Neutral Citation Number: [2019] EWCA Civ 2261

Case No: A3/2019/1125

IN THE COURT OF APPEAL (CIVIL DIVISION)
ON APPEAL FROM BRISTOL DISTRICT REGISTRY
His Honour Judge Paul Matthews
C30BS640

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 18/12/2019

Before:

LORD JUSTICE UNDERHILL
Vice-President of the Court of Appeal (Civil Division)
LADY JUSTICE ASPLIN
and
LORD JUSTICE ARNOLD

- -

Between:

Pauline Ann Price	**Appellant**
- and -	
Valery Ann Saundry	**1st Respondent**
Geraldine Sanders (as Executrix of Martin Gordon Sanders, Deceased)	**2nd Respondent**

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- -

Mr Alexander Learmonth (instructed by **Michelmores LLP**) for the **Appellant**
Mr Leslie Blohm QC and **Mr Ewan Paton** (instructed by **Powells Law**) for the **First Respondent**
the **Second Respondent** did not appear and was not represented

Hearing date: 3 December 2019

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Approved Judgment

Lady Justice Asplin:

1. This appeal is concerned with the circumstances in which a trustee is entitled to be indemnified from the trust fund in respect of costs incurred by her and awarded against her in litigation.

2. The issue arises in the context of a claim which was commenced by the Appellant, Mrs Pauline Price, against the First Respondent, Mrs Valerie Saundry, and a Mr Martin Sanders, who were the trustees of a trust which was declared in a document dated 6 July 2009 and which was made by Mrs Price and Mr Alan Saundry, Mrs Valerie Saundry's husband (the "Declaration of Trust"). By the Declaration of Trust the interests in the properties set out in the schedule, the legal titles to which were vested in Mr Saundry, the net proceeds of sale and the net income until sale were held upon trust for Mrs Price and Mr Saundry as beneficial tenants in common in equal shares. Mr Saundry was appointed as the sole trustee. On his death in 2013, his widow, Mrs Saundry became trustee as a result of being her husband's sole personal representative. By an undated deed executed on 10 December 2015, Mrs Saundry appointed her brother, Mr Martin Sanders, as an additional trustee of the Trust. Mr Sanders died after Mrs Price had commenced these proceedings and his widow and executrix, the Second Respondent, Mrs Sanders, was substituted as a party. (Mrs Sanders was not represented and has taken no part in the appeal before us.)

3. The proceedings were commenced by the issue of a Part 8 Claim Form dated 14 June 2016. Mrs Price, who was the Claimant and is now the Appellant before us, sought an order removing the then trustees of the Trust, Mrs Saundry and Mr Sanders, and their replacement with professional trustees, on three main grounds. They were that: Mrs Saundry had refused to appoint Mrs Price as a trustee but had appointed her brother, Mr Sanders, instead; that Mrs Saundry had attempted to buy one of the trust properties at what was alleged to be an undervalue; and that there had been a lack of disclosure of financial and accounting information. Further relief was sought in the form of: "Such further Orders (for example as to the sale of Trust assets and the taking of accounts and enquiries as appears to the Court to be necessary)". I will refer to this aspect of the litigation as "the Removal claim".

4. A month before the hearing of the application to remove the then trustees, the majority of the properties which were the subject of the Trust having already been sold, the parties agreed that the focus of the litigation should change and that it should proceed as the taking of an account in common form. As a result, an order dated 13 September 2017 was made by consent by Mr Simon Monty QC, sitting as a Deputy Judge of the High Court, vacating the pre-trial review and the trial of the Removal claim and giving directions for the then trustees to "produce a final account of the capital and income trust and the dealing with it, verified by a witness statement to which the account is exhibited". Detailed directions as to what the account should include, the date on which it should be produced and filed, the date by which any objections should be lodged, along with the date for any reply to such objections, were also set out. I will refer to this aspect of the litigation as the "Account claim".

5. Three attempts having been made to lodge accounts in accordance with the directions which had been made and objections having been lodged, the Account claim proceeded before HHJ Matthews, sitting as a Judge of the High Court. During the taking of the account an issue arose as to whether one of the properties was subject to

the Trust at all. Mrs Saundry claimed that it had been included by mistake and that the Declaration of Trust should be rectified in order to remove it. That issue was dealt with separately and is not directly relevant to the issue on this appeal. Nevertheless, for completeness I should add that the judge decided that the property in question, at 7 Linwell Close, Cheltenham, was trust property and, therefore, was subject to the account which was in the process of being taken. I will refer to this aspect of the litigation, if necessary, as the "Rectification claim".

