

Liability of a confidant (trustee) in fulfilling the obligation (trust)

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Trusts have been regarded a quintessential part of the common law family. It has been identified that the core of a trust structure, ie it being an obligation, has proven the test of time. Earlier known as ‘uses’, English knights used the structure in the Middle Ages to transfer their assets to a trusted third party during the Crusades so that there was no interruption in the performance and receipt of feudal services. Around this time as well, the English courts refused to enforce such trusts, as it viewed them as simply honorary obligations. It was only in the early 15th century that the court recognised the obligation of a third party to hold and manage the assets of a knight for the benefit of the knight and his family or help in the bequest of such property to the issue of the knight upon his death. The intent of creating trusts has evolved since to allow for the structure to be used as an effective method of protecting one’s assets. Such protection may be necessary for one undertaking risky ventures, dealing in highly volatile environments exposing private assets to economic erosion through potential tax, compulsory emergency contribution or for maintenance in matters of matrimonial disputes.

Due to a plethora of reasons for creating a trust, and its subsequent popularity, jurisdictions all over the world were obligated to draft rules and regulations that governed such structures. The Indian Trust Act 1882 (the 1882 Act) was passed with the intent to govern trusts in India and is based upon the English law on trusts. For example, Section 41 of the UK Trustee Act 1925 is very similar to Section 74 of the 1882 Act, discussing the appointment of new trustees. At a more fundamental level, it has been

seen that the legislative intent of both acts are alike. The basics of the 1882 Act are discussed below.

As per the 1882 Act, a trust is defined as an obligation attached to the ownership of property, arising from the confidence reposed in and accepted by the owner for the benefit of another or the owner. In essence, a trust is not recognised as a legal entity. A trustee assumes ownership of assets entrusted to him or her by a settlor (and therefore becomes owner of the said trust property), with the obligation to manage or invest and distribute these assets for the benefit of others (beneficiaries). As part of their duties, trustees may need to hold, manage and invest trust property in specified ways, either as directed or according to their judgment. This may involve entering into contractual obligations with third parties. The crux of the issue at hand is that, since, unlike companies, trusts are not considered legal entities, and therefore although technically and practically the contract is on behalf of the trust, trustees are required to enter into the said contracts in their individual capacity.

The critical question then arises: in cases of contractual breach, will the trustee, as the legal owner and decision-maker of the trust assets, be held personally liable, or would it be the trust which is liable for breach of the contract? Secondly, if a trustee is found liable, can he or she be indemnified against the trust assets? This article intends to shed light on the liability of a trustee when a trust enters into a contract with third parties.

The Indian perspective

It is interesting to note that the 1882 Act is silent on the trustee’s responsibilities in relation to contractual obligations to third parties. Section 23 of the 1882 Act limits the liability of the trustee for breach of trust against the beneficiary under certain circumstances. It states that the trustee is “liable to make good the loss which the trust-property or the beneficiary has thereby sustained”. The Specific Relief Act 1963 (the 1963 Act) has drawn a parallel with the 1882 Act in relation to the definition of a ‘trust’. This holds relevance, because as per Section 11 of the 1963 Act, “specific performance of a contract may, in the discretion of the court, be enforced when the act agreed to be done is in the performance wholly or partly of a trust”, and any contract that is made in excess of a trustee’s powers or is in breach of the trust

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cannot be specifically enforced. Interestingly, it is seen that the Indian legislation is largely silent on a trustee's obligations to a third party. Although it succeeds in discussing the trustee's liability towards beneficiaries, and the enforcement of specific performance of a contract by a trust that it has agreed to perform, it fails in stating the repercussions of non-performance.

Despite the Indian legislation being silent on the issue, there are enough examples of judicial precedents set discussing liability of the trust and trustee in such third-party contracts. As per a 1941 ruling, a trustee that is entering into a contract to purchase any kind of property, during the course of execution of the trust obligations, is required to serve as an individual, and is therefore personally liable. Consequently, in situations of breach of contract entered into between a third party and a trustee due to non-payment by the latter, it has been understood that since the trustee enters into a contract in his or her individual/personal capacity, the contention that a decree should not be against the trustee personally, rather against the trust estate or against him or her as manager of the trust estate shall not hold water.

