Insolvent Trusts—Where are we Now?

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Introduction

This article summarises the current state of the law in relation to insolvent trusts, as set out in two cases working their way through the courts, one in Guernsey and one in Jersey.[1] As the authors continue to be involved in those cases and appeals are ongoing in both of them, they cannot provide any critical commentary on the decisions at this stage, but hope to be able to do so once those cases have been finally determined.

We start with the Jersey case.

Re Z Trusts

Is there such a thing as an "insolvent" trust? If there is, what do you do with it? And what is the impact of art.32 of the Trusts (Jersey) Law 1984 with its limited recourse provision?[2] These were questions that had been discussed in the abstract but had never come before a court in the UK or the Channel Islands. That all changed in 2013 when the trustee of one of the Z Trusts sought the court's direction as to what it should do when faced with the administration of a trust whose liabilities far outweighed its assets.

In 2013, the Jersey court began the process of developing a kind of insolvency regime for trusts. As it has gone along, questions have been answered and the regime has started to take shape. The Jersey court has drawn inspiration from existing statutory insolvency procedures for companies, but these have been adapted to suit the trust scenario.

Could a trust be "insolvent" at all? An English lawyer would say not. Under English law, a trustee is personally liable for any liability that it incurs in that capacity. If it is unable to meet such liability, it becomes insolvent and its creditors simply step into its shoes by right of subrogation and avail themselves of the trustee's right of indemnity against the trust fund. In Jersey, the position is slightly different because of the existence of art.32 of the Trusts (Jersey) Law 1984, which recognises the ability of the trustee to act in its personal capacity and in its capacity as trustee. Under art.32(1)(a), where it acts as trustee and

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[1] *ITG Ltd v Geneva Trust (Tchenguiz Trusts)* [2019] GRC 064; *Re Z II Trust and Z III Trust* [2018] (2) JCR 81; *Re Z III Trust*[2019] (1) JCR 87 (CA); *Re Z II and Z III Trusts* [2020] JRC 072.

[2] Under the side-heading *Trustee's liability to third parties*, art.32 provides:

(1) Where a trustee is a party to any transaction or matter affecting the trust—
  (a) if the other party knows that the trustee is acting as trustee, any claim by the other party shall be against the trustee as trustee and shall extend only to the trust property;
  (b) if the other party does not know that the trustee is acting as trustee, any claim by the other party may be made against the trustee personally (though, without prejudice to his or her personal liability, the trustee shall have a right of recourse to the trust property by way of indemnity).

(2) Paragraph (1) shall not affect any liability the trustee may have for breach of trust.

is party to any transaction or matter affecting the trust where the other party knows that it is acting as trustee, any claim by the other party is against the trustee as trustee and extends only to the trust property. In other words, creditors who know that they are dealing with a trustee acting as trustee have limited recourse. The Jersey court took the view that a trust could be insolvent. Where a counterparty is not so aware, the classic position applies (see art.32(1)(b)).

The definition of trust insolvency

So how would one decide whether it was insolvent? Here the Royal Court borrowed the insolvency concepts of cash-flow insolvency and balance sheet insolvency. The Z Trusts were insolvent on both counts and so it was not difficult to determine. However, it is very likely in future that the court would follow similar considerations to those applicable to companies. If a trust is unable to meet its obligations as they fall due and is thereby cash-flow insolvent, the imposition of an insolvency regime will be virtually certain. If it is balance sheet insolvent but not yet cash-flow insolvent, as many Jersey and Guernsey property unit trusts were after the 2008 financial crash, the court is likely to consider whether the trust can realistically trade out of its situation or whether insolvency is inevitable. In any event, if the solvency position looks doubtful, it is likely to be better for a trustee to apply sooner rather than later for directions.

So, if a trust is insolvent, what does one do next? The usual answer will be to apply to the court for directions as to how the trust should be administered. The starting point for the court is to supervise the administration of the trust in the interests of the creditors as a whole.[3] Following existing authority about the court having power to appoint a receiver of a trust,[4] the court held that it had the power to appoint an insolvency practitioner to administer the insolvency. This was the case whether the trust assets remained in the legal ownership of the trustee or whether the insolvency practitioner was appointed as receiver.

However, where there were professional trustees in office with no unmanageable conflict, this was something that the court would generally be reluctant to do as it would ordinarily be much more cost-effective, and therefore in the best interests of creditors, for the trustees to conduct the winding-up process under the supervision of the court. In this case, where the trustees of the Z II and Z III Trusts were prepared to undertake the administration and there were a limited number of creditors, some of whom were connected, the court did not see the need to impose a full-blown insolvency regime modelled on the Bankruptcy (Désastre) (Jersey) Law 1990. The court also did not think that there were any issues of conflict that could not be managed under the supervision of the court.

