ANONYMISED AND REDACTED JUDGMENT
PUBLISHED ON 15TH MARCH 2017

GRAND COURT - CAYMAN ISLANDS

IN THE GRAND CO.URT OF THE CAYMAN ISLANDS
FINANCIAL SERVICES DIVISION

FSD CAUSE NUMBER

IN THE MATTER OF THE TRUSTS LAW (2011 REVISION)
AND IN THE MATTER OF THE GRAND COURT RULES ORDER 85 RULE 2

BETWEEN

X
(as Trustee of the A Trust) ("the Trustee")

PLAINTIFF

AND

Y
(beneficiary of the A Trust)

DEFENDANT

IN CHAMBERS
BEFORE THE HON. JUSTICE ANTHONY SMELLIE, CHIEF JUSTICE
18TH NOVEMBER, 2016; 31ST JANUARY 2016
PUBLISHED AS REDACTED ON 15TH MARCH, 2017

APPEARANCES: **Mr. John Machell QC, instructed by Mr. Simon Hurry of Collas Crill for the Trustee**

Trustee sued in foreign proceedings – foreign plaintiff asserting a contingent but non-proprietary claim to the Trust assets and right to enforce any judgment obtained against the Trust assets – whether Trustee entitled to defend the foreign proceedings at expense of the Trust assets – whether Trustee entitled to indemnity for costs of defence from Trust assets on pre-emptive basis - whether foreign plaintiff has standing to object to Trustee's application for directions.

REASONS FOR JUDGMENT

1. By its Originating Summons the Trustee seeks *Beddoe*[1] relief in relation to English proceedings[2] to which the Trustee has been joined as one of several defendants.

2. More specifically, the Trustee seeks directions permitting it to defend the English proceedings and in so doing, permitting it to borrow funds on behalf of the A Trust to discharge the costs of defending and indemnifying it against all and any costs and expenses properly incurred for those purposes.

3. Ancillary directions are also sought for preservation of the confidentiality of the material placed before this court for the purposes of this application.

4. Being satisfied that neither the principles of open justice[3] nor the public interest in the open administration of justice[4] would be offended in this case by protective orders for the preservation of the sensitive and confidential material necessarily placed before the court for the purposes only of this application, I granted the protective orders.

5. I now turn to deal with the application for *Beddoe* relief.

Background to the Trustees' Beddoe Application

6. Although rather complicated by various transactional engagements over the course of several years involving many different individuals, trusts and corporate entities, at its core, the nature of the dispute involved in the English proceedings leading to this application can be summarized as follows.

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[1] *Re: Beddoe* [1893] 1 CH 547. CA.

[2] Being Claim No. X of 2015 in the High Court of Justice, QBD Commercial Court, London, England (the "English Proceedings").

[3] As discussed and explained in *Scott v Scott* [1913] AC 417 at 435 and 437-438 and *Hodgson v Imperial Tobacco Ltd.* [1998] W.L.R. 1056,C.A. at page 1071.

[4] As recogonised by Articles 741 and 11 (1) of the Cayman Islands Constitutional Bill of Rights.

7. In the English proceedings, the plaintiffs are related corporate entities (together, for present purposes, "Z").

8. Z's claim is in contract for breach of warranties and in tort for deceit, in respect of the Sale and Purchase Agreement ("SPA"), by which for a sum of X amount, Z purchased from a consortium of sellers including the Trustee, a controlling interest in B Limited ("B") and B LLP, respectively a company and a limited liability partnership (together "B"). B, as the holding entity of the B Group, owned a successful investment fund management business and LLP acted as a sub-manager of the funds under management.

9. The negotiations with Z leading up to the SPA were conducted on the basis that Z would acquire a controlling interest in the B Group net of the Group's retained earnings.

10. It was therefore a condition of the completion of the SPA that B and its subsidiaries remove all *in specie* assets, claims and liabilities which had accumulated historically in their records of accounts (the "Retained Earnings").

<u>Z's claim in the English Proceedings</u>

11. Z's case in the English proceedings essentially advances two claims: (i) a claim that the defendants acted in breach of warranty and/or contract in various respects, including the alleged failure of the defendants (including Mr. Y, the Trustee and Mr. Q) to disclose the dispute between them regarding allocation of the Retained Earnings – a dispute which was current at the time of the execution of the SPA; and the failure to operate the business of B in accordance with applicable regulatory requirements and contractual terms; and (ii) a claim for damages for deceit.

12. Z's further claim in deceit is, essentially, that prior to entry into and/or completion of the SPA and in order to induce Z to enter into the SPA and to proceed to its completion; the defendants made material misrepresentations to Z to the effect that no B Funds under management had ever made an investment in any of the infamous and ill-fated Madoff Funds. It is averred that such investments were made and came to Z's attention only after the SPA was executed.

