Collas Crill acts for successful appellant in landmark Privy Council case on Jersey 'insolvent trusts'

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Collas Crill recently acted for the successful lead appellant before the Privy Council in *Halabi (Appellant) v Equity Trust (Jersey) Ltd (Respondent) in re the ZII Trusts* 2022 UKPC 36, in a case that will undoubtedly have a far-reaching and long-lasting impact on the Jersey trust industry, and likely on offshore trusts generally.

The primary question on appeal related to the correct method of dealing with the assets of what is colloquially referred to as an 'insolvent trust'. Given that a trust is not, as a matter of Jersey law, a legal personality, it cannot incur debts in its own name and so cannot technically be 'insolvent'; but the term is widely used to refer to a trust where the trustee is unable to settle liabilities incurred as trustee out of the available assets of the trust.

Collas Crill's team was led by Partners Damian James and Simon Hurry. Along with leading counsel Shân Warnock-Smith KC and Clare Stanley KC, Collas Crill represented Mr Simon Halabi, a creditor of the trustee of the ZII Trust, in proceedings initially instituted by a former trustee seeking to recover an alleged debt. The matter proceeded on an agreed assumption that the debt was indeed owing, and that there were no secured or preferred debts.

The Royal Court of Jersey ruled at first instance that the assets of an 'insolvent trust' should be distributed *pari passu,* in other words, distributed between all of the trustees so that each (and each creditor claiming from that trustee)[1] receives partial satisfaction of their debt, irrespective of the order in which the trustees assumed trusteeship. However, on appeal, the Jersey Court of Appeal found that the assets should be distributed on a first-in-time basis, so that the claims of earlier-ranking trustees are preferred over those of later trustees.

On appeal to the Privy Council, the matter was heard alongside a Guernsey appeal on similar issues. Over three days, extensive argument was made by leading counsel. In its judgment of 13 October 2022, the Privy Council considered four principal issues:

1. Whether a trustee's right of indemnity confers a proprietary interest in the trust assets;
2. Whether that right of indemnity survives the transfer of the trust assets to a successor trustee;
3. Whether a former trustee's claim ranks in priority to a successor trustee's equivalent claim; and
4. Whether the costs incurred by a trustee in proving its claim are included in the sum capable of recovery by the trustee.

The first, second and fourth issues were unanimously decided by the Privy Council. The third question, however, gave rise to three separate judgments and was decided on the basis of a 4:3 split of the seven-member Board, in favour of the appellant.

Issues 1 and 2: Nature and survival of the trustee's right of indemnity

The Privy Council held that the trustee's right of indemnity confers upon it a proprietary interest in the trust property.[2] This is on the basis that a trustee's rights to (i) apply trust assets which it holds to sums owed to the trustee itself under its indemnity, and (ii) seek security before transferring the assets to a successor trustee, are the practical means by which a trustee's interest is protected.

Having concluded that a trustee enjoys a proprietary interest in the trust assets in relation to their right of indemnity, the Privy Council then turned to consider the question of whether that interest survived the transfer of the trust assets to a new trustee.

Writing the decision of the Court, Lord Richards and Sir Nicholas Patten noted that this was not an issue that had been raised for consideration in any English court previously. Lord Richards and Sir Nicholas considered a number of Australian authorities in which it had been decided that the proprietary interest of an outgoing trustee survived transfer to a new trustee. It was also noted that numerous academic texts on the subject of the trustee's interest took the stance that the interest enjoyed by a trustee does not cease upon transfer of the assets to a new trustee.

On this basis, the Privy Council found that the proprietary interest of a trustee survives the transfer of the trust assets to a successor trustee.[3]

Issue 3: first in time or *pari passu*?

The third issue before the Privy Council resulted in three separate, reasoned, judgments. The majority view is set out in the judgment of Lord Briggs, with whom Lord Reed and Lady Rose agreed. Lady Arden was also in agreement, albeit for slightly different reasons. Lord Briggs noted that there is a dearth of authority on the point, "*anywhere in the common law world*".[4]

Proceeding from this starting point, Lord Briggs referred to the default rule that, as a matter of equity, first in time is first in law. However, he went on to note that there are "*sufficiently powerful reasons, of justice, equity, fairness and common sense to enable, indeed to require, the Board to prefer*"[5] the *pari passu* approach.

