COLLAS CRILL

Trustees seeking a court blessing for a decision: lessons in the exercise of discretion

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The Royal Court of Jersey has refused to bless a trustee's decision to sell the sole remaining asset in a trust in order to satisfy creditors including, importantly, paying its own administration fees.

The judgment is a cautionary tale for trustees in their approach to exercising their discretion to deal with trust assets, particularly in the context of cash-flow insolvency.

The facts

The trust was a conventional Jersey law discretionary trust. The settlor had died in 1984 and the beneficiaries were his widow and three children. The father's estate had been the subject of fiercely fought litigation since his death, including an appeal all the way to the Privy Council.

The trust's only material asset was a residential property in London. The family was based in Kenya, and the father's intention was that the house would be used by the siblings and their families when they were in London. The understanding was that the siblings would pay for the house's upkeep between them. As an indication of value, the property had been marketed in 2016 and received offers between £1m and £1.15m.

The evidence from the trustee was that the trust was illiquid and effectively cashflow insolvent. The house was poorly maintained and management fees left unpaid. The trustee considered that the only viable option was to sell the house and distribute the proceeds to the beneficiaries once the creditors had been satisfied. Given the disagreement between the beneficiaries, it applied to the Court for a blessing of this decision.

The legal arguments

All the siblings opposed the Court application. The widow did not take part in the proceedings. While the eldest son advocated the sale of the house, he considered that the trustee did not require the Court's blessing to do so. He argued that the Court ought not to intervene as this would simply encourage trustees to seek approval in circumstances where they do not need to do so.

The remaining two siblings opposed the sale and had put forward various options to buy out the elder sibling's share. None had come to fruition, although there was interest from a bank in potentially funding the buy-out and renovation of the property.

The Court's decision

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The Court was in no doubt that the decision was a "momentous" one and therefore satisfied the test for whether it was open to the trustee to seek a court blessing before proceeding. However, the Court chose not to bless the decision to sell the property. There were three main reasons for this:

1. Conflict of interest

The trustee had unpaid administration fees of around £112,000 which could be met if the property were sold. As a major creditor, the trustee was under an inherent conflict of interest in considering the sale. Although the Court found that this conflict was not so pervasive as to disable the trustee from taking the decision, the fact that the trustee did not address that conflict at the time of the decision, was fatal to the application.

The Court commented that it would have expected to see minutes in which, in reaching its decision, the trustee acknowledged the existence of the conflict but went on to explain why, despite the conflict, it was nevertheless in the interests of the beneficiaries and the trust estate that the property be sold.

2. Failure of the Trustee to obtain Tax Advice

The trustee did not obtain advice on the tax implications of any sale of the property and distribution of the proceeds. Its reason for not doing so was the absence of liquid funds in the trust. The Court considered that this was not a reasonable excuse for not obtaining its own tax advice in order to understand the potential consequences of a sale. The trust held a valuable asset, and the trustee would ultimately be able to reimburse itself for the cost of the advice.

3. Reasonableness

Where two of the four beneficiaries wanted to retain the asset, it was incumbent on the trustee to be proactive in seeking to establish whether there was an alternative solution to the illiquidity. The trustee was criticised for taking a "rather passive stance" on the issue. The Court was therefore not satisfied that it was reasonable to insist on a sale at this particular stage.

The Court's ultimate recommendation was that the two younger beneficiaries should be given a clear deadline to come up with concrete funding proposals. In the absence of a workable solution within a reasonable period, it would then be reasonable for the trustee to conclude that there was no alternative to a sale and either proceed with the sale or apply again to the Court for approval.

Take away points

- A trustee may be required to incur costs in the short term in circumstances where there is no cash in the trust to reimburse it immediately, in order to ensure that it can take decisions on a fully informed basis and assess properly what is in the best interests of beneficiaries;

- Trustees must be seen to take conflicts of interest into account in exercising their discretion. There needs to be an audit trail to demonstrate that the conflict has been declared and considered before any decision has been taken;

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- A conflict of interest may not necessarily disable a trustee from taking a decision which is nevertheless in the interests of beneficiaries; and

- Although the decision of the Royal Court in *Re Z II Trust* 2015 (2) JLR 108 would suggest that where a trust is cash-flow insolvent, the trustee must consider what is in the best interests of creditors as a whole without regard to the interests of the beneficiaries, a trustee should be careful not to be seen to prefer its own interests to those of the beneficiaries in order to avoid criticism.

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