Procedural points

What type of directions will the court give for the winding-up process? The recent directions given in *Re Z Trusts* have, ironically, taken their inspiration from the principles of corporate and personal insolvency.[5] The reason for the change of view from the earlier decision not to implement a full-blown insolvency regime was said to be that, at the time of the hearing in 2015, proposals were being put forward for the Z III Trust to be restructured. That was no longer the case. The court was also influenced by the fact that, although most of the creditors were connected, one, namely the former trustee, was not. The court therefore considered it important to have a proper winding-up process.

For the Z III Trust, the court therefore set up an insolvency procedure which is similar to that followed in personal and corporate insolvency. The trustee is required to place a notice in the Jersey Gazette. Creditors are then required to prove their debts. They do this by lodging proofs of debt with all relevant supporting evidence. Each creditor can then lodge an objection to the proof of any other creditor. It then

[3] *Re Z II Trust and Z III Trust* [2015] (2) J.L.R. 175.
[4] See *Re IMK Family Trust* [2008] J.L.R. 250.
[5] *Re Z III Trust* [2019] JRC 069.

falls to the trustee to determine whether a claim should be admitted or rejected. If a creditor is dissatisfied with the outcome, it can refer the matter to the court for determination. Finally, the trustee is required to prepare final accounts. Dividends are paid out and the winding-up is concluded. The trustee conducting the insolvency is entitled to claim its costs of the insolvency from the trust fund in priority to other unsecured creditors.

In respect of the Z II Trust, owing to the fact that some issues of potential conflict for the trustee have arisen, the court has recently directed that an insolvency practitioner be appointed to assist the trustee with the evaluation of creditors' claims with certain powers delegated to him.[6]

The biggest question to affect the insolvency of both the Z II Trust and the Z III Trust has been the order of priority of creditors.

Priority of creditors: the decision at first instance

One of the creditors is the former trustee who retired in 2006. On 31 July 2012, a company called Angelmist Ltd (Angelmist), which was within the Z II Trust structure and was subsequently placed into compulsory liquidation by HMRC, brought proceedings against two of its former directors and the former trustee in the English High Court. The claims against the former directors, who were employees of the former trustee, were for breach of fiduciary duty. The claims against the former trustee were for vicarious liability and that it had acted as a de facto or shadow director of Angelmist. Judgment was entered against the former directors. The matter was finally brought to a conclusion on 22 December 2015 when the former trustee and the liquidator of Angelmist entered into an agreement by which the former trustee made a payment of £16.5 million to the liquidator. Each side bore their own costs, the former trustee's costs amounting to over £2.3 million.

The former trustee claimed that it was entitled to priority over the other creditors on the basis that its claim was "first in time" and that it had priority over its own creditors by virtue of being a former trustee. This was in part based on an argument that a trustee's equitable lien was a single floating charge over the trust fund that arose by virtue of a trustee taking office.

For various reasons, the Royal Court determined that this question should be determined before proofs of debt were lodged. The hearing therefore proceeded on a number of assumptions which were that:

- The former trustee was entitled to be indemnified from the assets of the Z II Trust in relation to the liabilities and costs arising from the *Angelmist* proceedings;
- The former trustee did not enjoy the protection of art.32(1)(a) of the Trusts (Jersey) Law 1984;
- All of the other unsecured creditors of the Z II Trust were art.32(1)(a) creditors.

The estate of the late settlor (the Estate), which was itself a creditor of both the Z II and Z III Trusts, opposed the former trustee's claim to be entitled to priority. Its primary case was that all creditors of a trust should rank pari passu. Its alternative case was that a trustee's right of indemnity and associated equitable lien arose on a liability-by-liability basis.

The Royal Court began its analysis by noting that there was no English or Channel Islands authority on the issue.[7] *Lewin on Trusts* commented that there were two options. One was that all creditors ranked pari passu. The other was that they ranked on a first-in-time basis. *Lewin* appeared to lean towards pari passu stating that "competing equities do not always rank in order of time and a distribution pari passu would on occasion avoid difficult and cumbersome enquiries".[8]

[6] *Re Z II and Z III Trusts* [2020] JRC 072.
[7] See *Rawlinson & Hunter Trustees SA v Chiddicks* [2018] (2) J.L.R. 81.
[8] L. Tucker, N. Le Poidevin and J. Brightwell (eds), *Lewin on Trusts*, 19th edn (Sweet & Maxwell, 2015), para.22–047. References to the work in this article are to the 19th edition, being the edition relevant to the proceedings as they were conducted.

The Royal Court first considered the position of a trustee claiming in respect of an art.32(1)(b) liability and the trustee's own art.32(1)(a) creditors. Under the pre-existing law of trusts, the former trustee would have been personally liable for all of the transactions into which it entered as trustee. All the creditors would be paid in full. If the trustee became personally insolvent, its creditors would rank pari passu.

