[1999–00 Gib LR 211]

STG VALMET TRUSTEES LIMITED v. BRENNAN AND FOUR OTHERS

COURT OF APPEAL (Neill, P., Waite and Glidewell, JJ.A.): May 28th, 1999

Trusts—costs—indemnity from trust fund—pre-emptive costs—discretion to award trustee pre-emptive costs same whether claimant against trust is beneficiary or stranger—to consider trustee's prospects of success in defending claims (must be satisfied trial judge will award costs), possibility of injustice and any special circumstances

Trusts—costs—indemnity from trust fund—pre-emptive costs—order in favour of trustee accused of negligence and breach of trust rare—may award costs of defending claims in preliminary stages and trustee's application to strike out, in order to clarify issues and save future costs—award to cover discovery process premature if strike-out application pending

Trusts—costs—indemnity from trust fund—pre-emptive costs—application to be heard inter partes and claimant against trust, whether beneficiary or stranger, to have full opportunity to oppose costs order, but to be excluded when court assesses strength of trustee's case—non-beneficiary not to be joined as party to application

The respondent trustee applied to the Supreme Court for directions in respect of proceedings by the appellant against it and the trust.

The settlor established three Gibraltar trusts to benefit himself, his family, and a charitable foundation. A year after the last of the trusts was established, he petitioned for voluntary bankruptcy in the United States. The appellant, his trustee in bankruptcy, commenced proceedings against the trustee, alleging that the trusts had been established with the intent to defraud the settlor's creditors, since the settlor had been aware of major legal proceedings against him in the United States at the time he established the trusts, and the trustee had colluded in this.

He applied, *inter alia*, for (i) a declaration that the settlements were void as dispositions in fraud of creditors, contrary to the Fraudulent Conveyances Act 1571, and (ii) an order that the registrations of those dispositions under the Bankruptcy (Register of Dispositions) Regulations, 1990 be set aside, since they had been procured by the settlor's misrepresentations. He also claimed (iii) damages against the trustee for breach of

statutory duty or negligence in failing to ensure that the settlor was solvent when the dispositions to the trusts were registered, and/or (iv) constructive trusteeship on the trustee's part for knowing assistance in the concealment of assets through the trusts. Upon an application by the trustee, claims (ii) and (iii) were struck out and claims (i) and (iv) amended (see 1999–00 Gib LR 81).

Meanwhile, the trustee applied for directions on defending the action, seeking an order for advance provision from the trust for its costs of doing so and any liability in costs to other parties. The appellant was represented at the outset of the hearing and was permitted to make submissions on his own application to be joined as a full party to the directions application, and on the merits of the trustee's *Beddoe* application. His application to be joined was dismissed. The trustee was given leave to defend the proceedings until the close of discovery and authorized to take its costs of doing so and of its application to strike out the statement of claim, from the trust.

On appeal, the appellant submitted that (a) the court's discretion to award costs in trusts proceedings did not extend to making a pre-emptive costs order in favour of a trustee sued by a stranger to the trust, or could not properly be exercised to that effect, since it would be wrong in those circumstances to diminish the trust fund regardless of the outcome of the proceedings; (b) since the court had heard the joinder application and the *Beddoe* application together, he had been deprived of the opportunity to make adequate submissions on either; and (c) the court had erred in dismissing his application, since there existed, for the purposes of O.15, r.6(2)(b) of the Rules of the Supreme Court, a question or issue between him and the trustee relating to the relief sought by the trustee in its own application.

The trustee submitted in reply that (a) the court had a discretion to make a pre-emptive costs order in its favour, since it would otherwise be more vulnerable to personal liability when sued by a third party than when sued by a beneficiary of the trust; (b) the order was justified in respect of the strike-out application in the interests of clarifying the issues pleaded, thereby saving costs; (c) the appellant had had ample opportunity to present his case both on the joinder application and trustee's application; and (d) it would be contrary to legal principle and established case law to permit the appellant to be joined as a party in the present application. The trustee offered an undertaking to make a further *Beddoe* application after a forthcoming hearing before the Chief Justice to finalize the amendment of the statement of claim.

Held, allowing the appeal in part:

(1) The purpose of an application for directions was to enable the trustee to ascertain whether the proposed litigation to be brought or defended would be regarded as in the best interests of the trust for the purposes of a costs order under O.62, r.6(2) of the Rules of the Supreme Court. The directions given would vary depending on whether the dispute

was solely between rival claimants to the trusts or involved allegations of personal misconduct by the trustee. However, the court's discretion to award costs was the same whether the claimant against the trust was a beneficiary or a stranger to the trust. In deciding whether to make a pre-emptive order for the trustee's costs, the court had to have regard to the trustee's prospects of success in defending the claims against it, the need to be satisfied that the trial judge would make an order in the trustee's favour, the risk that the order might result in injustice, and the existence of any special circumstances (paras. 31–36; para. 38; para. 54).

(2) There would be few cases in which the court would direct the trustee to defend a stranger's claim, alleging the trustee's negligence or breach of trust, with the benefit of an advance indemnity as to costs. However, the mere fact that the plaintiff had added a personal claim against the trustee to those against it in its fiduciary capacity did not preclude such an order. Since a *Beddoe* application had to be made at an early stage in the litigation (when it was difficult to determine whether the claim was well-founded), the court had in the first instance authorized the trustee to defend the action in its preliminary stages and to test the sustainability of such claims by applying for them to be struck out. Having accepted that the claims against the trustee were weak, the court had reasonably concluded that the trial judge would make an order in the trustee's favour and had properly given leave for the strike-out application to be funded from the trust in the interests of clarifying the issues and potentially saving costs (para. 37; paras. 41–42; paras. 55–58).

