

# What can the trustee be liable for?

## Considering the liability standard for corporate trustees under English law

Despite being ubiquitous in capital markets documentation, the trustee's liability standard under English law governed documents often proves a contentious provision to negotiate. The issue of liability allocation is sensitive, as one party's liability exclusion necessarily (and often indirectly) increases the exposure on another. It is however generally accepted that a corporate trustee involved in a debt issuance is entitled to a potentially wide exclusion of liability. When discussing the trustee's liability standard, parties should consider when such a provision will be relevant and the usual standard of care owed by trustees and related case law and statutes.

### The relevance of the trustee's liability standard

The trustee's role in debt capital markets transactions means that it has two different relationships with two groups of parties. The trustee's relationship with the beneficiaries of the trust (i.e. the noteholders) is governed by the law of equity. The trustee is also a contractual counterparty to the issuer and the other transaction parties; this relation is governed by the law of contract. The liability standard is relevant to both relationships. It defines the scope and extent of the trustee's liability to the noteholders; it also dictates whether the trustee will be entitled to claim indemnity from the issuer where the trustee has suffered a loss or other liability.

The different nature of these relationships also impacts the nature of claims that could be made against the trustee. Noteholders do not have a contractual claim against the trustee; their claim could only be equitable. In respect of the trustee's relationship with the issuer, the liability standard defines the extent to which the trustee is entitled to claim under the indemnity.

The liability standard sits alongside specific exclusions of liability which help to define the scope of the trustee's duties. These specific exclusions of liability tend, for this reason, to be absolute because acting within such scope is, by definition to act without negligence. So, for example, the trustee will not generally be liable where it is acting in reliance on counsel's advice or on a transaction party's certificate where (as is standard) a specific exclusion permits it to do so.

### The liability standard refines the trustee's duty of care.

The standard of care required of trustees, and in particular professional trustees, has been established by case law<sup>1</sup> and statute<sup>2</sup> and requires trustees to 'exercise such skill and care as is reasonable in the circumstances' having regard, in the case of a professional trustee, to the skill expected of a professional. However, provisions in the trust instrument may exclude or restrict the statutory duty of care<sup>3</sup>. Exclusion provisions, provided they comply with statutory requirements<sup>4</sup>, may exonerate the trustee of all liability expect where caused by the trustee's own fraud<sup>5</sup>. However, corporate trustees involved in finance transactions generally do not seek such a broad liability exclusion. In debt capital markets documents the trustee's liability standard usually encompasses the following three key areas of culpability:

- **Dishonesty:** The trustee will be liable if it is guilty of fraud or fraudulent activity. Fraud does not necessarily need to be expressly included in the carve-out to the exclusion provision, as any attempt to exclude liability for fraud would be void under English law. This silent approach to the fraud carve-out is reflected in the LMA documentation. However, express reference to fraud is common in the liability standard set out in debt capital markets documents.
- **Contractual breach:** The trustee will be liable where it is in deliberate breach of trust or its express obligations. Two terms are often used to encapsulate this concept, 'wilful default' and 'wilful misconduct'. The term 'wilful default' has the advantage of having been defined by case law in the *Armitage*<sup>6</sup> case as a deliberate breach of trust which requires conscious and wilful misconduct on the part

<sup>1</sup> *Bartlett v Barclays Bank Trust Co. Ltd.* [1980] 1 All ER 139.

<sup>2</sup> Trustee Act 2000, s 1(1).

<sup>3</sup> Trustee Act 2000, Sch 1, para 7.

<sup>4</sup> Companies Act 2006.

<sup>5</sup> *Armitage v Nurse* [1997] 2 All E.R. 705.

<sup>6</sup> *Ibid*



of the trustee. The term 'wilful misconduct' is favoured by the LMA documentation (but lacks specific judicial interpretation).

- **Carelessness:** The trustee will be liable if it acts without due care in carrying out its duties. This concept is usually captured in debt capital markets documents by the terms 'negligence' or 'gross negligence'.

Defining the trustee's liability under these headings gives rise to the usual liability standard formulation, i.e. "negligence, wilful default or fraud". Such formulation serves as the carve-out in the trustee's exclusion of liability provision. As a result, noteholders will only have a claim against the trustee if they can show they have suffered loss caused by one of these types of misfeasance. Equally, the trustee will only be entitled to claim indemnity from the issuer for any loss the trustee has suffered if it can show that it is not culpable under any of these headings.

### Different formulations for the liability standard

There may be valid arguments in favour of different formulations to the liability standards. The extent and scope of the trustee's exclusion of liability provision is a matter of commercial discussions and each trustee corporation will have their favoured wording. However, in order to ensure certainty, parties should favour terms which have been clearly defined. Trustees have an additional incentive for seeking to make the provisions unambiguous as any doubt as to the exact extent of the exclusion clause will be resolved against the trustee<sup>7</sup>. The same care should be applied concerning the specific exclusions of liability. The market practice concerning these is not to make the specific exclusions of liability expressly subject to the liability standard. It is however understood that the trustee will be acting (non-fraudulently and non-negligently) where relying on such exclusions, for example where acting on instructions or in reliance on counsel's advice or a transaction party's certificate.

<sup>7</sup> Wight v Olswang (No. 1) [1999] 1 ITCLR 783.

## Court relief

Finally, even where the trustee breaches the liability standard defined in the trust instrument, the trustee may seek relief from liability from the courts under s 61 of the Trustee Act 1925. For such relief to be granted, the trustee will have to establish that it 'has acted honestly and reasonably, and ought fairly to be excused'. Professional trustees generally do not rely on such a relief and will favour a well-defined liability standard. Courts are indeed reluctant to exonerate professional trustees, as opposed to gratuitous trustees, because of high standard of skill and care expected.

## The Trustee's perspective

It is essential for trustees to have their scope of liability strictly defined. Trustees would expect the liability standard to cover the three key areas of culpability referred to above in order to have a degree of certainty as to the scope of the liability standard. For this reason it is common to see a liability standard expressed in terms of "negligence, wilful default or fraud".

*(A version of this article was published in April 2019 as part of our "Trustee Conversations" series, a weekly posting on LinkedIn on a key topic for trustees. If you would like to see other conversations in the series, please contact one of the team.)*

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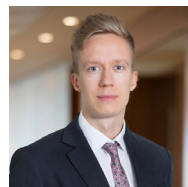
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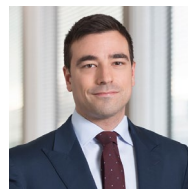
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