Article 32 was an innovation by which a trustee was given protection from personal liability where a party to a transaction knew that it was dealing with a trustee acting as trustee. It introduced a distinction between a trustee's personal and fiduciary capacities. However, that was the only way in which it changed the pre-existing law.[9] Thus, if the trustee was insolvent, the trustee's creditors would step into its shoes and exercise its right of indemnity against the trust fund by subrogation. The creditor therefore became the trustee for that purpose and exercised its right of indemnity. There was nothing to suggest that the trust creditors and the trustee came to the trust assets on an unequal basis. The Royal Court could therefore see no principled basis for claiming that the art.32(1)(b) claims of a trustee as against the trust assets should rank ahead of its own art.32(1)(a) creditors against the trust assets. The Royal Court also noted that, if such an argument were right, art.32(1)(b) creditors of an insolvent trustee would presumably claim that they ranked ahead of art.32(1)(a) creditors. There was no justification for this. Thus, they ranked pari passu.

The Royal Court then went on to consider the issue of how the claims of a former trustee, whether on its own behalf or those of its former creditors, ranked against those of a successor trustee. The Royal Court considered that there was clear authority that a trustee's equitable lien had priority over the interests of the beneficiaries. However, once a trust was insolvent, the beneficiaries no longer had any interest in the trust assets. The Royal Court then noted that, in general, equitable liens arose by operation of equity from the relationship between the parties. In the trust context, it arose out of the relationship between trustee and beneficiaries, and its purpose was to secure the trustee's rights as against the beneficiaries. It was not designed to secure rights of trustees as against each other. It was therefore possible to distinguish between the particular situations in English law where liens arose and the relationship between successive trustees. As it did not arise out of the relationship of successor trustees, there was no reasons to apply a first in time rule. Indeed, there were good reasons not do so. It was arbitrary, inequitable and contrary to the good administration of trusts. It would be inconsistent with the position as between trustees and their own creditors. It was prejudicial to successor trustees and was likely to lead to a reluctance on the part of creditors to agree to a novation of their claims to a new trustee because of the potential loss of priority that would follow. Thus, the claims of trustees should rank pari passu as well.

The Royal Court also agreed with the Estate's alternative case that the trustee's right of indemnity and associated equitable lien arose on a "liability-by-liability" basis. Thus, the trustee acquired successive rights of indemnification and lien as it incurred liabilities, with each such individual right and lien being extinguished as each liability was extinguished.

Further points: costs

There were two remaining issues to deal with. The first was whether the former trustee could claim its costs of proving its claim as part of its indemnity. The Royal Court applied classic insolvency principles and held that there was no right so to claim. The second issue was the costs of the action. The Royal Court held that this was hostile inter partes litigation and that costs should follow the event in the usual way.

[9] See *Investec Trust (Guernsey) Ltd v Glenalla Properties Ltd* [2018] GLR 97; [2018] UKPC 7; [2019] A.C. 271 per Lord Hodge at [59].

Court of Appeal

The matter then went to the Court of Appeal.[10] It reversed the Royal Court and adopted a "first-in-time" approach. The Court of Appeal began by stating that in *Investec v Glenalla* the Judicial Committee of the Privy Council had found that the Jersey law of trusts was essentially the same as the English law of trusts, save for some statutory and customary law differences. On that basis, the trustee had a right of indemnity which was secured by an equitable lien.

The characteristics of the right of indemnity and the equitable lien were not controversial. It was clear that the trustee's lien gave it priority over the beneficiaries and an equitable interest in the fund which in turn gave it a first charge or lien on the fund which took priority over the claims of beneficiaries. The Court of Appeal regarded a trustee's lien as an equitable interest in a trust fund and, on the strength of a passage in *Lewin on Trusts*[11] referring to the distinct situation of an assignment of a beneficial interest, proceeded to apply a "first-in-time" rule as regards priority. The Court of Appeal could see no reason not to apply this rule. It agreed with the Royal Court that the purpose of the equitable lien was to give the trustee priority over the beneficiaries but went on to say that this was not the only reason for it. It appeared to consider it important that the trustee's lien was a distinct right that could be exercised by the trustee at any time. The Court of Appeal also considered the Australian case of *Lemery v Reliance*,[12] where the court said that a new trustee took subject to the lien of a former trustee. The Court of Appeal saw this as supporting a first-in-time position. The Royal Court had viewed *Lemery* very differently and had taken the view that it said no more than that the former trustee's lien continued to subsist, not that it gave the former trustee priority. The Court of Appeal also did not believe that many of the practical difficulties of a "first-in-time" regime identified by the Royal Court would arise, although it did recognise that there could be a real disincentive to creditors to novate their rights.

On the Estate's alternative case, the Court of Appeal found that a trustee had a single right of indemnity and associated right of lien which was akin to a floating charge and arose as an incident of it accepting the office of trustee. For the purposes of the first-in-time regime, that had the effect of dating all liabilities incurred by a trustee to the date that it took office, even in respect of future and contingent liabilities.

