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Winding up an insolvent trust: An analogy with corporate insolvency law principles

In re the ZII Trust and the ZIII Trust [2020] JRC 072

Introduction

In its latest judgment on the ongoing litigation concerning the administration of two “insolvent” trusts, the ZII Trust and the ZIII Trust (together, the “Trusts”), the Royal Court of Jersey has for the first time directed that a trustee delegate its powers in order to enable an independent insolvency practitioner (“IIP”) to carry out part of the winding up process. In so doing, the Royal Court considered both trust and corporate insolvency legal principles, as well as the more practical considerations of costs, efficiency in the determination of creditors claims, and allocation of tasks if the winding up is being carried out in part by both a trustee and an IIP.

Background

The complex history of the administration of the “insolvent” Trusts has spanned well over 5 years, culminating in multiple judgments by the Royal Court and the Jersey Court of Appeal: see (amongst many others) *In re the ZIII Trust* [2019] JRC 069 (the “**Insolvency Procedure Judgment**”); and *In re Z Trusts* [2019] JCA 106 (the “**Appeal Judgment**”). In the Appeal Judgment, the Court of Appeal held that the original trustee’s (“**Equity Trust**”) lien takes priority over any successor trustee and a trust’s beneficiaries, even where the trust is “insolvent”. That decision is currently on appeal to the Privy Council.



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Meanwhile, the administration of the “insolvent” Trusts has continued to generate litigation before the Royal Court.

The use of the term “insolvent” is, of course, a technical misnomer as it is well-established that since a trust is not a legal entity, it cannot itself become insolvent. Nevertheless, for the purposes of this article, this term is used as a shorthand to describe the situation where a trustee cannot meet the liabilities incurred in that capacity out of the trust assets as they fall due.

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part of a suite of 8 trusts. The deceased was a beneficiary of seven of those trusts and the deceased’s son (“**Mr E**”) was a beneficiary of all of them. Mr E was also the executor of the deceased’s estate.

Geneva Trust Company (“**GTC**”) was the trustee of the ZII Trust. There were claims against the assets of the ZII Trust in the sum of approximately £211 million, including a claim by: (i) GTC in its capacity as trustee of the connected ZI Trust in the sum of £29.2 million; and (ii) Equity Trust in the sum of £18 million as former trustee (pursuant to the Appeal Judgment, Equity Trust’s claim had priority over the claims of the other creditors). In turn, the ZII Trust had a claim against the assets of the ZIII Trust in the sum of £186

million.

Zedra Trust Company (Jersey) Limited (“**Zedra**”) was the trustee of the ZIII Trust. As set out above, GTC had a claim against the ZIII Trust in its capacity as trustee of the ZII Trust. In addition: (i) Mr E, in his capacity as executor of the deceased’s estate; (ii) Mr E’s company, Buckingham Securities; and (iii) Equity Trust all had claims against the ZIII Trust.

Two other points should also be noted with respect to the ZIII Trust:

- Pursuant to the Insolvency Procedure Judgment, Zedra was already in the process of winding up the ZIII Trust. The procedure for winding up the ZIII Trust drew substantially on the usual procedures

adopted in individual and corporate insolvency situations, including providing for potential creditors to file proofs of debt, which would then be considered and rejected by the trustee with a right to apply to court to review the decision; see the Insolvency Procedure Judgment at [24].

- Subsequent to the 2019 Insolvency Procedure Judgment, where the Royal Court had held that it had no reason to consider that Zedra was conflicted from discharging its duties in winding up the ZIII Trust (at [19]), concerns had been raised about the possibility of there being a claim against Zedra. In particular, as trustee of the ZIII Trust, Zedra had made a decision to acquire a company (“**Company 1**”) for approximately £474 million, the business of which had failed shortly after the acquisition, causing substantial losses to the ZIII Trust.

The key inter-related issues for the Royal Court to consider now were:

- Whether GTC ought to be appointed as trustee of the ZIII Trust in place of Zedra; and
- Whether or not an IIP ought to be involved in the winding up process for the Trusts, in light of the conflict that GTC had both as trustee of the ZII Trust, against the assets of which it had a claim as trustee of the ZI Trust, and the conflicts it would have if appointed as trustee of the ZIII Trust, against which it would have a claim as trustee of the ZII Trust.

In an earlier judgment, the Royal Court had already strongly indicated that in light of the potential claim against Zedra, which would need to be investigated as part of the winding up process, Zedra ought to retire in favour of a new trustee; see [2020] JRC 044 at [23].

“It is in the interests of the creditors (and potentially the beneficiaries) of the ZIII Trust and of the creditors of the ZII Trust (which has a substantial claim against the assets of the ZIII Trust) that this potential claim [against Zedra] be investigated and clearly Zedra is not in a position to investigate itself.”

The issues for the Royal Court

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- Whether or not an IIP ought to be involved in the winding up process for the Trusts, in light of the conflict that GTC had both as trustee of the ZII Trust, against the assets of which it had a claim as trustee of the ZI Trust, and the conflicts it would have if appointed as trustee of the ZIII Trust, against which it would have a claim as trustee of the ZII Trust.

Equity Trust opposed GTC being appointed as trustee of the ZIII Trust and argued that an IIP ought to be appointed to deal with and determine the claims of the Trusts' creditors. Driving Equity Trust's opposition were its concerns that: (i) GTC would be conflicted in the circumstances; and (ii) GTC was purportedly under the influence of Mr E.