6. On the hearing of the Account the judge dealt with each matter as it arose. We have not seen a transcript of the judgment. From what we were told, I understand there to have been a series of ex tempore judgments. I shall refer in more detail to some of the points raised on the Account and the judge's determination of them, below. In any event, as a result of the judge's decisions, amendments were made to the Account and ultimately, Mrs Saundry was found liable to pay £52,701.54 plus interest in the agreed sum of £4,000 to the credit of the Trust.

7. Mrs Saundry's liability in respect of the credits and interest to which I have referred was set out at paragraph 1 of the judge's order dated 3 May 2019. By paragraphs 2 and 3 respectively, permission to amend the Part 8 Acknowledgment of Service to include the Rectification claim was granted and that claim was dismissed. It is the parts of the order which are concerned with costs and, in particular, with Mrs Saundry's entitlement to be indemnified in relation to costs of and incidental to the litigation which are relevant to this appeal. First, the judge made no order as to costs in relation to the proceedings up to and including the date of the consent order, in other words, in relation to the Removal claim, save that Mrs Saundry and Mrs Sanders be entitled to their costs in that regard out of the Trust fund, on the indemnity basis. Secondly, as to the costs of the Account claim in the proceedings after 13 September 2017, up to and including the trial, Mrs Saundry was ordered to pay Mrs Price's costs of the account: up to 28 December 2018 subject to a detailed assessment on the standard basis, if not agreed; and in relation to her costs of the Account after 28 December 2018 subject to a detailed assessment on the indemnity basis, if not agreed. The significance of 28 December 2018 is that Mrs Price had made a Part 36 offer which expired on that date, which had not been bettered on the taking of the Account. The judge went on to order that, save for the costs attributable to the Rectification claim, Mrs Saundry be entitled to the costs of the Account from the Trust fund on the indemnity basis, to include her own costs of those proceedings and the adverse costs order made against her.

8. The right to an indemnity from the trust fund in relation to both the costs of the Removal claim and the Accounts claim are the subject of this appeal.

What the judge found on the taking of the Account

9. As I have already mentioned, we were not provided with the transcript of the judge's ex tempore judgments on each point of challenge to the Account. However, Mr Learmonth, who appeared both before the judge and before us on behalf of Mrs Price, set out what he says is the gist of the judge's main findings in favour of Mrs Price, in his supplementary skeleton. He cross-referenced this summary to items in a schedule, described as a "ready-reckoner" which he relied upon before the judge for the purposes of the costs hearing. It sets out each positive change to the Account which was required as a result of the judge's findings and decisions on the Account and its

monetary effect. The items in the schedule total the £52,000 odd which Mrs Saundry was ordered to re-pay to the Trust. The content of the ready-reckoner is not in dispute.

10. The adjustments to the Account which were ordered and which were remedied by the order that Mrs Saundry restore £52,000 odd to the trust fund related to thirteen matters which were either admitted or were the subject of adjustment on the taking of the Account. Mr Learmonth relied upon the following seven items which he says all amounted to breaches of trust. They were: (i) a payment of remuneration to Mr Martin Sanders, Mrs Saundry's brother, when he was a trustee of the Trust in the sum of £21,367.85; (ii) a payment to Karl Saundry, Mrs Saundry's son, at a time when Karl was occupying trust property rent free, the amount of rent which should have been set off being £2,400; (iii) payments to Mrs Saundry's daughter, Jessica, some of which were accepted as being unjustified and some of which were disallowed by the judge in the sum of £3,349.84; (iv) payment of Mrs Saundry's late husband's income tax liability and personal accountant's fees in the sum of £4,916.09 and £3,880.32 respectively; (v) payment of interest to Mrs Saundry herself in the sum of £1,032.79; (vi) failure to account for proceeds of sale of a former trust property at Atlas Road which were in Mrs Saundry's hands in the sum of £4,305.74; and (vii) numerous other payments which Mrs Saundry was unable to justify in the taking of the Account.

11. Although the judge makes no mention of it in his judgment, we were informed by Mr Blohm QC, who appeared together with Mr Paton on behalf of Mrs Saundry, that the total value of the items which had been challenged by Mrs Price in the Account was in the region of £600,000.

The Judge's decision - Indemnity in relation to the Removal Claim

12. The judge dealt with the question of whether Mrs Saundry should be entitled to be indemnified out of the trust fund in relation to her costs of and incidental to the Removal claim at [26] - [32] of his ex tempore judgment, the citation of which is [2019] EWHC 1039 (Ch). He had already concluded at [16] – [25] that he was not in a position to make an inter partes costs order in relation to the Removal claim because he did not have the material upon which to decide whether such an order ought to be made because there was no determination of the issues by the court or a compromise between the parties. See [16], [24] and [25] of the judgment. As a result, he made no order as to costs in relation to the Removal claim. Permission to appeal that aspect of his judgment was refused.