The Court of Appeal also considered the issue of whether a trustee ranked equally with its own art.32(1)(a) creditors. It found that art.32(1)(a) was intended to give a trustee an advantage over its trust creditors, namely protection against personal liability, and could see no reason why this should not extend to a situation where there were claims both by the trustee itself and its art.32(1)(a) creditors against the fund.

On the question of whether a former trustee's costs of proving its claim could form part of its claim in the insolvency, the Court of Appeal held that it could. The Court of Appeal applied trust principles rather than désastre principles and held that this was the effect of art.26(2) of the Trusts (Jersey) Law 1984.

The Bailiff's separate judgment

But that was not the end of the story. The Bailiff of Jersey, Sir William Bailhache JA, gave his own judgment and said that, had he not felt bound by the dictum of Lord Hodge in *Investec v Glenalla*, he would have dissented. There were two main reasons for this.

First, the Bailiff did not consider that the English law of trusts had been imported wholesale into Jersey law. Inevitably, Jersey law of trusts was heavily influenced by the English law of trusts as England was a much larger jurisdiction with many more cases.

[10] *Rawlinson & Hunter Trustees SA v Chiddicks* [2019] (1) JLR 87.
[11] Tucker, Le Poidevin and Brightwell (eds), *Lewin on Trusts*, 19th edn (2015), para. 33–013.
[12] *Lemery Holdings v Reliance Financial Services* (2008) NSWSC 1344.

This gave rise to a particular issue as to whether the English concept of an equitable lien could simply be read across to Jersey law. The Bailiff saw no reason to assume this for two reasons. First, an equitable lien is not really a creature of trust law. It is really a creature of the law of security. Jersey law of security is very different from the English law of security and, crucially, does not recognise the concept of equitable security. Prior to the introduction of the Security Interest (Jersey) Law 1983 (as amended by the Security Interest (Jersey) Law 2012), it had not been possible to take security over movable property under the doctrine of *meuble n'a point de suite par hypothéque*. The Bailiff's view was that any security arrangement that fell outside the Security Interest Laws would fall foul of the doctrine. It was not clear that any of these principles had been addressed to the Judicial Committee in *Investec v Glenalla*. Second, the position of an outgoing trustee had been addressed by art.43A of the Trusts (Jersey) Law 1984, which gave an outgoing trustee a statutory entitlement to reasonable security for liabilities, whether present, future or contingent.

The second main reason was that the Bailiff did not consider it correct that the sole effect of art.32 was to limit the liability of the trustee to the trust property. The Bailiff considered that this finding in the judgment of Lord Hodge in *Investec v Glenalla* was heavily influenced by reliance placed on art.54(4) to indicate that art.32 was intended to ensure that creditors went against the trust fund through the trustee's right of indemnity. Article 54(4) provides as follows:

> "Where a trustee becomes insolvent or upon distraint, execution or any similar process of law being made, taken or used against any of the trustee's property, the trustee's creditors shall have no right or claim against the trust property except to the extent that the trustee himself or herself has a claim against the trust or has a beneficial interest in the trust."

The Bailiff's view was that art.54(4) was concerned with a different question relating to the trustee's personal insolvency. Having considered the practical effect of the dictum in *Investec v Glenalla* and the difficulties to which it gave rise under the Jersey law of bankruptcy, in particular for art.32(1)(a) creditors, the Bailiff appeared to think that it was time to recognise reality and treat an insolvent trust as if it were a separate entity.

Leave to appeal

And so, the matter moves on to the Judicial Committee of the Privy Council, the Court of Appeal having granted the Estate unconditional leave to appeal on the basis that there were at least two arguable points of law of public importance. These were the correct method of dealing with a trust whose liabilities exceed its assets and the status of a trustee's lien as a matter of Jersey law.

Investec v Glenalla

That brings us to the ongoing proceedings in Guernsey concerning the Tchenguiz Discretionary Trust (TDT) in which the priority of claims in an "insolvent trust" has also been considered. As with the *Z II Trust* in Jersey, this is another case where legal proceedings had a role in the solvency of the trust.

The background to the proceedings in Guernsey concerning the TDT is now well known. Following a restructuring of the trust in December 2007 the shares in a number of BVI companies (that had been used to hold the majority of the trust assets) were charged to Kaupthing Bank who had agreed to provide further funding to the trust. This restructuring involved the transfer of assets to the TDT from the earlier family trust, coupled with novations by which some of the liabilities of the earlier trust were taken over by the TDT. Most of these liabilities were then transferred to a new subsidiary company whose shares were owned indirectly by the original trustees of the TDT, but crucially the debts owed to two BVI companies (the first defendants in the main proceedings) were omitted from this latter transfer.