13. The sum of the damages claimed by Z in the English proceedings is significant and is claimed as representing the value of the shares acquired by Z in B, which are now said by Z to have been rendered worthless because of the consequences of the alleged breaches of warranty and deceit, together with consequential losses.

14. Having identified the Retained Earnings as an asset of the defendants against which it might enforce a judgment obtained in the English proceedings, Z seeks to have them preserved as far as possible by the injunctive order obtained in support of the English proceedings that it has obtained in this Court towards those ends.

The present application and the competing interests of Z

15. An adverse judgment in the English proceedings in favor of Z to be enforced against the Retained Earnings, could therefore result in the complete loss of the Trust's only realizable asset.

16. This is the reason for this application by the Trustee, seeking the directions of the Court to defend the English proceedings and permission to borrow funds from the C Trust, to discharge the costs of defending and, pre-emptively, for an indemnity for any costs and expenses properly incurred for those purposes, to be ultimately reimbursed from the A Trust assets.

17. Such directions would arise as a consequence of the exercise of the Court's inherent and/or statutory powers to give directions binding on those interested under a trust or otherwise protecting or supervising trustees.

18. The statutory powers are expressed in compendious terms in section 48 of the Trusts Law (2011 revision):

> "*Any trustee or personal representative shall be at liberty, without the institution of suit, to apply to the Court for an opinion, advice or direction on any question respecting the management or administration of the trust money or the assets of any testator or intestate, such application to be served upon, or the hearing thereof to be attended by, all persons interested in such application, or such of them as the court shall think expedient*[5]*; and the trustee or personal representative acting on the opinion, advice or direction given by the court shall be deemed, so far as regards his own responsibility, to have discharged his duty as such trustee or personal representative in the subject matter of the said application.*
>
> *Provided that this shall not indemnify any trustee or personal representation in respect of any act done in accordance with such opinion, advice or directions as aforesaid, if such trustee or personal representative shall have been guilty of any fraud, willful concealment or misrepresentation in obtaining such opinion, advice or directions,*

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[5] Hence directions were given on 3 November 2016 for service of notice of this application upon the Attorney General on behalf of charity as a beneficiary of the Trust and allowing for informal notice to be given by letter to Z as a contingent judgment creditor through its local lawyers.

and the costs of seeking application shall be in the discretion of the Court.

19. It will be seen that section 48 describes the general jurisdiction of the Court for the administrative oversight of trusts and the nature of the indemnity given to trustees when acting in accordance with directions or advice properly obtained from the Court, the trustees having made full disclosure of the strength and weaknesses of their case and of all other relevant information.

20. The advisability of a trustees' application to the court for directions *specifically on the question of engagement in litigation*, has been established ever since *Re Beddoe* (above) where Lindley LJ, on behalf of the English Court of Appeal, reflected on the ill- advised pursuit of litigation without such directions and explained the principle in these terms (at 557-558):

> *"... a trustee who, without the sanction of the Court, commences an action or defends an action, unsuccessfully, does so at his own risk as regards the costs, even if he acts on counsel's opinion; and when the trustee seeks to obtain such costs out his trust estate, he ought not to be allowed to charge them against his cestui que trust, unless under very exceptional circumstances....*
>
> *If, indeed, the judge comes to the conclusion that he would have authorized action or defence had he been applied to, he might, in the exercise of his discretion, allow the costs incurred by the trustee out of the estate: but I cannot imagine any other circumstances under which*

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the costs of an unauthorized and unsuccessful action brought or defended by a trustee could be properly thrown on the estate....

I entirely agree that the trustee is entitled as of right to a full indemnity out of his trust estate against all of his costs, charges, and expenses properly incurred: such an indemnity is the price paid by cestui que trusts for the gratuitous and onerous services of trustees[6]*; and in all cases of doubt, costs incurred by a trustee ought to be borne by the trust estate and not by him personally....*

But considering the ease and comparatively small expense with which trustees can obtain the opinion of a judge of the Chancery Division on the question whether an action should be brought or defended at the expense of the trust estate, I am of opinion that if a trustee brings or defends an action, unsuccessfully, and without leave, it is for him to show that the costs so incurred were properly incurred. The fact that the trustee acted on counsel's opinion is in all cases, a circumstance which ought to weigh with the court in favor of a trustee; but counsel's opinion is no indemnity to him, even on a question of costs."

21. The effect of this dictum for present purposes is clear: where a trustee pursues or defends an action unsuccessfully without having the protection of an order obtained pursuant to the *Beddoe* dictum, it is likely to be only in exceptional circumstances that he will be granted an indemnity by the Court. A prudent trustee will wish to be assured of such an indemnity conveying the imprimatur of the court, irrespective of

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[6]. Nowadays these are services provided by paid professional trustees and hence the insistence by trustees upon having contractual indemnities.

the entitlements to a contractual indemnity. The imprimatur of the court removes any doubt as to whether the trustee acted in breach of trust or otherwise improperly.

