Insolvent Trusts: A further development

Insights - 31/03/2020

In our October 2018 update, we provided a briefing on the important decision in Representation of the Z Trusts [2015] JRC 196C which provided welcome guidance, and something of a warning, to trustees who find themselves administering trusts that are insolvent. A link to this briefing can be found here. The briefing concluded by noting that the Royal Court had yet to establish the appropriate insolvency regime for trusts and, in particular, whether it would appoint insolvency practitioners to undertake the asset realisation process.

Earlier this month, the Royal Court set out its position on these issues in Representation of the Z Trusts [2015] JRC 214.

Background

As a reminder, "*Mrs C*", the settlor, had established a series of Jersey trusts. Two of the trusts were "*insolvent*" - the Z II Trust and the Z III Trust - meaning that the trustees were unable to discharge liabilities as they fell due out of trust assets.

The Z II Trust had a number of creditors including the former trustees. Their creditor claim was in relation to liabilities arising from litigation commenced against them by a third party regarding events connected with their former trusteeship. There was a background of hostility between the former trustees and Mrs C. The current trustees were also creditors in relation to their unpaid fees.

The Z III Trust had a number of creditors including, in particular, the Z II Trust for a substantial sum of money. Thus, the respective solvency of the two trusts was interlinked, with the fate of the Z III Trust ultimately dependent on the fate of the Z II Trust.

Mrs C and her family (who are beneficiaries) had been pressing for new trustees to be appointed over the Z II Trust and the Z III Trust. Earlier in the year, Mrs C exercised her power to give effect to this change. That action was later set aside by the Royal Court for reasons explained in our previous briefing. The extant issue, therefore, was what the appropriate regime for administration of the trusts should be.

The Parties' positions

The current trustees of the Z II Trust and the Z III Trust proposed a regime that was based on a regime previously utilised in a case involving an insolvent estate (and which was itself based on the *désastre* provisions that exist for insolvent companies and individuals). This envisaged a process by which creditor claims would be examined and either admitted or rejected, and the orderly realisation of assets for the benefit of the creditors.

The current trustees indicated that they felt able to undertake the examination of creditor claims themselves, rather than delegating this task to an insolvency practitioner. In this regard, they relied on the operation of Article 32 of the Trusts (Jersey) Law 1984 which states that, where a creditor knows that a trustee is acting as trustee, creditor claims will only extend to the trust property. Thus, in their view, the Jersey position had been shorn of the potential personal exposure which would arise were there not to be such a limitation on liability, and which would create an inherent conflict.

The former trustees argued that the Royal Court, exercising its inherent supervisory jurisdiction, should appoint an insolvency practitioner to wind up the trusts. This would have been commensurate with the approach in other insolvency scenarios, for example companies and individuals. It said that different insolvency practitioners should be appointed for each trust, and, as officers of the Court, they should conduct an investigation into the circumstances in which the trusts had become insolvent. This stance was resisted by Mrs C, who pointed amongst other things to the potential expense of such a step.

The Decision

The Royal Court held as follows:

- in the case of an insolvent trust, the starting point for the Court is to supervise the administration of the trust in the interests of the creditors;
- in the case of the Z II Trust and the Z III Trusts, the trustees technically had the power to appoint insolvency practitioners voluntarily to assist them in the administration of the trusts, and to delegate tasks to them. Whether this would be the case in other trusts would depend on the terms of the relevant trust deed, and the circumstances of the trust and its creditors;
- there is precedent for receivers being appointed by the Court over trusts, but it is a power that is exercised very rarely. There is no obvious example of where it has been done in relation to insolvent trusts;
- however, the Royal Court does in principle have the power to make such an order given the breadth of its inherent supervisory jurisdiction;

- examples of where it may be appropriate to make such an order might be where there are lay trustees without the necessary skills to conduct an orderly winding up, or where the trustee found itself in a position of real conflict. This is a non-exhaustive list;

- however, where there was no unmanageable conflict then it may be more cost effective for the regime to be operated by the trustee under the supervision of the Court;

- the Royal Court should retain a discretion as to the appropriate regime to implement, notwithstanding the decision in this (or any) case. There was simply not a "*one size fits all*" solution for the issues arising from insolvent trusts.

In this case, the Royal Court saw little point in engaging a formal process of examining, admitting or rejecting claims in relation to the Z II Trust and the Z III Trust as, with the exception of the claim of the former trustee, all of the creditor claims were accepted.

In addition to the above, the Royal Court granted leave to the current trustees of the Z II Trust to retire and be replaced by the new trustees. However, this was subject to a number of conditions including that the new trustees would preserve the creditor claim of the Z II Trust against the Z III Trust, would not themselves charge any fees or expenses (their charges were being paid by another individual who was not the settlor or a beneficiary) and that they would procure agreement of the other creditors not to demand repayment until the position of the former trustees had been clarified.

Comment

Although the Royal Court did not appoint an insolvency practitioner over the insolvent trusts in this instance, it clearly left the door open to the possibility that one could be appointed over other insolvent trusts in the future. The recognition that there could be circumstances where such an appointment is justified is important. In a corporate context, it is recognised in case law that liquidation is ordinarily the function of a liquidator, not that of a director. It has also been held that a liquidator is in the advantageous position of being able independently and impartially to investigate the affairs of a company. There are, therefore, compelling practical reasons why, by analogy, and in a different factual situation, the administration of an insolvent trust might be left to an insolvency expert.

A trustee is subject to the inherent jurisdiction of the Court, and the Court can supervise administration in times of difficulty. Thus, trustees can be placed under its direction, which may provide comfort to creditors that their position is protected. Ultimately, however, it is the interests of the creditors that are paramount in an insolvent trust, as this case again confirms. A groundswell of creditor support for the appointment of an insolvency practitioner may be hard to resist, especially if that is the unanimous view of the creditor body.

There are also a number of residual questions regarding the approach of the Royal Court in

insolvent trust situations. For example, is the existing test in *Beddoe* applications appropriate, or does it need to be modified (or the threshold increased) given the lack of net funds in the trust, and the need to deploy any remaining assets and cash in a more careful way? This sort of question may need to be addressed in future cases.

Ultimately, careful consideration should be given to whether statutory amendments to the Trusts (Jersey) Law 1984 (to provide further clarity in this difficult area) would be helpful to the trust industry in Jersey. The legislature saw fit to introduce limited liability under Article 32, which seemingly entrenches the insolvent trust conundrum (and arguably causes more problems than it solves), but has not subsequently introduced further amendments to assist the industry in dealing with it.

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