When Kaupthing collapsed in October 2008 it enforced its security and ultimately liquidators were appointed over 11 BVI companies whose shares had formerly been held as part of the trust assets. Three of those BVI companies ("the BVI Companies") subsequently claimed in proceedings before the Royal Court of Guernsey that I&B owed them monies arising out of loans ("the Loans") that had been made between I&B and the BVI Companies for the purpose of moving funds around the TDT for the purpose of the trust's investments.

Eight years of litigation in Guernsey were brought to an end by the judgment of the Judicial Committee of the Privy Council on 23 April 2018. The factual background to those proceedings is set out in more detail in the speech of Lord Hodge, for the majority.

The legal proceedings concerning the TDT were wide ranging and involved a number of issues such as the proper meaning of art.32 of the Trusts (Jersey) Law, 1984, which this article does not intend to address and which were discussed in an earlier article in this journal.[13]

One set of proceedings began in March 2010 and involved allegations that I&B were guilty of grossly negligent breach of trust in relation to the Loans. The trial of that action took place over twelve days in June 2012. Unfortunately, the judge took over 17 months to complete and hand down his judgment, which was delivered on 6 December 2013. The breach of duty allegations were dismissed.

The matter proceeded to the Guernsey Court of Appeal who issued no less than eight judgments in the course of the appeals against the Lieutenant Bailiff's judgment. The Court of Appeal upheld the dismissal of the breach of duty claims.

In the meantime, a further claim was issued against I&B in June 2013. Part of that claim was dismissed in November 2015 by the Royal Court as an abuse process. The Guernsey Court of Appeal upheld that decision and dismissed the rest of the claim as an abuse of process.

Before the Judicial Committee of the Privy Council the various appeals against the dismissal of the breach of duty claims were also dismissed.

Aftermath of the initial proceedings

As the dust settled on the Judicial Committee's decision, the parties were left in the following position:

- The BVI Companies had established that the Loans were due from I&B but only *as trustee*, and so that I&B were not personally liable to repay them.
- I&B had successfully seen off attempts to hold them liable for breach of duty in relation to the Loans.
- The successor trustees holding office after I&B (GTC and then F&B) had failed in their attempt to prevent the Loans being discharged out of the TDT assets.
- All parties had incurred very significant legal costs over the course of these proceedings.

As referred to above, LB Chadwick handed down his decision in December 2013. Having found that the Loans were due, and that I&B had not acted in grossly negligent breach of duty, his decision necessarily raised the prospect that the TDT assets might be insufficient to discharge the Loans so that the TDT might be termed "an insolvent trust".

Following his judgment, the BVI Companies applied for and obtained an Order appointing receivers over the assets of the TDT. That Order was made on 24 January 2014. That Order entitled the receivers to "retain, get in and realise" the assets of the TDT but they were not authorised to make any distributions.

Further, certain assets were excluded from the receivership, i.e. the TDT's interest in a company that owned a property in which the primary beneficiary lived with his family.

[13] J. Wessels and T. Pursall, "Limited Liability for Trustees of Jersey and Guernsey Trusts?" [2019] P.C.B. 90; see also T. Pursall, "Limited Liability for Trustees? Part II: Practical Implications of Investec v Glenalla for Trustees and Third Parties" [2019] P.C.B. 132.

The Receivership Order also created a regime empowering the Joint Receivers to seek information from the current and former trustees of the Trust whose rights of indemnity were expressly preserved.

This regime stayed in place, with certain modifications, during the appeal process.

The priority proceedings

In September 2018 the BVI Companies commenced proceedings before the Royal Court for directions with a view to identifying those liabilities which properly fell to be met out of the TDT assets so that the Joint Receivers could be authorised to make the appropriate distributions. The court sat to give directions on 15 October 2018. The court ordered the Joint Receivers to report as to whether there were any further assets of the TDT that could be brought into the receivership. Further, the court directed the parties to submit any such claims to the Joint Receivers by January 2019, following publications notifying potential claimants.

Ultimately some 15 proofs of debt were lodged with the Joint Receivers. Pursuant to further Orders of the court a procedure was devised for testing those proofs and for adjudicating upon them. Parties were ordered to file notices of objection to proofs and to lodge evidence in support of their own proofs with a view to the court being able to decide whether there were objections in principle to the validity of the claim, or arguments in relation to their quantification.

Save for the judgment debt in favour of the BVI Companies in relation to the Loans, the claims lodged principally relate to costs incurred in the litigation concerning the TDT. Proofs of debt have been lodged by the all successive trustees of the TDT, and its protector, for the legal and other costs incurred in relation to the litigation.

The assignment issue

The largest claim against the assets of the TDT was that for the judgment debts owed to the BVI Companies in relation to the Loans. At the time of a case management conference in May 2019 the value of that judgment debt, with judicial interest, was about £230 million.

On 22 March 2019, F&B, as the then current trustee of the TDT, took an assignment of the judgment debt ("the Assignment") which was then notified to the other parties on 26 March.