13. Having set out CPR 46.3 and PD46.1, paragraphs 1.1 and 1.2, the judge went on to conclude that: PD46.1(a) was of no relevance because Mrs Saundry had not obtained directions from the court before defending the Removal claim (see [29]); in relation to PD46.1(c) he was not in a position to say that the conduct of the Removal claim itself had been unreasonable or that Mrs Saundry acted unreasonably in defending it because there had been no conclusion to those proceedings and he had never had to decide any of the issues which arose in relation to them (see [30]); and in relation to PD46.1(b), having noted paragraph 1.2, he went on at [32] as follows:

> ". . .

> So the mere fact that the trustee has defended the claim because a claim has been made against her does not automatically mean that it is done in some interest other than that of the trust estate.
>
> The question is whether I can go on to say that she has acted in substance for a benefit other than that of the estate. The difficulty again is that, of course, I have made no findings in relation to the allegations made under this part of the claim and I do not see how I can reach the conclusion that she has committed such misconduct as would justify her being deprived of her indemnity. In relation to the first part of the claim, I can make no order as to costs and I see no basis upon which to deprive the trustees of their indemnity."

The Judge's decision - Indemnity in relation to Account claim

14. The judge went on to consider what would be the appropriate inter partes costs order in relation to the Account claim at [33] - [46] of his judgment. In this regard, he noted at [34] that: "*. . . it is to be borne in mind that an account claim (that is to say, an account in the common form) is very different from a breach of trust claim because here, there is no necessary suggestion that the trustee has committed any wrongdoing whatever except that the account may or may not be correct. It is a question of whether the accounts are correct. . .*" He went on at [37] to state that:

> "I consider that in the present case the claimant [Mrs Price] has had sufficient success on the account to justify the first defendant [Mrs Saundry] paying those costs of taking the account. The success has been not just a few small sums here and there. There were included some significant ones too. In my judgment, the claimant was wholly justified in seeking an account and has been shown to be right in a number of important matters, even if the total amount of the adjustments that will be effected as a result does not match up to some of the sums which were being bandied about in the earlier correspondence between solicitors."

In relation to the repeated attempts to produce accounts in accordance with the orders which had been made and points made in relation to discrepancies in the account, the judge stated that they added weight to his decision but that he did not think them necessary for it. See [39]. He then went on to consider the effect of the Calderbank offer and the Part 36 offer upon the basis upon which costs should be awarded and concluded at [46] that the Part 36 offer had been successful and that the consequences of CPR 36.17(4) should follow. It was his conclusion in this regard which led to costs being awarded on the standard basis before 28 December 2018 and upon the indemnity basis thereafter.

15. The judge turned next to the question of an indemnity from the trust fund in relation to the costs of the Account claim. He made no mention of section 31 of the Trustee Act 2000 (as to which see below) but addressed the issue as follows:

> "47. The last point on this part is the question of the impact of the trustee rules, which I have referred to in CPR 46.3 and in Practice Direction 46.1, and that is whether or not the first defendant should lose

> her indemnity from the trust fund to which, under the general trust law, she is entitled. I ask myself, therefore, similar questions. Did the first defendant act unreasonably in the conduct of the account? Looking at the way in which the account went through, there were some glitches, there were some difficulties, but I cannot say that at any point in my judgment she acted unreasonably in the conduct of it.
>
> 48. The other question is whether the first defendant acted in substance for the benefit of another party or for herself. Here it seems to me that, in relation at any rate to the matters which were found on the account obviously the same point arises as arose before. This is that there were some payments which were struck out of the account or which were put back in because they were wrongly dealt with. But I cannot say that the first defendant was acting in substance for the benefit of another party, so I cannot find any misconduct in this case. I do not consider that there is any justification for removing the indemnity from the first defendant."

The postscript

16. After the ex tempore costs judgment had been given, the judge was asked to clarify three points and counsel made further written submissions in relation to them. Two of those issues are directly relevant to this appeal. The first was whether Mrs Saundry's indemnity from the trust fund extended to the costs order made against her in favour of Mrs Price and the second was whether the trustee's indemnity extended beyond the expiry of the Part 36 offer. In relation to the first point, the judge held that the indemnity extended to the costs order made against Mrs Saundry and that Mr Paton, who appeared on behalf of Mrs Saundry below, was right that she could only lose her indemnity in relation to an adverse costs order for the same reasons as she could lose it for her own costs. See [64] and [65]. He went on:

> ". . . I have not found the first defendant to have been guilty of misconduct or any breach of trust causing loss to the trust fund. I have corrected the first defendant's accounting after hearing the evidence, but taking an account in this way is not at all the same as finding proved an actionable breach of trust. The default position for a trustee engaged in litigation is that he or she will have an indemnity for costs properly incurred (including for adverse costs orders) unless guilty of misconduct. In these circumstances I have no basis for saying that the first defendant is not entitled to the indemnity even in respect of the adverse costs order. In any event, I am not aware of any authority for distinguishing the cases where the trustee was also a beneficiary from that where she was not, or was defending a third party's claim and see no principled reason for doing so."

