

Guidance For Trustees Dealing With Insolvent Trusts: The Z Trust Cases

Authors: Robert Lindley, Partner | Anna Lin, Partner | Natalie Fung, Legal Manager

In October 2022, the Privy Council delivered its judgment in the Z Trust case of *Equity Trust (Jersey) Ltd (Respondent) v Halabi (in his capacity as Executor of the Estate of the late Mdam Intisar Nouri) (Jersey)* which was consolidated with *ITG Ltd and others (Respondents) v Fort Trustees Ltd and another (Appellants) (Guernsey)*. The Privy Council considered the nature and scope of the right of a former trustee to recover from or be indemnified out of assets of an insolvent trust in respect of liabilities and other expenditures properly incurred by the trustee. The Privy Council held that the rights of indemnity of successive trustees against the assets of an insolvent trust fund (i.e. a trust fund that is unable to meet those liabilities) rank *pari passu* and not on a first in time basis. This decision is one of the first to discuss the general principles under the English and Jersey law in the context of an insolvent trust and to consider the ranking as well as the nature of the trustee's proprietary interests.

Whilst the case concerns trusts established under the laws of Jersey, the decision is expected to have a great impact on trusts established in other common law jurisdictions and can give guidance to current or former trustees of offshore trusts and creditors.

Background

Equity Trust, the former trustee of ZII trust (a Jersey law governed trust), claimed indemnity from the trust for costs incurred in litigation in England. The successor trustee, Volaw, claimed payment of its professional fees incurred as successor trustee. The ZII trust assets consisted of a loan repayable by the connected (but also insolvent) ZIII trust, such that the liabilities of the ZII trust exceeded its assets. Neither Volaw's request for payment of their fees as trustee, nor Equity Trust's indemnity following compromise of the litigation, could be satisfied from the trust assets.

Equity Trust sought to exercise its equitable lien over the assets held by Volaw as replacement trustee. This gave rise to argument between Equity Trust and Volaw as to their respective entitlements to be indemnified out of the available assets, and the correct method under Jersey law of dealing with trust liabilities in such circumstances. As there were insufficient funds to meet the claim, including those of other creditors, the trust was placed into a bespoke insolvency procedure devised by and administered by the Jersey Royal Court. The question arose as to the order of priority of Equity Trust, which was the original trustee, and third party creditors claiming through it and successor trustees and creditors claiming through them.

Principle issues

The four principle issues considered by the Privy Council were:

- Whether the right of indemnity confers on the trustee a proprietary interest in the trust assets;
- Whether the proprietary interest of a trustee survives the transfer of the trust assets to a successor trustee;
- Whether a former trustee's proprietary interest in the trust assets takes priority over the equivalent interests of successor trustees; and
- Whether a trustee's indemnity extends to the costs of proving its claim against an insolvent trust in the sense that the trustees' claims to indemnity exceed the value of the trust fund.

The Judges reached unanimous decisions on the first, second and fourth issues. It was unanimously held that the right of indemnity will confer on the trustee a proprietary interest in the trust assets that would survive the transfer of trust assets to a successor trustee. The Judges also unanimously held that a trustee's indemnity shall extend to the costs of proving its claim against an insolvent trust.

The third issue however attracted different views of the Judges. The minority of the Judges (3 out of 7) were of the view that the first in time, being the former trustee, should enjoy propriety over the competing interests of the successor trustees. On the other hand, the majority of the Judges (4 out of 7) were of the view that the former trustee's proprietary interest and claims to be indemnified out of the trust assets shall rank *pari passu* with the equivalent interests of successor trustees. The basis for such decision is that the Judges were of the view that this issue concerns equity's approach to the ranking of proprietary claims and in the absence of any solutions identified previously, the Judges prefer a *pari passu* solution as it displays equity's flexible and pragmatic approach to the task of devising an appropriate solution. The majority further noted that the appointments dates of the trustees should have no connection of any kind with equity or justice and it would not make sense for fiduciaries who were appointed on different dates but worked together in a common enterprise for the benefit of others rather than themselves to not be paid *pari passu* from a deficient fund.

The position in Bermuda, BVI and the Cayman Islands

The Privy Council's decisions on the first and second issues are consistent with the Bermuda Court's judgment of *Meritus Trust Company Limited v Butterfield Trust (Bermuda) Limited* [207] SC (Bda) 82 Civ (13 October 2017) where Kawaley CJ sets out and confirms the general principles concerning the right of indemnity and proprietary interest of the former trustee. This also seems to be the case in the Cayman Islands judgment of *ATC (Cayman) Limited v Rothschild Trust Cayman Limited* [2016 CILR 73] where Smellie CJ confirms that it is settled principle that the beneficial entitlements under a trust are subject to the right of indemnity to which a retiring trustee is entitled and to the lien which that trustee will have over the assets in his possession for satisfaction of that indemnity.

It is also helpful to note that in the British Virgin Islands and the Cayman Islands both contain similar provisions with Article 32 of the Trusts (Amendment No 4) (Jersey) Law 2006. Sections 97 and 98 of the BVI Trustee Act provide that when a trustee discloses its fiduciary capacity and enters into a contract with a third party, the trustee is personally liable for any sum payable under the contract only to the extent of the value of the trust fund when payment falls due. Sections 21 and 47 of the Cayman Islands Trusts Act (2021 Revision) together allows trustees to enter into certain agreements on behalf of the trust without being responsible for any loss occasioned by the agreement, limits the trustees' liabilities to the amounts they have received on behalf of the trust and permits trustees to reimburse from the trust assets all expenses incurred in or about the execution of the trusts or powers.

Conclusion

Whilst there are limited offshore authorities dealing with the trustees' rights of indemnity against an insolvent trust, and also limited guidance as to how trustees should conduct themselves when unable to pay the trust's debts or where liabilities exceed the available assets held in the trust fund, the Privy Council's decision provides trustees with much needed clarity and guidance as to the ranking of their proprietary interests, and affords a degree of protection to successor trustees and their creditors. The implications of the Privy Council's judgment for incoming trustees are significant, and should prompt a review and update of procedures undertaken when considering taking on the trusteeship of an existing trust.

Author:

Robert Lindley
Partner, Head of Cayman & BVI Private Client & Trust,
Cayman Islands
robert.lindley@conyers.com
+1 345 814 7360

Anna Lin
Partner, Hong Kong
anna.lin@conyers.com
+852 2842 9591

Natalie Fung
Legal Manager, Hong Kong
natalie.fung@conyers.com
+852 2842 9427

This article is not intended to be a substitute for legal advice or a legal opinion. It deals in broad terms only and is intended to merely provide a brief overview and give general information.

For further information please contact: media@conyers.com