(3) However, the court's order authorizing the trustee to defend the claims until the close of discovery might have been premature, since only when the outcome of the strike-out application was known could the court know which issues had survived and form a view of the nature and extent of the discovery to be funded. The trustee would be required to give the offered undertaking to make a renewed application after the hearing before the Chief Justice, at which time the court would be in a position to make an informed decision whether to authorize further steps in the litigation and on what terms as to costs (paras. 59–61).

(4) A claimant to the trust, whether or not he was connected with it, should be given the maximum opportunity to be heard on the trustee's application for a pre-emptive costs order consistent with the need to maintain confidentiality in matters arising for consideration between the trustee and the court alone. Accordingly, the application should be heard *inter partes* and the plaintiff should be heard as fully as if he were a party to the proceeding, save that he should not be permitted to be present when the strength of the trustee's defence was discussed. The court had properly ruled that a claimant against the trust who was not a beneficiary should not be made a party to the *Beddoe* application, since this would afford it access to privileged or confidential material which would not be available through discovery (paras. 39–40; para. 42; para. 53).

(5) Unfortunately, the appellant's exclusion from the latter stages of the *Beddoe* application had restricted its opportunity to make submissions on the joinder issue. It would have been a more satisfactory and courteous practice for the court to hear the applications separately and to recall the appellant to inform him of the outcome of each application. However, this was a matter for the court's discretion, and it had made no error of law (paras. 51–52).

Cases cited:

(1) *Alsop Wilkinson* v. *Neary*, [1996] 1 W.L.R. 1220; [1995] 1 All E.R. 431, applied.
(2) *Beddoe, In re, Downes* v. *Cottam*, [1893] 1 Ch. 547; (1892), 62 L.J. Ch. 233; 37 Sol. Jo. 99, applied.
(3) *Biddencare Ltd., Re*, [1994] 2 BCLC 160; [1993] BCC 757.
(4) *Dallaway, In re*, [1982] 1 W.L.R. 756; [1982] 3 All E.R. 118, not followed.
(5) *Eaton, In re, Shaw* v. *Midland Bank Exor. & Trustee Co. Ltd.*, [1964] 1 W.L.R. 1269; [1964] 3 All E.R. 229n.
(6) *Evans, In re*, [1986] 1 W.L.R. 101; *sub nom. Evans* v. *Evans*, [1985] 3 All E.R. 289, applied.
(7) *McDonald* v. *Horn*, [1995] 1 All E.R. 961; [1995] I.C.R. 685, applied.
(8) *Moritz, In re*, [1960] Ch. 251; [1959] 3 All E.R. 767.
(9) *Walters* v. *Woodbridge* (1878), 7 Ch. D. 504; 47 L.J. Ch. 516, applied.
(10) *Westdock Realisations Ltd., Re*, [1988] BCLC 354; (1988), 4 BCC 192.
(11) *Weth* v. *Att.-Gen.*, [2001] W.T.L.R. 155, applied.

Legislation construed:

Rules of the Supreme Court, O.15, r.6(2)(*b*)(ii): The relevant terms of this sub-paragraph are set out at para. 46.

O.62, r.3(3): "If the Court in the exercise of its discretion sees fit to make any order as to the costs of any proceedings, the Court shall order the costs to follow the event, except when it appears to the Court that in the circumstances of the case some other order should be made as to the whole or any part of the costs."

r.6(2): The relevant terms of this paragraph are set out at para. 33.

J.E. Triay, Q.C. for the appellant;
T.R. Mowschenson, Q.C. for the trustee;

1 **WAITE, J.A.:** This appeal arises from an application made by a trustee in the Supreme Court's Chancery jurisdiction under the authority of *In re Beddoe, Downes* v. *Cottam* (2). That decision confirmed in classic terms the right of a trustee, threatened with litigation directed against the

trust estate, to invoke the administrative or supervisory jurisdiction which the Court of Chancery traditionally exercises over trustees, to seek directions as to whether he should defend the action, and if so, upon what terms as to costs. Such terms may, in a proper case and if the interests of justice so require, include an order protecting a trustee whose defence of the action has been directed or authorized by the court from personal exposure to costs liability, by providing that in any event—whatever the outcome of the action—the trustee's costs (including any that he may be ordered to pay) shall be paid out of the trust fund.

2 The *Beddoe* applicant in this case is a corporate trustee of offshore settlements registered in Gibraltar. It claims no interest of its own in the trust funds. Competing claims to them are made on the one hand by a representative of the overseas creditors of the original settlor (an American financier who is now bankrupt), asserting title to the entire funds on the basis that the original settlements were in fraud of creditors, and on the other hand by the overseas beneficiaries (relatives of the settlor and a charitable foundation with a reversionary interest for the settlor himself) who assert the validity of the settlements.

3 The beneficiaries are willing that the creditors' claim should be defended at the expense of the trust funds, but are unable or unwilling to give the trustee any indemnity for its costs from such independent resources as they may own. The creditors, for their part, claim that the entire settlement funds are theirs by right, and object to any part of them being irrevocably committed in advance of the day when the result of the litigation is known to provide for the costs of the trustee.

4 The situation thus far described is not (as the cases show) by any means an unusual one. But this case has an unusual further feature in that the creditors have added to the claim which they make against the trustee as custodian of the disputed funds a direct claim against the trustee itself, alleging that the trustee accepted its trusteeship with guilty knowledge of the intended fraud on creditors, that it was itself party to that fraud, and that it is liable to recompense the creditors by way of damages for fraud and/or negligence.

