Insolvent trusts: misnomer or reality?

"TO TALK OF AN INSOLVENT TRUST IS OF COURSE A MISNOMER" (COMMISSIONER CLYDE-SMITH, *Z TRUSTS* [2015] JRC 031)

It is, of course, not possible for a trust (as opposed to its trustees) to become insolvent since a trust is not a legal entity. Despite this, recent judgments of the Jersey and Guernsey Courts have addressed the administration of insolvent trusts, the exercise of fiduciary powers in respect of insolvent trusts, and the liabilities of trustees of insolvent trusts.

In Guernsey, the Court of Appeal considered whether trustees of a Jersey law trust were personally liable in circumstances where the trust's assets were insufficient to meet its liabilities, and the trustees' liability was limited by statute to the extent of the trust assets *(Investec Trust (Guernsey) Ltd v Glenalla Properties Ltd* [2014]).

The Court of Appeal held that Article 32 of the Jersey Trusts Law limited trustee liability to third parties to the extent of the trust assets available to satisfy the trustee's indemnity, provided the third party knew the trustees were contracting as trustees. A former trustee's right to be indemnified by the successor trustee was similarly limited to the trust assets, however the priority between former and current trustees' indemnities where there is a deficiency of trust assets is still to be answered (*Z Trusts* [2015] JRC 031 at [16]).

The extent of the trust's assets is to be judged at the time the claim falls to be satisfied, even if the trust assets have been substantially reduced, provided that any reduction is a result of the regular administration of the trust. Article 32(1)(a) applies even if the trustee is in breach of trust, but where the trustees have acted improperly they can expect a counterclaim from the beneficiaries.

Trustees of an insolvent trust will not, therefore, be personally liable for debts or claims exceeding the trust assets, provided that the statutory limitation applies. In England there is no statutory limit on trustees' liability to the trust assets, but personal liability of trustees can be limited contractually.

In Jersey, the Royal Court gave guidance on exercise of fiduciary powers in the context of insolvent trusts in the *Z Trusts* litigation. Importantly the focus shifts from the interests of the beneficiaries to the interests of the creditors:

"…a trust that becomes insolvent should thereafter be administered on the basis that it is insolvent, treating the creditors, rather than the beneficiaries, as the persons with the economic interest in the trust." ([2015] JRC 196C at [31])

The authors of Lewin at 22-089 question this approach: *"we consider that the duties of the trustees remain owed to the beneficiaries alone, even when the trust is of doubtful solvency"*.

In *Z Trusts* the Commissioner considered that the test for an insolvent trust should be on the cash-flow basis (at [28]). This practical guidance is difficult to reconcile with the position that trusts cannot become insolvent.

At a further hearing in October 2015 ([2015] JRC 214) the Court held that if a trust was insolvent, or likely to become insolvent *"the starting point for the Court is to supervise the administration of the trust in the interests of the creditors as a body by way of directions given to the incumbent trustee."* However, the court *"should be flexible in its approach"*. In England trustees could bring an application for directions under CPR Part 64. Distribution of assets from an insolvent traditional trust has not arisen in the UK, but the English courts have given directions for distribution of assets from statutory trusts (most recently: *Re Worldspreads Ltd* [2015] EWHC 1719).

It is yet to be seen whether the concept of the insolvent trust will be adopted in other jurisdictions and whether legislation will be enacted to place administration of insolvent trusts on a statutory footing.

SOPHIE HOLCOMBE is regularly instructed in relation to contentious domestic and offshore trust and probate matters, including acting on behalf of trustees of *The Z II Trust* in 2014 and 2015.

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I am delighted to introduce this new edition of Serlespeak on topics in insolvency. I begin the edition by assessing how universalism in cross-border insolvency has fared since the decision of the Privy Council in *Singularis Holdings*. Matthew Morrison then considers the changes brought about by the Small Business Enterprise and Employment Act 2015 to the directors' disqualification regime. James Mather examines the recent tendency of the courts to grant freezing orders to claimants on the basis of future claims by an office-holder in a putative insolvency, while Thomas Elias discusses the extent to which a charge over a lease may secure the goodwill of a business. Finally, Sophie Holcombe explores recent decisions relating to the paradoxical concept of the insolvent trust. **Lance Ashworth QC**

Cross-border insolvency

HOW IS MODIFIED UNIVERSALISM FARING IN PRACTICE FOLLOWING *SINGULARIS*?