The inability to differentiate between an individual that has entered into a contract as a trustee, and an individual that has entered into the same in his or her personal capacity is evident. The difficulty to discern the two entities is because the opposite contracting party/third party enters into a contract with the individual irrespective of the capacities that he or she holds. Therefore, the third party views and treats him or her as a single entity, making it difficult to separate the two roles.

It is opined that the rationale behind finding a trustee personally liable is understood better when it is compared to the liability of an agent. It is proposed that the element of personal liability of the trustee is attributable to his or her role. A valid trust shall have assets, including but not limited to property, goods or money that are bestowed on the trustee, by giving the trustee ownership over the trust assets. In an agency, the property is vested solely in the principal, on whose behalf the agent acts. An agent in a contract is not personally liable, as contrastingly the contract is with the principal instead. Since the ownership of the trust assets is vested in the trustee him or herself, the trustee stands liable.

Although a judicial body, such as a trust, is enabled to deal with the property for the benefit of another person or persons, it is understood that it is incapable of managing trust properties as a partnership firm in its own individual basis. When a trust does form a partnership with a settlor to manage trust properties, the trustee of the respective trust is in effect joining the partnership with the settlor, therefore implying that the trustee takes on such liability that may arise in a partnership.¹

A way out for trustees

It has been noticed that there are a total of three options for a trustee to exonerate him or herself of any personal liability. First, a trustee can be entitled to be indemnified from a trust, in respect of the liability incurred by the trustee, provided that the trustee undertook such action of incurring liability in furtherance of the trustees' stipulated duties. In other words, the question posed to determine the liability of a trustee is whether the trustee had the power under the terms of the instrument under which such a person was made a trustee to enter into the contract and subsequently incur liability. Second, building on the earlier rationale, in case of the existence of any explicit or implicit term of contract allowing the creditor or third party to indemnify him or herself from the trust property, then the liability would be transferred to the trust, instead of the trustee being held personally liable. Third, as per jurisprudence other than an explicit provision for the third party to recover their debt from the trust property, Section 52 of the Indian Civil Procedure Code 1908 provides for a single exception allowing a third party to automatically recover debts from the estate. The provision states that "where a decree is passed against a party as the legal representative of a deceased person, and the decree is for the payment of money out of the property of the deceased it may be executed by the attachment and sale of any such property".

The situation in India is undeniably close or similar to the views taken by the courts of foreign jurisdictions in relation to liability of a trustee against a third party, and the method of exoneration of such liability. The article hereon shall provide some relevant instances of foreign courts discussing the same.

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United Kingdom

In England a distinction exists between cases where a certain specific trust property is set apart or earmarked for the carrying on of a business by a trustee against a debt incurred for the contract of supply of goods for the benefit of the trust. If the former has taken place by the trustee in the course of the business, the creditor shall be allowed to stand in the shoes of the trustee and to recover the money from the trust property. It is to be noted that such a right would only be available if it was explicitly expressed via a condition that a trustee, him or herself, would have a right of indemnity against the trust property. If nothing is due to the trustee, then the trust property cannot be used to indemnify the third party or creditor. It is to be noted that in a scenario where a creditor lends money to the trustee or sells goods to the trustee, such third party has no claim against the trust property. In *Strickland v Symonds*,² the English Court of Appeal's rationale made this distinction, since the creditor or third party in the latter scenario of a debt being incurred for the supply of goods for the benefit of the trust is entering into a contract in the personal security of the trustee, it would be unfair to pass a decree holding the trust property liable.

To exonerate a trustee, the English courts have advised that the liability of a trustee depends upon the intention of the parties when entering into a contract. The intention of the parties is understood by viewing the language of the contract as a whole, with a focus on its language, its incidents and its subject matter. When it is apparent that the trustee's personal liability was intended to be excluded and even though the trustee was a contracting party to the obligation, the creditors should look into the trust estate alone.