5 The creditors' representative having sued in the Gibraltar court for an order setting aside the settlements and for damages against the trustee personally, the trustee applied to the court by a separate summons taken out in the *Beddoe* jurisdiction for leave to defend the action and for an order making advance provision for its costs. The application was heard by Pizzarello, A.J. on December 15th, 1998. Notice of the application had been given to the creditors' representative as plaintiff in the main action, and his counsel had been allowed to be present for part of the hearing and to make submissions on its merits, but his application to be joined as a full party to the *Beddoe* application was dismissed.

6 The judge gave the trustee leave to defend the action down to the close of discovery, on the footing that the application would then be returned to court for directions as to any further involvement by the trustee in the defence of the main action, and a decision as to how far (if at all) it would be proper to make any advance provision for costs from that point onwards. The trustee was expressly authorized in the meantime to apply to strike out the statement of claim as disclosing no cause of action. The judge further directed that the trustee would be authorized to take its costs of both these steps out of the settlement funds in any event.

7 The creditors' representative does not object to the grant of leave to the trustee to defend the proceedings, nor to the authorization of a striking-out application. But he does object to the refusal to allow joinder of the plaintiff as a full party to the application and—even more strenuously—he objects to the indemnity as to costs. From those directions he now appeals to this court.

The essential facts

8 From early in the 1980s, Robert E. Brennan ("the settlor") had conducted a substantial investment broking business trading in securities on the New York Stock Exchange. His activities attracted litigation. It is common ground that in November 1984 he had settled proceedings brought against him by the New York Securities & Exchange Commission ("the SEC"). On October 31st, 1985 the SEC started further proceedings against him which remained outstanding after he had made an unsuccessful attempt to settle them in 1987. Customers who had bought or sold securities through the settlor or his trading company brought proceedings against him in 1985 which were consolidated into a class action which he settled in 1987 by paying US$10m. into a court restitution fund. Between October and December 1992 a number of suits were filed by customers against the settlor in the New York District Court. A motion to consolidate them was filed in December 1992.

9 Bankruptcy law in Gibraltar is governed by the Bankruptcy Ordinance 1934, which substantially reproduces the English Bankruptcy Act 1914, including s.42 of that Act. By an Ordinance of 1990 a new s.42A was introduced, which provided a system of registration for settlements made by any individual who was not insolvent at the date of disposition and did not become so as a result of it. In the case of registered settlements which satisfied the condition of the settlor's solvency at the date of the settlement, the Ordinance provided that the settlement should not be voidable at the instance of creditors of the settlor.

10 Regulations passed under the amending Ordinance provide for registration to be effected solely on the application of the trustee, who

must be a trust corporation with a financial standing approved by the Gibraltar Government and who must have obtained prior government approval of the forms of inquiry administered to the settlor. Every application for registration must include undertakings from the trustee that the settlor has satisfactorily completed the approved forms of inquiry, that the trustee has itself completed all reasonable inquiries to substantiate the information provided by the settlor, and that the trustee has obtained an affidavit from the settlor confirming that he is not insolvent.

11 STG Valmet Trustees Ltd. ("Valmet"), formerly Seamark Trust Co. (Gibraltar) Ltd., is a Gibraltar-registered company and trust corporation. It carries on the business of providing trustee services for reward and has been authorized by the Gibraltar Government to act as a trustee for the purposes of the Bankruptcy (Register of Dispositions) Regulations, 1990. Shortly before making the settlements which I am about to mention, the settlor completed certain questionnaires administered by Valmet and swore the required affidavit of solvency. In answering the paragraph in the questionnaire which read: "Are there, to your knowledge, any actions filed or threatened to be filed against you from any source, for damages?" he said: "Yes, various class action lawsuits. Settlor believes are without merit and intends to defend. SEC civil lawsuit filed in 1985. Settlor believes it to be without merit and has, and will continue to defend." In his sworn declaration of solvency he said:

> "I am not aware of any action, cause or litigation of whatever type threatening or outstanding, contingent or pending against me or affecting any of my assets and I do not have actual notice of any such claim or of the facts or circumstances which may render me liable to any such claim."

12 On January 25th, 1993 the settlor created two settlements of which Valmet was the sole trustee. They were called the Seton Trust and the Benedictine Trust. The trusts of each were in identical terms. The initial beneficiaries were the settlor's former wife, his three children and the Robert E. Brennan Foundation, a charity based in New York. I need not recite the detailed clauses of the settlements because it is common ground between the parties that the effect of them was that after a period of 10 years the capital and accumulated income of the trusts would revert to the settlor except to the extent that they might have been appointed to the beneficiaries by Valmet with the consent of a committee of trust advisers. The settlements reserved power to the settlor to "expand or contract the class of permissible beneficiaries." There was a further provision in the settlements that upon the happening of any "event of duress" Valmet would be deemed to have transferred the management and control of the settlements to an emergency trustee outside Gibraltar. "Event of duress"

was defined as including any governmental action or court order restraining free disposal of the trust fund.

13 The Seton Trust was established with an initial trust fund of US$100 cash deposited in an account maintained by Valmet with a Swiss bank in Guernsey. That fund was supplemented by a payment of a further US$3m. The Benedictine Trust was established with a fund of US$100 cash and a promissory note drawn by a New Jersey corporation in favour of the settlor for US$13,750,000. The cash was paid into Valmet's same Guernsey bank account and the promissory note was assigned to Valmet by the settlor. The combined assets transferred to the settlements were therefore in the region of US$16m. and now (we were told) amount in value to some US$20m.

