When to indemnify

Natasha Dzameh clarifies the circumstances in which Beddoe *orders and protective cost orders can be used*

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The role of a trustee can be an arduous and financially precarious one. Trustees are fiduciaries who are subject to a wide range of duties concerning issues such as investment and distribution of the trust property, not profiting from the trust and the keeping of accounts. Breach of trust can occur where a trustee acts without the requisite standard of care, fails to carry out a duty or acts outside the scope of their powers.

Unclear trust instruments and unascertained beneficiaries complicate the process of trust administration. However, applications for directions can be made to the court under Part 64 of the Civil Procedure Rules. Trustees can become embroiled in various types of claims, but they are often most concerned by those which require them to decide whether to bring or defend proceedings, or even whether to continue to do so, in their capacity as a trustee. Should the trustees make the wrong decision they may find themselves personally liable to the beneficiaries. In these circumstances an application under Part 64 of the CPR is known as a *Beddoe* application, albeit these circumstances do not automatically mean a *Beddoe* application is warranted. The trustees may request that the court approve their decision or that the court make the decision for them.

A successful *Beddoe* application indemnifies the trustees as between themselves and the beneficiaries. This indemnity is secured from the trust fund in respect of the costs incurred in the proceedings the application relates to and includes costs the trustees may be ordered to pay to other parties involved in the proceedings. Practitioner texts concerning *Beddoe* applications often neatly categorise litigation as a specific type of claim. However; in reality it is not uncommon for the main litigation to be comprised of more than one type of claim. This complicates the process of determining whether a *Beddoe* application is appropriate. The case of *Pettigrew & ors v Edwards* [2017] is a prime example of such a situation.

Facts

The deceased died leaving her residuary estate on trust to the first and second trustees beneficially in equal shares, however; this was subject to an income to be paid to the life tenant (the deceased's fourth husband). The first and second trustees were the deceased's sons while the third trustee was her solicitor. The value of the residuary estate exceeded £500,000 and included a promissory note for the sum of £100,000 signed by the life tenant to the deceased in respect of a loan. The hope had been that the loan would only be repaid upon the death of the life tenant.

When the deceased died, she had not paid the entire £100,000 and this was treated as a liability of her estate. The trustees sought repayment of the loan. There was much correspondence between them and the life tenant regarding security, but no security was provided.

Ultimately the trustees took the decision to withhold the income from the life tenant on the basis that these funds could be used to repay the loan. The life tenant disputed that there was any such debt and issued a claim against the trustees in the Chancery Division of the High Court (the main claim). The life tenant sought an order requiring payment of the outstanding income, plus interest along with a

direction that the trustees must pay the income to him during his lifetime. The trustees filed a set-off defence on the basis that they could retain the income to pay off the life tenant's debt. They also counterclaimed for the entirety of the loan and/or a declaration that they were entitled to retain the income until the debt was discharged.

The trustees subsequently applied for a *Beddoe* order and a protective costs order.

Main submissions

Counsel for the trustees made the following arguments:

- Trustees are entitled to an indemnity out of trust funds for all administration expenses properly incurred.
- The promissory note is an asset of the trust.
- Whether the debt is due and owing is a third party dispute.
- It is the trustees' duty to protect and preserve the fund.
- Provided the court considered it was reasonable to claim the sums as due to the estate the trustees were, on the face of it, entitled to an indemnity in respect of the costs of the third party dispute.
- The trustees should have recourse to the fund to do so as the trust stood in the shoes of the deceased and the capital beneficiaries should not be required to fund the proceedings.
- *Re Dallaway* [1982] and *Re Evans* [1986] both concerned cases where the whole fund was in dispute and could be reconciled. Whether it was proper to disburse funds in the dispute or to effectively intervene was a decision for the trustees, having regard to all the circumstances including the merits of the claim, but generally required exceptional circumstances.
- The trustees' ability to withhold the income in discharge of the debt was a question of trust administration and the trustees would abide by any given court directions. The income was not lost to the fund; the only question was its application.