At [62] of her judgment of 9 December 2019 ("the judgment") Lieutenant Bailiff Hazel Marshall QC said:

> "The reasons for the Assignment are rather obvious. The value of the total net assets in the TDT estate in the hands of the Joint Receivers is around £55 to £60 million. The claims of 'outside' creditors i.e. those other than entities connected with or acting for the Tchenguiz family would total about £272 million if the BVI Companies … were included, but reduced to about £37 million if they had taken off the potentially hostile side of the picture. Prima facie the Assignment would seem to put into the hands of F&B claims which would out value the claims of 'outside' creditors many times over. If, therefore, the proper approach to priority of all claims against the TDT estate were to be that of pari-passu distribution as found by Commissioner Clyde-Smith in the *re Z II Trust* case, this would vastly increase the share of the TDT assets which F&B would receive from the Joint Receivers".[14]

The Royal Court decided to take as preliminary issues both the question of the validity of the Assignment and also the issue of the priority of the various claims against the TDT estate. As LB Marshall recorded in the judgment at [49], I&B had lodged claims of about £26 million in its proof of debt, the bulk of which

[14] *ITG* [2019] GRC 064 at [62].

related to the costs of the litigation. GTC, who had taken over as trustee from I&B had lodged claims of about £8 million. On a practical basis it therefore made good sense to know whether I&B's claim had first priority over the assets of the TDT and also whether the Assignment was valid. In particular, time need not be spent quantifying F&B and other "insider" claims if other claims had to be paid first.

It was common ground that the Assignment was valid and effective per se. As the judge put it:

> "It does what it purports to do, namely to assign the benefit of the BVI Companies judgment debts and costs orders (as defined) to F&B, expressly in their respective capacities as co-trustees of the TDT".[15]

I&B argued that in F&B's hands as trustees of the TDT the Assignment had been discharged or extinguished by the doctrine of merger. The judge explained the argument:

> "F&B, as trustees of the TDT, are already entitled to the assets of the TDT (subject to the claims of creditors) and they therefore cannot, as a matter of law and logic, pursue a claim against assets which they already hold".[16]

F&B argued that the doctrine of merger did not apply. The judge explained their case at [90] of her judgment: "The debts are not, and never were the liabilities of F&B; they have always been and remain the liabilities of I&B". F&B also argued that the Receivership Order prevented any merger because:

> "F&B were not the current holders of the Trust assets, the Joint Receivers were … F&B were not entitled to the TDT assets before and never would be because they would only ever be entitled to receive the surplus (if any) out of any such assets after the Receivership had been concluded and all required payments made."[17]

LB Marshall ruled in favour of I&B. She held that:

> "the effect of the assignment of the BVI debts (owed out of the assets of the TDT) to F&B as the trustees of the TDT was to extinguish the independent existence of those debts because the ultimate right to receive and the ultimate obligation to pay simply became coincident".[18]

The judge also tested her conclusions against the "practicalities" and decided that the "result is the same". As she explained:

> "For F&B to advance the claim as assignees of the BVI debts they would be in a position at least equivalent to that of 'suing themselves', because they would both have to institute the necessary action of plaintiff and also respond to that action as the ultimate defendant to the consequent claims over which would be made, and this would all be in the same unitary capacity, namely that of their being trustees of the TDT".[19]

As for the Receivership Order, the court held that this did not affect the result. As the judge explained:

> "The Receivership Order was intended to do, and did, nothing more than install a neutral entity as controller of the material assets for the purpose of protecting and preserving those assets pending the definitive determination of liabilities to which those assets were exposed, where they were likely to be insufficient to satisfy all such liabilities. The Order neither intended to, nor did, affect any change and any underlying right or entitlement to those assets."[20]

[15] *ITG* [2019] GRC 064 at [81].
[16] *ITG* [2019] GRC 064 at [90].
[17] *ITG* [2019] GRC 064 at [102].
[18] *ITG* [2019] GRC 064 at [119].
[19] *ITG* [2019] GRC 064 at [120].
[20] *ITG* [2019] GRC 064 at [126].

The nature of a trustee's equitable lien

During the course of argument F&B argued that any distributions paid to them by the Joint Receivers

> "would be held by F&B on behalf of the beneficiaries of the TDT and would not be liable to be brought back into the pool of assets available to satisfy any remaining unpaid creditors claiming against the TDT estate".[21]

This submission was a response to I&B's submission that anything recovered by F&B pursuant to the Assignment must be a "trust asset" and therefore available for distribution amongst the "trust creditors".