14 There was a third settlement, known as the Cardinal Trust, made by the settlor with Valmet as sole trustee on July 13th, 1994. The beneficiaries were the same, save that the settlor's former wife was excluded. The trust fund consisted of New York City bonds with a face value of US$5,285,000. The terms of the Cardinal Trust were similar to those of the Seton and Benedictine Trusts, but Valmet is no longer a trustee of that settlement, which is therefore of no more than marginal relevance to these proceedings and, having stated its existence as part of the general background, I need not refer to it further. References hereafter to "the settlements" will be to the Seton and Benedictine Trusts alone.

15 The settlements were duly registered under the Bankruptcy (Register of Dispositions) Regulations already described.

16 On August 7th, 1995 the settlor filed a voluntary petition for relief pursuant to Chapter 11 of the US Bankruptcy Code. On June 10th, 1997 the Bankruptcy Court for the District of New Jersey approved the appointment of Donald F. Conway as trustee in bankruptcy for the settlor's estate.

17 The SEC proceedings were concluded in December 1996, when the Second Circuit of the US Court of Appeals upheld a finding by the District Court against the settlor and his trading company that they had been engaged in "a massive and continuing fraud" on their customers.

18 By a writ issued in Gibraltar on April 28th, 1998 ("the main action"), Mr. Conway, suing in the capacity of trustee in bankruptcy of the settlor, claimed as plaintiff against Valmet as sole defendant orders setting aside the registration of the settlements, a declaration that the settlements were void under s.42A of the Bankruptcy Ordinance, a declaration that the settlements were void under the Fraudulent Conveyances Act 1571, and injunctive and declaratory relief designed to prevent alienation or dissipation of the settlement funds. To that claim there was added a personal claim against Valmet for damages for fraud

and/or negligence. *Mareva* orders have been made in the main action restraining alienation of the settlement funds.

19 On May 13th, 1998 Mr. Conway commenced proceedings in the New York court against the settlor and the beneficiaries of the settlements, seeking declarations that the settlor was insolvent at the date when he established the settlements and orders avoiding them as having been made in fraud of creditors.

20 The statement of claim in the main action was served on April 28th, 1998 and amended shortly afterwards on May 20th, 1998. It is a long document, which it is unnecessary for me to recite in full, because the thrust of it is contained in the following summary taken from the skeleton argument of Mr. Conway's counsel in this appeal:

> "In the main action [Mr. Conway] has two claims as follows:
>
> 1 A claim against [Valmet], as trustee of the settlements, to have the settlements set aside on the ground that the settlements are dispositions made in fraud of creditors contrary to the Statute of Elizabeth, and that the registration thereof under the Bankruptcy (Register of Dispositions) Regulations was procured by misrepresentations by the settlor as to his solvency.
>
> 2 Claims against [Valmet] personally as follows:
>
> (a) for negligence and breach of statutory duty in failing to examine properly, sufficiently or at all, the settlor's financial position prior to and for the purposes of an application under reg. 5 of the Bankruptcy (Register of Dispositions) Regulations, 1990;
>
> (b) as constructive trustees for rendering knowing assistance to the settlor in the dishonest design of the settlor to hide assets away and thus delay, hinder and avoid his creditors."

I shall refer hereafter to these two heads of claim in the main action as "the claim against the trust" and "the personal claim against the trustee," respectively.

21 Extensive further and better particulars of the statement of claim were supplied by Mr. Conway on June 24th, 1998. On July 6th, 1998 Valmet issued a summons seeking an order striking out the statement of claim. A defence was served by Valmet on August 21st, 1998.

22 On September 29th, 1998 Valmet issued an originating summons ("the *Beddoe* application") seeking: (a) leave to defend the main action and in particular to make an application to strike out the same; and (b) an indemnity for the costs of Valmet and its liability for costs of other parties (the only other party in fact being Mr. Conway). The defendants to that

summons were the beneficiaries under the settlements, all of whom instructed attorneys in the United States who stated that their clients supported the relief proposed. They were not, therefore, represented at the hearing. A copy of the *Beddoe* application was served on Mr. Conway.

23 During November 1998 Mr. Conway issued a cross-summons for an order that he be made a party to the *Beddoe* application. The summons and cross-summons were heard together by Pizzarello, A.J. on December 16th, 1998. Mr. Conway's counsel was allowed to attend at the outset of the hearing and to make submissions both in respect of his own application to be made a party to the *Beddoe* application and in respect of the merits of that application. Having been heard to that limited extent, he was not permitted to remain for the rest of the hearing and was not invited to return to hear the judgment.

24 The result of the hearing was, first, an order dismissing Mr. Conway's application to be made a party to the *Beddoe* application, and then, on the application itself, an order that Valmet should be authorized to defend the main action down to the completion of discovery, when the *Beddoe* application would be restored to the judge for further directions. The judge authorized Valmet to apply to strike out the main action, and further provided that Valmet would be entitled to have its costs of the entire proceedings down to the close of discovery (including the striking-out application) paid out of the settlement funds.

25 Mr. Conway gave notice of appeal from that decision to this court on December 23rd, 1998. The memorandum of appeal objected only to the order below in so far as it provided an indemnity out of the trust assets to Valmet in respect of its own costs (including those incurred to date) and its liability for other parties' costs in the main action.

26 During the pendency of that appeal, Valmet proceeded with its striking-out application, which was heard by Schofield, C.J. on February 8th–12th, 1999, when the court reserved judgment. The Chief Justice's decision was still awaited when this court began the hearing of the appeal from Pizzarello, A.J.'s order on March 9th, 1999. After the appeal had been briefly opened, it became apparent to this court that there was a substantial risk that if the action were to be struck out by the Chief Justice the hearing of this appeal would prove to be unnecessary. In the interests, therefore, of saving costs, it was decided to adjourn the appeal to a specially fixed hearing which took place on May 26th–27th, 1999.

