The Ardent) [1997] 2 Lloyd's Rep 547, p.586 col.2 – discussed further below).

32. For those reasons, the HKBA remains of the view that gross negligence is an unsatisfactory basis upon which to regulate trustee exemption clauses.

C3. Deleting the word "gross"?

33. Unfortunately, it is not clear that the problem can be solved by simply deleting the word "gross" from the proposed s.41W. This is because, on the current state of authorities, it is *not* safe to say that negligence and gross negligence are the same thing.

34. Even in ***Armitage v Nurse*** (supra), Millett LJ appeared to recognise at least a possible distinction between negligence and gross negligence when he commented at 256B-C:

> *"At the same time, it must be acknowledged that the view is widely held that these clauses have gone too far, and that trustees who charge for their services and who, as professional men, would not dream of excluding liability for ordinary professional negligence should not be able to rely on a trustee exemption clause excluding liability for gross negligence."*

35. In other cases, the courts have gone further and recognised a distinction between negligence and gross negligence, at least within the particular contracts in question. In ***Red Sea Tankers*** (supra), Mance J considered an exclusion clause containing an exception for "gross negligence". Mance J held that the defendants were therefore protected by the clause from liability for negligence but not for *gross* negligence. In other words, Mance J accepted that there was a difference – in degree, if nothing else – between the two concepts. Mance J described gross negligence at p.586 col.2:

> *"...the concepts of 'gross negligence' here appears to me to embrace serious negligence amounting to reckless disregard,*

without any necessary implication of consciousness of the high degree of risk or the likely consequences of the conduct on the part of the person acting or omitting to act...

"Gross negligence is clearly intended to represent something more fundamental than failure to exercise proper skill and/or care constituting negligence. But, as a matter of ordinary language and general impression, the concept of gross negligence seems to me capable of embracing not only conduct undertaken with actual appreciation of the risks involved, but also serious disregard of or indifference to an obvious risk."

And at p.615 col. 2:

"I have considered the proper interpretation of cll.7.9/7.10 of the two agreements, and the meaning of "gross negligence". I concluded that the test is ultimately objective, and that it would be relevant to consider the degree of risk which a reasonable person would perceive as involved in the conduct, not just by considering the likelihood of the risk materializing, but also by considering other factors such as the seriousness of the risk if it did materialize, whether any steps at all had been taken to avoid the risk and how simple it would have been to take any."

36. Mance J explained further (at p. 589 col. 2) about the mental element involved in the concept of gross negligence (which he did not think was purely subjective):

'...the concept of gross negligence in these clauses does not involve, necessarily, any subjective mental element of appreciation of risk. It may therefore include...conduct which a reasonable person would perceive to entail a high degree of risk of injury to others coupled with heedlessness or indifference to or disregard of the consequences. The heedlessness, indifference or disregard need not be conscious.'

37. Applying the distinction, Mance J held that the defendants' actions were negligent but not *grossly* negligent, and therefore fell within the protection of the exclusion clauses. He concluded at p. 624 col. 1:

"It follows from my findings that, although I consider that there was causatively relevant negligence on the part of [the corporate

defendants], I do not consider that it amounted to gross negligence or forfeited under cll.7.9 and 7.10 the contractual immunity otherwise available to protect these defendants."

See also: pp. 615 col. 2, 617 col.2, 618 col. 1, 622 col. 2., 623 col. 2., 624 col.1

38. The extent to which Mance J's approach to gross negligence is of general application is debatable, for a number of reasons:

(1) Mance J expressed himself to be focusing on the interpretation of the particular contract before him (p. 586).

(2) Mance J did not cite any of the numerous cases (e.g. ***Armitage v Nurse***) in which the courts have doubted the distinction between negligence and gross negligence.

(3) Since the contract was expressed to be governed by New York law, Mance J may have been influenced by the fact that New York law recognises a distinction between negligence and gross negligence: see pp. 581-585. (On the other hand, Mance J stated that his construction of the contract was the same whether under New York or English law: p. 586 col. 2).

39. Nonetheless, ***Red Sea Tankers*** does show that negligence is not *necessarily* the same thing as gross negligence. In certain contexts, there may be a substantive difference between the two.

40. Mance J's approach in ***Red Sea Tankers*** was followed more recently by Andrew Smith J in ***Camerata v Credit Suisse*** [2011] 1 CLC 627, §§160-162.

