

# **A WARNING TO TRUSTEES: THE STING IN THE TAIL OF WARRANTIES**

*By Jeremy Cousins QC*

Almost all trustees will have to consider, from time to time, whether to sell some or all of the assets which form part of the trust fund which they manage. Frequently they will not be asked to give warranties upon a sale. For example, if they are proposing to sell securities quoted upon a stock exchange, there will be question of giving a warranty. Similarly, if real property is sold, it is most unlikely that a warranty will be sought, although trustees may have to make representations arising from pre-contract enquiries.

### *Liability upon warranties, and equities of retention and exoneration*

When trustees enter into contracts in respect of the sale of trust property, they will be personally liable, without limit, upon the transaction. Unless a contract specifically provides otherwise, the trustee will be liable to the other contracting parties even though the value of any trust asset retained, and not distributed to a beneficiary, may be much lower than the liability incurred on a sale. This leaves the trustee exposed. To protect the trustee, he undoubtedly has equities of exoneration and retention in respect of liabilities and contingent liabilities. The equities are supported by a lien over the fund concerned; see the discussion in *Lewin on Trusts*, 18th edition at paragraph 21-33, and also the decision of Mrs Justice Arden as she then was in *X v. A* [2000] 1 All ER 490. No beneficiary can demand a transfer of an asset until a trustee's just demands are met; *Re Chennel* (1878) 8 Ch D 492, especially at 503.



In the case of more substantial trusts, particularly those holding shares in family companies, the trustees are however likely to find that if they wish to sell an asset, say the shares in the family company, they are presented with a dilemma. If they are not prepared to give a warranty as to all manner of aspects of the asset being sold (for example, as to tax liabilities and trading history), they will not achieve a sale, or a sale will only be achieved at a comparatively disadvantageous price. On the other hand, if they do give warranties, the purchaser will reasonably demand, effectively as security, that those warranties are backed up with an undertaking on the part of the trustees not to distribute the fund to beneficiaries unless the beneficiaries undertake a liability on the warranties, equivalent to that previously undertaken by the trustees, as to the relevant proportion of the fund distributed. Such provisions are common, and are discussed in *Sinclair on Warranties and Indemnities*, 7th edition, see especially at 2-06. See also Stilton, *Sale of Shares and Businesses: Law, Practice and Agreements*.

#### *Fettering of powers*

The conscientious trustee may consider that it is very much in the beneficiaries' interests to effect a sale, and for a warranty to be given, but he can find himself in a very difficult position if in order to meet the purchaser's demand that assets be retained to secure performance of the warranty, he restricts the power to appoint and distribute the trust fund. This potential liability was highlighted in the recent decision of Mr Justice Briggs in *Jones & others v. Firkin-Flood & others* [2008] EWHC 2417 Ch), [2008] All ER (D) 175(Oct); in *Jones* no liability actually arose given the powers contained in the relevant Will Trusts, and the factual circumstances of the case.

The potentially very serious problem for a trustees is that for them to undertake to a third party not to distribute the whole or part of a trust fund may amount to an unlawful fetter upon their discretions; trustees cannot properly fetter a discretion possessed by them as trustees. This is well established; see such cases as *Oceanic Steam Navigation Co v. Sutherland* (1880) 16 Ch D 236, especially at 243-244, and *Swales v IRC* [1984] 3 All ER 12, especially at 24. Thus by giving a warranty which enhances the sale value of an asset, and backing that warranty by an undertaking not



to release proceeds without a beneficiary's assuming liability on the warranty, the trustees may have unlawfully fettered their discretion. This would amount to a breach of trust on the part of the trustees. As a result, they might be liable to beneficiaries for having fettered discretion, or for breach of contract to a purchaser if they release monies to the beneficiary.

*Ascertaining powers conferred by the trust instrument*

This dilemma can be avoided if the powers conferred by the relevant trust instrument make clear that the trustees may give a warranty and undertake to a purchaser to retain proceeds. Equally, a clause conferring on the trustees the powers of "an absolute beneficial owner" will be wide enough to enable trustees to sell, subject to warranties, and to agree to retain proceeds. Mr Justice Briggs so held in *Jones*. Here again a note of caution must be sounded; even where a power exists because of such a provision, a trustee will still be in breach of trust if he exercises the power imprudently; see *Bartlett v. Barclays Bank Trust Co (No 1)* [1980] 1 Ch 515 at 536-537. (Again in *Jones* there was no liability; the sale occurred on terms which were of immense advantage to the trust.) Thus trustees, when selling, giving warranties, and undertaking to retain funds (even where the sale agreement may permit them to release proceeds to a beneficiary who covenants with the purchaser in the terms of the warranty) need to be satisfied, first, that they have the power to give such warranties and tie up funds (because of the fetter on discretion), and secondly that it is, in any event, a prudent thing to do.

Not unnaturally, many trustees may be unwilling to take on themselves the considerable risk of selling, giving warranties, and undertaking to release funds only on terms. If they make the wrong decision, though acting with the best of motives, a dissatisfied beneficiary may well complain, leaving the trustees with potentially very large liabilities. What then can a careful trustee do to protect his or her position if it becomes apparent that a sale may necessitate providing warranties and will involve



restrictions on the release of proceeds? First, it is obviously sensible for a trustee to seek legal advice. The adviser will need as a preliminary step to consider the width of the trustee's powers to sell. An "absolute beneficial owner" clause is likely to afford protection against any suggestion that the sale led to an improper fettering of powers of disposition.

Secondly, consultation amongst beneficiaries may provide a solution. If all the beneficiaries can be ascertained, and have capacity, and consent, then the trustees can rely on that consent and deal accordingly. Often, however, not all the beneficiaries may be able to give consent because they may be minors, or unborn. In such a case the trustees can make an application to the Court under CPR Part 64. Provided that the Court confirms that the trustees powers are wide enough, and approves of the transaction, its decision will protect the trustees.

Thirdly, even where the powers conferred by the trust instrument are not sufficiently wide to empower the trustees to sell on the proposed terms, the Court can confer the necessary power to enter into the transaction under section 57 of the *Trustee Act 1925*.

Clearly the guidance for a trustee who, having taken advice, remains in any doubt as to his power to enter into a particular transaction, or its wisdom, must be first to seek consent of all beneficiaries. If that is not forthcoming, or cannot be obtained or given because, for example, there are too many beneficiaries, or there are minors interests to consider, then an application should be made to the Court before the transaction is undertaken. It should generally be possible to expedite such an application so that a good commercial opportunity will not be lost.

(Jeremy Cousins was Leading Counsel for the Trustees in *Jones & others v. Firkin-Flood & another* mentioned in this article.)

