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Sequana – Impact on Jersey Trusts and Company Law

Thursday 6th July 2023

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Call: 1996
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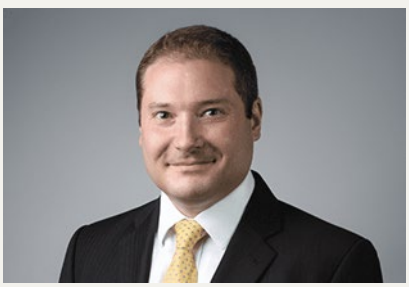

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The seminal decision of the Supreme Court in *Bti 2014 LLC v Sequana SA* [2022] 3 WLR 709 has had, and for many years will continue to have, a significant effect on English law as to the duties of directors of companies in the twilight zone of insolvency. There remain a number of issues that will require clarification and development in subsequent case law, particularly as a number of points were addressed by the Justices on an obiter basis only.

As a judgment of the Supreme Court, the decision is also bound to have a significant effect on the law of other jurisdictions which draw on English law. One such jurisdiction is Jersey where substantial areas of English law are closely followed by legislation or by judicial decision, including the laws relating to companies and trusts. The inter-relation of these laws of England and Jersey were the subject of recent consideration by Mr Justice Edwin Johnson in *Adams & Others v FS Capital & Others* [2023] EWHC 1649 (Ch).

The facts of the case were complex but, in short, the claimants were beneficiaries under three Jersey law EBT trusts which had been set up as part of the "K2" tax avoidance schemes. The nature of the schemes were such that the claimants were also debtors of the trusts in respect of loans made to them as part of the tax planning. Following the introduction of the loan charge and the failure of the schemes, the trustees assigned the loan debts to a third party (FS Capital) for a price capped at the value of creditor claims.

The claimants challenged the assignments on the grounds that the powers of sale were exercised for an improper purpose. At the time of the sales the trusts were cash-flow insolvent.[1] The question arose whether the trustees were entitled to exercise their fiduciary powers only in the interests of creditors or whether they also had to have regard to the interests of the claimants as beneficiaries. In other words, what was the content of their duties

[1] Strictly speaking there is no such thing as insolvent trust, but it may be used as shorthand label for a situation in which a trustee is unable to pay the liabilities reasonably incurred in the course of its trusteeship as such liabilities fell due.

Prior to *Sequana*, the leading authority in Jersey on this issue was the decision of Commissioner Clyde-Smith in *Representation of the Z Trusts* [2015] JRC 196C. At [28] and [29] in his judgment, the Commissioner stated that although the point had not been canvassed at the hearing, the test for insolvency, in the case of a trust, should be the cash-flow test. The Commissioner cited in this context *Del Amo v Viberts, Collas Crill and others* [2012] (1) JLR 180. The Commissioner then continued, in the following terms (emphasis added):

"*30. As stated at paragraphs 24 and 28 of Del Amo, in relation to estates, insolvency brings about a shift towards the interests of the creditors analogous to that seen in company law and 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. As a matter of logic and principle, it is difficult to see how else an insolvent trust should be administered by the trustee and supervised by the Court. We note that this approach accords with the advice of Elspeth Talbot-Rice QC given to Barclays on 10th May, 2013, in relation to the insolvency of the Z III Trust...*

32. We conclude, therefore, that once there is an insolvency or probably insolvency of a trust, the trustee and all those holding fiduciary powers in relation to the trust can only exercise those powers in the interests of the creditors. The trustee or fiduciary of such a trust would be wise therefore to exercise their powers either with the consent of all of the creditors or under directions given by the Court."

Taking what was said by the Commissioner at [30] and [32] at face value, as a matter of Jersey law, where a trust is insolvent, the trustee can only exercise fiduciary powers in the interests of the creditors. The beneficiaries are no longer to be treated as the persons with the economic interest in the trust. The same principle would seem to apply in the context of Jersey company law.

However, the Judge held that some considerable tempering of this approach was required in the light of *Sequana*. After considering the expert evidence, he held at [185] that:

1. The position is not as absolute as stated in *Z Trusts* at [32]. There is no absolute rule that, once there is an insolvency or probable insolvency of a trust, the trustee and all those holding fiduciary powers in relation to the trust can only exercise those powers in the interests of the creditors. A Jersey court would take account of the decision of the Supreme Court in *Sequana*, and would adopt a more nuanced approach to this question;

2. In a situation of insolvency or probable insolvency a trustee should primarily exercise their fiduciary powers and duties in the interests of the creditors;

3. Whether and, if so, to what extent the residuary interests of the beneficiaries should be taken into account in the exercise by the trustee of their fiduciary powers and duties in a situation of insolvency is a fact sensitive question which depends upon the circumstances of the particular case;

4. In answering the question at 3. above, the court should adopt the approach set out by Lord Briggs in *Sequana*, at [176];[2] that is to say a balancing exercise. The extent to which the interests of the beneficiaries can and should be subordinated to the interests of the creditors will depend upon all the circumstances of the case and, in particular, on the question of whether the situation is one where there is light at the end of the tunnel or one where the insolvency situation is irreversible.

Applying that approach, the Judge held on the facts that, although the trusts were cash flow insolvent, it was not possible to say that they were balance sheet insolvent and there was the possibility that the loan debts could have had substantial value above the capped price. He therefore held that the trustees were required to have regard to the interests of the claimants as beneficiaries, but that they had failed to do so. This was a significant step in him ultimately deciding that the assignments had been entered into for an improper purpose and were void.

This part of the decision in *Adams* illustrates the significant effect that *Sequana* has, at least as held by an English court, already had on the law of Jersey in relation to trusts and company law. No doubt it is one of many to come as the effects of *Sequana* continue to be worked through in England and other jurisdictions which draw on English law.

James Morgan KC and Josh Lewison were instructed to act for FS Capital by Freeths LLP.

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[2] "*In my view, prior to the time when liquidation becomes inevitable and section 214 becomes engaged, the creditor duty is a duty to consider creditors' interests, to give them appropriate weight, and to balance them against shareholders' interests where they may conflict. Circumstances may require the directors to treat shareholders' interests as subordinate to those of the creditors...This is likely to be a fact sensitive question. Much will depend upon the brightness or otherwise of the light at the end of the tunnel...*"

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