Australia

Resembling the view in the United Kingdom and India, Australian courts have held that the trustee shall be held personally liable for debt or liabilities incurred while executing his or her duties and powers for the business of his or her trust.³ Such liability incurred can be tortious, statutory, contractual and equitable (arising out of ordinary principles of law) in

nature. A demarcation has been made, identifying that although creditors and third parties cannot directly indemnify themselves against trust assets, but in equity the creditors and third parties may be subrogated to the rights of the trustee against the trust assets. Provided the trustee executes his or her duties, powers and obligations properly, then liabilities and debts incurred can be indemnified against. Subject to the terms of the instrument via which the trust was created, such right of indemnity is capable of having priority over the claims of beneficiaries.

United States

Comparable to the explanation provided earlier, the US courts have ruled that a trustee is a principal and not an agent for the trust.⁴ In certain state jurisdictions, such as California, there are no laws explicitly stipulating the various powers of control of trustees, and therefore no direct personal liability can be imposed on them. The courts have slowly but surely evolved their interpretation of the capability of a trustee being held liable. In the *Taylor* case,⁵ it was ruled that a contract was a personal undertaking of the trustee, for "unless he is bound, no one is bound, for he has no principal". In *Jessup v Smith*,⁶ the plaintiff was retained by the trustee, however, since the latter was unable to pay the counsel fee involved, the plaintiff agreed to render his professional services, provided he could look to the trust estate for payment. The trial court initially held that since the services provided were for the benefit of the trustee him or herself, and not the estate, the trustee would be personally liable. This ruling was reaffirmed by the Appellate Division, however, it was later reversed by the Court of Appeals. The court, in its reasoning, stated that the services rendered were beneficial to the trust. The trustee in such circumstances is capable of and "has the power, if other funds fail, to create a charge, equivalent to his own lien for reimbursement, in favour of another by whom the services were rendered", and the plaintiff could therefore maintain a suit against the trustee in his or her representative capacity.

It is opined that the US courts have gone a step

further to understand the intention of the parties entering into contract by reviewing the language of the same. For example, in cases where the trustee has added 'trustee' or 'as trustee' as part of his or her signature of the contract with a third party, such additions have been categorised as merely 'surplusage'. 'Surplusage', in other words, is language within the contract that has no legal bearing or significance, and therefore may be ignored. It may be argued that, to the common reasonable man, such an addition goes beyond surplusage and clearly highlights the representative nature of the trustee signing the contract. It has been observed that the US courts are looking for explicit language to allow for the exoneration of trustees.

Practical issues

It is suggested that the courts around the world are of the view that the trustees ought to be held personally liable with respect to obligation arising out of a contract. As stipulated above, the courts have limited the exoneration of trustees in case of explicit language present within trust instruments. This must be looked at while considering that as per Section 4 of the 1963 Act, a trust requires to be created for a legal purpose. Since a trustee is acting in furtherance of such legal purpose, it is inferred that a trustee cannot be prescribed illegal powers by the trust instrument. Alternatively, such limitation is due to stipulations within the contract signed between the trustee and third party, which is limited by Section 23 of the Indian Contract Act 1872, stating that every agreement of which the object or consideration is unlawful is void. Therefore, upon the existence of either of the two factors mentioned above, the solvency or insolvency of a trustee is irrelevant to a third party considering that the exoneration of trustee liability shall automatically allow the grieved third party to tap into the trust property.

In the United Kingdom and United States, often a trustee is allowed to compensate themselves from the trust assets when facing personal liability, before making payments out of their personal assets. For example, in *Cunningham v Montgomerie*,⁷ the English Sessions Court dealing with a similar issue stated that where a trustee can approach the trust assets to compensate him or herself, such a right may be assigned to the third party to directly enforce their

right of relief against the trust property, provided the trustee was acting as per the powers provided within the trust instruments. In other words, the trustee would now be liable in his or her representative capacity instead of being personally liable. However, it is also pertinent to note that in some cases such assignment of rights only takes place once the court has ascertained that the trustee is absolutely incapable or impossible for the trustee to personally pay off the debts of the creditor, for example, due to reasons such as insolvency. Accordingly, it would require a third party to first wait for the court to adjudicate upon the insolvency of the trustee, before being able to be compensated for their losses.