17. In relation to whether the indemnity continued to apply after the expiry of the Part 36 offer, Mr Learmonth had submitted that the indemnity could not apply "since a trustee who refused a Part 36 offer (which is then beaten) cannot say that her costs incurred thereafter were "properly incurred", reasonably incurred or incurred for the benefit of the trust. Rather they were incurred in an unsuccessful attempt to avoid the consequences of the Part 36 rules for the trustee personally." See [66] of the

judgment. Mr Paton, on behalf of Mrs Saundry, had submitted that the mere non-acceptance of a Part 36 offer was not misconduct or any other behaviour justifying removal of the indemnity.

18. Having concluded at [69] of the judgment that "[F]rom a trust law point of view, failing to beat a Part 36 offer can hardly be characterised as a breach of trust, or any kind of misconduct, at any rate not automatically", the judge went on to draw an analogy with the position of a director litigating on behalf of a company who is not liable to the company because it does not beat a Part 36 offer (see [70]), to conclude that it is not sensible to attribute an intention to the draftsmen of CPR 36.17 that they intended to interfere with the pre-existing trustee indemnity rules (see [71]) and to pose the question: "Has the first defendant committed misconduct, or a breach of trust causing loss to the trust estate in failing to accept the Part 36 offer and then failing to beat it?" (see [72]). He answered that question in the negative and concluded that Mrs Saundry remained entitled to her indemnity even after the expiry of the Part 36 offer.

The basis for a Trustee's right to indemnity

19. Before considering the judge's reasoning in more detail, it is helpful to have in mind the statutory provisions and Civil Procedure Rules which apply in relation to trustee indemnity. The general proposition in relation to reimbursement of a trustee from the trust fund is now to be found in section 31(1) of the Trustee Act 2000. It provides as follows:

> "(1) A trustee—
>
> (a) is entitled to be reimbursed from the trust funds, or
>
> (b) may pay out of the trust funds,
>
> expenses properly incurred by him when acting on behalf of the trust."

Mr Learmonth also took us to the predecessor of section 31(1), section 30(2) of the Trustee Act 1925. That was in a slightly different form. It provided:

> "A trustee may reimburse himself or pay or discharge out of the trust premises all expenses incurred in or about the execution of the trusts or powers."

20. In relation to the costs of proceedings in which a trustee is or has been involved, there are specific provisions in the CPR. CPR 46.3 is concerned with the powers of the court to award costs in favour of trustees or personal representatives. It applies where a person is or has been a party to any proceedings in either of those capacities and costs are not payable under a contract to which CPR 44.5 applies. The general rule is that such a person:

> "(2) . . . is entitled to be paid the costs of those proceedings, insofar as they are not recovered from or paid by any other person, out of the relevant trust fund or estate."

Those costs will be assessed on the indemnity basis: CPR 46.3(3). The Rule is supplemented by 46PD.1 which provides as follows:

> "1.1 A trustee or personal representative is entitled to an indemnity out of the relevant trust fund or estate for costs properly incurred. Whether costs were properly incurred depends on all the circumstances of the case including whether the trustee or personal representative ("the trustee")—
> (a) obtained directions from the court before bringing or defending the proceedings;
> (b) acted in the interests of the fund or estate or in substance for a benefit other than that of the estate, including the trustee's own; and
> (c) acted in some way unreasonably in bringing or defending, or in the conduct of, the proceedings.
>
> 1.2 The trustee is not to be taken to have acted for a benefit other than that of the fund by reason only that the trustee has defended a claim in which relief is sought against the trustee personally."

21. The relevant Supreme Court Rules which preceded CPR 44.6 were also in a slightly different form. Order 62, r 6 which was headed "Cases where costs do not follow the event" provided (in its 1994 form, at least) where relevant, as follows:

> "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."

22. It was common ground that the source of the right to an indemnity is to be found in section 31(1) of the Trustee Act 2000 and that the provisions of the CPR can only be a commentary upon and complementary to that section. That must be right and must also have been the case in relation to section 30(2) of the 1925 Act and Order 62 r 6 of the Supreme Court Rules. There was some discussion as to whether section 31(1) had changed the law and that the earlier case law should be seen in that light. It seems to me that that was not the effect of section 31(1) of the Trustee Act 2000. On the contrary, it seems to me that it was an attempt to codify the law as it stood.

