

Power-sharing in the winding up of the insolvent *Z Trusts*

In April 2020 Jersey's Royal Court handed down its latest judgment in the long running *Z Trusts* litigation¹. The Court gave further directions to the trustees of the Z II and Z III Trusts (the "**Trusts**") as to the approach to the affairs of these two "*insolvent*"² trusts to ensure that they are wound up in the interests of the creditors of each trust as a body, and in a manner that is consistent and proportionate. Adopting a novel approach in order to manage conflicts of interest affecting the trustee, the Court ordered the appointment of an independent insolvency practitioner ("**IIP**") to work alongside the trustee in winding up the affairs of the Trusts.

Background

The Trusts are two of eight trusts established by Mrs C, now deceased. Mrs C's son, E, is the driving force behind the activities of the trusts. The Trusts are "*insolvent*", the Court having adopted that description as shorthand for describing the shortfall in assets in both Trusts to meet both certain and contingent creditors' claims. Their administration has long been under the Court's supervision to ensure that they are "*administered for the benefit of the creditors as a body*", under the new, creditor-oriented dispensation arising from the Trusts' "*insolvencies*".

Geneva Trust Company (GTC) SA ("**GTC**") is the current trustee of the Z II Trust. Zedra Trust Company (Jersey) Limited ("**Zedra**") is the current trustee of the Z III Trust and is in the course of winding up the affairs of the trust following an insolvency procedure put in place by the Court in April 2019.

The assets of both Trusts are dwarfed by the claims against them. There are claims against the assets of the Z II Trust of some £211 million on the part of creditors connected to the family of E or trusts associated with them (the "**Connected Creditors**"), one of which is GTC in its capacity as trustee of the Z I Trust with a claim in the sum of £29.2 million. The Connected Creditors also have claims against the assets of the Z III Trust in the approximate amount of £320 million. Importantly, GTC as trustee of the Z II Trust has a claim against the Z III Trust potentially valued at £230 million (subject to the recoverability of contractual interest).

Equity Trust (Jersey) Limited ("**Equity**"), as a former trustee of both Trusts, also has claims against both Trusts (valued at approximately £18 million against Z II Trust and £400,000 respectively against Z III Trust). Equity has maintained (successfully in the Court of Appeal, but subject to an appeal to the Privy Council) that its claims as former trustee take priority over the claims of the other creditors.

¹ [2020] JRC 044.

² "A trust is not, of course, a separate legal entity and cannot, as a matter of law, be insolvent, but it is a useful form of shorthand and we will continue to use it" ([2015] JRC 214, para 2)

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None of the claims against the Z II Trust have yet been proved. The claims against the Z III Trust have been submitted and inspection taken place but Zedra has yet to make any determination under the insolvency procedure.

Issues

The Court “sat” in April 2020 to consider the following matters:

- Whether GTC be appointed as trustee of the Z III Trust among other reasons in order to investigate a possible claim against Zedra (as trustee) arising out of its decision to acquire the Esporta health and fitness business for a total consideration of £474.3 million, which business failed shortly thereafter, causing substantial losses to the Z III Trust (all parties, including Zedra, having accepted that Zedra could not investigate itself); and
- Directions as to the winding up of both Trusts, including the identity of the person charged with conducting the windings up and the precise terms of the insolvency procedures to be applied.

Given COVID 19 restrictions, the hearing took place on the papers, with the parties filing detailed written submissions and responsive submissions.

GTC acknowledged that it was in a position of (several) conflicts of interest: as trustee of the Z I Trust it had a claim into the Z II Trust, of which it was also trustee, and as trustee of the Z II Trust it had a claim into the Z III Trust, of which it was seeking to be appointed Trustee. GTC, with the support of the other Connected Creditors, contended that it should nevertheless be appointed trustee of the Z III Trust. This was in line with the longstanding wishes of the late Settlor, Mrs C. It was proposed that GTC’s conflicts of interest could be managed through the Court on the basis of surrender of discretion. Equity however did not consider that to be a fair or workable solution and proposed that (1) an IIP be appointed to carry out the winding up of both Trusts and (2) GTC should not take office as trustee of the Z III Trust.

The Court was therefore concerned with whether or not an IIP should be brought into the winding up process of both Trusts, the terms of the insolvency regime for each Trust and whether GTC should be appointed trustee of the Z III Trust.

Regime to date

The need for an IIP in relation to the Trusts had been previously considered by the Court in 2015³. At the time the trustees put forward proposals modelled on a regime approved in the case of an insolvent estate (Re Hickman [2009]).

The Court had noted how, unlike with an executor, creditor claims are brought against the trustee personally such that a trustee was inherently conflicted when undertaking the process of examining, admitting or rejecting claims against itself (albeit that the conflict would often be more perceived than real as creditors would normally know that the trustee was acting as trustee such that the claims will only extend to the trust property pursuant to Article 32 of the Trusts (Jersey) Law 1984).

³ [2015] JRC 214

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In October 2015 Equity sought the appointment of IIP (a different one in relation to each Trust) to undertake the winding up of the Trusts, including the realization of the Trusts' assets, reducing the trustees to that of a bare trustee.

The Court was not persuaded to make such an appointment as there were professional trustees in office with no unmanageable conflict and it would be much more cost effective, and therefore in the interest of the creditors, for those trustees to remain in office and to conduct the winding up process under the supervision of the Court.