Interestingly, the ratio found in various judgments is that the metaphysical personification of trusts is purely fictional in nature, and impractical considering that legal relations can only exist between persons. In addition, since a trustee is the owner and decision maker of the trust assets, such person must be found liable. However, considering that often a trustee simply plays the role of an administrator, and does not necessarily benefit from the existence of or distributions from the trust, is it justifiable to pin the economic burdens on the trustee?

The traditional argument set forth for imposing personal liability on trustees is that it is difficult for a third party to gauge the extent or value of the trust estate. A trustee is capable of entering into contracts considering his or her own personal reputation and assurances provided. The potential effect of an absolute exoneration of trustee's liability is the implicit allowance for a trustee to contract recklessly, negligently or fraudulently without any kind of repercussions. Additionally, the fact that the trustees owe a duty of care to the beneficiaries must be kept in mind. Any reckless, negligent or fraudulent act affecting the trust property shall allow the beneficiaries to sue the trustees personally.

It is believed that the courts want to strike a balance between ensuring that the third parties receive adequate justice in terms of compensation, and to avoid abuse of rights and power by trustees. A hard-and-fast rule or formula that narrows the liability applicable to a trustee or to the trust assets shall cause gaps, as mentioned above. Ideally, a subjective approach should be adopted while adjudicating trustee liability when the trustee's

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actions are *ultra vires* in nature. For example, instead of limiting the exoneration of a trustee only during the presence of explicit language within the trust instruments or due to stipulations within the contract, the court may also attempt to understand the intent of the trustee when dealing with third parties to ascertain whether there was either negligence or fraudulent intent involved.

Conclusion

India's jurisprudence in relation to trust and trustee liability is in line with views taken by multiple other foreign jurisdictions. It is evident that in relation to trustee liability the jurisprudence discussed above has shifted away from the Roman and civil law theories of 'fiction' and 'concession', where an artificial person that is created by the law is placed in the same category as that of natural persons, with the intention of ease and convenience in administering common commercial interest. It is opined that it is the reason

for the attribution of human-like features to artificial persons such as 'character' and 'intent'. However, since a trust is so intrinsically a result of the decisions of its trustee, in relation to liability, the law has clearly made an active step to signify the role and the corresponding liabilities of a trustee *apropos* the trust activities. A trustee can be held liable due to his or her role as owner of the trust properties and decision maker to ensure the absolute best utilisation of the trust properties for the benefit of beneficiaries. Thus, a trustee though acting in a fiduciary capacity will be required to make good the losses for the contracts entered into by him or her. It is imperative that such liabilities of the trustee are negotiated while entering into contracts. As seen, however, in the case where there is explicit or implicit mention of a third party being able to indemnify him or herself against the trust properties in the contract being signed, the trustees are not held liable.

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1 *Dr Thomas Varghese v State of Kerala*, Kerala High Court, 9 November 2022.
 2 *Strickland v Symonds* [1917] 1 MLJ 259; [1894] 26 ChD 245.
 3 *Re Johnson* (1880) 15 ChD 548 at 552; *Vacuum Oil Co Pty Ltd v Wiltshire* (1945) 72 CLR 319 at 324, 335; [1946] ALR 50; and *Octavo Investments* at CLR 367; ALR 580; ACLR 134.

4 *Taylor v Davis*, 110 US 330, 28 L Ed 163; *Everett v Drew*, 129 Mass 150.
 5 *Ibid.*
 6 *Jessup v Smith* 223 NY 203; 119 NE 403 (1918).
 7 *Cunningham v Montgomerie* (1879) 6R 1333.