Counsel for the life tenant submitted:

- The first and second trustees are adult beneficiaries and, as such, could decide whether the claim should be resisted without the assistance of the court. This was indistinguishable from *Re Evans*.
- There was no prejudice to the trustees. If they were unsuccessful in their application but successful in the main proceedings they could apply for costs in the normal way.
- The life tenant would be prejudiced if the application were granted and the trustees failed in the main proceedings. He would indirectly pay for the trustees' unsuccessful defence.
- The trustees do not require permission to make a counterclaim as they have already made such a claim.
- The application was unnecessary in respect of the trustees who were also beneficiaries. They were requesting permission to pay for the proceedings out of money which would eventually be theirs.
- The life tenant has an ongoing right to the income and it is incidental to that right that the trust fund not be prematurely depleted by a prospective costs order.

Judgment

Master Matthews stated there were three elements to the main claim:

- the claim by the life tenant concerning the failure to pay him the income due under the will trust fund;
- the defence of set-off of the alleged debt due to the trustees by the life tenant; and
- the counterclaim by the trustees for the whole of the loan and/or a declaration that they are entitled to retain the income due to the life tenant until the debt was discharged.

Although there were three elements, the litigation involved two separate cases:

- Case 1 concerned the validity and enforceability of the promissory note.
- Case 2 concerned how the result bore an obligation on the trustees to pay the income to the life tenant which he was otherwise entitled to.

The trustees filed a set-off defence on the basis that they could retain the income to pay off the life tenant's debt.

Case 1 was a third party claim and was a candidate for a *Beddoe* order. The mere fact that it was a candidate did not necessarily mean it was appropriate to make such an order. The master applied *Re Evans*, doubting whether *Re Dallaway* was consistent with the later Court of Appeal decision. He made reference to Nourse LJ who stated in *Re Evans*:

> In my view, in a case where the beneficiaries are all adult and *sui juris* and can make up their own minds as to whether the claim should be resisted or not, there must be countervailing considerations of some weight before it is right for the action to be pursued or defended at the cost of the estate. I would not wish to curtail the discretion of the court in any future case but, as already indicated, those considerations might include the merits of the action. I emphasise that these remarks are directed only to cases where all the beneficiaries are adult and *sui juris*.

The master accepted that Nourse LJ relied heavily on the judge's belief in *Re Dallaway* that the claim was weak and that there was no direction to join the beneficiaries to the action. He noted that although there were minor factual differences between the two cases he struggled to see why the results should be different. In his opinion, the assessment by a judge at the *Beddoe* stage was speculative so there could be no real confidence the result would follow and it was possible to join the beneficiaries in *Re Dallaway* in the same way as in *Re Evans*.

Master Matthews referred to the fact that in the present case the beneficiaries were adults and *sui juris*. If the court were to make a *Beddoe* order it would result in injustice to the life tenant. Should the trustees' claim against the life tenant fail, a *Beddoe* order having been made, the life tenant's status as a beneficiary meant he would have paid in part for the unsuccessful claim despite his own success. The fact that the disputed property constituted less than a fifth of the estate made no difference in principle. It meant that the third party would simply be paying part of the costs if he was successful rather than the entirety of them.

He stated that this was simply a question of the degree of injustice and did not affect whether injustice occurred in principle. The master explained that the risk of injustice could be removed by ensuring the costs risk of the third party claim fell onto the two capital beneficiaries for whose benefit the litigation continued. Nonetheless, because the life tenant had an income interest in the entire fund, an indemnity could not be granted out of the capital as payment of costs from the capital would reduce the fund generating the income. While this did not result in injustice as great as in *Re Evans* it was significant.

Case 2 was internal to the trust and was not a candidate for a *Beddoe* order.

It was not considered appropriate to direct the trustees as to whether they should make or continue their counterclaim in light of the refusal of the *Beddoe* order.

In relation to the trustees' request for a protective costs order, the master noted that the court could not determine at this stage who would win Case 1 thus the costs must come out of the trust estate. Case 2 was to be characterised as a breach of trust claim, and costs for such claims do not come out of the trust fund. Although

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the court could make a protective costs order subject to any order made by the trial judge, this would not assist the trustees in determining their next steps. Furthermore, as the court could not currently determine whether any of the trustees' costs must inevitably be taken from the trust fund, it could not authorise the incurring of costs up to a certain point either.