Cambridge Gas Transportation Corporation v Official Committee of Unsecured Creditors of Navigator Holdings plc [2006] UKPC 26 is commonly regarded as the high watermark of "universalism" in insolvency proceedings.

This is the principle that insolvency proceedings should move towards a single law and a single jurisdiction covering all assets, so as to produce a result equivalent to that which would be obtained if there were a single universal bankruptcy jurisdiction. This, it is said, allows for a coherent procedural approach, and minimises the inconvenience and costs associated with ancillary proceedings.

However, in November 2014, in *Singularis Holdings Ltd v PricewaterhouseCoopers* [2014] UKPC 36, the Privy Council reconsidered the limits on the powers of a court to assist foreign insolvency proceedings.

In *Singularis*, the Privy Council was split 3-2 on the question whether the Bermuda court had a common law power to assist office-holders of a foreign court (Cayman), the majority holding that it did. Lord Sumption, in the majority, provided the following guidance:

(a) It is only available to assist the officers of a foreign court of insolvency jurisdiction or equivalent public officers. It is not available in a voluntary winding up which is a private agreement;

(b) It is a power of assistance, existing for the purpose of enabling those courts to surmount the problems posed for a world-wide winding up of the company's affairs by the territorial limits of each court's powers. It is not available to enable them to do something which they could not do even under the law by which they were appointed;

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(c) It is available only when necessary for the performance of the office-holder's functions;

(d) It is subject to the limitation that such an order must be consistent with the substantive law and public policy of the assisting court. Common law powers of this kind are not a permissible mode of obtaining material for use in actual or anticipated litigation;

(e) Its exercise is conditional on the applicant being able to pay the third party's reasonable costs of compliance.

In May 2015 the High Court of New Zealand had to consider modified universalism (or as the Judge there, Heath J, put it *"universalist"* principles) in *Batty v Reeves* [2015] BCC 568. The issue for the New Zealand court was whether it had jurisdiction to grant certain assistance to a trustee in bankruptcy in proceedings commenced in England, which bankruptcy had been recognised in New Zealand. The judge considered whether the residual powers conferred by section 8 of the (New Zealand) Insolvency (Cross-border) Act 2006 permitted him to make the order. He distinguished *Singularis* on the grounds that the issue in that case was the breadth of the common law, noting that the Privy Council had specifically acknowledged that such assistance could be given *"within the limits of the receiving court's own statutory"* powers. He was satisfied that the grant of assistance on "universalist" principles can be exercised when a statute expressly permits that course. The New Zealand statute expressly authorised the court to make an order that it could make if the issue had arisen in New Zealand. Therefore, it was open to him to make the order sought and he did so.

By contrast in *In the matter of X (a bankrupt)* (6th July 2015), the Royal Court of Guernsey refused to make an order granting assistance. The trustee of X had her appointment as X's trustee recognised by the Royal Court along with her rights to collect funds and assets of his in Guernsey. She also sought an order "to examine any person(s) connected to and/or involved in the conduct of the affairs of the Bankrupt, including an examination of any person(s) connected to and/or involved in the management or control of" two companies, which were resident in Guernsey. Concerned about the likely reaction of the bankrupt to the publicity that would attach, the trustee decided not to seek a formal Letter of Request from the English Court, which would have allowed the Royal Court to make such an order. Rather she argued that the Royal Court had jurisdiction to grant the trustee relief directly without any such request. In a lengthy judgment, which is very illuminating on the history of Guernsey insolvency legislation, the Lieutenant Bailiff considered various ways in which the court might have such a power to assist the trustee by making such an order. Had she been untrammelled by authority, she would have found that there was no common law power i.e. an inherent jurisdiction to treat a power conferred only by a statute *"as being available in a case which is not within the statute relying on some combination of usefulness, a generous assessment of analogy and resort to a supposed beneficial principle of "modified universalism" of insolvency law, of definite and necessarily presupposed extent"*. Even if she were constrained to follow the majority view of the Privy Council in *Singularis*, she said that she would refuse relief on the grounds, first, that the absence of such an inherent jurisdiction had already been established in local law, and that no such inherent jurisdiction in support of the *"modified universalism"* of bankruptcy procedures applied, but also that any such inherent jurisdiction would be available only when it was *"necessary"* for the performance of the officeholders' functions, and it was not; powers to obtain the compulsory provision of information were available under the Letters of Request procedure.

