

Jersey Royal Court reaffirms approach to indemnification of trustees

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Summary

In the recent case of *Representation of White Willow (Trustees) Limited*, the Royal Court reaffirmed a trustee's broad right to an indemnity as reasonable security when making an interim distribution to beneficiaries.

While this may be an uncontroversial principle, in this case the Royal Court helpfully confirmed that it was unnecessary for a trustee to have to demonstrate, as a precursor, the existence of known contingent liabilities.

Furthermore, the justification for an indemnity was not necessarily undermined if substantial assets remained in the trust fund after the payment of the interim distribution.

Background

In this case, the Trustee acts as the trustee of a charitable trust (the **Foundation**). The Foundation has eight charitable sub-trusts, each with an equal right to receive distributions. Five of the sub-trusts are administered by one third party trustee (**Sub-Trustee A**). Three of the sub-trusts are administered by a different third party trustee (**Sub-Trustee B**).

The Trustee wished to make a distribution from the Foundation to the eight sub-trusts of US\$20 million, or US\$2.5 million per sub-trust. The total assets of the Foundation were at that stage US\$30 million. The Trustee determined that it required reasonable security, and sought an indemnity from each of the sub-trusts in this regard.

The key terms of the indemnities sought were straightforward. In particular:

- they were unfortified
- they applied only in relation to proper trust liabilities, and

- recourse under the indemnities was limited to the lower of: (i) the amount initially distributed; and (ii) the amount of distributed assets that continued to be held by the respective sub-trusts at the time the indemnity were to be called upon

As a matter of basic trust law, a trustee is entitled to reasonable security under Article 43A of the Trusts (Jersey) Law 1984. In this case, the Trustee considered that indemnities sought were reasonable because:

- first, there were a number of contingent liabilities it had identified, including potential tax liabilities. While the Trustee conceded that these contingent liabilities were unlikely to arise, it maintained that there was a small risk that they could
- secondly, the Trustee contended that, even without these contingent liabilities, there may still be unknown liabilities of the Foundation which might only come to light after the distribution to the sub-trusts had been made

The Trustee's position was supported by Sub-Trustee A.

The Trustee's position was, however, opposed by Sub-Trustee B. It argued that the risks of the contingent liabilities identified by the Trustee were fanciful. On this basis, Sub-Trustee B argued: (i) that the contingent liabilities identified by the Trustee should be ignored; and (ii) the distributions should be made without the provision of any indemnities, noting that the funds remaining in the Foundation would be sufficient to meet any liabilities.

Court's decision

The Court held that the proposed indemnities constituted reasonable security. The Trustee was therefore entitled to withhold distribution to a sub-trust until that sub-trust had provided the Trustee with an indemnity substantially in the approved form.

The Court held that any risk of liability, even if minimal, was enough to justify an indemnity. In this case, the Court held that although the risk of the contingent tax liabilities was low, it could not be said that it was non-existent. The Court held that the provision of indemnities in this case would cost the sub-trusts nothing, because they would only bite if legitimate trust liabilities arose in the future.

It did not matter that there were assets remaining in the Foundation after the interim distribution had been made.

Moreover, the Court held that even if the Trustee had not identified any contingent liabilities then the proposed indemnities would still have been reasonable security against any unknown liabilities. The Court's reasoning was, again, that if no liability ever arose then the indemnities would never bite. However, if a liability did arise, then it would be entirely reasonable for that liability to be borne by the sub-trusts rather than the Trustee.

In analysing what terms would be reasonable in any indemnity, the Court said that this would depend on the extent of the risks. In summary, the greater the ongoing and remaining risks of a liability materialising after the distribution, the greater the nature and extent of security that could be sought.

Comment

The Court's decision in this matter will be welcome clarification for the trust industry. It makes clear that a trustee should not be expected to take on any risks when distributing trust assets, even on an interim basis. These risks should instead be borne by the beneficiaries benefitting from the distributions.

If what is sought is an unsecured indemnity in broadly standard form, then there is likely to be little (if any) need to justify it. This is the case even if the trustee has identified no contingent liabilities and the purpose of the indemnity is to protect only against unknown ones.

While each matter will turn on its individual circumstances, this case should, therefore, provide trustees who are in a similar situation to the Trustee with some comfort and assist them in making interim distributions with suitable protection in doing so.

Nick Williams appeared as the Advocate for the Trustee in this matter.

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