In considering this argument the judge referred to *Rothmore Farms v Belgravia*, a decision of the Federal Court of Australia.[22] In that case Mansfield J held that an outgoing trustee's right of indemnity applied to all of the assets of the trust and was not confined to the assets of the trust as at the date of its removal. LB Marshall approved of that outcome and held that an outgoing trustee's lien

> "operated as such a floating charge, and not as a fixed charge biting only on the assets in his hands as trust property at the time of it ceasing to be trustee (or at the time when some subsequent claim was sought to be made, or otherwise)".[23]

At [138]-[139] of the judgment the judge noted that it would be cumbersome and inefficient if the position were otherwise. If a trustee's lien bit only on the assets of the trust at the time of its removal then records would need to be kept of such assets and the proceeds thereof if they changed in order for such a lien to be effective.

The priorities issue

Following the decisions of the Judicial Committee, the only means of recourse to trust assets is by claims which can be made by trustees. As LB Marshall explained:

> "They can be made directly only by the present trustees, who have possession of the assets and can therefore satisfy their entitlement directly. They must be made indirectly by creditors of present trustees, by requiring the present trustees to use their rights of exoneration or indemnity to satisfy those creditors' claims. Former trustees can make claims in respect of their own entitlements by asserting their trustee's lien. Creditors of former trustees, pursuing claims contracted or incurred by such former trustees, must make their claims by requiring the former trustees to exercise their lien over the trust property to obtain the necessary satisfaction of those claims. The creditors are granted a right to subrogation to the rights of the relevant former trustee to achieve this": see paragraph 143 of the judgment."[24]

Accordingly, the judge decided that the "first stage" in ascertaining priorities was to determine the application of priority between the rights of successor trustees in respect of the total of the claims advanced by or under the banner of each successor trustee. The judge described that as the "Global Priority Issue". The judge then went on to describe the second issue of priority as "the question of priority between the various classes of claims within the claims being made in light of any particular trustee". She explained that "it is broadly one of the priority, if any, between that trustee itself and the external creditor (F) claiming through it". The judge described that as the "creditor priorities issue".

[21] *ITG* [2019] GRC 064 at [134].
[22] *Rothmore Farms Pty Ltd v Belgravia Farms Pty Ltd* (1999) FCA 745.
[23] *ITG* [2019] GRC 064 at [137].
[24] *ITG* [2019] GRC 064 at [143].

Global priority issue

The Global Priority Issue was therefore a contest between I&B as the first trustee of the TDT, GTC as the successor to I&B and F&B as the current trustee.

The applicable law

F&B argued that the question of priority was a matter for the lex fori, i.e. Guernsey law and not Jersey law. During the hearing F&B accepted that if the applicable law was Jersey law then they were "precluded by the authority of the *Re ZII Trust* case"[25] from arguing that priority as between successor trustees is anything other than "first in time".[26] Further, the judge refused to adjourn any decision until after the Privy Council considered the *Re ZII Trust* case on appeal.

The judge decided that Jersey law should govern the question of priorities between the competing claimants to the funds in the Joint Receivers' hands. She held that the receivership process was "in effect, carrying on the administration of a Jersey law trust". She held that

> "the competing claims to the funds … have a relationship with each other under a single common legal system, arising out of their relations constituted by their dealings with the TDT".[27]

Accordingly, as a matter of conflicts of laws, Guernsey law would hold Jersey law to be the properly applicable law to govern the issue of priorities.

Having reached that decision it was "strictly unnecessary" for the judge to indicate what her decision would have been had she been persuaded to apply Guernsey law to the issue of priorities.

However, the judge went on to set out what her decision would have been had Guernsey law applied "for completeness" and said that "the short answer is that I would have come to the same conclusion [as the Court of Appeal in *Re Z II Trust*]".[28]

The judge gave a number of reasons for that conclusion. First, the judge recognised that although the Jersey Court of Appeal decision in *Re Z II Trust* was not binding on her she described it as "hugely persuasive". She was not persuaded by F&B's arguments that the decision was wrong were "anyway near sufficient to make me feel it would be possible, let alone appropriate" not to follow it.[29]

Second, the judge was persuaded that the reasoning of the Jersey Court of Appeal in *Re Z II Trust* was correct and said that "I find myself respectfully in full agreement with the main judgment of Logan Martin JA in the case". The judge then set out her reasons for this finding. In short she held that the "first-in-time" approach was

> "an inevitable consequence of upholding the rights of a trustee to indemnity out of the trust assets in the hands of successor trustees. The trust estate passes to a successor trustee subject to the obligation to satisfy any indemnity to which an earlier trustee is entitled. Their rights arise upon their taking up office and have thus plainly and clearly created an order of time."[30]

The judge also considered that a *first-in-time* approach was better suited to the potential insolvency of a trust where it may be difficult to identify a moment in time when some other scheme of priority commences.

