

Beddoe Relief: a case study from the Grand Court of the Cayman Islands

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In the case of X (as Trustee of the A Trust) v Y (as Beneficiary of the A Trust) (unreported) 15 March 2017, Smellie CJ, the Grand Court of the Cayman Islands granted Beddoe relief to a trustee in circumstances where a successful third party claim would have exhausted trust assets. Partner Rachael Reynolds and Associate Shaun Maloney assess the decision's potential ramifications.

What issues did this case raise?

The trustee of a Cayman Islands trust had been joined as a defendant to a claim brought by a third party in England. The third party claimed substantial damages against the trustee for breach of contract and in tort. An adverse judgment in the English proceedings would have exhausted the trust assets.

The trustee sought directions under section 48 of the Trusts Law (2011 Revision) to defend the English proceedings and, if so granted, an indemnity out of the trust assets for its costs and expenses properly incurred for that purpose.

The Cayman Islands court was required to address the ability of a trustee to obtain Beddoe relief in these circumstances and also determine who should bear the burden of costs, as between the third party and the trustee.

What did the court decide and what are the practical implications?

The court recognised the well-established principle, beginning with *Re Beddoe* [1893] 1 Ch 547 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.

The trustee's application for Beddoe relief turned upon whether the trustee would be acting properly in defending the third party's claim.

If the English proceedings went undefended, the third party would have been entitled to default judgment. This would have exhausted the trust assets to the detriment of the beneficiaries. On the other hand, any reduction in the value of the trust assets from an unsuccessful defence by the trustee would have depleted the trust property against which the third party could enforce any judgment in the English proceedings.

On balance, the court decided that the potential prejudice suffered by the third party from the trustee's defence was not a factor that could outweigh the interests of the beneficiaries.

The third party had only asserted a personal (ie non-proprietary) claim against the trustee and its right to enforce any judgment in the English proceedings was held to be limited to whatever the trust assets may be at the time of judgment.

The court therefore granted the trustee's application for Beddoe relief and allowed the trustee to indemnify itself for the costs that it reasonably incurred in defending the English proceedings from the trust assets, irrespective of the eventual outcome of that claim.

The practical effect of this approach is that if a third party brings a personal claim against a trustee that may exhaust the trust assets then, win or lose, the third party will not only be required to pay its own litigation costs, but will also, in effect, bear the costs of the trustee, by reason of the depletion in value of the trust fund against which it has a claim.

To what extent is the judgment helpful in clarifying the law in this area?

The judgment confirms that a trustee is not precluded from obtaining Beddoe relief simply because its defence costs will reduce the assets against which a third party may wish to enforce a judgment.

The decision also provides valuable guidance on the scope of 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 by the trustee in respect of litigating any such liability. The second, 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 any third party claim and any costs which the trustee might be ordered to pay a third party.

By permitting the trustee in this case to pre-emptively indemnify itself against the costs and expenses incurred in defending the English proceedings, and then requiring the third party to take the trust assets as it found them at the date of judgment—the Cayman Court essentially followed the second view.

What are the implications for practitioners? What will they need to be mindful of when advising in this area?

In the absence of obtaining an indemnity from all beneficiaries to defend a third party claim, a prudent trustee should seek the court's authorisation before doing so. This is so, even if the trustee has already taken a view that it is in the best interests of the beneficiaries to defend the claim.

A Cayman Islands trustee can now also be assured that its position as to costs in defending a third party claim can be adequately safeguarded by a contractual limitation of liability. It does not matter if the value of a third party claim exceeds the amount of the trust assets.

Are there still any unresolved issues practitioners will need to watch out for? If so, how can they avoid any possible pitfalls?

The comfort that trustees may derive from this decision is limited to personal claims against trust assets. Different considerations apply where a third party asserts a proprietary claim or the trustee faces a breach of trust claim.

Second, the decision must be confined to circumstances where the trustee has contractually limited its third party liability to the amount of the trust fund. 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. Once the trust assets have been exhausted, neither a Beddoe order nor any indemnity in the trust deed will protect a trustee that remains liable to a third party. The trustee will need to pay any shortfall out of its own pocket.

This reinforces the need for trustees to properly limit their personal liability to third parties. This limitation will not be presumed and trustees must therefore be careful to ensure that the limitation is properly conveyed to any third parties with whom they conduct business.

To what extent will the decision be persuasive in other jurisdictions?

Cayman Islands decisions are internationally respected and the jurisdiction is regularly recognised as being at the forefront of trust law.

There is very little guidance internationally on what a trustee should do in circumstances where it is faced with a third party claim that may exhaust the trust assets and the scope of a trustee's contractual indemnity in such a situation.

We therefore expect that this decision will be considered persuasive by trust practitioners and courts throughout the common law world.

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