In April 2019⁴ the Court dealt with an application made by Zedra for orders to allow for the orderly winding up of the Z III Trust. Equity again sought the appointment of an IIP albeit, this time, not to be appointed as a receiver of the assets but with the trustee retaining legal title to the assets of the trust, as a bare trustee, deferring to the insolvency practitioner regarding the realisation and management of the trust assets.

At that time the Court was again content to let the insolvency procedure in relation to the Z III Trust proceed with the trustee at the helm, under the Court's supervision. The Court did not consider it necessary or proportionate for an IIP to be appointed which would add another layer of costs to a process which the trustee was perfectly able to undertake itself.

Until now, therefore, the trustee had been able to continue to act alone in relation to both insolvent Trusts, including by dealing with the administration of the insolvency procedure relating to the Z III Trust.

Current positions of the parties

In relation to GTC's application, Equity objected to GTC being appointed as trustee of the Z III Trust for reasons which can be summarised as follows:

- (a) GTC's existing and potential conflicts were crucial to Equity, because it is the priority creditor over the assets of both Trusts, whose interests GTC should be considering first and foremost.
- (b) It was alleged that GTC lacked independence and was under the influence of E, which would affect both Trusts if GTC takes over the insolvency regimes. One issue in any claim against Zedra would be the role of E in the Esporta investment.

Equity considered that an IIP should be appointed to deal with and make determinations in relation to the claims of all of the creditors and that the same IIP should be appointed to both Trusts, given the interlinked issues. After determination of all of the claims against the assets of the trust, the trustee would apply to the Court for approval of the trust accounts and authority to distribute the assets in accordance with those accounts.

On the other hand, GTC's position was informed by following principles:

- (a) The Court supervises the administration of insolvent trusts and enjoys the widest possible discretion in giving directions in this regard.

⁴ [2019] JRC 069.

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- (b) The same liquidator(s) may be appointed to related companies, even when the liquidator(s) would suffer from a conflict of interest. This can avoid the expense of having different liquidators investigate the same transactions and the Court can resolve any conflicts when they arise.
- (c) Only in the case of a truly unmanageable conflict (where the liquidator and the Court, acting together, could not manage the conflict of interest) will the Court remove, or refuse to appoint, an otherwise appropriate liquidator. In any event a liquidator could surrender its discretion to the Court on specific matters.

GTC therefore proposed to conduct the winding up of both Trusts with any claim in which it had a conflict of interest and any dispute being referred directly to the Court, in which proceedings GTC would remain neutral.

Allowing GTC to conduct the winding up of both Trusts would streamline the process and save substantial costs.

It also made sense for GTC to become trustee and handle the Esporta investigation, as it and its legal advisers already had a significant amount of relevant background knowledge and understanding as a consequence of its trusteeship of the Z II Trust. Whilst GTC enjoyed a good professional relationship with E and nothing more there was no evidence before the Court to support Equity's concern that it was under the control or influence of E.

GTC's concern was that the appointment of an IIP would be wasteful in terms of cost and could achieve little purpose. The disputes were likely to be highly technical. It was very probable, given the history, that a party disaffected by a decision of an IIP would refer the matter to the Court, which would become seized of all disputes in any event. Thus, there was a risk of the IIP's decisions being rendered otiose.

Decision

The Court confirmed the decision that Zedra retire as trustee of the Z III Trust in favour of GTC so that the potential claim against it may be properly investigated, and if appropriate pursued, for the benefit of the creditors.

The Court reached the view that an IIP should be brought in to the winding up process in respect of both Trusts (with the same IIP acting in relation to both) due to:

- the extent of GTC's conflicts of interest that GTC; and
- GTC having a working relationship with E. The Court simply recognised that, given the relationship and the background of hostility between E's family, Equity was entitled to have someone considering its claims, and the claims of the Connected Creditors, who is wholly independent of any of the parties.

Whilst the Court recognised that the appointment of an IIP may increase costs, the Court considered that to be proportionate (to the claims in issue) and in the interest of the proper winding up of both Trusts. In particular there was value in a process in which claims are independently assessed and filtered, so that matters are not referred up to the Court (with all the delay which such referrals give rise to) unnecessarily.

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The Court could use its wide discretion to give direction to trustees of insolvent trusts to direct GTC to exercise its powers of delegation to appoint the IIP (to be accountable to the Court).

Comment

The case illustrates once again the vibrancy of the Court's inherent jurisdiction to supervise trusts and has added to the range of tools available in the context of insolvent trusts, to ensure that they are "*administered for the benefit of the creditors as a body*".

The appointment of an IIP in relation to the Trusts is a significant departure from the approach taken by the Court to date whereby the trustees had remained alone in charge of the affairs of the insolvent Trusts, and in the case of the Z III Trust, had also been given standard insolvency regime powers to wind up the affairs of the trust, albeit under the Court's ultimate supervisory jurisdiction.

Whilst this creative flexibility will be welcomed, it remains to be seen whether this novel power-sharing approach involving a professional trustee continuing to act as such, with the assistance of an IIP, will achieve its ambitious objective of reducing the need for Court supervision and intervention, thereby avoiding delay and overall costs, or whether the hostility among creditors will inevitably lead to the referral of disputes to the Court.

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