

## Beddoe relief where a third party claim may exhaust Trust assets

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The Grand Court of the Cayman Islands has granted *Beddoe* relief to a trustee, in circumstances where a successful third party claim would have exhausted the trust assets.

### Introduction

The Honourable Chief Justice Anthony Smellie QC has delivered an important judgment, clarifying the ability of a Cayman Islands trustee to obtain *Beddoe* relief when faced with a third party claim that exceeds the value of the assets currently held in trust<sup>[1]</sup>.

In reaching this decision, the Chief Justice also addressed the scope of a third party litigant's ability to participate in a *Beddoe* application and who should bear the burden of costs, as between the third party and the trustee.

### Facts

The Trustee of the A Trust (the "**Trustee**") had been joined as a defendant to a claim brought by a third party ("**Z**") in England concerning a sale and purchase agreement (the "**English Proceeding**"). Z claimed damages against the Trustee in the English Proceeding for breach of contract and the tort of deceit. The sum claimed by Z was significant and an adverse judgment in the English Proceeding would have resulted in a complete loss of the A Trust's assets.

In these circumstances, the Trustee sought directions under section 48 of the Trusts Law (2011 Revision) to defend the English Proceeding and, if so granted, an indemnity out of the A Trust assets for any costs and expenses properly incurred by the Trustee for that purpose.

Prior to seeking *Beddoe* relief, the Trustee had sent a letter to Z notifying it of the intended application for directions. Z replied, contending that:

- (a) Z should be given formal notice of the *Beddoe* application and be allowed to make written submissions to the Court; and

(b) the Trustee should not be granted *Beddoe* relief.

(the "Response Letter")

## Decision

### *Importance of Beddoe relief*

The Court began by recognising the well-established principle, beginning with *Re Beddoe*,<sup>[2]</sup> that where a trustee pursues or defends an action unsuccessfully without the protection of a court order, it will only be granted an indemnity by the Court in exceptional circumstances. A prudent trustee will consequently wish to seek the Court's authorisation, irrespective of any entitlement to a contractual indemnity.

The Trustee's application for *Beddoe* relief turned upon whether the Trustee would be acting properly in defending Z's claim.

### *To what extent should Z be able to participate in the Beddoe application?*

The beneficiaries of the A Trust were necessary parties to the *Beddoe* application because the question of whether trust funds should be spent or placed at risk in defending Z's claim directly affected them.

In contrast, Z was not a beneficiary of the A Trust, nor did Z assert a proprietary claim to any assets of the A Trust. Z was simply a third party that asserted a disputed personal claim against the Trustee. This was a "third party dispute" within the meaning of *Alsop Wilkinson v Neary*<sup>[3]</sup> category (3). As such, the Court found that Z did not have any basis to be formally notified of the *Beddoe* application.

However, the Court considered that, as a contingent or putative creditor, Z should still have an opportunity to make representations to the Court as to whether the Trustee should be given a direction to defend Z's claim. The rationale for this approach was that a third party claimant in Z's position might, for example, be able to identify an argument not previously appreciated by the trustee, which would render the trustee's intended defence hopeless. In such circumstances, there would be value in the Court receiving the views of the claimant.

In the present case, the Court was satisfied that it was sufficiently aware of Z's position from its Response Letter and did not grant Z permission to either make any further written submissions or to participate in the *Beddoe* application more generally.

### *Should the Trustee be granted Beddoe relief?*

The Court was required to decide how Z's views on the *Beddoe* application should be balanced

against the interests of the beneficiaries of the A Trust. Z would be entitled to default judgment in the English Proceeding if its claim went undefended and the assets of the A Trust would certainly be exhausted to the detriment of the beneficiaries. Conversely, any reduction in the value of the assets of the A Trust, through an unsuccessful defence by the Trustee, would reduce the value of the property against which Z could enforce any judgment later given in its favour in the English Proceeding.

The Court did not consider the representations made by Z in the Response Letter to be determinative and held that the reduction of the trust assets to Z's potential prejudice by the Trustee's defence of the English Proceeding was not a factor that could outweigh the interests of the beneficiaries.

A contingent or putative creditor in Z's position, who is not asserting a proprietary claim to the trust assets, was found to take the trust assets as it finds them at the time of judgment. Z had only asserted a personal claim against the Trustee and its right to enforce any judgment against the assets of the A Trust was consequently held to be limited to whatever those assets may be from time to time in the ordinary and proper administration of the A Trust.

The Court concluded that, in the unusual and uncertain circumstances confronting the Trustee, it would be unjust to allow Z's putative, contingent and non-proprietary claim to outweigh the interests of the beneficiaries. The Trustee was allowed to defend the English Proceeding and would have an indemnity from the Trust assets for the costs reasonably incurred in doing so.