Accordingly, despite the majority view of the Privy Council in *Singularis* that a common law power of assistance exists, other jurisdictions may not be as willing to recognise it in practice. Rather, a much better bet is to seek assistance by way of a formal Letter of Request where available and to rely on statutory powers in the jurisdiction in which assistance is sought. While modified universalism exists, it is proving difficult to apply in practice.

LANCE ASHWORTH QC has an extensive English and offshore insolvency practice.

The Small Business, Enterprise and Employment Act 2015: what lies beneath?

WHILE SLIGHTLY LESS OPAQUE THAN SOME COYLY NAMED STATUTES, THOSE PRACTISING IN THE FIELD OF INSOLVENCY MIGHT BE FORGIVEN FOR NOT IMMEDIATELY RECOGNIZING THE EXTENT TO WHICH THE SMALL BUSINESS, ENTERPRISE AND EMPLOYMENT ACT 2015 ('SBEEA 2015') WILL AFFECT THEM.

These include clarifying that shadow directors are to be subject to the general directors' duties stipulated by sections 170 to 177 of the Companies Act 2006 ('CA 2006'), conferring the ability on administrators to bring fraudulent and wrongful trading claims and permitting office-holders to assign rights arising in connection with wrongful and fraudulent trading, preferences and transactions at an undervalue. However, the most extensive changes of note are those augmenting the disqualification regime under the Company Directors

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Disqualification Act 1986 ('CDDA 1986'). These amendments have been in force since 1 October 2015.

A number of the changes to the CDDA 1986 regime are concerned with its international ambit. It has long been established that directors of companies incorporated under the Companies Act 1985, and latterly the CA 2006, are liable to disqualification irrespective of nationality, domicile or the country in which the actions demonstrating unfitness took place (see *Re Seagull Manufacturing Co Ltd (in liquidation) No.2* [1993] Ch 91).

In addition, disqualification orders have been held to be available against those who have been directors or shadow directors of foreign incorporated companies that are wound up pursuant to the provisions of the Insolvency Act 1986 ('IA 1986') (see *Re Eurostem Maritime* [1987] PCC 190).

> "Increased account is also to be taken of victim impact"

Section 104, SBEEA 2015 now introduces a new section 5A, CDDA 1986 permitting the Secretary of State to seek a disqualification order or accept an undertaking from a director convicted of an offence outside Great Britain which equates to an indictable offence under United Kingdom law in connection with the promotion, formation, management, liquidation or striking off of a company, and the receivership of a company's property.

Further, section 106, SBEEA 2015 provides that the Court shall take into account a person's conduct as a director of one or more overseas companies when appraising unfitness and determining the period of disqualification. Specific matters to which the Court is required to have regard accordingly now include the extent to which a director was responsible for a foreign company's contravention of legislative or other requirements, the foreign company's insolvency and the nature and extent of any loss or harm caused by such foreign company.

Given the increasingly global manner in which the affairs of modern companies are conducted, including the extensive use of foreign subsidiaries for the purposes of tax planning and the facilitation of international trade, these developments are clearly necessary

to ensure that those operating with the benefit of limited liability within the United Kingdom are not free to escape liability by offshoring their misdeeds.

Further steps towards the avowed purpose of strengthening the CDDA 1986 regime *"to give the business community and consumers confidence that wrongdoers will be barred as directors"* include providing for the disqualification of persons in accordance with whose directions or influence a disqualified director acts, even if such persons do not satisfy the requirements of shadow directorship (section 105, SBEEA 2015; new CDDA, section 8ZA).

Increased account is also to be taken of victim impact, section 106, SBEEA 2015 stipulating that the schedule of matters to be taken account of shall include the nature and extent of any harm which has been occasioned, as well as the frequency of misconduct. Indeed, section 110, SBEEA 2015 goes so far as to provide that a new section 15A, CDDA 1986 shall for the first time permit a compensation order to be made against a director on the application of the Secretary of State where a disqualified director's misconduct has caused an identifiable loss to a creditor or creditors.

Although buried within an unprepossessingly named statute, these extensions to the CDDA and other modifications summarized above warrant unearthing and careful consideration by those whose practices include consideration of directors' liabilities in insolvency and disqualification.

MATTHEW MORRISON has a broad insolvency and company law practice with a particular emphasis on shareholder claims and director misfeasance. He is a contributing editor of chapters on insolvency liabilities and disqualification to *Butterworths Corporate Law Service* and *The Law of Limited Liability Partnerships*, Whittaker and Machell (4th edition, 2016).