22. Those being the guiding principles which have since come to be settled in case law[7]; ultimately, a trustee's right to indemnity as between himself and his beneficiaries from the trust fund in respect of the cost of third-party litigation, turns upon the issue whether or not he will act properly in bringing or defending the claim.

23. It is for the reason that this will often be a pre-emptive issue for a trustee, that a *Beddoe* application seeking the court's permission to incur the costs, must be made in separate proceedings as it has been made here.

24. As Lewin explains[8] the *Beddoe* application is concerned with a question that directly affects the beneficiaries, namely whether trust funds [whatever the actual source of funding] should be spent or placed at risk in the main action – in this case, Z's claim in the English Proceedings. Accordingly, the beneficiaries are necessary parties to a *Beddoe* application as they are entitled to be heard on that issue. Here Mr. Y, as primary beneficiary, has been joined and gives his consent, and, as already mentioned, charity's interest has been recognized by notice to the Attorney General who does not object, seeing charity's interest as being fully aligned with that of the other beneficiaries on this issue[9].

25. The question whether the costs of the main action should be recoverable by the Trustee from the trust funds necessarily also involves a review of the merits in the main action from the viewpoint of the A Trust, another reason why the *Beddoe*

[7] As explained by Lewin on Trusts, 19th Ed. Para 27-215 et. Seq. including by reference to a number of cases decided by this Court.
[8] Op. cit., at para 27-239.
[9] As expressed by letter.

application must be made in separate proceedings (and in the typical case will be taken by a different judge[10]).

26. Z, through its local lawyers, having been sent a letter informally notifying it of this application, contended in its reply, ("Z's response letter") among other things, that formal notice of the proceedings should be given to Z to allow it to make at least written submissions of its position to this Court in keeping with the practice settled in *In Re Eaton*[11], and notwithstanding that Z would not thereby be entitled to appear and get access to any confidential material placed before the Court by the Trustee.

27. While I have seen and considered Z's response letter (including as it sets out Z's objections to the Trustee's application), I regard this particular argument for entitlement to notice as misconceived.

28. This is for the reason, first of all, that the Trustee is entitled to bring the *Beddoe* application on the basis explained above, seeking the Court's sanction for action which it proposes to take in defending the English Proceedings. No issue to be decided in the English Proceedings as between Z and the Trustee can be involved in or affected by this application.

29. Secondly, Z's reliance on *In Re Eaton* (above) is misplaced because that case and the guidance given in it, concerned a claim by a trustee against a beneficiary of the subject trust. Z is not a beneficiary of the A Trust here; nor does it assert a proprietary claim to the A Trust assets: Z is simply a third party that asserts a disputed personal claim in contract or tort against the Trustee.

[10] These last are not in issue here because the English Proceedings are foreign proceedings.

[11] [1969]1 WLR 1269.

30. There are further reasons why I must reject the argument propounded in Z's response letter and which I now turn to address.

31. First classified in *In Re Buckton*[12], it is now accepted that there are three kinds of litigation in which trustees might become involved. This classification was restated in *Alsop Wilkinson v Neary*[13] in terms which have become widely accepted in the modern case law and can be summarized as follows[14]:

    (1) a dispute as to trusts on which (trustees) hold the subject matter of settlement ("a trust dispute");

    (2) a dispute with one or more of the beneficiaries as to the propriety of any action which the trustees have taken or omitted to take or may or may not take in the future ("a beneficiaries dispute"); and

    (3) a dispute with persons, otherwise than in the capacity of beneficiaries, in respect of rights or liabilities assumed by the trustees as such in the course of the administration of the trust ("a third party dispute").

32. In the present case, it is clear that Z's claim in the English Proceedings is a third party dispute within the meaning of *Alsop Wilkinson* category (3).

33. Z's response letter, nonetheless, seeks to suggest that the dispute between Z and the Trustee in the English Proceedings is a trust dispute (category (1)) rather than a third party claim and asserts, by reference to *Alsop Wilkinson,* that the Trustee's Originating Summons by which it brings this application, seeks a pre-emptive costs order which anticipates the outcome of the English Proceedings.

[12] In Re Buckton, Buckton v Buckton [1907] 2 Ch 406.
[13] [1996] 1 W.L.R. 1220, at 1223-1224, per Lightman J.
[14] See Lewin op. cit. at para 27-001.

34. I do not share that view. In the present case, the Trustee's application is simply for *Beddoe* relief as to whether the Trustee should defend the claim in the English Proceedings and, if so, for an indemnity out of the A Trust assets. Such an application is clearly not a pre-emptive costs application that would pre-determine the incidence of costs as between Z and the Trustee in the English Proceedings. Aside from anything else, this application is not made in the English Proceedings[15].