### **Points of interest**

The decision reinforces the importance of a trustee seeking *Beddoe* relief to protect their own position as to the costs incurred in defending third party litigation. Once such an order has been obtained, beneficiaries cannot assert that the trustee has acted in breach of trust or otherwise acted improperly in defending the claim - even if the trustee is unsuccessful. In this sense, the trustee's right to an indemnity *vis-à-vis* the beneficiaries is assured.

This ordinarily produces an equitable outcome for all the parties concerned, but presupposes that the trust assets will be sufficient to cover the costs which the trustee may have to bear if the third party's claim succeeds. Where the trustee faces a claim that may exhaust the trust fund, a much more difficult balancing exercise is required.

The Cayman Court appears to have implicitly proceeded on the basis that the Trustee's personal liability to Z was limited to the amount of the A Trust assets. It is possible that the underlying sale and purchase agreement between the Trustee and Z limited the Trustee's liability in this fashion, although the decision does not refer to any factual evidence on this point.

If a trustee has not contractually limited their own liability to the amount of the trust fund, it is difficult to justify a contingent or putative creditor having to take the trust assets as it finds them

at the date of judgment. A trustee's personal liability to a third party is prima facie unlimited and any right to an indemnity conferred by a *Beddoe* order traditionally operates only as between the trustee and the trust assets, not between the trustee and third parties. This aspect of the Court's decision must therefore be confined to circumstances where the trustee has contractually limited their third party liability to the amount of the trust fund.

The decision also provides valuable guidance on the scope of a contractual limitation of a trustee's liability. Academic commentators had previously expressed two differing views on this issue.

One view was that a contractual limitation of a trustee's liability only applied to the contractual liability itself and not to any costs incurred in respect of litigating any such liability (the "**First View**"). On this approach, a trustee could be personally liable to a third party in respect of the costs of an unsuccessful defence that depleted the trust assets, even if the trustee had acted reasonably and in accordance with a *Beddoe* order in doing so.

The alternate view was that a trustee's total liability was limited to the net trust fund after deducting the trustee's proper expenses, including the costs incurred by the trustee in defending a third party claim and any costs which the trustee might be ordered to pay the third party (the "**Second View**").

The difference between these alternate views may be illustrated by the following example. Suppose the trust fund is \$1,000,000 and a third party is awarded \$1,500,000 damages against the trustee for breach of contract. The trustee's own costs in unsuccessfully defending the claim are \$50,000 and the adverse costs that the trustee is ordered to pay the third party are \$30,000.

	Damages	Trustee's costs	Adverse costs	Personal liability
<b>No contractual limitation</b>	\$1,500,000	\$50,000	\$30,000	\$580,000
<b>First View</b>	\$1,000,000	\$50,000	\$30,000	\$80,000
<b>Second View</b>	\$920,000	\$50,000	\$30,000	-

If the trustee has not contractually limited its liability to the amount of the trust fund, it needs to pay the third party \$1,500,000 in damages and also bear its own costs of \$50,000 and pay adverse costs of \$30,000. Since the value of the trust fund is only \$1,000,000, the trustee bears a personal liability of \$580,000, for which no indemnity is available from the trust assets.

If the trustee has limited its liability, on the First View the trustee pays only \$1,000,000 of damages, exhausting the trust fund, and the third party bears the \$500,000 shortfall. The trustee

then bears its own costs of \$50,000, and pays the third party's costs of \$30,000. This leaves the trustee with an \$80,000 personal liability.

On the Second View, the trustee only needs to pay \$920,000 in damages, plus adverse costs of \$30,000. The trustee is then able to indemnify itself for its own costs of \$50,000 out of the remaining trust assets. As a result, the trustee is not personally liable to pay any amount for which it cannot indemnify itself out of the trust assets.

By permitting the Trustee in *X v Y* to pre-emptively indemnify itself against the costs and expenses incurred in defending the English Proceeding, and then requiring Z to take the assets of the A Trust as he may find them at the date of judgment, the Cayman Court has essentially followed the Second View. By adopting this approach, the Court has decided that, win or lose, a third party in Z's position will bear the burden of all the costs in circumstances where the claim exceeds the value of the trust fund.

Whilst it is possible to have some sympathy with a third party in this situation, it must be kept in mind that the third party would face a similar costs burden if it had instead contracted with, and litigated against, a company with insufficient assets to satisfy the judgment sum awarded.

## Conclusion

The decision should provide some comfort to trustees that may be exposed to substantial claims, which have the potential to exceed the value of the trust assets. By obtaining a *Beddoe* order, a Cayman Islands trustee can now safeguard its position as to costs - even if the third party ultimately succeeds in its claim and is awarded a judgment sum that exhausts the trust assets.

However, the door appears to remain open for an alternative approach in circumstances where the trustee has not contractually limited its liability to the third party.

[1] *X (as Trustee of the A Trust) v Y (as Beneficiary of the A Trust)* (unreported) 15 March 2017, Smellie CJ

[2] [1893] 1 Ch 547 (CA)

[3] [1996] 1 W.L.R. 1220, at 1223-1224, per Lightman J

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