23. Although many more trustees are remunerated as a result of express provisions in the trust deed than in Victorian times and in the early twentieth century, the policy behind the availability of an indemnity has not changed. It is designed to ensure that the trustee is not out of pocket when acting in his capacity as trustee on behalf of the trust and that the trust is efficiently and properly administered. Nothing has changed. The right to an indemnity is part of the fabric of the relationship between the settlor, the trustees and the beneficiaries: see *Turner v Hancock* (1882) 20 Ch D 303 per Jessel, MR at 305.

24. The test for whether the indemnity is available or has been lost or curtailed is also the same under section 31(1) of the 2000 Act and section 30(2) of the 1925 Act. It is best expressed in the form of two questions: were the expenses properly incurred?; and were the expenses incurred by the trustee when acting on behalf of the trust? The

answer to those questions is often far from straightforward. They are dependent upon all the circumstances of the case.

25. In this case, we are concerned specifically with the costs incurred in litigation. There are a number of cases in which the courts have attempted to categorise the kinds of dispute in which a trustee may become involved and the circumstances in which an indemnity will or will not be available, the first of which was *Re Buckton* [1907] 2 Ch 406. In *McDonald v Horn* [1995] ICR 685, Hoffmann LJ (as he then was) described Kekewich J's consideration of the issue in that 1907 case as the "classic statement of the principles upon which the court acts".

26. *McDonald v Horn* itself was concerned with a slightly different point from the one here. The question was whether a pre-emptive costs order should have been made in favour of claimant employee beneficiaries of a pension scheme who had commenced proceedings against the pension fund trustees and others alleging improper use of the powers in the trust deeds and breach of trust in the investment of the trust fund. They had sought an order that their costs and any costs which they might be ordered to pay to the defendants should, win or lose, be paid on an indemnity basis out of the pension fund. As the position of trustees in relation to the costs of litigation had, in some circumstances, been extended by analogy to others, Hoffmann LJ set out the position in relation to trustees involved in litigation at 695G – 696B. Having mentioned Kekewich J's consideration of the relevant principles in *Re Buckton* [1907] 2 Ch 406 at 413–415, Hoffmann LJ went on to note as follows:

> "While warning that it was 'well nigh impossible to lay down any general rules which can be depended on to meet the ever varying circumstances of particular cases', he said that trust litigation could be divided into three categories. First, proceedings brought by trustees to have the guidance of the court as to the construction of the trust instrument or some question arising in the course of administration. In such cases, the costs of all parties are usually treated as necessarily incurred for the benefit of the estate and ordered to be paid out of the fund. Secondly, there are cases in which the application is made by someone other than the trustees, but raises the same kind of point as in the first class and would have justified an application by the trustees. This second class is treated in the same way as the first. Thirdly, there are cases in which a beneficiary is making a hostile claim against the trustees or another beneficiary. This is treated in the same way as ordinary common law litigation and costs usually follow the event."

27. A similar categorisation was adopted by Lightman J in *Alsop Wilkinson v Neary & Ors* [1996] 1 WLR 1220. He set out the categories and their likely effect in relation to the trustee's indemnity at 1223H – 1224G as follows:

> "Trustees may be involved in three kinds of dispute. (1) The first (which I shall call "a trust dispute") is a dispute as to the trusts on which they hold the subject matter of the settlement. This may be "friendly" litigation involving e.g. the true construction of the trust instrument or some other question arising in the course of the administration of the trust; or "hostile" litigation e.g. a challenge in whole or in part to the validity of the settlement by the settlor on grounds of undue influence

> or by a trustee in bankruptcy or a defrauded creditor of the settlor, in which case the claim is that the trustees hold the trust funds as trustees for the settlor, the trustee in bankruptcy or creditor in place of or in addition to the beneficiaries specified in the settlement. The line between friendly and hostile litigation, which is relevant as to the incidence of costs, is not always easy to draw: see *In re Buckton; Buckton v. Buckton* [1907] 2 Ch. 406. (2) The second (which I shall call "a beneficiaries dispute") is 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. This may take the form of proceedings by a beneficiary alleging breach of trust by the trustees and seeking removal of the trustees and /or damages for breach of trust. (3) The third (which I shall call "a third party dispute") is a dispute with persons, otherwise than in the capacity of beneficiaries, in respect of rights and liabilities e.g. in contract or tort assumed by the trustees as such in the course of administration of the trust.
>
> 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. Views may vary whether proceedings are properly brought or defended, and to avoid the risk of a challenge to their entitlement to the indemnity, (a beneficiary dispute), trustees are well advised to seek court authorisation before they sue or defend. . . .
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> A beneficiaries dispute is regarded as ordinary hostile litigation in which costs follow the event and do not come out of the trust estate: see *per* Hoffmann L.J. in *McDonald v. Horn* [1995] I.C.R. 685, 696."

