

**Consultation of Detailed Legislative Proposals on Trust Law Reform**  
**Issued in March 2012**

**Position Paper of the Hong Kong Bar Association**

**A. INTRODUCTION**

1. In June 2009, the Administration issued a Consultation Paper (“**the 2009 Consultation Paper**”) to review the trust law regime in Hong Kong to amend and modernise the Trustee Ordinance (“**TO**”) to provide a better framework for the operation of trusts in Hong Kong.
2. In response to the 2009 Consultation Paper, the Hong Kong Bar Association (“**HKBA**”) prepared a Position Paper which was sent to the Administration in November 2009 (“**the 2009 Position Paper**”).
3. In its 2009 Position Paper, the HKBA confined its views to matters of broad legal principles. Its views can be summarised as follows:
  - (1) The proposals based on the recommendations of the major Commonwealth legislation (principally the legislation in England) and the major Commonwealth law reform bodies (principally the English Law Commission) can be followed in Hong Kong because the existing trust law in Hong Kong has always been largely based on the English law (§§4-6 of the 2009 Position Paper).
  - (2) The ability of professional trustees to exempt their liability is an area deserving serious attention because such exemption clauses are commonly included in the trust instruments by professional

trustees as a matter of routine and form part of a “take-it-or-leave-it package” for the clients. The HKBA considered that such exemption clauses should be controlled by legislation and suggested the statutory intervention be modelled on the Hong Kong Control of Exemption Clauses Ordinance (§§8-13 of the 2009 Position Paper).

(3) There was a proposal to codify the rules concerning the beneficiaries’ right to information. The HKBA did not support this proposal (§§14-16 of the 2009 Position Paper).<sup>1</sup>

(4) There were other proposals to introduce wide-ranging and extensive matters into the Hong Kong TO based on the experience of offshore trust jurisdictions and tax havens. The HKBA observed that there was no reported consensus internationally on such matters. The HKBA did not see any present need to reform the existing rules in Hong Kong and therefore was not in favour of such changes (§§17-18 of the 2009 Position Paper).

4. In March 2012, the Administration issued a further Consultation Paper to set out further detailed legislative proposals on trust law reform based on the consultation conclusions (“**the 2012 Consultation Paper**”).

## **B. SUMMARY OF THIS POSITION PAPER**

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<sup>1</sup> It is noted that this proposal has now been dropped by the Administration following a consultancy study of Professor Lusina Ho of the HKU commissioned by the Administration: see §§1.14-1.19 of the 2012 Consultation Paper.

5. The HKBA's positions on the 2012 Consultation Paper are summarised as follows:

- (1) In line with the approach adopted in its 2009 Position Paper, the HKBA is in favour to adopt the proposals based on the English legislation. See §§6 and 7 below.
- (2) As to the Administration's proposal to introduce legislation in Hong Kong to control trustee exemption clauses, there are still some serious questions which remain unanswered. Unless and until those issues are fully dealt with, the HKBA has serious reservations about the current proposal. See §§8-17 below.
- (3) As to the Administration's proposal to introduce legislation to provide that a reservation of power by the settlor does not affect the validity of the trust, there does not appear to be any necessity to do so because the common law position seems to be clear on the point. Nonetheless, other than the question of necessity, the HKBA sees nothing inherently problematic about the Administration's proposal. See §§18-22 below.

## **C. PROPOSALS BASED ON ENGLISH LEGISLATION AND REFORM**

6. In the 2012 Consultation Paper, the following proposals are repeated:

- (1) Proposal to introduce a statutory duty of care similar to §7 of Schedule 1 of the Trustee Act 2000 ("**TA 2000**") (by adding a new

provision to the TO) (§§2.2-2.10 of the 2012 Consultation Paper).

