Costs management in trust proceedings

It is well established that a trustee is entitled to be indemnified out of the trust fund in respect of all liabilities to which the trustee may become subject in the proper execution of the trust and the trustee's powers and discretions. This includes all costs incurred by the trustee in the proper conduct of legal proceedings. In the absence of a breach of trust or misconduct, trustees are not expected to put their hands into their own pocket to fund litigation involving the trust, whether such litigation involves the trustee and the beneficiaries (e.g. a dispute about the construction of the trust deed) or whether it is a dispute between the trust and a third party.

In his seminal report, *Review of Civil Litigation Costs: Final Review*, Lord Justice Jackson expressed the view that without costs capping and strict adherence to cost estimates, much litigation involving trusts can lead to the exhaustion of the fund by the impact of costs. He recommended that the amount of costs that may be paid out of the trust fund "ought to be set at a proportionate level at an early stage of the litigation", determined by reference to the value of the trust and the complexity of the issues in dispute. He further recommended that costs be saved by dispensing with the need for an oral hearing in Beddoe applications made by trustees.

The Civil Procedure Rules Committee has taken up Jackson LJ's recommendation by implementing, in a new Practice Direction 23B and in an amendment to Practice Direction 64, changes that will affect all litigation involving trust funds. The amendments are effective from 1 October 2011.

Costs capping orders against trustees

A trustee who intends to apply for an order for the payment of costs out of the trust fund must file and serve on all other parties notice of that intention, together with an estimate of the costs likely to be incurred. There is no prescribed form for the cost estimate, but there will need to be sufficient detail to enable a proper assessment of the costs to be made. The parties on whom notice is served may apply for, or the court may make on its own initiative, a costs capping order limiting the amount of costs which may be recovered from the trust fund (PD 23B.2 and 23B.3).

Before the court will make a costs capping order it must be satisfied that it is in the interests of justice to do so, that there is a substantial risk that without such an order costs will be disproportionately incurred, and that the risk cannot be adequately controlled by case management directions or a detailed assessment of costs at the end of the case. In considering whether to exercise its discretion, the court will consider all relevant circumstances, including whether there is a substantial imbalance between the financial position of the parties and the stage which the proceedings have reached. The purpose of the order is to enable the trustee to manage the process of bringing the case to trial at a cost which is in line with the cap.

A costs capping order will limit the costs recoverable by the trustee unless they successfully apply to vary the order in circumstances where there has been a material and substantial change of circumstances since the date when the order was made or there is some other compelling reason why a variation should be made.

Trustees are entitled to take their proper costs out of the trust fund without an order of the court, so the new rules will not be a feature of all trust proceedings but will impact on a substantial number. It should be noted that the new rules are not limited to trustees; anyone who intends to apply for an order for payment of their costs out of a trust fund will need to comply.

Beddoe applications

Trustees have had a long standing right to make a Beddoe application seeking the court's approval to bring or defend proceedings and for an order to be indemnified out of the trust fund in respect of the costs of the proceedings. Beddoe applications are useful because they provide protection to the trustee by removing any doubt which may otherwise exist as to whether such costs have been reasonably and properly incurred and whether the trustee is entitled to an indemnity out of the fund. The costs of making a Beddoe application will usually come out of the trust fund, which is itself another burden on the fund.

Jackson LJ raised two issues: (a) whether *Beddoe* applications are made too often out of an abundance of caution, and (b) whether more Beddoe applications could be dealt with on paper. Jackson LJ did not advocate any rule change to discourage inappropriate Beddoe applications, but PD 64 has been amended so that all Beddoe applications will be disposed of without an oral hearing in the first instance. Any request for an oral hearing must be stated in evidence.

Implications for trustees

It is important for trustees who are engaged in litigation to protect themselves as far as possible against personal liability for costs. The usual mechanism is for a trustee to obtain a contractual indemnity from the beneficiaries under the trust deed or separately from the party with the beneficial interest in the claim, but trustees also rely on their right to indemnification out of the trust fund.

Although the existing rules on cost capping did not limit the type of case in which an order could be made, such orders have not been sought in trust proceedings due to the widely held view that it could not be right to circumscribe a trustee's right of indemnity by the imposition of a costs cap. This was the view expressed by the Chancery Division in commenting on the proposed changes, but these have been implemented nonetheless out of a concern, expressed by Jackson LJ and the Civil Procedure Rules Sub-Committee, that excessive expenditure on costs by trustees amounts to a serious inroad on the value of trusts.

To date, cost capping has been an unusual step and has only been ordered upon cogent evidence. PD 23A.1 stresses that the court will make a costs capping order only in exceptional circumstances. Nevertheless, the requirement for a trustee to file and serve notice of their intention to apply for an order for the payment of costs out of the trust fund, together with an estimate of those costs, will focus close attention on these issues at an early stage. The requirement will apply equally to any Beddoe application that the trustee may make. It will provide beneficiaries with an opportunity to try to limit the costs that may be taken out of the trust fund, whether by discussions with the trustee or by making an application for a cost capping order.

A cost capping order will also limit the application of existing cost rules which give trustees a right to be paid their costs out of the trust fund on an indemnity basis, e.g. in claims relating to the construction of a trust deed. It is worth emphasising that the costs of all parties to such disputes normally come out of the trust fund and that the new rules will apply equally to any beneficiary or representative party who intends to apply for an order in respect of their costs. The party applying for a cost capping order will need to assess whether the costs that will be incurred in making the application, which they may bear themselves, may be disproportionate to the amount of costs in issue.

In relation to Beddoe applications, the Chancery Division has noted that an oral hearing may in be justified where there appears to be a real risk that the trustee may incur disproportionate costs. This would enable the court to consider whether to make a costs capping order of its own initiative and to apply active case management to the trustee's participation in the litigation.

A trustee's contractual indemnity for costs

It will be important for trustees under the new rules to take additional steps to ensure that their contractual indemnities are robust and sufficiently wide in their scope. It is not uncommon for contractual indemnities to be limited by, for example, the need for costs to be reasonable and approved in advance by the indemnifying party. If such limitations have been agreed, trustees should be prepared for the

indemnifying party to argue that any costs in excess of any cap fall outside the scope of the indemnity. Further, whilst there is no requirement under the new rules to send the requisite cost estimate to anyone who is not a party to the litigation, an indemnifying party may expect to receive such material if there is any obligation to consult. Similarly, a trustee may feel that it is important to share these cost estimates with beneficiaries such as noteholders, from whom directions are to be sought in relation to the litigation.

Conclusion

The new rules will require trustees to take these additional factors into account when agreeing contractual indemnities and in conducting litigation. They will also need to focus on whether litigation costs are being managed as economically as possible, with the possibility that trustees may have to put their hands into their own pocket if costs exceed any cap. This may seem astonishing where trustees have no economic interest in the litigation and are not usually, in the absence of breach of trust or misconduct, expected to incur costs personally in the performance of their duties.

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