

Insolvent Trusts: the Order of Priority is.....

UPDATE

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Justin Harvey-Hills, who was involved in the Jersey case of *Re Z Trusts*, and Jeremy Wessels, who is involved in the Guernsey case of *ITG –v– Glenalla*, report on the very recent Privy Council decision in those cases.

In one of the most important trust decisions of recent years, which was handed down on Thursday 13 October 2022, the Judicial Committee of the Privy Council (the **JCPC**) held that the rights of indemnity of successive trustees against the assets of an insolvent trust fund (ie a trust fund that is unable to meet those liabilities) rank *pari passu* and not on a first in time basis.

In *Re Z Trusts* (the Jersey appeal), the former trustee, Equity Trust (Jersey) Limited (**ETJL**) and the former directors of a trust-owned company, Angelmist Limited (**Angelmist**), which had been supplied by the former trustee, were sued some years after ETJL's retirement and the resignation of Angelmist's directors by the liquidators of Angelmist. The former directors were found liable for breach of fiduciary duty. ETJL sought to recover an amount in excess of GBP 18 million from the trust fund.

There were insufficient funds to meet the claim, let alone those of other creditors. Consequently, the trust was placed into a bespoke insolvency procedure devised by and administered by the Royal Court. The question arose as to the order of priority of ETJL, which was the original trustee, and third party creditors claiming through it and successor trustees and creditors claiming through them.

The Royal Court held that the trustees and their respective creditors claiming through them ranked *pari passu* in respect of their claims on the trust assets. It also held that ETJL was not entitled to its costs of proving its claim. The Court of Appeal reversed the Royal Court's decision and held that trustees' claims ranked on a first in time basis. It also held that ETJL was entitled to its costs of proving its claim.

In *ITG*, the original trustee, ITG, and its co-trustee, Bayeux Trustees Limited (**Bayeux**), were liable under loans due to two BVI companies (the BVI Companies) of approximately EUR 80 million and GBP 80 million respectively.

In October 2018, the BVI Companies commenced proceedings to identify and resolve the various claims against the assets of the Tchenguiz Discretionary Trust (the **TDT**). The then trustees of the TDT took an assignment of the (now) judgment debts due to the BVI Companies and submitted proofs of debt in respect of the judgment debts. The TDT did not have sufficient assets to satisfy the claims against it. The Guernsey Royal Court went with the first in time approach and this was upheld by the Guernsey Court of Appeal.

Before the JCPC, the original issue about priority broadened into more of a root and branch discussion about the nature of a trustee's right of indemnity and whether it conferred a proprietary interest in the trust assets that continued to exist following the trustee's retirement. Thus, there were four main issues before the JCPC:

1. Whether the right of indemnity conferred on the trustee a proprietary interest in the trust assets rather than being merely possessory;
2. Whether the trustee's interest survived the transfer of the property to a successor trustee;

3. The priority question;
4. Whether a trustee's indemnity extended to the costs of proving its claim against the trust fund if the trust was insolvent.

On the first question, the JCPC held unanimously that the trustee's right of indemnity conferred a proprietary interest in the trust assets. The right of indemnity gave rise to an equitable lien, which takes effect as a type of equitable charge over the trust assets. In this respect, the JCPC upheld a long line of authority dating back more than a century in both England and other common law jurisdictions, in particular Australia. The issue had arisen in the Jersey courts as to whether a trustee's right of indemnity could give rise to an equitable lien as Jersey law does not recognise equitable security. The JCPC held that the right of indemnity gave rise to a proprietary interest rather than security and therefore that the issue did not arise.

On the second question, the JCPC held that the trustee's equitable lien continued after the transfer of the trust assets to a successor trustee. Again, having found that the right of indemnity gave rise to a proprietary interest in the trust fund, this was unsurprising and consistent with a long line of existing English and Australian authority.

It was the third question that formed the core of the decision. The JCPC found by a majority of 4-3 that successive trustees' interests ranked *pari passu* where the trust assets were insufficient to meet the claims against them. As there was no authority on the question, the JCPC was faced with exactly the same question that had faced Commissioner Clyde-Smith in the Royal Court of Jersey right at the outset. The judgment of the majority of the JCPC echoes that original judgment of the Royal Court of Jersey. The majority of the JCPC held that a trustee's lien was unlike other forms of equitable interest and that there was no reason for the first in time rule to be applied. Equity was flexible and one had to look at the purpose for which the lien was created and consider carefully the outcome which gave rise to better justice. A first in time rule could lead to very odd and unjust results between successive trustees based on the time of their appointment. Furthermore, the fact that trustees' creditors had to claim through their respective trustees by subrogation made a first in time rule even more invidious for them. Thus, the majority held that justice, fairness, equality and common sense militated strongly in favour of *pari passu*.

On the fourth issue, the JCPC held that the trustee's indemnity extended to the costs of proving the trustee's claims.

So, the question of priority of trustees when a trust is 'insolvent' is finally settled. The JCPC's decision affords a degree of protection to successor trustees and to their creditors, albeit at the expense of retiring trustees. It is now likely to be even more important for retiring trustees to ensure that they novate any contractual obligations to the successor trustee and that they have sufficient security to cover any prospective liabilities.

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