Anti-avoidance and freezing injunctions

INSOLVENCY PROCEDURES HAVE LONG PLAYED AN IMPORTANT ROLE IN THE RECOVERY OF ASSETS IN CIRCUMSTANCES WHERE A JUDGMENT HAS BEEN OBTAINED BUT CANNOT READILY BE ENFORCED.

There is a growing tendency, however, for claimants to point to the steps that an insolvency office holder could take on the defendant's putative insolvency after judgment as a basis for freezing assets at the outset of a claim.

A commonly encountered scenario is that the defendant's assets are held in offshore company or trust structures, or have been transferred to a spouse or family members, in circumstances leading to a suspicion that the assets are in reality the defendant's own or under his control. Insofar as the defendant in fact beneficially owns them, they will be caught by the standard form freezing order. To establish that this is so, however, will generally require the claimant to argue that the arrangements are a sham (and the allegation often made that the assets are held as the defendant's nominee itself usually amounts in substance to an allegation of sham). Because a shamming intent must be shown on the part of both the transferor and the transferee at the time of the original transfer, that may not be an easy task.

By contrast, the mere timing of transfers, or absence of other potential sources of wealth on the part of the transferee, may go a long way to establish a good arguable case that transfers could later be unpicked by an office holder under one or more of the anti-avoidance provisions of the Insolvency Act 1986. In the case of transactions defrauding creditors, a victim can bring a claim under the Insolvency Act whether or not the transferor is bankrupt or has been wound up. In the case of provisions such as sections 238 and 239 of the Insolvency Act, the claim must be brought by an office holder and therefore only after the onset of insolvency.

> "it should generally be a liquidator or provisional liquidator...who seeks the freezing relief"

Since the assets caught by a freezing injunction are in principle confined to those amenable to future enforcement, it might be thought objectionable to permit the freezing of an asset on the basis of at least two contingencies, namely (i) that there may be a future insolvency, in which (ii) the office holder may commence a claim to recover the assets concerned. However, it was made plain in *Revenue and Customs Commissioners v Egleton* [2007] 1 All ER 606 that this is not so. That case was concerned with the making of a freezing order against a third party under the *Chabra* jurisdiction, rather than the defendant. Moreover, Briggs J observed that it should generally be a liquidator or provisional liquidator, rather than a petitioning creditor, who seeks the freezing relief.

In more recent decisions, however, it has been treated as unexceptional that the potential availability of Insolvency Act claims to a putative future office holder should justify the grant of freezing relief to the claimant himself. As illustrated by two recent as yet unreported cases, *Bataillon v Shone* (QB, 18 June 2015) and *Avonwick v Shlosberg* (Ch, 6 November 2014), moreover, this may encompass orders both against the transferor defendant (who is suspected of still controlling the assets) and the transferee third party (under the *Chabra* jurisdiction).

JAMES MATHER acted in both the *Bataillon* and *Avonwick* cases and specialises in fraud, insolvency, company and partnership disputes.

Chambers news

People

We are delighted to welcome as new tenants Richard Wilson QC and Constance McDonnell, who join us from 3 Stone Buildings. We are also delighted to congratulate Andrew Moran, Daniel Lightman, Richard Wilson and Professor Jonathan Harris (*honoris causa*) on taking silk, and to introduce our three pupils for 2015/16: Charlotte Beynon, Sophia Hurst and Eleni Dinenis.

Directories and awards

The latest editions of the two major legal directories have now been released. In Chambers & Partners, we are recommended as a set in 10 practice areas, and we have 109 individual barrister recommendations, placing us in joint 7th place in the "sets with the highest proportion of barrister rankings" table. In the Legal 500 directory, we are recommended as a set in 9 practice areas and received an impressive 120 individual recommendations. We are described as *"A quality set from top to bottom"* and *"a tremendous chambers housing numerous leaders in their fields"*.

We have also been shortlisted for a number of awards:

- We received 2 nominations for the Chambers & Partners Bar Awards: Christopher Stoner QC for Real Estate Silk of the year and Giles Richardson for Chancery Junior of the year.
- As a set, we were nominated for Chambers of the year for Private client: trusts and probate at the Legal 500 UK Awards and Elizabeth Jones QC was nominated for Silk of the year in the same area.
- We were one of only 7 chambers shortlisted for Chambers of the Year at the British Legal Awards.