35. That said, it is recognized and accepted that Z as claimant in the English Proceedings, could be adversely affected if its claim is successful and the Trustee will have defended the claim at the expense of the Trust. This is because the costs of the defence would reduce the value of the assets against which Z would wish to enforce its judgment.

36. But that consideration is no basis for denying the Trustee its *Beddoe* relief.

37. As already mentioned, Z cannot assert and does not assert a proprietary interest in the A Trust assets.

38. In a trust dispute properly so called, (*Alsop Wilkinson* category 1), the claimant contends that the assets are his assets and so it becomes a concern whether it is unfair (if his case is shown to be well-founded) for the assets to be used to defend his claim.

39. In this case, Z claims no proprietary interest but is potentially affected by the way in which the A Trust is administered pending resolution of its claim. It is in that sense that Z was regarded as having a sufficient interest to be informally notified so that if it wished, it could make representations to this Court, as it did by way of Z response letter.

[15] As to the difference between a *Beddoe* order and a pre-emptive costs order, see Lewin (op. cit.) para 27-240 and 27-241.

40. That being the case, I had to decide upon the Trustee's *Beddoe* application having regard, not only to Z's position but importantly, to those of the Trustee and the Beneficiaries as well.

41. As was stated in *Alsop Wilkinson*[16]:

> *"Trustees (express and constructive) are entitled to an indemnity against all costs, expenses and liabilities properly incurred in administering the Trust and have a lien on the trust assets to secure such indemnity. Trustees have a duty to protect and preserve the trust estate for the benefit of the beneficiaries and accordingly to represent the trust in a third party dispute. Accordingly, their right to an indemnity and lien extends in the case of a third party dispute to the costs of proceedings properly brought or defended for the benefit of the trust estate."*

42. Views will differ (as do those of the Trustee and Z here) as to whether the English Proceedings are properly brought or defended. Z having been given the opportunity to make representation by the Z response letter, a question for me is how much weight should be given to Z's views as a putative judgment creditor and how those views should weigh against the interests of the beneficiaries of the A Trust, given that, if Z's claim which exceeds the value of the A Trust assets goes undefended, Z will be entitled to default judgment and so the A Trust will certainly be exhausted to the detriment of the beneficiaries.

[16] At 1224 D-E.

43. The Trustee expresses its understanding of its obligation to manage the litigation efficiently and to minimize costs wherever possible. These obligations, as well as the obligation of an applicant Trustee to disclose the weaknesses in its case when seeking *Beddoe* costs relief for defense of hostile litigation, is settled in the case law in this jurisdiction; see *Bridge Trust et al v A.G. et al* 2001 CILR 132.

Conclusions

44. Given that, if the claim is not defended, the beneficiaries are not likely to derive any value from the A Trust, viewed from the perspective of the beneficiaries I accept that it is appropriate to direct the Trustee to defend the claim in the English Proceedings and to do so by borrowing from the C Trust.

45. The concern with which I have had to grapple is whether the points made by Z in the Z response letter are such as to outweigh the interest of the beneficiaries.

46. While, as explained above, a contingent or putative creditor in the position of Z should have opportunity to make representations to the Court as to whether a direction to defend should be given[17], such representations may or may not be determinative. Where they are not, as I find to be the case here, the fact that the A Trust assets will be reduced by the defence of the English Proceedings, is not a factor that can outweigh the interest of the beneficiaries. A contingent or putative creditor in Z's position not capable of asserting a proprietary claim to the trust assets, takes the trust assets as it finds them at the time of judgment. It asserts only a personal claim and a right to enforce any judgment against the assets of the A Trust, such as

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[17] A claimant might, for example, be able to point out to the court an argument not appreciated by the trustee that would render a defence hopeless.

those assets may be from time to time in the course or the ordinary and proper administration of the A Trust.

47. Existing A Trust assets (such as they are) will not be spent but the proposed borrowing from the C Trust will have the same effect on the net asset position of the A Trust. This assumes that the borrowing is deemed to be in the proper administration of the A Trust, as I deem it to be for present purposes.

48. In granting the Trustee's application for *Beddoe* relief, I conclude that, in the unusual and uncertain circumstances confronting the Trustee, it would be unjust to allow Z's putative contingent and non-proprietary claim to outweigh the interests of the beneficiaries.

49. The Trustee is allowed to defend the English Proceedings and will have an indemnity from the Trust assets (to be funded by a loan from the C Trust) for the costs reasonably incurred in defending.

50. Orders in those terms were granted on the 18th November 2016. These are the reasons.

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Hon. Anthony Smellie
Chief Justice

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