41. It is also relevant to consider the Jersey Court of Appeal's judgment in ***Midland Bank*** (supra), where the defendant trustee attempted to rely on an exemption clause to relieve itself from liability. The Court held that Art. 26(9) was applicable and hence the clause would not avail the trustee if the trustee had committed gross negligence. The Court explained (at §177) what was meant by gross negligence:

> *"All that this phrase means is a serious or flagrant degree of negligence. It does not import any question of intentional or reckless fault."*

The Court (at §176) based its definition on a number of Canadian cases where:

> *"...the approach was to treat 'gross negligence' as meaning 'very great negligence', or flagrant or extreme negligence, or negligence consisting of 'a very marked departure from the standards' of responsible and competent people. In none of them was it suggested that 'gross negligence' involved either 'a certain mens rea ' or 'an intentional disregard of danger' or 'recklessness'."*

42. In short, the Jersey Court recognised a difference between negligence and gross negligence. This difference was one of degree, but it was a difference nonetheless.

43. ***Midland Bank*** is especially important in the present context because the proposed s.41W is modelled on Art.26(9) of the Trusts (Jersey) Law 1984, which (as amended in 1989) 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."*

44. However, it is notable that the Jersey Court's definition in ***Midland Bank*** differed from the explanation given by Mance J in ***Red Sea Tankers***. The Jersey Court held that gross negligence did not include any element of

intention or recklessness. By contrast, Mance J perceived a close connection between recklessness and gross negligence (see above).

45. In the recent case of ***Spread Trustee Co v Hutcheson*** [2012] 2 AC 194, the Privy Council (on appeal from Guernsey) considered whether Guernsey customary law was the same as English common law as expressed in ***Armitage v Nurse***, i.e. that trustees could be exempted from liability for gross negligence. In giving the majority judgment, Lord Clarke JSC recognised (at §§50-51) that English law did recognise gross negligence, as a concept distinct from negligence, in some contexts. As examples, Lord Clarke pointed out that gross negligence plays a role in the liability of a gratuitous bailee; damages for wrongful arrest of a ship; priority between an equitable incumbrancer and a legal mortgagee; and libel. (Sir Robin Auld took a slightly different view and expressed at §117 that negligence and gross negligence *"differ only in degree or seriousness of the want of due care they describe. It is difference of degree, not of kind"*).

46. Lastly, it should be noted that gross negligence is an important and distinct concept in criminal law, where it provides one of the bases of liability for involuntary manslaughter (***R v Adomako*** [1995] 1 AC 171). Although the English Law Commission (see CP No 171 at §§4.74-4.75) doubted the usefulness of comparison with criminal law, Mance J in ***Red Sea Tankers*** (at p.586 col. 2 - p.587 col. 1) thought that a helpful analogy could be drawn.

47. In the premises, although there have been isolated judicial statements equating negligence with gross negligence, this is not a consensus view. That being the case, the deletion of the words "gross" would potentially represent a substantive change to the section (one in favour of beneficiaries and adverse to trustees). This may be something which the Legislature is prepared to accept. But if it is not, then the Legislature would have

investigate other solutions to deal with the uncertainty behind the gross negligence concept.

C4. Statutory definition: a possible solution?

48. In light of the above, one solution may be to introduce a statutory definition for the term "gross negligence". On balance, the HKBA considers that there would be good justification for such a definition to be included.

49. As explained above, the concept of gross negligence is an extremely ill-defined one. The authorities contain a variety of confusing and often inconsistent definitions. For instance, there are competing statements about the relationship between gross negligence and recklessness (see §44 above). And even if gross negligence does import the concept of recklessness, recklessness could have a subjective meaning or an objective meaning (see ***Red Sea Tankers*** at pp. 582 col 2 - 585 col 1).

50. Thus, if gross negligence is simply included in s.41W without an accompanying definition, that would (as the English Law Commission observed, see §30 above) lead to significant uncertainties and probably an increased risk of litigation. In many cases, exemption clauses would be drafted in such a way that the trustee would only be liable if gross negligence (or fraud, or wilful misconduct) could be established. In the event of a breach of trust, both the beneficiary and the trustee would face substantial difficulties in deciding whether the trustee fell within the protection of the clause.

51. If a statutory definition were provided, such uncertainties would not disappear, but they would at least be lessened.

52. Given those uncertainties, it arguably behooves the Legislature to provide a statutory definition. If the Legislature enacts legislation which prevent

trustees from escaping liability for certain types of misconduct, it would only be fair to give trustees and beneficiaries a reasonable amount of certainty concerning the type of misconduct being targeted. This would allow trustees and beneficiaries to regulate their affairs accordingly.

53. In any event, the inclusion of a statutory definition is something which the Legislature should at least seriously investigate and consider.

54. As for the content of the statutory definition, the HKBA opines that that is for the Legislature to consider and determine. It may choose to adopt one of the definitions that have been expressed in the authorities. To this end, it may have to compare the competing explanations, such as those in ***Midland Bank*** and ***Red Sea Tankers***.

Dated 16th May 2013

Hong Kong Bar Association