Insolvent trusts: The latest twist in the Z - Re Z Trusts [2018] JRC 203

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The Royal Court of Jersey refuses a former trustee's claim for the legal costs it incurred in making applications regarding an insolvent trust.

The Z – Trust litigations

Following the decision in *Re Z Trusts* [2018] JRC 119 at the start of the summer, we know that when a trust becomes insolvent, a trustee loses its priority right to be indemnified out of the trust assets for liabilities, costs and expenses reasonably incurred in connection with the performance of its duties as trustee (the equitable lien). At the point of insolvency, the beneficiaries no longer have any interest in the trust assets, as these interests are turned over to creditors. The trustee simply ranks *pari passu* with other creditors.

Re Z Trusts [2018] JRC 164 dealt with the separate issue of whether a former trustee could recover the costs it had incurred in proving its claim against the assets of the insolvent trust. Commissioner Clyde Smith found that it could not. The Court drew on the leading case of *Investec v Glenalla* [2018] UKPC 7 to remind us that all claims to the assets of a trust come through the former or current trustees, and they are the only persons who can assume liabilities in relation to a trust. In the interests of fairness, each creditor should bear the costs of proving their own claim (subject to the discretion of the court in any given case). The Court held it would not be acceptable for the rights of a former trustee to enable it to "scoop the pot" in relation not only to its claim but also to the cost of proving that claim.

The costs application

In the latest instalment, *Re Z Trust* [2018] JRC 203, the former trustee was unsuccessful in trying to recover its costs in connection with the above two applications. The issue to be determined was essentially how the hearings ought to be characterised - and therefore how they should be treated in terms of allocation of costs.

The Court considered the guidance set out in *Re Buckton* [1907] 2 Ch 406 to determine whether the costs of the court proceedings can be recovered from the trust estate. The former trustee unsuccessfully argued that the hearings came within the first category set out in *Buckton*, which deals with the scenario where a trustee goes to court to seek guidance - for example, regarding the administration of a trust. In these circumstances, *Buckton* held that the costs of all parties as necessarily incurred for the benefit of the estate, are paid out of the estate.

The executor in *Re Z Trust* successfully argued that the hearings came within the third category identified in *Buckton*. In this class, the applicant takes advantage of a convenient court procedure which is available for non adversarial applications when the remedy sought by the applicant would, but for the availability of this procedure, need to be initiated by the usual process for adversarial claims. In litigious circumstances such as these the unsuccessful applicant usually bears the costs of all other parties.

Commissioner Clyde-Smith noted in Re Z Trust that, whilst in form the applications had the appearance of applications by a trustee for directions, in substance these were adverse claims by one creditor against the others. The former trustee had incurred costs for its own benefit, and not for the benefit of the trust estate.

Therefore, said the Court, this was hostile *inter partes* litigation to which the ordinary principles set out in *Watkins v Egglishaw* [2002] JLR 1 applied. The executor had successfully resisted the application, and so the former trustee was required to bear the executor's costs in addition to their own.

Take away points

- A trustee cannot automatically assume that it will be awarded its costs out of trust funds when applying for directions. When it comes to where the burden of costs should lie, the characterisation of a given application is important and the answer is not always obvious. The Court may have cause to consider, among other matters, whether it is on the one hand a non contentious application for the benefit of the trust estate, or on the other, a contentious application made by an applicant in its own interests.

- An overriding lesson from the *Z Trusts* cases as a whole is that trustees may be well advised to keep in mind the possibility of taking formal security over trust assets at an appropriate juncture, to avoid competing with other trustees and creditors further down the line.

It will be interesting to see how this line of authority develops, and in particular the outcome of the pending appeal of the substantive judgment. Will there be an ever increasing trend in restricting the circumstances where a trustee can rely on its equitable lien to recover from the assets of a trust?

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