- (2) Proposal regarding trustee's power of delegation similar to section 7 of the Trustee Delegation Act 1999 (by amending section 27(2) of the TO) (§§2.11-2.14 of the 2012 Consultation Paper).
- (3) Proposal to provide trustees with a general power of appointment agents similar to section 11 of the TA 2000 (by repealing the existing section 25 and replacing it by new provisions in the TO) (§§2.15-2.21 of the 2012 Consultation Paper).
- (4) Proposal to provide trustees with a general power to employ nominees and custodians similar to sections 8 and 23 of the TA 2000 (by repealing the existing section 8 and replacing it by new provisions in the TO) (§§2.22-2.25 of the 2012 Consultation Paper).
- (5) Proposal to provide safeguards in relation to the appointment of agents, nominees and custodians similar to paragraph 3 of Schedule 1 and sections 15, 19 and 22 of the TA 2000 (by adding new provisions in the TO) (§§2.26-2.28 of the 2012 Consultation Paper).
- (6) Proposal to widen trustees' power to insure similar to section 34 of the TA 2000 (by repealing the existing section 21 and replacing it by a new provision in the TO) (§§2.29-2.30 of the 2012 Consultation Paper).
- (7) Proposal to provide a statutory charging clause to enable the

remuneration of professional trustees of non-charitable trusts similar to sections 28-30 and 33 of the TA 2000 (by adding new provisions in the TO) (§§2.31-2.39 of the 2012 Consultation Paper).

(8) Proposal to give beneficiaries a statutory right to remove trustees similar to sections 19 and 20 of the English Trusts of Land and Appointment of Trustees Act 1996 (by adding new provisions in the TO) (§§2.47-2.51 of the 2012 Consultation Paper).

7. These proposals are modelled exactly on the English legislation. As mentioned above, the HKBA in its 2009 Position Paper submitted to the Administration that all of these proposals could be followed in Hong Kong. There is no reason to depart from that view. The HKBA therefore adopts the same position as that set out in its 2009 Position Paper.

#### **D. STATUTORY CONTROL ON TRUSTEES' EXEMPTION CLAUSE**

8. In the 2012 Consultation Paper, it is recommended that trustee exemption clauses should be subject to statutory control where the clauses seek to exempt remunerated professional trustees from liability. The proposal is for Hong Kong to follow the relevant statutory provisions of Jersey and Guernsey to provide that the terms of a trust must not (1) relieve, release or exonerate a trustee from liability for breach of trust arising from the trustee's own fraud, wilful misconduct or reckless act, or (2) grant the trustee any indemnity against the trust property in respect of the liability. See §§2.41 and 2.42 of the 2012 Consultation Paper.

9. In its 2009 Position Paper, the HKBA already indicated that trustee exemption clauses should be controlled by legislation (see §3(2) above). Accordingly, the current proposal to subject such clauses to statutory control is uncontroversial from the HKBA's point of view.
10. However, the contents of the proposed legislation may be subject to a number of questions to be raised by the HKBA. The following views are confined to matters of broad legal principles.
11. Before getting into the details, it is right to recognise the various conflicting interests of the parties at stake, namely the settlor, the trustees and the beneficiaries.
  - (1) From the settlor's point of view, he would want to ensure that the trust is properly and effectively administered according to its terms, but at the same time to retain the widest possible freedom to stipulate what the terms of the trust are.
  - (2) From the trustee's point of view, they would want their liabilities to be carefully and clearly proscribed.
  - (3) From the beneficiaries' point of view, they would not want their rights to enforce the terms of the trust to be curtailed in any way.
12. Accordingly, it must be right that the broad objective of the legislative control of trustee exemption clauses is to achieve a satisfactory balance between the rights and interests of the settlor, the trustees and the beneficiaries of the trust. In particular:

- (1) Although the settlor should be free to make whatever lawful disposition of his property he wishes to make, he should be aware not only of the existence of the provisions in the trust instrument which exclude trustees from liability for breaches of trust, but also of their legal consequences.
  - (2) At the same time, those who act as trustees in the course of their business receive fair recompense for their services and should be expected to achieve reasonable standards of competence for those services and should be accountable for their conduct.
13. With these objectives in mind, the following questions as to the contents of the proposed legislation may be raised.
14. First, although the 2012 Consultation Paper has chosen Jersey/Guernsey legislation as the model for the proposed legislation in Hong Kong, no reason has been given as to why such a model is more suitable for Hong Kong and is therefore preferred over the other models.
  - (1) The relevant provision in Jersey provides as follows:

*“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.”<sup>2</sup>*

- (2) The relevant provision in Guernsey provides as follows:

*“The terms of a trust may not (a) relieve a trustee of liability for a breach of trust arising from his own fraud, wilful misconduct or gross negligence, or (b) grant him any indemnity against the trust property in respect of any such liability.”<sup>3</sup>*

