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## Why trustee exemption clauses don't always work: two cautionary tales

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The courts used to permit trustees to have broad exemption clauses because without them it would be too hard to attract appropriate people to act as trustees.

But the freedom to write such broad clauses led to abuse and Parliament intervened to constrain the acts for which trustees could claim exemption.

The current New Zealand constraints are contained in s 40 of the Trusts Act 2019, which provides that:

*The terms of a trust must not limit or exclude a trustee's liability for any breach of trust arising from the trustee's dishonesty, wilful misconduct, or gross negligence.*

Trustee exemption clauses are not the only means for relieving trustees from financial liability. Section 131 of the Trusts Act provides that a court can relieve a trustee from personal liability if the court is persuaded that “the trustee has acted honestly and reasonably and ought fairly to be excused for the breach of trust”.

How effective are these two methods of relieving trustees from liability for breaches of trust?

I will refer to two cases that illustrate the courts' response.

## The parameters

The first case is *Wong v Burt* [2005] 1 NZLR 91, a decision of the Court of Appeal (attached below).

In this case, a family trust was settled by a father on his family. One of his daughters died unexpectedly early, leaving two grandchildren with no support.

The settlor's widow who was the chair of the trust, sought legal advice to learn how she could provide financial support for the two grandchildren.

A potential source of funds was a bequest that the settlor (her husband) had left to her in his will. She was to have a life interest in the bequest and after her death the funds were to go to one of the children. When asked by the lawyers whether the child was likely to complain if the moneys were distributed to the grandchildren (who were not beneficiaries of the trust), the widow said she thought not. So, \$250,000 was distributed to the widow who settled it in turn for the benefit of the two grandchildren. One of this country's major law firms advised the trustees that the strategy could be adopted.

But the prediction that the distribution would not be challenged was wrong and the child who was disadvantaged by the distribution to the widow alleged that its distribution for the benefit of the two

grandchildren was a breach of trust.

The exemption clause in the will provided that no trustee would be liable for any loss “not attributable to his or her own dishonesty or the willful commission by him or her of an act known to be a breach of trust ...”

Neither the exemption clause, nor s 131 was of benefit to the trustees.

In giving judgment for the Court of Appeal, Hammond J held that:

- The trustees had the burden of establishing that they were protected by one or both of the exemptions [51]
- Any exemption clause was to be construed narrowly against the trustees [51]
- The term “acting dishonestly” meant simply “not acting as an honest person would in the circumstances” [52].
- A person can be acting dishonestly even though he or she genuinely believes that his or her actions are morally justified [53]

- Although the trustees acted on legal advice and they contended that in such circumstances their conduct could not be characterised as “dishonest”, the court said that “acting on incorrect advice cannot of itself provide trustees with a shield” [55]
- The trustees had also obtained accountancy advice before making their decision, but this did not relieve them of liability [56].
- The Court of Appeal said the conduct of the trustees “was not merely unreasonable – it was downright foolish... knowing that it could come under critical legal scrutiny, as being an allegedly unlawful device” [57]

It was held that the trustees were liable, both in their capacity as trustees and in their personal capacities, to restore the sum of \$250,000 to the trust, together with interest [59].

## **Not honest**

A second case on this topic is *Spencer v Spencer* Civ 2001-485-00857 19 October 2011, a decision of Justice French (attached below).

Barry and Alia Spencer had established a trust during their marriage. Following their separation the trust was changed so that some of its assets were settled on a new trust.

In very broad terms, one trust was generally intended for the wife's interests and the other trust was intended for the husband's interests.

The trustees of the second trust did many things which were the subject of judicial criticism.

The trustees denied any wrongdoing and contended that they had complied with the provisions of the trust deed. They also said they were protected under an exemption clause which provided that “no trustee acting or purporting to act in the execution of the trust ... shall be liable for any loss not attributable to his or her own dishonesty or to the wilful commission or omission by him or her of an act known to be a breach of trust ...” [187]

French J adopted the various principles for interpreting exemption clauses that Hammond J had referred to in *Wong v Burt* [189] and said:

*“The general tone of the trustees’ evidence was very much one of righteous self-indignation. They expressed a strong sense of outrage at being sued ... They consider they have done absolutely nothing wrong and have worked very*

*hard in the interests of the beneficiaries.” [190]*

Despite this, the judge held that the three trustees “simply did not act as an honest person would in the circumstances” [194].

One of the trustees was an accountant and the trustees relied on his expertise. To this, French J held that “acting on incorrect advice cannot in itself provide trustees with a shield” [196].

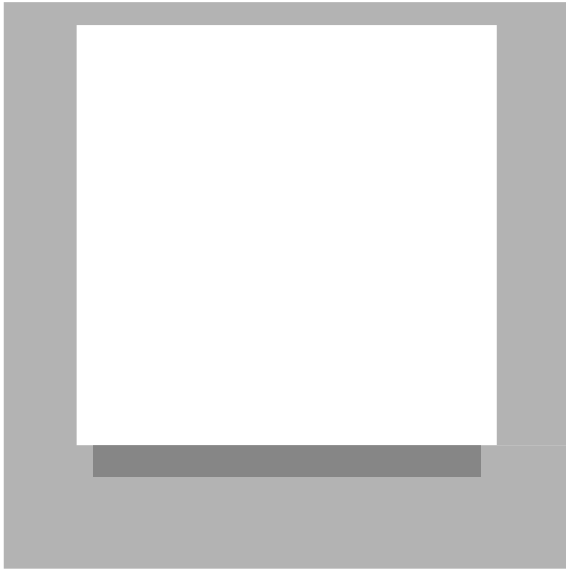
As for s131 (which at the time was s73 of the Trustee Act 1956), the judge said “the evidence satisfies me that none of the trustees acted ‘reasonably or honestly’” [200].

## **The learnings**

Three conclusions that can be drawn from the two cases.

- Many non-lawyer trustees do not understand the responsibilities of trusteeship
- Neither an exemption clause nor s 131 of the Trusts Act may provide trustees with the degree of protection they will want

- Trustees should give active consideration to obtaining indemnity insurance for any errors they may make in their role as trustees.



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[WONG V BURT case](#)

[Spencer v Spencer case](#)