

Cayman Court applies insolvency law cases in trustee blessing application

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Over the past two years, there has been an interesting trend of courts, in certain circumstances, relying upon insolvency law cases when determining analogous questions of trust law. Most recently, the private wealth industry has seen this very application in connection with the now infamous proceedings relating to the trust known as the Ironzar II Trust. [1]

As a pre-eminent jurisdiction for both trust and insolvency disputes, it is unsurprising that the Cayman Islands has seen a number of decisions which explore this very nexus between trusts and insolvency law.

Indeed, late last year, the Grand Court did so when considering the novel issue of a trustee's ability to use trust assets, which may be the subject of third-party proprietary claims, to meet its fees and expenses.

Background

In *In the Matter of the X Trust and the Y Trust*, [2] A Limited, in its capacity as trustee of two Cayman Islands trusts, sought orders relating to: (1) payment of its fees and expenses including those already incurred and those already paid, as well as those to be incurred in the future (2) the sale of two trust assets to provide liquidity to, *inter alia*, meet those fees and expenses and (3) for its costs of the application to be paid out of the trust fund of the two trusts.

At first blush, this seems like an entirely usual fact pattern and the relief uncontentious. However, matters were complicated by the fact that there existed a potential proprietary claim over the trust assets. As such, it was not clear whether the trustee could use assets, which may well not ultimately be trust assets, to meet its fees and expenses. Accordingly, the trustee sought directions from the Court.

The law

The Court gave useful guidance on two principal issues (1) the Court's supervisory jurisdiction to bless decisions proposed by a trustee faced with difficult circumstances and (2) the impact of a trustee's ability to use trust assets to meet its fees and expense when it has been put on notice of a potential third-party proprietary claim against those assets.

The Court's supervisory jurisdiction

Section 48 of the Trusts Act (2021 Revision) provides that a trustee may apply to the Court for an opinion, advice or direction on any question concerning the management or administration of the trust and provides that, where the Court "blesses" a trustee's proposed decision pursuant to this provision, the trustee acting upon that blessing is deemed to have discharged its duty as trustee in respect of the subject matter of the application. This jurisdiction is particularly valuable for a trustee which is forced to make a difficult decision which, for instance, could result in conflict between it and the trust's beneficiaries.

An application made under section 48 is governed by the principles set out in the familiar English decision of *Public Trustee v Cooper* [2001] WTLR 901. [3] In the present case, the trustee was not surrendering its decision to the Court, notwithstanding its personal interest in pursuing payment of its fees. As a result, this was an application which fell within the second of the categories identified in *Public Trustee v Cooper* so the questions for the Court to consider were: [4]

1. Does the trustee have power to enter into the proposed transactions?
2. Is the Court satisfied that the trustee has genuinely formed the view that the proposed transactions are in the best interests of the trust and its beneficiaries?
3. Is the Court satisfied that this is a view that a reasonable trustee could properly have arrived at (the **Rationality Standard**)?
4. Has the trustee any conflict of interest, and if so, does the Court consider that the conflict prevents it from approving the trustee's decision?

While the case law governing the Court's supervisory jurisdiction is well established, the Court considered that such an application, being one which balanced the right of a trustee to remuneration with the rights of beneficiaries and potential third-party proprietary claimants not participating in the application was atypical. It therefore considered that, in order to satisfy itself that the application satisfied the Rationality Standard, it needed to consider what a trustee should do when faced with third party claims over trust assets.

The impact of third party proprietary claims over trust assets

Having not dealt with this issue before, the Court gave guidance on two separate, but

connected, issues: (1) what should a trustee do faced with third party proprietary claims over trust assets and (2) the impact of such claims on the trustee's ability to look to trust assets to meet its fees and expenses?

As to (1), the Court agreed with the trustee's decision to comply with the principle set out in *Guardian Trust and Executors Company of New Zealand v Public Trustee of New Zealand*, [5] which states that "a trustee will be liable for dealing with assets contrary to the interests of actual or potential proprietary claimants who subsequently establish their interest in the relevant fund".

As to (2), in the absence of direct authority on the issue, the Court relied upon insolvency law authority dealing with the steps liquidators and other fiduciaries can take where they are administering assets which, while notionally company assets, are the subject of proprietary claims from third parties. In particular, the Court considered the dicta [6] of the former Chief Justice of the Cayman Islands which held that:

"the Court has an inherent jurisdiction to order liquidators' fees and expenses to be paid from trust property held by a company in liquidation provided that such fees and expenses were reasonably incurred in returning the trust property to those beneficially entitled to it".

The Court found that dicta to be persuasive in the present context and saw no reason that it ought not to be applied as, in their respective capacities, both liquidators and trustees act as fiduciaries with respect to the assets in question. As such, the Court found that the Court has jurisdiction to permit or direct a trustee to use assets to meet their fees and expenses, notwithstanding the existence of claims or potential claims from third parties:

"for reasons of both pragmatism and principle, a trustee holding assets for named beneficiaries which are subject to potential third-party proprietary claims, and invoking this Court's supervisory jurisdiction under section 48 of the Trusts Act, will generally be entitled to payment of its reasonable fees and expenses out of the relevant fund in relation to:

- work done in accordance with the terms of the trust instrument before notice was received of the third-party claims; and
- work done (and to be done) to administer the trust assets after receiving notice of the potential third-party proprietary claims in accordance with the best interests of whomever may ultimately be confirmed to be the true beneficiaries of the express or constructive trusts".

Importantly, the Court took care to curtail any impression that the use of the assets may be unfettered by considerations of what was in the best interests of its true beneficiaries. In so doing, the Court considered that: "If there is any overarching legal policy imperative, in my judgment it must be that the relevant fund should continue to be administered in a way which

involves the least possible prejudice to all interested parties, including the actual or contingent rights of the third-party proprietary claimant".

This need to do as little prejudice as possible in its use of trust assets was relevant in the present case as the trustee had asserted that, in order to recover its fees, it should be permitted to sell certain of the trusts assets at a value which was substantially lower than their current value; a matter which was objected to by the trust's beneficiaries.

With the above principles in mind, whilst the Court ultimately directed that the trustee was entitled to its fees and expenses, it gave the beneficiaries additional time to propose alternative strategies to unlock trust liquidity to meet the same so as to avoid selling trust assets at a discount. The Court was satisfied that the interests of the third-party proprietary claimants were protected because the trust assets were being almost entirely preserved but for the proportionate payment of trustee fees and expenses.

Conclusion

The judgment serves as a further useful example of the Cayman Court demonstrating flexibility and creativity in order to provide assistance and clarity to fiduciaries placed in positions of difficulty. While it is yet to be seen the extent to which the Cayman Court will continue to explore the connection between insolvency and trust law in resolving novel issues, it is no doubt a welcome relief to local trust practitioners that the Court will apply a pragmatic approach in support of fiduciaries and other interested parties.

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[1] [2022] UKPC 36.

[2] (unreported, FSD 57 of 2022 (IKJ), Kawaley).

[3] See also *AA v BB and Colin Shaw (as Amicus Curiae)* (FSD Cause No. 137 of 2019 (ASCJ), Judgment dated 14 February 2020 (unreported), Anthony Smellie CJ.

[4] See *AA v BB*.

[5] [1942] AC 115.

[6] See *One Tradex Ltd* (FSD, 1 October 2020, Unreported).

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