- (3) The Jersey/Guernsey legislation therefore allows limited effect to trustee exemption clauses but restrict their invocation once the conduct of the trustee crosses a certain threshold.
- (4) The other major and obvious model is one based on the reasonableness of the clause.
  - (a) In Hong Kong, there is the Control of Exemption Clauses Ordinance (Cap 71) which restricts the extent to which civil liability for breach of contract, negligence or other breach of duty can be avoided by means of contract terms. The Ordinance prevents a person from excluding or restricting his liability for negligence by reference to any contract term or to a notice, unless the term or notice satisfies the requirement of reasonableness.
  - (b) Schedule 2 to the Ordinance sets out “guidelines” to which regard must be had where the reasonableness test is applied to certain contracts. These include the relative strength of the bargaining positions of the parties, any inducement made to the customer to agree to the term and the extent of the

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<sup>2</sup> See footnote 23 of the 2012 Consultation Paper.

<sup>3</sup> See footnote 23 of the 2012 Consultation Paper.



customer's knowledge of the term.

- (c) This Ordinance, however, does not apply to trustee exemption clause because it is extremely unlikely that a Hong Kong court would consider a trust instrument containing such a clause to be a "contract".
- (d) It is possible to introduce legislation specifically directed at trustee exemption clauses which imposes a requirement that all such clauses satisfy a test of reasonableness.<sup>4</sup> Such an approach would have the benefits of flexibility and adaptability to the circumstances of each trust. It is right to acknowledge that it would take time for a meaningful body of precedent to build up in view of the various factors involved in each case. However, over a period of time, the courts would be able to indicate which clauses are likely to be upheld and which are likely to be struck down, and gradually some clarity would be introduced.
- (e) The HKBA in fact advocated this model in its 2009 Position Paper (see 3(2) above)). It is unclear why this model is considered by the Administration to be inferior to the Jersey/Guernsey model.

15. Secondly, even if one accepts that the best statutory model for Hong Kong is to allow limited effect to trustee exemption clauses but restrict

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<sup>4</sup> See further Goodhart "Trustee Exemption Clauses and the Unfair Contract Terms Act 1977" [1980] Conv 333 and "Trust Law for the Twenty-first Century" (1996) 10 TLI 38.

their invocation once the conduct of the trustee crosses a certain threshold, it is unclear why the Administration considers that the relevant threshold should be set at a level similar to that adopted in the Jersey/Guernsey legislation.

- (1) The Jersey/Guernsey legislation prohibits reliance on trustee exemption clause if the conduct of the trustee constitutes “*fraud, wilful misconduct or gross negligence*”.
- (2) A different threshold has been proposed by the British Columbia Law Institute in a Report on Exculpation Clauses in Trust Instruments published in March 2002 (BCLI Report No 17). The substance of the proposals was as follows. Prima facie, a trustee exemption clause would be effective according to its terms to relieve a trustee of liability for a breach of trust. However, in the event of a breach by the trustee, a beneficiary would be able to apply to the court for a declaration that the exemption is ineffective in relation to that breach. They proposed that such a declaration may be made:

*“Where it appears to the court that the conduct of a trust*

- (a) would constitute a breach of trust, and*
- (b) has been so unreasonable, irresponsible or incompetent that, in fairness to the beneficiary, the trustee ought not to be excused.”*

This approach would require the court to focus upon the breach of trust committed by the trust rather than the terminology of the exemption clause.

- (3) It is fair to acknowledge that the British Columbia proposal has not yet found its way into the Canadian legislation. Be that as it may, when considering the different legislative models for Hong Kong, it is not clear that British Columbia proposal is on its face so unworkable so much so that it should be ignored.
16. Thirdly, even if one accepts that the best statutory model for Hong Kong is to follow the Jersey/Guernsey legislation, it is unclear why the current proposal allows all acts of negligence on the part of the trustees to be capable of being excluded by trustee exemption clauses.
- (1) Rather than following exactly the model in Jersey/Guernsey, the Administration proposes to replace “*gross negligence*” in the Jersey/Guernsey legislation by “*reckless act*”. The implication of this change is that any acts of negligence (whether gross negligence or ordinary negligence) on the part of the trustees are capable of being excluded by trustee exemption clauses.
- (2) It is readily accepted that “*gross negligence*” is not a sufficiently defined concept. As Millett LJ said in *Armitage v Nurse* [1998] Ch 241 at 254C-D, “*the difference between negligence and gross negligence [is] merely one of degree [and] English lawyers have always had a healthy disrespect for the latter distinction*”. However, because of the difficulty to define “*gross negligence*”, it seems illogical that the reference should simply be replaced by something completely different (namely “*reckless act*”) and thereby implicitly allowing the trustees to be absolved from any