27 The Chief Justice in the meantime had delivered judgment in the striking-out application on March 18th, 1999 (reported at 1999–00 Gib LR 81). So far as the claim against the trust was concerned, he ruled that the claim to avoid the settlements by cancelling their registration under the Bankruptcy (Register of Dispositions) Regulations was misconceived.

The challenge ought to have been directed not at the settlements themselves but at the dispositions of the funds now comprised in them. He therefore struck out the claim to avoid the settlements on the basis that their execution and registration offended the Statute of Elizabeth, but at the same time gave Mr. Conway leave to amend the pleading by substituting a plea that the dispositions of funds to the settlements were fraudulent and unlawful at the time they were made. As for the personal claim against the trustee, the Chief Justice struck out the claim for damages for negligence on the ground that no duty of care was owed by the trustee, at the date of the settlements, to the inchoate class of potential creditors of the settlor, but allowed the personal claim to stand, so far as it was based upon a plea that the transfers into settlement were fraudulent according to the law which governed them.

28 The precise formulation of the claims which the Chief Justice gave leave to introduce by amendment will not be known until the outcome of a hearing (due to take place before him within the next month or two) to approve the terms of such amendments. For present purposes it is sufficient to say that the effect of the order made on the striking-out application was that the claim against the trust continues as a claim that the original transfer of the settlement funds was fraudulent and unlawful and ought to be set aside, and the personal claim against the trustee continues as a claim to damages for fraudulent participation in a transaction known to involve a fraud on creditors.

29 That being the background, I now turn to the law governing the objections raised by this appeal.

The law

A. *Pre-emptive costs orders generally*

30 There has been a substantial body of recent authority on the question whether it is ever, and if so in what circumstances, appropriate to make an order that regardless of the outcome of the proceedings a party holding the legal title to disputed assets shall be indemnified for his costs by an order that they are to be paid out of such assets in any event. Those decisions (with a brief reference to the context) are:

1. *Re Westdock Realisations Ltd.* (10). The liquidators of insolvent companies sought indemnity for their costs in claiming funds held by a receiver to which a competing claim was maintained by the Export Credit Guarantee Department.

2. *Re Biddencare Ltd.* (3). In proceedings in which a fund-holder sought an order from the court as to whether the funds were held for its own benefit or for the liquidators of an insolvent company, the liquidators claimed an indemnity out of the fund for their costs of prosecuting their claim.

3. *McDonald* v. *Horn* (7). In an action by employee members of an occupational pension scheme alleging maladministration of the fund by the employers and trustees, the employees sought an indemnity for their costs out of the pension funds by analogy with orders made in a minority shareholder's derivative action.

4. *Weth* v. *Att.-Gen*. (11). Following an order appointing a receiver and manager of a charity, the suspended trustees of the charity sought directions from the court as to their prosecution of an appeal against the appointment of a receiver and an indemnity out of the charitable funds for their costs.

31 It is unnecessary to recite the outcome in each of those cases, which depended on their particular facts. The statements of principle which they contain are, however, of importance. The gist of those statements can be summarized as follows: In deciding whether to make a pre-emptive order for costs, the court should have regard to—

(a) the prospect of success of the claim or defence sought to be made or resisted;

(b) the general reluctance of the court to make a prospective costs order unless satisfied that it is clear that the judge at trial would be bound to make an order in favour of the applicant;

(c) the degree of risk that such an order might work injustice; and

(d) the existence of any special circumstances.

B. ***Applications by trustees for advance indemnity out of trust fund for the costs of defending proceedings***

32 *Beddoe* applications are acknowledged to have much in common with applications in other contexts for pre-emptive costs orders, but they still stand in a class of their own because of the special relationship with the court that is carried by the status of trusteeship.

(1) The nature of a Beddoe application

33 The fundamental principle of all litigation, enshrined in O.62, r.3(3) of the Rules of the Supreme Court, is that a successful litigant has a *prima facie* right to his costs. A limited exception to that principle is to be found in O.62, r.6(2) which reads:

> "Where a person is or has been a party to any proceedings in the capacity of trustee . . . he shall be entitled to the costs of those proceedings, in so far as they are not recovered from or paid by any other person, out of the fund held by him in that capacity . . . and the Court may order otherwise only on the ground that he has acted unreasonably or, in the case of a trustee . . . has in substance acted for his own benefit rather than for the benefit of the fund."

34 That formula contains an obvious problem for a trustee facing litigation directed against the trust estate. Litigation is a hazardous process and every lawsuit is prone to develop into a tale of the unexpected. How can a trustee feel absolutely assured, at the start of a case, that his decision to defend it will be incapable of criticism on the grounds of unreasonableness or personal benefit?

35 The answer to that dilemma was classically expressed in *In re Beddoe* (2) by Bowen, L.J. in these terms ([1893] 1 Ch. at 562):

> "If there be one consideration again more than another which ought to be present to the mind of a trustee . . . it is that all litigation should be avoided, unless there is such a chance of success as to render it desirable in the interests of the estate that the necessary risk should be incurred. If a trustee is doubtful as to the wisdom of prosecuting or defending a lawsuit, he is provided by the law with an inexpensive method of solving his doubts in the interest of the trust. He has only to take out an originating summons, state the point under discussion, and ask the Court whether the point is one which should be fought out or abandoned. To embark in a lawsuit at the risk of the fund without this salutary precaution might often be to speculate in law with money that belongs to other people."