Lord Briggs notes that there may be situations in which the *pari passu* approach is not appropriate, but these would need to be shocking to the conscience of the Court and wholly exceptional to militate in favour of a departure from the rule now created by the Privy Council in this case.

In coming to the conclusion that insufficient trust assets should be allocated on the *pari passu* basis, the Privy Council compared a number of other scenarios where competing claims are made to assets insufficient to meet them all in full. These alternative scenarios included directors in a company insolvency (who are ranked *pari passu* amongst themselves) and liquidators and administrators (who enjoy priority over other classes of creditors in a liquidation, but have no priority within their group).

These examples stand in contrast to the position of solicitors enjoying a lien[6] over the proceeds of litigation in respect of unpaid fees, where the recovery is insufficient to meet the fees: in that instance, the second or later solicitor enjoys priority. This example shows that there is no historical support for applying a first-in-time allocation to equitable liens, and indeed the lien of a solicitor is adjudicated on the opposite basis.

Lord Briggs made one further, and commercially important, point in favour of *pari passu* ranking of trustees' claims, with which Lady Arden agreed: ranking trustees' claims on a first-in-time basis would subject creditors to settlement of their claims on the basis of the date of appointment of the trustee with whom they contracted. Not only is this information unavailable to creditors in the ordinary course, it is likely to be no more than happenstance in the context of the commercial transaction.[7]

Initially in favour of what is now the minority view (that first in time should prevail), Lord Briggs concluded that "*the impressive arguments, coupled with lengthy ensuing debate and reflection, have caused me to change my mind*"[8]. Lord Briggs then found that

trustees' claims in terms of their lien or interest in the trust assets should rank *pari passu*.[9] This is the majority view of the Privy Council, and is how claims on 'insolvent trusts' as a matter of Jersey law will be resolved going forward.

Issue 4: a question of costs

The final issue that was before the Privy Council for consideration was the question of whether, as part of any claim against the assets of the trust, the trustee ought properly to include its costs of proving that claim.

In contrast to the position in *desastre* proceedings (insolvency of companies or individuals, where costs of the proof of claim are not recoverable), the Privy Council found that a trustee is entitled to recover the costs of its claim, as part of its recovery from the trust assets. This is on the basis that the trustee is not "proving a claim" in the traditional sense; rather, it is simply proving the extent of its existing proprietary interest in those assets.[10]

Concluding remarks

This case can accurately be described as trailblazing. For the first time clarity has been provided in relation to the position of current and former trustees of insolvent trusts, and their creditors, who have claims against current and former trustees under DORAs and/or statutory provisions. The lengthy and extremely detailed judgments are expected to bring a great deal of certainty to trustees' interactions with creditors, and bring comfort to those who hold claims against a trust that becomes 'insolvent'.

Collas Crill team

A multi-disciplinary and multi-jurisdictional team of Collas Crill lawyers acted for the successful appellant in the Jersey appeal giving rise to the decision of the Privy Council. The team was led by Jersey Head of Dispute Resolution Damian James.

[1] It should be borne in mind that, as a trust lacks separate legal personality, any claim must be brought by a creditor against the trustee with whom that creditor contracted initially, as opposed to against the trust itself. In this way, creditors' claims are effectively subrogated to the claims of the various trustees.

[2] Para 105.

[3] Para 166.

[4] Para 238.

[5] Para 239.

[6] Usually, a lien is a possessory right whereby the lienholder is entitled to retain possession of assets that it possesses until such time as a liability owing to the lienholder is satisfied. This effectively operates as a charge over the assets in the lienholder's possession, but does not grant the lienholder any proprietary rights in the assets, Para 72.

[7] Para 276.

[8] Para 239.

[9] Para 277.

[10] Para 237.

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