liability arising from their negligent acts, however serious they may be.

- (3) As a matter of principle, there is much to be said for the law to be such that a trustee remunerated for his services as trustee cannot rely on an exemption clause to exclude liability for breach of trust arising from any negligence (and worse). Professional trustees accept the price of liability for negligence in acting as paid trustees and to insure against such risk. To allow professional trustees to exclude any kind of liability for negligence may be said to be too deferential to the trustees.
- (4) In any event, it is unclear what kind of acts are intended to be excluded from trustee exemption clauses under the current proposal that are not already covered by the common law.
  - (a) The current proposal intends to prohibit trustees to exclude liability for “*fraud, wilful misconduct or reckless act*”.
  - (b) At common law, trustee exemption clauses can validly exempt trustees from liability for breaches of trust except fraud: see *Armitage v Nurse* [1998] Ch 241. Therefore, the inability of trustees to rely on trustee exemption clauses to relieve themselves of liability arising from their own fraud is already covered by the common law.
  - (c) In §2.43 of the 2012 Consultation Paper, it is stated that the Administration regards “*reckless act*” as something between

*“negligence “ and “wilful misconduct”*. It is unclear that this is necessarily the case. In *Armitage v Nurse* [1998] Ch 241 at 251E, Millett LJ regarded “fraud” for the purpose of the trust exemption clauses as *“[connoting] at the minimum an intention on the part of the trustee to pursue a particular course of action, either knowingly that it is contrary to the interests of the beneficiaries or being recklessly indifferent whether it is contrary to their interests or not”*.<sup>5</sup> Accordingly, if the trustees pursue an act and are recklessly indifferent as to whether it is contrary to the beneficiaries’ interest or not, that would constitute fraud and the trustees would not be able to rely on the relevant exemption clause at common law. To this extent, there is a significant overlap between “*fraud*” and “*reckless act*” in the proposal and it is uncertain if this overlap is intended. If it is not so intended, it is unclear what kind of “*reckless act*” would fall outside the “*fraud*” category.

17. For all the above reasons, there are still some serious questions which remain unanswered in relation to the Administration’s proposal to introduce legislation in Hong Kong to control trustee exemption clauses based on the Jersey/Guernsey legislation but with certain important words replaced. Unless and until those issues are fully dealt with, the HKBA has serious reservations about the current proposal.

## **E. VALIDITY OF CERTAIN TRUSTS**

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<sup>5</sup> This passage is also quoted in §2.44 of the 2012 Consultation Paper.

18. Ordinarily, once a trust is created by the settlor and in the absence of any express provision in the trust instrument to the contrary, all the powers vis-à-vis the trust property become vested in the trustees and the settlor has no further say in relation to the trust property.
19. As pointed out in §2.52 of the 2012 Consultation Paper, if the settlor reserves to himself excessive powers, the court may consider that there is insufficient certainty as to the settlor's intention to create the trust and may treat the arrangement as a sham.
20. However, as pointed out in Lewin on Trusts (18th ed, 2008) p 97, if the settlor retains power to direct investments, that does not make the trusts a sham and his directing investments through the machinery of the trusts recognise them as real.
21. The current proposal is to introduce a statutory provision in the TO to say that a "*trust is not invalid by reason only of the person creating the trust (the settlor) reserving to the settlor any or all powers of investment or asset management functions under the trust*".
22. In view of the statement in Lewin on Trusts quoted above, it does not appear to be necessary to introduce a statutory provision to expressly spell out the effect of something which is already clear at common law. Nonetheless, apart from the question of necessity, there seems to be nothing inherently problematic about the Administration's proposal.

**21st May 2012**

**Hong Kong Bar Association**