Conferences and seminars

An LLP seminar was held in September following the *Flanagan v Liontrust* case, which was the first LLP case concerning the applicability of the doctrine repudiatory breach to LLP and widely regarded as the most important partnership/LLP case of 2015. John Machell QC led the seminar with Jennifer Haywood and Tom Braithwaite.

We hosted a successful property litigation seminar in Southampton in October. Our next London property law seminar takes place in March. We return to Bristol in April for a roadshow which will include seminars on commercial and property law. Speakers will include Christopher Stoner QC, Andrew Francis, Richard Walford, David Drake, Amy Proferes and Suzanne Rab.

We will be hosting a full-day litigation conference at the Merchant Taylor's Hall in September, which follows on from the highly successful conference in 2014.

We are also sponsoring a number of forums and conferences this year including the C5 forum on Fraud, Asset Tracing & Recovery (Geneva), the Legal Week Trust & Estates Litigation forum (Provence) and the IBC International Trusts & Private Client forum (Jersey).

Books and publications

The 4th edition of *The Law of Limited Liability Partnerships* was published in January. In producing this new edition, John Whittaker and John Machell QC were assisted by a team of contributors from Chambers: Tom Braithwaite, Jennifer Haywood, Matthew Morrison, James Mather, Adil Mohamedbhai, Amy Proferes and Emma Hargreaves, as well as specialist outside contributors.

Khawar Qureshi QC launches a Legal Handbook series in March, consisting of 3 books: *Public International Law Before the English Courts, Conflict of Interest in Arbitration,* and *Investment Treaty Claims.*

LinkedIn

We have 4 discussion groups on LinkedIn to enable Serle Court members and clients to discuss topical issues in Partnership and LLP Law, Fraud and Asset Tracing, Contentious Trusts and Probate, and Competition Law; please join us.

Edited by JONATHAN FOWLES

Securing a share of goodwill

WHAT VALUE IS SECURED BY A CHARGE OVER A LEASE OF COMMERCIAL PREMISES?

A recent *ex tempore* decision in the Companies Court in *Re Crosscastle (in liquidation)* (unreported) held that even though a lease may, on the face of it, have negligible value, when it is sold in connection with a business, a portion of the goodwill of the business carried on at the premises may adhere to the lease. A charge over a lease may therefore secure part of the goodwill of a business.

Crosscastle Ltd operated two "Spar" branded convenience stores in Battersea. Capper & Co. had loaned money to Crosscastle secured by two charges over the lease of one of its two premises. There was no mention of goodwill in the charges.

In 2010, Crosscastle entered administration, and the whole business, including the leases of two premises, stock, chattels, intellectual property and goodwill was sold. Crosscastle subsequently went into liquidation.

The liquidator and Capper & Co. could not agree the value of the charges and the liquidator applied for directions under section 112 of the Insolvency Act 1986. There were two issues: (1) what proportion of the goodwill of the business attached to the lease; and (2) what was the value of the lease plus any adherent goodwill.

In *Chissum v Dewes* (1828) 5 Russell 29, the Master of the Rolls held that the goodwill of a business could not be separated from the lease of the premises in which the business was carried on. However, by the time of *Muller & Co's Margarine v Commissioners of Inland Revenue* [1901] AC 217, it was understood that goodwill arose not just from location, but also from other factors, including the name and reputation of the person carrying on the business.

Accordingly, in *Crosscastle* the court held that the proportion of goodwill adhering to a lease was a question of fact. The business was a convenience store, with most customers coming from within a small geographical area. However, there were no restrictive covenants preventing competitors establishing themselves in close proximity. The business also had goodwill which arose from other factors, such as its right to use the Spar brand. The court held that 50% of the goodwill of the business carried on at the premises adhered to the lease.

As to the valuation issue, it was common ground that the value of the lease of the premises, if sold as an empty unit, was nil or nominal. The only real value was in the adherent goodwill. This was determined following cross-examination of the experts.

It is notable that, while the sale contract for the business assigned a value to the goodwill, the court placed little weight on that valuation, it being common ground between the experts that such apportionment was usually done for the convenience of the buyer, and bore little relation to the real value.

The decision shows that, even where a lease has no apparent value, the security over such a lease may still be valuable. This will, however, depend on the facts. While a significant proportion of the goodwill of a business may adhere to the lease of a pub or convenience store, for other types of business, such as those operating principally or exclusively over the internet, it may be that no goodwill adheres to the business premises at all.

THOMAS ELIAS acted for the liquidator.

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