On the other hand, GTC argued that notwithstanding the conflict it ought to be appointed as trustee of the ZIII Trust and conduct the winding up of the Trusts without the appointment of an IIP. However, GTC also proposed that where there was a conflict of interest any dispute could be referred

directly to the Royal Court with GTC remaining neutral in such proceedings. In so doing, it relied on corporate insolvency principles with respect to the appointment and conduct of liquidators derived from other jurisdictions, in particular:

- The advice of the Privy Council, on appeal from the Cayman Islands, in *Parmalat Capital Finance Limited v Food Holdings Ltd* [2009] 1 BCLC 274 at [13], where the Board held that “*[i]t is not unusual for the same liquidators to be appointed to related companies, even though the dealings between them may throw up a conflict of interest.*”
- The judgment of the English High Court in *Re Energy Holdings (No.3) Ltd* [2011] 1 BCLC 84 at [48], where it was held that it was appropriate for a liquidator to surrender its discretion to the Court on specific matters.

GTC further contended that as a practical matter it would be appropriate for it to be appointed as trustee of the ZIII Trust given its background knowledge as a consequence of its trusteeship of the ZII Trust, and that it had a track record of bringing proceedings successfully against a former trustee of the ZII Trust. It further argued that the appointment of an IIP would be wasteful in terms of costs when there was a supposedly high likelihood

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...the Royal Court found a solution by holding in respect of these Trusts that since the Court may, in its supervisory role, give directions to a trustee, it could direct GTC to exercise its powers of delegation to appoint an IIP.

that any decision made would be challenged in court.

The Royal Court's Judgment

The decision of the Royal Court represents a sound compromise of the competing parties' interests and the practical issues at stake. On the one hand, the Royal Court accepted GTC's submission that it ought to be appointed as trustee of the ZIII Trust in order to ensure a timely investigation of a potential claim against Zedra in respect of the acquisition of Company 1. In so doing, the Royal Court noted at [17]-[18], [26]:

• *"It is in the interests of the creditors (and potentially the beneficiaries) of the ZIII Trust and of the creditors of the ZII Trust (which has a substantial claim against the assets of the ZIII Trust) that this potential claim [against Zedra] be investigated and clearly Zedra is not in a position to investigate*

itself."

• A new trustee with access to the trust records would therefore have to take over and investigate the claim. Given that GTC had previously conducted a successful claim against the former trustee of the ZII Trust, GTC was in the best position to take over the trusteeship of the ZIII Trust and investigate the claim against Zedra.

• GTC had the support of creditors, whose claims in value amounted to more than 99% of the overall claims against the assets of the ZII Trust. Although GTC clearly had a working relationship with those creditors (predominantly Mr E), there was nothing to question GTC's professionalism or integrity.

• In any event, GTC's proposals for the funding of the claim against Zedra and investigation into the

acquisition of Company 1 would require the Royal Court's approval.

However, on the other hand, given the extent of the conflict that GTC would face as trustee of the Trusts, and the fact that GTC plainly did have a relationship with Mr E, the Royal Court considered that an IIP ought to be appointed for the purpose of determining the creditors' claims (at [18]-[19]). The Royal Court was further reinforced in its view given that (at [19]-[21]):

• The claims of the Trusts' creditors were substantial and not without difficulty such that an independent forensic assessment of the claims was appropriate.

• There would be no duplication of costs since the task of determining claims that would have fallen on the trustee would now fall on the IIP. Indeed, it was *"arguable that an IIP would be able to conduct that exercise in a more cost effective manner than a professional trustee, whose officers are not insolvency experts."* To the contrary, GTC's proposal that any matter on which it was conflicted would be referred to the Royal Court would be likely to be more costly and cause further delays to the winding up process.

• Even if the appointment of an IIP did increase costs, any increase would be

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proportionate in light of the quantum of the claims against the assets of the Trusts and the interest in ensuring that the Trusts were properly wound up.

The Royal Court also considered that “[b]y analogy with the liquidation of a company and following the case of *Parmalat* appointing one IIP to both trusts avoids the expense of having different IIPs for each trust and any conflicts that might arise (and none have been suggested) can be dealt with by the Court” (at [19]).

The final point to note is how the Royal Court considered that the IIP ought to be appointed. Although the Royal Court accepted that its role was to supervise a trustee in the administration of an “insolvent” trust (*In re Z Trusts* [2015] JRC 214 at [26]), there was no authority to suggest that the Court itself could appoint an IIP (at [23]).

On this point, it ought to be noted, although not referred to in the Royal Court’s judgment, that the editors of *Lewin on Trusts* (20th edn. at §§27:094–95), take the view that a court may not appoint a liquidator or such similar IIP to wind up a trust¹. However, the Royal Court found a solution by holding in respect of these Trusts that since the Court may, in its supervisory role, give directions to a trustee, it could direct GTC to exercise its powers of delegation to appoint an IIP.

Conclusion

This decision is a useful illustration of the application of both trust and corporate insolvency law principles to the winding up of a trust. The Royal Court’s use of its supervisory jurisdiction to give directions to a trustee to delegate its powers to an IIP to carry out part of the winding up process can be

regarded as a particularly practical solution to the commonly understood bar to the jurisdiction of the court to directly appoint a liquidator.

The decision to appoint GTC as trustee of the ZIII Trust, but at the same time appoint an IIP for the purpose of determining the claims of creditors, also represents a sound approach to issues concerning conflicts of interest, costs and efficient management of the winding up process. It highlights the court’s preference for pragmatic solutions in order to strike a balance between the differing interests of creditors. ■

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¹ *C.f. Stewart v Att-Gen. for Northern Ireland* [2013] NICH 10.