

Cayman Privy Council provides important clarification of the rights of current and former trustees

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The Cayman Islands' Privy Council in a consolidated decision of two unconnected Court of Appeal cases from Jersey and Guernsey, clarified the method of dealing with a trust which has insufficient assets to settle its liabilities (colloquially referred to as an "insolvent trust"), [1] in: *Equity Trust (Jersey) Ltd (Respondent) v Halabi (in his capacity as Executor of the Estate of the late Madam Intisar Nouri) (Appellant)*; and *ITG Ltd and others (Respondents) v Fort Trustees Ltd and another (Appellants)* [2022] UKPC 36.

Both cases raise common issues about the nature and scope of the rights of a trustee to recover from, or be indemnified out of, trust assets in respect of liabilities and other expenditure properly incurred by the trustee and clarifies the position of not only current and former trustees of insolvent trusts, but also their respective creditors who can access the trust assets in satisfaction of claims by way of the trustee's right of indemnity.

The Cayman Islands' 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 proprietary interest takes priority over a successor trustee's equivalent claim
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 an enlarged seven-member Privy Council, but on the third issue the Board was split 4:3 giving three separate judgments.

Issues one and two: 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 and that this proprietary interest of a trustee survives the transfer of the trust assets to a successor trustee.

A trustee is therefore entitled to protect their interests by (i) applying, or seeking an order of the court to apply trust assets in their possession in payment of amounts due under their right of indemnity; or (ii) retaining sufficient assets or requiring security before transferring the assets to a successor trustee. The interest enjoyed by a trustee does not cease upon transfer of the assets to a new trustee, their rights will remain protected.

Issue three: priority as first in time or *pari passu*?

The Privy Council was divided on the third issue: whether a former trustee's proprietary interest takes priority over a successor trustee's equivalent claim.

Traditionally, the default rule for dealing with competing claims was, as a matter of equity, that the first in time should prevail. In a trust context, if applied, this would mean that the former trustee's proprietary interest in the trust assets would be preferred over those of the beneficiaries and any subsequent trustees. This was the position taken by the respondents' in both appeals.

However, the majority of the Board considered the application of this rule to be inequitable. Of particular concern to the majority was the position of any trust creditors in that the priority of those claims would be dependent upon the respective date of appointment of the trustee with whom they happened to contract. Given the date of appointment of the trustee is arbitrary in the context of the relevant commercial transaction and would, in any event, be information not ordinarily available to creditors, the Board considered that an application of a rule which depended on this timing was impractical and "unbusinesslike". For this reason, the majority view (set out in the judgment of Lord Briggs) was in support of a *pari passu* approach meaning that competing claims of former and successor trustees are to be treated the same, ranking equally and without preference, irrespective of the time at which they arose.

Lord Briggs considered there was an "inherent justice in equal division, or equal sharing in a common misfortune, which is captured in the equitable maxim equality is equity", particularly in circumstances where all trustees as fiduciaries are loyally serving the interests of their beneficiaries. Moreover, to have competition between trustees serving at different times for unequal shares of the inadequate fund would be incompatible with their joint pursuit of a common cause.

It should be noted however, that the Board did acknowledge that there may be situations in which the *pari passu* approach is not appropriate. While they did not set out what those situations may

be, they did indicate that those circumstances would need to be wholly exceptional with the result that any disapplication of the pari passu approach would likely be limited.

Issue four: trustee costs

On the final issue concerning the trustees claim for costs, the Privy Council found that a trustee is entitled to recover the costs of their claim from the trust assets on the basis that, on a proper analysis in a trust context, a trustee is not "proving a claim" in the traditional sense as a creditor but is rather proving the extent and quantum of its existing proprietary interest over the trust assets.

Conclusion

This decision is likely to have significance in the wider common law trusts world and provides helpful guidance of the applicable principles, both in law and equity, as they relate to trusts and insolvency.

Following this decision, it is clear that:

1. a trustee's right of indemnity confers a proprietary interest in the trust property in favour of the trustee
2. this proprietary interest survives the transfer of the trust assets to a successor trustee
3. competing trustee claims in respect of "insolvent trusts" will now be resolved on a pari passu basis
4. a trustee's indemnity extends to the costs of proving its claim, or more accurately, establishing the quantum of its proprietary interest in the trust assets

[1] Technically a trust cannot be "insolvent" as a trust is not, as a matter of Jersey law, a legal personality and cannot incur debts in its own name.

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Key Contacts



[Deborah Barker Roye](#)

Partner

[Cayman Islands](#)

E: deborah.barkerroye@ogier.com

T: [+1 345 815 1779](tel:+13458151779)

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