Conclusion on case

In my view *Re Evans* and *Re Dallaway* are consistent decisions, with *Re Dallaway* capable of being distinguished for the reasons cited by Nourse LJ. *Beddoe* applications are fact-specific hence they are, by their very nature, often expensive and strongly contested. I appreciate that the assessment of prospects by a judge at the *Beddoe* stage is speculative. Nonetheless counsel and/or the instructing solicitors will have assessed the prospects of the main claim before the trustees decide to make the *Beddoe* application and there is no reason why the judge should not do so, or why this element should be dismissed from the list of possible countervailing considerations provided by Nourse LJ. In a *Beddoe* application, the trustees will have disclosed to the judge relevant documentation such as counsel's opinion concerning the main claim. Further, the trustees have the option of requesting the court's approval of a decision already made or forcing the court to make the decision. In doing the latter the court will be forced to pay heed to the merits of the main claim and it may be that these applications have greater prospects of success than those where the trustees are seeking approval.

The master's focus on the risk of injustice clearly refers to the concept of the costs risk falling upon the third party. In this respect the conclusion would have been the same had the value of the main claim constituted one tenth of the trust fund, or even one fiftieth. He acknowledges that the costs risk in a third party claim can be directed to fall on the capital beneficiaries who benefit from the litigation continuing, provided none of the other beneficiaries have an income interest in the fund. Nonetheless where such beneficiaries have an interest in the fund income this result cannot be achieved in any obvious way.

One is then left to consider whether the injustice is significant and this is where the real problem with this decision lies. Although *Pettigrew* clarifies the position in respect of *Beddoe* and protective costs orders by setting out the relevant factors and the process of analysis in relation to the principles at large, it also provides an unsatisfactory result on the concept of significant injustice. While I agree that the value of the fund does not affect whether injustice is present, I consider it highly relevant in relation to whether that injustice is 'significant'. The reduction in income generated due to payment of costs where the trust fund has a value in the region of £500,000, while not trifling, would be far from monumental. The indication in the Master's decision is that the mere fact the third party suffers any costs risk constitutes significant injustice.

If this were simply a question of the quantities involved one may wonder whether it would be of assistance to provide an estimate of litigation costs in relation to the main claim, accompanied by an expert's assessment of the likely income reduction and the life expectancy of the third party. As the issue appears to be one of where the costs risk lies, one must then contemplate how this could be directed towards the other beneficiaries. Would the court be minded to grant a *Beddoe* application if the other beneficiaries provided an undertaking to the court, or a payment into court, in respect of the projected income reduction to compensate the third party if they are successful in the main claim? In my view, whether this is a matter of quantity or allocation of costs risk, either solution would simply serve to make *Beddoe* applications unnecessarily convoluted and needlessly increase the cost of what is already a notoriously expensive application. Furthermore, the option of a payment in or an undertaking may not be financially viable for the other beneficiaries. Consequently, it appears that Master Matthews' decision relegates *Beddoe* orders in third party claims to a state whereby they are virtually impossible to obtain if the third party possesses an interest in the fund income (assuming the beneficiaries are all adults and *sui juris*).

Beddoe applications are fact-specific hence they are, by their very nature, often expensive and strongly contested.

Key points for practitioners

- A claim may be comprised of more than one type of case, each of which must be considered when determining eligibility for a *Beddoe* order.
- Where a claim involving a trust fund can be categorised as a third party claim, the beneficiaries are adults and are *sui juris*, the court will refuse to make a *Beddoe* order unless the injustice caused would not be so significant as to justify the refusal.
- The injustice caused may warrant refusal of a *Beddoe* order even where the dispute does not concern the entire trust fund and the third party simply has an income interest in the entire fund.
- The court may make a protective costs order in circumstances where it has refused to make a *Beddoe* order if it is satisfied that the applicant's costs will inevitably come out of the trust fund. ■

Re Beddoe (Downes v Cottam)
[1893] 1 Ch 547 (CA)
Re Dallaway
[1982] 1 WLR 756
Re Evans
[1986] 1 WLR 101
Pettigrew & ors v Edwards
[2017] EWHC 8 (Ch), to be reported in a future WTLR