In conclusion the judge held that the trustee's lien operates, in effect, as a floating charge over the assets from time to time of the trust and that the lien operates so as to confer priority as regard the aggregate

[25] *Re ZII Trust* [2019] JCA 106.
[26] *ITG* [2019] GRC 064 at [159].
[27] *ITG* [2019] GRC 064 at [167].
[28] *ITG* [2019] GRC 064 at [171].
[29] *ITG* [2019] GRC 064 at [172].
[30] *ITG* [2019] GRC 064 at [186].

claims advanced by or through successive trustees on the basis of priority for the "first in time" by reference to the date of appointment as trustee of the trust in question.

Although the judge decided the point as a matter of the application of the Jersey law principles, she decided that the principles would operate in exactly the same way in Guernsey law.

Creditor priority issue

LB Marshall explained that the creditor priority issue is a

> "competition … between (a) trustee, making its own claims … for recoupment in respect of its having expended its own money on trust debts or liabilities, and other third party creditors claiming against that trustee in respect of debts or liabilities claimed to be owed to them, but payable out of the trust assets, as to which they claim subrogation to the trustee's rights under its equitable lien".[31]

Again, the judge held that Jersey law was the applicable law. However, she noted that the comments on this issue in *Re Z II Trust* were obiter and therefore not binding authority. The judge went on to decide, at paragraph 207, that:

> "I am satisfied that Guernsey law on this aspect will be the same as Jersey law, and that in either case the re Z II Trust case is persuasive. Even apart from the Z II Trust decision, logic and proper analysis of the situation supports the approach enunciated in the re Z II Trust".[32]

She held that

> "the proper scheme or priority between, on the one hand, a trustee making claims against trust assets in the exercise of his equitable lien for the proper costs, expenses and liabilities incurred by him as trustee, and, on the other hand, unpaid creditors of the trust claiming by virtue of their right of subrogation to the trustee's lien, is that the former takes priority over the latter".[33]

The court also found that as between competing creditors (i.e. of the relevant trustee), then there would be a pari passu distribution.[34]

The judge's reasons for this decision were that that this conclusion was necessary "in order to respect and implement the trustee's right to indemnity for proper costs and expenses and liabilities incurred by them" as trustee of the relevant trust. Further, the judge said that this gave the "only correct" legal effect to the principle that creditors under trust transactions have no right to payment out of the trust assets except by claiming to be a subrogated to the rights of the trustee with whom they have contracted the relevant obligation.

The fall-back point

I&B had submitted that if they were wrong on the question of creditor priority, then a pari-passu distribution was not a hard and fast rule but was a matter of discretion.

The judge held that she was not "attracted [to the argument] as a broad principle on its own". She held that the approach to a proper scheme of distribution was a matter of "objective categorisation according to principle" of the various claims.[35] However, the court did leave open the possibility that claimants could be distinguished on an objective basis so that, if there was something that "shocked the conscious of the court", the broad principle of a pari-passu distribution could be disturbed. The judge explained that in her

[31] *ITG* [2019] GRC 064 at [193].
[32] *ITG* [2019] GRC 064 at [207].
[33] *ITG* [2019] GRC 064 at [208].
[34] *ITG* [2019] GRC 064 at [209].
[35] *ITG* [2019] GRC 064 at [215].

view any distinctions "as it might be fair to draw" would need to be based on "dispassionate objective criteria" and were more likely to involve "penalising particular claimants" because of a "lack of objective merit in their position" rather than "rewarding particular claimants" for "some perceived virtue" in their position.[36]

Trustee's remuneration

Finally the judge had to deal with F&B's submission that whatever the priority of any claim by I&B under their right of indemnity for costs incurred in relation to the TDT, no priority attached to an outstanding claim for remuneration.

Having reviewed the position under English law, by reference to *Lewin*[37] paras 220 to 224 and a number of Australian cases the judge decided that "this particular issue falls to be decided from first principles".

The judge held that a former trustees' claim in respect of its proper remuneration as trustee should be accorded the same priority as between itself and other competing trust creditors, entitled to claim under the aegis of its equitable lien and right of indemnity as the trustee's own claims for indemnification, i.e. they will rank ahead of such competing trust creditor claims.

The judge gave a number of reasons for this decision. In particular she decided that it was unsatisfactory as a matter of the good administration of trusts for departing trustees to retain control of trust assets i.e. according an outgoing trustee protection in relation to unpaid trustee remuneration furthered the desirable objective of enabling trust assets to be handed over to a new trustee as quickly as possible. Further the judge held that it was for the benefit of the local trust industry that those who administer trust assets should be fairly and effectively remunerated.

Conclusion

The TDT case is due to be heard by the Guernsey Court of Appeal September 2020 and *Re Z Trusts* is due to be heard by the Judicial Committee of the Privy Council in June 2021. On top of the other issues in *Re Z Trusts*, it also seems that the Judicial Committee is going to have to review *Investec v Glenalla*. Watch this space …

[36] *ITG* [2019] GRC 064 at [216].
[37] Tucker, Le Poidevin and Brightwell (eds), *Lewin on Trusts*, 19th edn (2015), paras 22–20 to 22–24.