That statement goes right back to the first principles that were evolved, centuries ago, when the trust emerged as a creature of the courts of equity. Trusteeship is often a burdensome status, and the Court of Chancery has traditionally encouraged trustees to seek the directions of the court in cases of doubt, embarrassment or difficulty. It is a door open to all trustees, of whatever kind and calibre. Of the numerous authorities cited in this appeal, there is not one in which the court has gone to the lengths of penalizing in costs any trustee who has turned to the court for directions in the *Beddoe* jurisdiction, and it is not suggested that the trustee in the present case should be deprived of those very limited costs.

36 That is not to say, of course, that a trustee who applies in that jurisdiction will necessarily obtain for the future the directions to defend, or the indemnity for the future costs of defending, which he was hoping to receive. In a case where the dispute in substance lies between rival claimants to the entire trust fund (whether such claimants be creditors of the settlor on the one side and beneficiaries on the other, or one or more of several beneficiaries in contest with the remainder) there must be a probability that the court will direct the trustee to take a passive role, namely, to file a defence pleading (or amending any existing defence to plead) that the trustee submits to act as the court directs. The burden is then thrown upon the persons with a real interest in resisting the claim to continue the defence of the proceedings at their own risk as to costs if unsuccessful. If they forbear to do so, the claim may succeed by default.

Similarly, in the case of a trustee who is defending personal charges of misconduct or maladministration in the establishment or conduct of the trust, the court may tell him that the claim is entirely a personal one which he must defend thereafter at his own risk as to costs.

37 A *Beddoe* application, being in essence an application for advance approval of a proposed course of conduct in the action and an advance indemnity for costs, is a process which, by its very nature, must be brought at the beginning, or at a very early stage, of the litigation. At that point it may be difficult for the court to judge whether the claim against the trust estate is or is not well-founded in law and supported by the evidence. It is by no means uncommon, therefore, for the court to make an order in the first instance authorizing the trustee to continue the defence of the substantive action down to the close of pleadings, or the conclusion of discovery.

38 That accords with the principle stated by the Court of Appeal in *In re Evans* (6) ([1986] 1 W.L.R. at 107, *per* Nourse, L.J.) that the prospect of the claimant's success in the action "is a most important question to be considered in deciding whether the action or its defence should be financed at the cost of the estate." Other authorities in which these propositions of law appear to me to be explicitly or tacitly supported are *In re Moritz* (8) ([1960] Ch. at 255, *per* Wynn-Parry, J.); *McDonald* v. *Horn* (7) ([1995] 1 All E.R. at 970, *per* Hoffmann, L.J.); and *Alsop Wilkinson* v. *Neary* (1) ([1995] 1 All E.R. at 435, *per* Lightman, J.). See also 1 *The Supreme Court Practice, 1999*, O.85 and the note in para. 85/2/2, at 1561–1562.

(2) Beddoe applications and the audi alterem partem rule

39 The original view taken by the courts was that where the claimant to the fund was himself a beneficiary under the trust, he should be allowed a limited right to be heard on the *Beddoe* application but should be excluded from the hearing when the merits of his claim and the defence to it were discussed between the trustees and the judge: see *In re Moritz* (8) and *In re Eaton, Midland Bank Exor. & Trustee Co. Ltd.* (5). A claimant who was not himself a beneficiary had no such right to be heard, and might not even be aware that the application was being made at all: see *In re Dallaway* (4) ([1982] 1 W.L.R. at 760, *per* Megarry, V.-C.). In *In re Evans* (6), Nourse, L.J. had this to say about the nature of a *Beddoe* application ([1986] 1 W.L.R. at 106):

> "First and foremost, every application of this kind depends on its own facts and is essentially a matter for the discretion of the master or judge who hears it. The application is heard in chambers and the claimant is excluded from any consideration of the merits of the action which are discussed before the court in much the same way as

> they would have earlier been discussed with counsel in his chambers. Being entirely domestic to the estate or trust concerned, the application is often conducted in a comparatively informal manner."

40 There are indications in more recent authority that the courts look with disfavour on the exclusion of the claimant from a *Beddoe* application; accepting that he should not be present when the strength of the case against him is discussed, but insisting that in all other respects the rules of natural justice require him to be heard as fully as if he were a party to the proceeding. Thus in *Weth* v. *Att.-Gen.* (11) Lawrence Collins, Q.C., as Deputy Judge of the High Court, said ([2001] W.T.L.R. at 178):

> "That such applications should be *inter partes* is now enshrined in O.15, r.12A. In *McDonald* v. *Horn* . . . it was held that applications of this kind in pension fund cases should also be *inter partes*, and it may be that today, when greater openness in litigation is being encouraged, the relaxation of the *In re Moritz* practice in *Re Eaton* should be liberally applied. Justice requires that a party has a right to be heard before an order is made that the party will bear, whether it wins or loses, the whole costs of what may be substantial litigation."

(3) Claims against a trustee personally

41 In general terms it is not easy to visualize cases in which the court would regard it as appropriate to allow a trustee against whom charges of negligence or breach of trust are made to conduct his defence with the benefit of an advance indemnity for his costs. Nevertheless, there may be instances where it would be appropriate to allow a trustee facing such charges to take steps at the expense of the fund to test the *bona fides* of the claim or its sustainability in law by issuing, for example, a striking-out application. It is certainly not the case that the mere fact that a claimant against the trust estate chooses to add to the claim against the trustee as a fiduciary a further claim against him personally operates in any way to inhibit the court from making any provision for the trustee's costs that the interests of justice would otherwise require: see *Walters* v. *Woodbridge* (9).