28. The issue was subsequently considered in the Court of Appeal by Millett LJ (with whom Hutchinson and Hirst LJJ agreed) in *Armitage v Nurse & Ors* [1998] Ch 241. That was a case which was primarily concerned with the application and effect of a trustee exoneration clause. The judge had held that the trustees were entitled to rely upon the exoneration clause and the appeal against this aspect of the judgment was dismissed. It was held that the clause operated to absolve the trustees from liability for the alleged breaches of trust so long as they had not acted dishonestly. The incidence of the trustees' indemnity was also considered. The judge had awarded the trustees 80% of their costs, depriving them of the remaining 20% because they were unsuccessful on two of the points which had been argued. He also directed that they should not be at liberty to reimburse themselves out of the trust fund to the extent of that 20%. The judge had considered that they were defending themselves and, having taken points which cost money and in respect of which they were unsuccessful, ought to bear those costs themselves. Millett LJ addressed that matter in the following way at 262 C-G:

"The Respondents cross-appeal from the Judge's ruling which, they claim, deprives them of their legal rights. They submit that trustees are entitled to a lien over the trust fund for their costs, and that this lien extends to the costs of litigation, including the costs of defending themselves against a charge of breach of trust: see *Turner v Hancock* (1882), 20 Ch.D. 303; Re *Spurling's Will Trusts* [1966] 1 WLR 920. The lien is only lost by misconduct.

But the principle is in my opinion overstated. Trustees are entitled to a lien on the trust fund for the costs of *successfully* defending themselves against an action for breach of trust. That was the position in *Re Spurling's Will Trusts* as it was in *Walters v Woodbridge* 7 Ch.D. 504 which it followed. But on what principle can one justify their right to recoup themselves out of the trust fund for the costs of *unsuccessfully* defending themselves against such an action? It offends all sense of justice. The Respondents rely on *Turner v Hancock* and submit that that was just such a case; but I do not think that it was. The action was an action for an account. On taking the accounts it was found that a sum was due from the trustee and not to him as he contended. It was therefore a case in which the trustee was unsuccessful; but it was not a case in which he was found to be guilty of misconduct or breach of trust. In the course of his judgment Sir George Jessel, MR said at p. 304;

> "These rights can be lost or curtailed by such inequitable conduct on the part of a mortgagee or trustee as may amount to a violation or culpable neglect of his duty under the contract...It is not the course of the court in modern times to discourage persons from becoming trustees by inflicting costs upon them if they have done their duty, or even if they have committed an innocent breach of trust."

As Ungoed-Thomas J pointed out in *Re Spurling's Will Trusts*, it is not enough to deprive trustees of their right to recoup their costs out of the trust fund that the claim is a claim to recover money from them for the benefit of the trust. If the trustees succeed, then the claim was not well founded, and they cannot be denied their right of recoupment. I would add that even if the claim succeeds, yet they may not have so conducted themselves as to lose their right of recoupment.

In the present case the Judge deprived the Respondents of 20% of their costs because they had put forward arguments on which they had been unsuccessful. That was a proper exercise of his discretion. But he also deprived them of their right to recoup themselves out of the trust fund to the extent of that 20% on the ground that the claim was a hostile claim against them personally for breach of trust. In my opinion that was not a sufficient ground for denying them their contractual rights. As things stood at the conclusion of the Judge's judgment, he had held that the Respondents were absolved by Clause 15 from liability in respect of all the claims for breach of trust pleaded against them, with the result that the greater part of the Action was bound to fail (there is a claim to an

> account in respect of a separate matter which is not particularly contentious and which would survive). Accordingly, unless the pleadings were amended, the Action would be dismissed without any inquiry into the trustees' conduct. This would not provide any basis for depriving the Respondents of their rights."

29. All of this discussion brings one back to the question of whether the costs incurred by trustees in defending an action or arguing a point in the particular circumstances were expenses "properly incurred" when acting on behalf of the trust. It seems to me that "properly incurred" should be interpreted to mean "not improperly incurred". This was the way in which Lindley LJ approached trustee indemnity in *Easton v Landor* (1892) 62 L.J. Ch 164 and in *In re Beddoe, Downes v Cottam* (1893) 1 Ch 547. See also *In re Grimthorpe Dec'd* [1958] Ch 615 per Danckwerts J at 623.

