

Z Trusts – costs of proving a claim are not recoverable from the assets of the insolvent trust

UPDATE

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On 10 September 2018, the Royal Court handed down its judgment on the final outstanding issue in the current round of the Z Trusts case on the question of entitlement, in the context of an insolvent trust, to recover from the insolvent estate the costs incurred in proving a claim. Justin Harvey-Hills (Partner, Jersey), Luke Olivier (Counsel, Jersey) and Bethan Watts (Associate, Jersey), who act for a major creditor, successfully argued that such costs could not be recovered. This judgment will soon be published on www.jerseylaw.je.

Issue

Following its determination in July that the claims of creditors of an insolvent trust should rank *pari passu* rather than on a first in time basis, the Court dealt separately with the question of whether a creditor (in this case also a former trustee) could claim from the insolvent trust its costs incurred in proving its claim.

In the context of a solvent trust, under normal principles of trust law a former trustee has the right to recover costs reasonably incurred in bringing a claim under its right of indemnity. However, while the costs of making a claim might ordinarily form part of the trustee's lien and take priority over the interests of the beneficiaries where a trust was solvent, it was not clear that this applied in the context of an insolvent trust.

Furthermore, the classic rule in a personal or corporate insolvency is that the costs of proving a claim are not generally recoverable from the insolvent estate (see Article 30(2) of the Bankruptcy (Désastre) (Jersey) Law 1990).

Decision

A former trustee of one of the Z Trusts had incurred expenses in the sum of £247,000 (which the Court noted were arguably disproportionate) in pursuing its claim to £90,000 out of trust assets and sought to recover these costs under its right of indemnity and equitable lien securing that right. The former trustee argued that the trust law principle should extend to insolvent trusts, as a fundamental principle of trust law in order to protect the safety of trustees and prevent *"the effect of frightening wise and honest people from undertaking trusts."*

However, the Court agreed with the submissions that we put forward on behalf of one of the other that, consistent with the creation of an insolvency regime for trusts, normal insolvency rules should apply and the costs of proving a claim should not ordinarily be recoverable from the insolvent estate.

This was consistent with the earlier judgment in which it was held that a trustee's lien took priority over the interests of the beneficiaries but not over those of other creditors.

On a practical level, it was also the fairer and more equitable outcome. There was no reason to make an exception for trustees or former trustees as otherwise all creditors would have an incentive to argue that they fell within the exception. This would be burdensome for the estate and its administration, as well as detrimental to the interests of the creditors as a whole. Furthermore, creditors with well-established claims

would effectively be forced to subsidise the proving costs of those with claims that were marginal and thus difficult to prove. This would encourage an uncommercial attitude to proving and be detrimental to the creditors as a whole.

The Court added that it did not consider that this would have "*the effect of frightening wise and honest people from undertaking trusteeships*". What could well frighten them was the possibility that, in the unlikely event of a trust becoming insolvent, the rights of a former trustee would enable it to "*scoop the pot*". This applied just as much to the cost of proving the claim as to the claim itself.

Comment

This decision represents a logical next step in the creation of an insolvency regime for trusts. The Court has used personal and corporate insolvency law as its guiding star throughout this process and it makes perfect sense to follow the principles of insolvency law in this regard, particularly where the Court had already found that a trustee's or former trustee's lien does not take priority over the interests of creditors.

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