Summary of the law

42 The effect of the authorities is to support the general proposition that the unusual and (as it may appear to some) arcane procedure of a *Beddoe* application survives in our law as a valuable facility for trustees, but the exercise of this specialized jurisdiction is subject to two guiding principles:

1. Claimants to the trust fund, whether they be beneficiaries or strangers to the trust, should be allowed the maximum opportunity of being heard on the application consistent with the need to maintain

confidentiality on matters which properly arise for consideration between the trustee and the court alone.

2. Orders that the trustee is to have his costs paid out of the trust fund in any event should be made sparingly, and with due regard to the principles which apply to the analogous case of pre-emptive costs orders sought in the general jurisdiction.

The arguments on appeal

A. *The joinder issue*

43 Mr. J.E. Triay, Q.C., leading counsel for the appellant, Mr. Conway, made it clear that this is a minor aspect of the case compared with his general complaint in relation to the costs indemnity order. It is nevertheless an issue which he wishes to maintain. His first complaint is a general one of unfair procedure. He protests that although he was heard both on the application to be joined as a party and on the substantive *Beddoe* application in the limited way that I have mentioned, he did not receive the elementary rights which should have been accorded to him at an *inter partes* hearing.

44 The judge's notes of argument confirm that Mr. Triay made an application at the outset to have his joinder application heard first. That failed, and the judge went on to deal with both applications together. He first heard Mr. Mowschenson, Q.C., on behalf of Valmet, who made submissions on the general nature of a *Beddoe* application in aid of a contention that the joinder of Valmet as a party to that application would not be appropriate. He was then addressed at some considerable length by Mr. Triay, who not only dealt with the procedural (joinder) point, but, turning to the merits of the *Beddoe* application, made the submission—which has also been his primary submission in this court—that whatever costs orders of a pre-emptive nature may be appropriate in proceedings between a trustee and beneficiaries, when a claim is made to the entire trust fund by a stranger to the trust it can never be right to make an order which will result in the fund being reduced, in any event, by costs awarded to the trustee, regardless of the outcome of the action. In support of that he cited a number of the authorities which I have mentioned in this judgment. Having made those submissions, he was required to withdraw from the hearing. The judge then proceeded to hear Mr. Mowschenson on the merits of the *Beddoe* application. For that purpose, the judge had before him leading counsel's opinion setting out the grounds for asserting that the statement of claim was (in respect of both the claim against the trust and the personal claim against the trustee) suitable subject-matter for an application to strike out the pleading as disclosing no cause of action.

45 Mr. Mowschenson submits that the procedure followed was essentially a fair and proper one and disputes the claim under this head.

46 Mr. Triay next submits that, in any event, the judge erred in principle in refusing his application to be joined. Such refusal was contrary to the policy reflected in O.15, r.6(2)(*b*)(ii), which provides that the court may join as a party—

> "any person between whom and any party to the cause or matter there may exist a question or issue arising out of or relating to or connected with any relief or remedy claimed in the cause or matter which in the opinion of the Court it would be just and convenient to determine as between him and that party as well as the parties to the cause or matter."

Support for this contention is, he submits, to be found in *Weth* v. *Att.-Gen*. (11) in the passage which I have already quoted.

47 Mr. Triay was not able to produce any authority in which a claimant to the trust fund who was not himself a beneficiary under the trust had been joined as a party to a *Beddoe* application, and Mr. Mowschenson submitted that it would be contrary to principle and authority for such a step to be taken.

B. *The substantive Beddoe application*

48 Mr. Triay accepts that a *Beddoe* application gives rise to a discretion in the judge who hears it. His first and fundamental submission, nevertheless, is that whatever powers that discretion may confer upon the court in proceedings between the trustee and the beneficiaries under the trust, the position is altogether different when it comes to dealing with a claim to the entirety of the trust fund being made by a third party who is a stranger to the trust. In such a case, he submits, it could never be a proper exercise of the discretion to make an order which would have the effect of diminishing the size of the fund by charging it in advance with any order for costs in favour of the trustee—whether those costs be in relation to a single step in the action or to the conduct of the entire action.

49 Mr. Triay next submits that even if (contrary to his first submission) the discretion has to be regarded more widely, it is a discretion which falls to be exercised on established lines—including a due regard to the principles mentioned earlier in this judgment—*i.e.* those derived from the authorities on pre-emptive costs orders. No judge applying those principles could properly, he submits, have reached the conclusion—given the nature of the claims against the trust fund and the trustee personally—that it would be proper to make a "costs from the fund in any event" order, even in respect of the preliminary steps which he authorized, namely the striking-out application and discovery.

50 Mr. Mowschenson responds that Mr. Triay's first submission is wholly unsupported by authority and would, if accepted, place trustees at a severe disadvantage by making them more exposed to personal liability when sued by a stranger than they are when sued by a beneficiary. As to the second, Mr. Mowschenson informed this court that in the course of his submissions on the *Beddoe* application he made it clear to the judge that the basis of the application for a striking-out order was that in numerous respects (to which he drew the judge's attention in careful detail) the statement of claim was misconceived in law. The judge had every justification, he submits, for taking the view that his criticisms of the pleading had merit, in which case a striking-out application would clarify the issues at an early stage and thus save costs. That alone would justify making the trustees' costs of the strike-out summons recoverable out of the fund in any event.

Conclusion

The joinder application

51 I feel some sympathy with Mr. Triay's concern that the consequence of his joinder application being dealt with at one and the same time as the substantive *Beddoe* application was that—due to his exclusion from the later stages of the latter application—he lost the right he would normally have enjoyed to be present when his opponent replied to the joinder application. It would no doubt have been more satisfactory, and more in accord with ordinary principles of justice, if the two applications had been dealt with separately, so that his exclusion from part of the *Beddoe* proceedings did not affect his right to attendance at every stage of the argument of the joinder application. It would have also been more courteous (to put it no higher) if he had been called back to court to learn of the judge's decision under both applications.