30. In *Easton v Landor*, the judge, having granted the relief sought by the claimant beneficiaries including an account of the proceeds of sale of certain trust property, a declaration of breach of trust, the taking of an account and the administration of the trusts of the settlement, did not allow the defendant trustee any costs of the action, and the order provided for the taxation of the defendant's charges and expenses properly incurred not being those costs. The appeal from that order was dismissed and Lindley LJ, with whom Bowen and Smith LJJ concurred, stated at 165 that: " . . . Trustees who act properly are to be paid all costs properly incurred, and, in my opinion, that means all costs not improperly incurred." He went on to explain that that meant that where there was doubt as to whether the costs had been properly incurred, the trustee was to have the benefit of that doubt. He also stated that: "The rule is that where a trustee has by his misconduct occasioned a suit, and costs are incurred, the costs are in the discretion of the court."

31. It seems to me, therefore, that if a breach of trust causing loss to the trust fund or other misconduct is established against the trustee, the trustee may be deprived of his indemnity depending upon all the circumstances. Misconduct in this context should be construed widely to include not only misconduct in the sense of dishonesty but also conduct which is unreasonable in the circumstances. It does not extend, however, to a mere mistake on the part of the trustee: see *Lewin on Trusts,* 19th ed. para 27-112. This is consistent with *Turner v Hancock* upon which Mrs Saundry sought to rely. As Millett LJ explained in *Armitage v Nurse*, that was a case in which the action was for an account. The trustee had contended that money was due to him from the trust rather than vice versa. On the taking of the account, however, he was unsuccessful and he was ordered to pay £62 to the trust fund. No misconduct was found, however, and therefore Jessel, MR held that there was no ground for depriving the trustee of his costs. It would appear that there had been a mistake.

32. How do these principles apply to the Removal claim and the Account claim and did the judge apply them correctly?

33. As I have already mentioned, in relation to the costs of the Removal claim, the judge decided that he was not in a position to decide about Mrs Saundry's conduct in defending the Removal claim because those proceedings were never concluded and, accordingly, the court was never required to decide whether in the circumstances it was in the best interests of the beneficiaries to remove the trustees. See the judgment at [30]. He also concluded that he was not in a position to decide that in defending the

Removal claim, Mrs Saundry was acting other than for the benefit of the trust, for the same reasons. As a result, he concluded that he was not in a position to decide that she had committed misconduct in relation to the defence of the Removal claim which would justify her being deprived of her indemnity. See [32] of the judgment. In my judgment, he was entitled to take that view.

34. The Removal claim was not pursued, nor was there any agreement or compromise in relation to it or the costs in relation to it. Furthermore, the bases for it were different and distinct from those pursued in the Account claim. Mr Learmonth, on behalf of Mrs Price, submitted, however, that those proceedings were hostile litigation and when they were not pursued and directions were obtained for an account, it was on the basis that Mrs Price would be entitled to make submissions about the costs of the Removal claim at the conclusion of the litigation.

35. It seems to me that the fact that it was intended to make submissions as to costs does not alter the unusual situation in which the judge found himself. He had no basis upon which to conclude that the costs of the Removal claim had not been properly incurred. Just as in *Armitage v Nurse*, there had been no inquiry into the conduct which had been alleged. In the circumstances, the trustee was entitled to the benefit of the doubt. This is not a situation like the one which arose in *In re Hodgkinson, Hodgkinson v Hodgkinson* [1895] 2 Ch 190 in which the judge had made an order that accounts be taken in relation to the administration of a testator's estate and had declared that "he did not think fit to make any order as to the costs of the action". Lindley LJ, with whom Lopes and Kay LJJ concurred, held that it was clear that the judge had meant that each party should pay his own costs and that the trustee could not be indemnified from the trust fund. The express words of the order in and the intention of the judge in this case are quite obviously different.

36. Furthermore, I agree with the judge that in the absence of more, the mere fact that Mrs Saundry had defended the Removal claim is insufficient from which to conclude that she was acting on her own behalf and not that of the trust. As the judge pointed out at [32] of his judgment, PD 46.1 para 1.2 provides that a trustee is not to be taken as having acted for a benefit other than that of the trust fund by reason only of the fact that he has defended a claim in which relief is sought against him personally. Although Mr Learmonth referred us to a number of cases in which costs have been awarded despite there being no decision as to the merits/on the substance of the claim, I do not think they assist him. They all arose in materially different circumstances. This is a case in which nothing can be inferred about the merits of the Removal claim from the fact that it was not pursued and that the order for the account was made by consent.

37. It follows, therefore, that, in my judgment, the appeal in relation to Mrs Saundry's indemnity in respect of her costs of the Removal claim must be dismissed.

38. What of the indemnity in relation to Mrs Saundry's costs of the Account claim and Mrs Price's costs of that claim which Mrs Saundry was ordered to pay? In my judgment, the judge approached this aspect of the matter in the wrong way. He stated that the Account claim, which was for an account in common form, was very different from a breach of trust claim because there was no necessary suggestion that the trustee had committed any wrongdoing whatever. See [34] of the judgment. He also reiterated at [65] that he had not found Mrs Saundry guilty of misconduct or any

breach of trust causing loss to the trust fund but had merely corrected her accounting. It seems to me that that approach was incorrect and informed his conclusion.

39. I accept that the mere taking of an account in common form in itself does not suppose that there has been misconduct, unlike an account taken on the basis of wilful default. See *Partington v Reynolds* (1858) 4 Drew 253; 62 ER 98 per the Vice-Chancellor, Sir Robert Kindersley at 256. I also accept that providing an account per se is likely to be considered to be in the interests of the proper administration of the trust. That does not mean, however, that on taking an account in common form, breaches of trust causing loss to the trust fund and/or other misconduct may not be found and that in the circumstances, the trustee may be found not to have acted properly and not to have acted on behalf of the trust. In fact, as Mr Learmonth pointed out, as explained at para 39-003 of *Lewin on Trusts*, 19th ed, the claim for compensation for breach of trust has traditionally been brought by way of action for an account.

40. As Mr Learmonth submitted, it seems to me that the judge misled himself about the Account claim and the nature of his findings and did so, in part, because he did not refer back to section 31(1) of the Trustee Act 2000 but concentrated upon sub-paragraphs (a) to (c) of PD 46.1 and treated them as if they were exhaustive. The very nature of the matters which appeared in Mr Learmonth's ready-reckoner, and which had been found upon the taking of the account and which led to the order that Mrs Saundry credit the trust with £52,000 odd plus £4,000 interest, was sufficient for the judge to decide to make an adverse costs order against Mrs Saundry and should have led him to the conclusion that there was misconduct and breaches of trust of a nature which warranted the removal of the indemnity. The nature of the matters recorded in the ready-reckoner is not such that they could be characterised as mere accounting errors or mistakes, as appears to have been the case in *Turner v Hancock*. Nevertheless, that is the way in which the judge appears to have approached them once he had convinced himself that the Account claim was not concerned with breaches of trust or misconduct and that all that he had done was to correct Mrs Saundry's accounting. See [8], [34] and [65] of the judgment. The account revealed some serious misconduct and breaches of trust, such as the retention of the proceeds of sale of a former trust property at Atlas Road and the payment of Mrs Saundry's husband's income tax liability and personal accountant's fees from the trust fund.

41. It seems to me that the judge failed to recognise the serious misconduct which he had already found when taking the account and also failed to recognise that the Account claim was essentially hostile litigation falling within the third type of case referred to in *In Re Buckton.*

42. Furthermore, it seems to me that because of the approach that the judge adopted in relation to the taking of an account in common form, he failed properly to consider whether the second requirement in section 31 was met. He failed to address the question of whether Mrs Saundry was acting on behalf of the trust in providing the account or was acting for herself.

43. Whilst it was in the interests of the Trust to provide an account, it seems to me that the judge's findings on the taking of the account which are reflected in the seven headings in the ready-reckoner to which Mr Learmonth referred us, reveal that in those matters at least, Mrs Saundry unsuccessfully defended herself against breaches of trust and serious misconduct. In doing so she was clearly acting on her own behalf

and not that of the Trust. As Millett LJ pointed out in *Armitage v Nurse*, it offends all sense of justice to allow a trustee to recoup themselves of the trust fund for the costs of unsuccessfully defending themselves in relation to breaches of trust and, I would add, for doing so in relation to serious misconduct. It seems to me that the nature of the judge's decision in relation to inter partes costs ought to have been some indicator about the indemnity. Although an adverse costs order made inter partes does not necessarily lead to the loss of a trustee's indemnity, it is a strong indicator that the requirements of section 31 may not have been met. In this case, which was essentially hostile litigation, it seems to me that it was a good indicator which ought to have caused the judge to consider section 31(1) of the 2000 Act and the trustee's indemnity in the round. The same is true of the effect of CPR 36.17. Although the failure to meet a Part 36 offer cannot of itself be determinative of whether a trustee is guilty of misconduct in the conduct of an action such that they should not be entitled to an indemnity from the trust fund, in appropriate circumstances, it may be a material indicator in that assessment. The judge, however, failed to give it any weight. See [69] and [72] of the judgment.

44. For all these reasons I would allow the appeal in relation to the indemnity in respect of Mrs Saundry's costs and the costs she was required to pay in relation to the Accounts claim. As I have already said, I would dismiss the appeal in relation to Mrs Saundry's indemnity for her costs of the Removal claim.

Lord Justice Arnold:

45. I agree.

Lord Justice Underhill:

46. I also agree.