52 That being acknowledged, however, it was very much a matter of discretion for the judge as to whether the two applications should be dealt with separately or together, and I would not, for my part, think that the judge fell into any error of law in dealing with the two applications compendiously, given the close relationship between them. Mr. Triay had an opportunity—though it may not have been the fullest opportunity—of making his points fully and effectively.

53 As for the more technical proposition that the judge was in any event wrong in law when he refused the joinder application, it would, in my judgment, be contrary to principle and to authority (notably *In re Evans* (6); *In re Moritz* (8); and *In re Eaton, Midland Bank Exor. & Trustee Co. Ltd.* (5)) to allow a claimant to be accorded the status of a party to the *Beddoe* application, so as to entitle him to participate fully in that application with all the privileges that a party enjoys, including the right

of inspecting trust documents which might be privileged or otherwise not available to him through the ordinary processes of discovery.

The substance of the Beddoe application

54 Mr. Triay's fundamental submission as to the proper exercise of the discretion is, in my judgment, contrary to principle and unsupported by any authority. When it comes to determining the scope of the court's discretion on a *Beddoe* application there is no distinction of significance to be drawn between a claimant who is a beneficiary under the trust and a claimant who is a stranger to it. In the latter case, as in the former, there are competing claimants to the same fund and the same discretion must apply to both.

55 In his second submission (that the conclusion reached in this case would not have been open to any judge applying the principles derived from the pre-emptive costs order cases) I see a great deal more force. It is, I agree, at first sight, surprising to discover that a trustee, against whom it is claimed that the disposition of the entire fund was a fraud by the settlor and that the trustee itself was privy to that fraud, has been awarded his costs in any event for any stage of the litigation.

56 Nevertheless, now that Mr. Mowschenson has explained to us that the sole or principal purpose of his colloquy with the judge at the *Beddoe* hearing after the departure of Mr. Triay was to acquaint the judge with the perceived weaknesses in law of the case made out by the statement of claim, I find it easier to understand why the judge made an order for Valmet's costs of the striking-out application to be paid out of the fund in any event.

57 He did not give a reasoned judgment, but his reasoning may fairly be presumed to have proceeded on these lines. Accepting (as he clearly must have done) that the pleaded case against the trustee, both in respect of the fund and personally, was—arguably at least—a very weak one in law, a strike-out application would have the potential to achieve an ultimate saving of costs to the trust estate by ensuring that the claim is dismissed at the earliest possible stage (if indeed it be a bad one) or, even if the claim survived the strike-out application, there would at the very least be an early clarification of the issues to which it gives rise. He was, moreover, entitled, when applying the four criteria mentioned earlier in this judgment as having been approved in the pre-emptive costs order cases (notably in *McDonald* v. *Horn* (7)), to regard the second criterion—namely, that the court is satisfied that the judge at trial would be bound to make an order in favour of the applicant—as satisfied in regard to the case as currently pleaded.

58 I would therefore hold that although a costs indemnity order might not have appealed to many judges called upon to make the same decision,

the decision of the judge in the instant case is capable of being supported by reasons sufficiently cogent to place it within the range of a discretion properly exercised according to the authorities.

59 That is sufficient to dispose of the points raised by Mr. Triay, but I must mention an aspect of the appeal which has troubled the court and caused us, in effect, to raise a point of our own motion. The judge gave leave to proceed with the strike-out application in respect of both the claim against the trust and the personal claim against the trustee. It was within his discretion to do so and, for reasons already stated, it was within his discretion also to direct that the trustee's costs of that limited step should be charged in any event against the fund. But the judge went further and authorized the trustee, in addition to maintaining the striking-out application, to continue the defence of the action—again at the expense of the fund in any event—down to the close of discovery.

60 In litigation of this kind, the process of discovery is liable to prove elaborate, contentious and expensive. The justification, therefore, for an indemnity to the trustee for its costs of discovery could not be gauged until the outcome of the strike-out application was known. Only at that point would the court be in a position to know what issues had survived the strike-out and to form a view as to the nature and extent of the discovery to which those issues would give rise. It seemed, therefore, to us to be at least arguable that the judge had been premature in making a direction that Valmet should have its costs of the discovery stage of the proceedings paid in any event out of the fund.

61 When those doubts were put to Mr. Mowschenson, he offered to meet them by an undertaking to take out a further *Beddoe* application for directions as soon as the result of the strike-out application has been clarified at the forthcoming hearing before the Chief Justice. He accepted that at such a renewed *Beddoe* hearing, everything would be at large as regards the conduct of the litigation thereafter, and the judge could bring a fresh mind to the question whether he was prepared to authorize any further steps (including discovery) to be taken, and if so upon what terms as to costs. I propose to accept that undertaking which, in my judgment, effectively overcomes the problem which had troubled the court.

62 I have no doubt that, perhaps with assistance from this judgment, the judge will take full advantage of the opportunity which that renewed application will afford him of looking at the claims against the trust fund and the claims against the trustee personally, as they will by then have become finally framed, and make an appropriate judgment as to how far, if at all, it would be appropriate—consistently with the principles stated in the authorities—to allow the trustee to continue to defend them at the expense of an indemnity from the fund.

63 To the very limited extent, therefore, that is involved in accepting the undertaking from Valmet to which I have referred, I would allow the appeal.

NEILL, P. and **GLIDEWELL, J.A.** concurred.

Appeal allowed in part.
